

UNITED PARCEL SERVICE INC  
Form 10-Q  
November 06, 2009  
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**United States**  
**Securities and Exchange Commission**  
Washington, D.C. 20549

**Form 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2009, or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-15451

**United Parcel Service, Inc.**

*(Exact name of registrant as specified in its charter)*

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**Delaware**  
*(State or Other Jurisdiction of*

**58-2480149**  
*(IRS Employer*

*Incorporation or Organization)*

*Identification No.)*

**55 Glenlake Parkway, NE Atlanta, Georgia**  
*(Address of Principal Executive Offices)*

**30328**  
*(Zip Code)*

**(404) 828-6000**

*(Registrant's telephone number, including area code)*

*Former name, former address and former fiscal year, if changed since last report.*

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "accelerated filer", "large accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Check one:

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

There were 286,578,274 Class A shares, and 706,225,998 Class B shares, with a par value of \$0.01 per share, outstanding at October 29, 2009.

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**UNITED PARCEL SERVICE, INC.**

**QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2009**

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****September 30, 2009 (unaudited) and December 31, 2008****(In millions)**

|                                                                   | <b>September 30,<br/>2009</b> | <b>December 31,<br/>2008</b> |
|-------------------------------------------------------------------|-------------------------------|------------------------------|
| <b>ASSETS</b>                                                     |                               |                              |
| Current Assets:                                                   |                               |                              |
| Cash and cash equivalents                                         | \$ 2,242                      | \$ 507                       |
| Marketable securities                                             | 546                           | 542                          |
| Accounts receivable, net                                          | 4,851                         | 5,547                        |
| Finance receivables, net                                          | 305                           | 480                          |
| Deferred income tax assets                                        | 698                           | 494                          |
| Other current assets                                              | 924                           | 1,275                        |
| <b>Total Current Assets</b>                                       | <b>9,566</b>                  | <b>8,845</b>                 |
| Property, Plant and Equipment, Net                                | 18,092                        | 18,265                       |
| Goodwill                                                          | 2,111                         | 1,986                        |
| Intangible Assets, Net                                            | 509                           | 511                          |
| Non-Current Finance Receivables, Net                              | 362                           | 476                          |
| Other Non-Current Assets                                          | 1,571                         | 1,796                        |
| <b>Total Assets</b>                                               | <b>\$ 32,211</b>              | <b>\$ 31,879</b>             |
| <b>LIABILITIES AND SHAREOWNERS EQUITY</b>                         |                               |                              |
| Current Liabilities:                                              |                               |                              |
| Current maturities of long-term debt and commercial paper         | \$ 1,397                      | \$ 2,074                     |
| Accounts payable                                                  | 1,486                         | 1,855                        |
| Accrued wages and withholdings                                    | 1,787                         | 1,436                        |
| Self-insurance reserves                                           | 791                           | 732                          |
| Other current liabilities                                         | 1,313                         | 1,720                        |
| <b>Total Current Liabilities</b>                                  | <b>6,774</b>                  | <b>7,817</b>                 |
| Long-Term Debt                                                    | 8,908                         | 7,797                        |
| Pension and Postretirement Benefit Obligations                    | 6,048                         | 6,323                        |
| Deferred Income Tax Liabilities                                   | 927                           | 588                          |
| Self-Insurance Reserves                                           | 1,620                         | 1,710                        |
| Other Non-Current Liabilities                                     | 888                           | 864                          |
| Shareowners Equity:                                               |                               |                              |
| Class A common stock (290 and 314 shares issued in 2009 and 2008) | 3                             | 3                            |
| Class B common stock (705 and 684 shares issued in 2009 and 2008) | 7                             | 7                            |
| Additional paid-in capital                                        | 49                            |                              |
| Retained earnings                                                 | 12,453                        | 12,412                       |
| Accumulated other comprehensive loss                              | (5,531)                       | (5,642)                      |
| Deferred compensation obligations                                 | 108                           | 121                          |

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|                                                  |           |           |
|--------------------------------------------------|-----------|-----------|
| Less: Treasury stock (2 shares in 2009 and 2008) | (108)     | (121)     |
| Total Equity for Controlling Interests           | 6,981     | 6,780     |
| Noncontrolling Interests                         | 65        |           |
| Total Shareowners' Equity                        | 7,046     | 6,780     |
| Total Liabilities and Shareowners' Equity        | \$ 32,211 | \$ 31,879 |

See notes to unaudited consolidated financial statements.

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****STATEMENTS OF CONSOLIDATED INCOME****(In millions, except per share amounts)****(unaudited)**

|                               | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|-------------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                               | <b>2009</b>                                 | <b>2008</b> | <b>2009</b>                                | <b>2008</b> |
| Revenue                       | \$ 11,153                                   | \$ 13,113   | \$ 32,920                                  | \$ 38,789   |
| Operating Expenses:           |                                             |             |                                            |             |
| Compensation and benefits     | 6,341                                       | 6,425       | 19,003                                     | 19,447      |
| Repairs and maintenance       | 265                                         | 289         | 814                                        | 890         |
| Depreciation and amortization | 441                                         | 456         | 1,297                                      | 1,360       |
| Purchased transportation      | 1,298                                       | 1,680       | 3,698                                      | 4,954       |
| Fuel                          | 635                                         | 1,209       | 1,670                                      | 3,326       |
| Other occupancy               | 241                                         | 247         | 738                                        | 771         |
| Other expenses                | 1,003                                       | 1,175       | 3,158                                      | 3,462       |
|                               | 10,224                                      | 11,481      | 30,378                                     | 34,210      |
| Operating Profit              | 929                                         | 1,632       | 2,542                                      | 4,579       |
| Other Income and (Expense):   |                                             |             |                                            |             |
| Investment income (loss)      | 6                                           | (13)        | (3)                                        | 58          |
| Interest expense              | (93)                                        | (104)       | (356)                                      | (342)       |
|                               | (87)                                        | (117)       | (359)                                      | (284)       |
| Income Before Income Taxes    | 842                                         | 1,515       | 2,183                                      | 4,295       |
| Income Taxes                  | 293                                         | 545         | 788                                        | 1,546       |
| Net Income                    | \$ 549                                      | \$ 970      | \$ 1,395                                   | \$ 2,749    |
| Basic Earnings Per Share      | \$ 0.55                                     | \$ 0.96     | \$ 1.40                                    | \$ 2.69     |
| Diluted Earnings Per Share    | \$ 0.55                                     | \$ 0.96     | \$ 1.39                                    | \$ 2.67     |

**STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME****(In millions)****(unaudited)**

|            | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|            | <b>2009</b>                                 | <b>2008</b> | <b>2009</b>                                | <b>2008</b> |
| Net income | \$ 549                                      | \$ 970      | \$ 1,395                                   | \$ 2,749    |

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|                                                                             |        |          |          |          |
|-----------------------------------------------------------------------------|--------|----------|----------|----------|
| Change in foreign currency translation adjustment                           | 163    | (33)     | 126      | 80       |
| Change in unrealized gain (loss) on marketable securities, net of tax       | 12     | (10)     | 33       | (50)     |
| Change in unrealized gain (loss) on cash flow hedges, net of tax            | (117)  | 223      | (166)    | 253      |
| Change in unrecognized pension and postretirement benefit costs, net of tax | 39     | 32       | 118      | 98       |
| Comprehensive income                                                        | \$ 646 | \$ 1,182 | \$ 1,506 | \$ 3,130 |

See notes to unaudited consolidated financial statements.

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****STATEMENTS OF CONSOLIDATED CASH FLOWS****(In millions)****(unaudited)**

|                                                                            | <b>Nine Months Ended<br/>September 30,</b> |                |
|----------------------------------------------------------------------------|--------------------------------------------|----------------|
|                                                                            | <b>2009</b>                                | <b>2008</b>    |
| <b>Cash Flows From Operating Activities:</b>                               |                                            |                |
| Net income                                                                 | \$ 1,395                                   | \$ 2,749       |
| Adjustments to reconcile net income to net cash from operating activities: |                                            |                |
| Depreciation and amortization                                              | 1,297                                      | 1,360          |
| Pension and postretirement benefit expense                                 | 659                                        | 542            |
| Pension and postretirement benefit contributions                           | (758)                                      | (119)          |
| Self-insurance reserves                                                    | (31)                                       | (15)           |
| Deferred taxes, credits and other                                          | 352                                        | 113            |
| Stock compensation expense                                                 | 312                                        | 374            |
| Asset impairment charges                                                   | 181                                        |                |
| Other (gains) losses                                                       | 65                                         | 581            |
| Changes in assets and liabilities, net of effect of acquisitions:          |                                            |                |
| Accounts receivable                                                        | 550                                        | 51             |
| Other current assets                                                       | 161                                        | 961            |
| Accounts payable                                                           | (319)                                      | 106            |
| Accrued wages and withholdings                                             | 266                                        | 355            |
| Other current liabilities                                                  | 33                                         | (69)           |
| Other operating activities                                                 | 70                                         | (41)           |
| <b>Net cash from operating activities</b>                                  | <b>4,233</b>                               | <b>6,948</b>   |
| <b>Cash Flows From Investing Activities:</b>                               |                                            |                |
| Capital expenditures                                                       | (1,185)                                    | (2,108)        |
| Proceeds from disposals of property, plant and equipment                   | 40                                         | 104            |
| Purchases of marketable securities and short-term investments              | (1,866)                                    | (2,514)        |
| Sales and maturities of marketable securities and short-term investments   | 1,854                                      | 2,228          |
| Net (increase) decrease in finance receivables                             | 206                                        | (132)          |
| Other investing activities                                                 | 72                                         | (271)          |
| <b>Net cash (used in) investing activities</b>                             | <b>(879)</b>                               | <b>(2,693)</b> |
| <b>Cash Flows From Financing Activities:</b>                               |                                            |                |
| Net change in short-term debt                                              | (1,161)                                    | (1,602)        |
| Proceeds from long-term borrowings                                         | 3,140                                      | 7,189          |
| Repayments of long-term borrowings                                         | (1,753)                                    | (5,582)        |
| Purchases of common stock                                                  | (395)                                      | (3,284)        |
| Issuances of common stock                                                  | 104                                        | 135            |
| Dividends                                                                  | (1,313)                                    | (1,781)        |
| Other financing activities                                                 | (283)                                      | (112)          |
| <b>Net cash (used in) financing activities</b>                             | <b>(1,661)</b>                             | <b>(5,037)</b> |
| <b>Effect Of Exchange Rate Changes On Cash And Cash Equivalents</b>        | <b>42</b>                                  | <b>(6)</b>     |



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|                                                             |          |          |
|-------------------------------------------------------------|----------|----------|
| <b>Net Increase (Decrease) In Cash And Cash Equivalents</b> | 1,735    | (788)    |
| <b>Cash And Cash Equivalents:</b>                           |          |          |
| Beginning of period                                         | 507      | 2,027    |
| End of period                                               | \$ 2,242 | \$ 1,239 |

See notes to unaudited consolidated financial statements.

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. BASIS OF PRESENTATION**

*Principles of Consolidation*

In our opinion, the accompanying interim, unaudited, consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly our financial position as of September 30, 2009, our results of operations for the three and nine months ended September 30, 2009 and 2008, and cash flows for the nine months ended September 30, 2009 and 2008. The results reported in these consolidated financial statements should not be regarded as necessarily indicative of results that may be expected for the entire year. The interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008.

For interim consolidated financial statement purposes, we provide for accruals under our various employee benefit plans and self-insurance reserves for each three month period based on one quarter of the estimated annual expense.

Certain prior period amounts have been reclassified to conform to the current period presentation.

*Accounting Estimates*

The preparation of the accompanying interim, unaudited, consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Estimates have been prepared on the basis of the most current and best information and actual results could differ materially from those estimates.

*Subsequent Events*

We have evaluated the period from October 1, 2009 through November 6, 2009, the date the financial statements herein were issued, for subsequent events requiring recognition or disclosure in the financial statements. During this period, no material recognizable subsequent events were identified.

**NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS**

In June 2009, the FASB issued Statement No. 168, The FASB Accounting Standards Codification and the Hierarchy of GAAP ( FAS 168 ), which replaces Statement No. 162, The Hierarchy of GAAP and establishes the Accounting Standards Codification ( ASC ) as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. SEC rules and interpretive releases are also sources of authoritative GAAP for SEC registrants. The codification was developed to organize GAAP pronouncements by topic so that users can more easily access authoritative accounting guidance. FAS 168 became effective for the third quarter of 2009, and all accounting standard references have been updated in this report with ASC references.

*Adoption of New Accounting Standards*

Certain disclosure requirements of ASC 820, *Fair Value Measurements and Disclosures*, took effect on January 1, 2008 and are presented in Notes 4 and 12. On January 1, 2009, we implemented the previously deferred provisions of ASC 820 for nonfinancial assets and liabilities recorded at fair value.

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

The accounting requirements for determining fair value when the volume and level of activity for an asset or liability have significantly decreased, and for identifying transactions that are not orderly, contained in ASC 820 were adopted on April 1, 2009, but had an immaterial impact on our financial statements.

Certain disclosure requirements of ASC 815, *Derivatives and Hedging*, took effect on January 1, 2009 and are presented in Note 14.

The new accounting requirements of ASC 805, *Business Combinations*, which took effect on January 1, 2009, were adopted but had no impact on our financial statements.

The accounting and presentation requirements for noncontrolling interests in ASC 810, *Consolidation*, which took effect on January 1, 2009, had an immaterial impact on the financial statements.

The disclosure requirements of ASC 825, *Financial Instruments*, are presented in Note 12.  
*Standards Issued But Not Yet Effective*

Beginning in the fourth quarter of 2009, provisions of ASC 715, *Compensation-Retirement Benefits*, will be adopted that require disclosures about plan assets of a defined benefit pension or other postretirement plan, investment policies and strategies, major categories of plan assets, inputs and valuation techniques used to measure the fair value of plan assets and significant concentrations of risk within plan assets.

Other new pronouncements issued but not effective until after September 30, 2009, are not expected to have a significant effect on our consolidated financial position or results of operations.

**NOTE 3. STOCK-BASED COMPENSATION**

We issue employee share-based awards under the UPS Incentive Compensation Plan, which permits the grant of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, performance shares, performance units, and management incentive awards to eligible employees. The primary compensation programs offered under the UPS Incentive Compensation Plan include the UPS Management Incentive Awards Program, the UPS Long-Term Incentive Program and the UPS Long-Term Incentive Performance Award program. We also maintain an employee stock purchase plan which allows eligible employees to purchase shares of UPS class A common stock at a discount.

During the first quarter of 2009, we granted target restricted stock units ( RSUs ) under the UPS Long-Term Incentive Performance Award program to eligible management. Of the total 2009 target award, 90% of the target award will be divided into three substantially equal tranches, one for each calendar year in the three-year award cycle from 2009 to 2011, using performance criteria targets established each year. For 2009, those targets consist of consolidated operating return on invested capital and growth in consolidated revenue. The remaining 10% of the total 2009 target award will be based upon our achievement of adjusted earnings per share for the three-year award cycle compared to a target established at the beginning of the award cycle.

The number of RSUs earned each year will be the target number adjusted for the percentage achievement of performance criteria targets for the year. The percentage of achievement used to determine the RSUs earned may be a percentage less than or more than 100% of the target RSUs for each tranche. Based on the date that the eligible management population and performance targets were approved for the 2009 performance tranches, we determined the award measurement date to be March 13, 2009, and therefore the target RSU grant was valued for stock compensation expense purposes using the closing New York Stock Exchange price of \$43.09 on that date.



**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

During the second quarter of 2009, we granted stock option and restricted performance unit ( RPU ) awards to eligible employees under the UPS Long-Term Incentive Program. Stock options are granted to a limited group of employees, while a larger proportion of the total award under the UPS Long-Term Incentive Program is being made in the form of RPUs. Stock option and RPU awards will generally vest over a five year period with approximately 20% of the award vesting at each anniversary date of the grant (except in the case of death, disability, or retirement, whereby immediate vesting occurs). Prior to 2008, stock option and RPU grants vested five years after the date of grant (again with the exception of death, disability, or retirement). Consistent with previous awards, the options granted will expire ten years after the date of grant. In the second quarter of 2009, we granted 0.3 million stock options and 2.2 million RPUs at a grant price of \$55.83. In the second quarter of 2008, we granted 0.2 million stock options and 1.9 million RPUs at a grant price of \$71.58. The fair value of our employee stock options granted, as determined by the Black-Scholes valuation model, was \$10.86 and \$16.77 for 2009 and 2008, respectively, using the following assumptions:

|                          | 2009   | 2008   |
|--------------------------|--------|--------|
| Expected life (in years) | 7.5    | 7.5    |
| Risk-free interest rate  | 3.22%  | 3.79%  |
| Expected volatility      | 23.16% | 22.24% |
| Expected dividend yield  | 3.25%  | 2.39%  |

Awards granted under the Management Incentive Awards program are normally granted during the fourth quarter of each year. Compensation expense for share-based awards recognized in net income for the three months ended September 30, 2009 and 2008 was \$93 and \$123 million pre-tax, respectively. Compensation expense for share-based awards recognized in net income for the nine months ended September 30, 2009 and 2008 was \$312 and \$374 million pre-tax, respectively.

**NOTE 4. MARKETABLE SECURITIES**

The following is a summary of marketable securities as of September 30, 2009 and December 31, 2008 (in millions):

|                                                | Cost   | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|------------------------------------------------|--------|------------------|-------------------|----------------------|
| <b>September 30, 2009</b>                      |        |                  |                   |                      |
| Current marketable securities:                 |        |                  |                   |                      |
| U.S. government and agency debt securities     | \$ 129 | \$ 2             | \$ 1              | \$ 130               |
| Mortgage and asset-backed debt securities      | 151    | 3                | 2                 | 152                  |
| Corporate debt securities                      | 212    | 7                |                   | 219                  |
| U.S. state and local municipal debt securities | 22     |                  |                   | 22                   |
| Other debt and equity securities               | 21     | 2                |                   | 23                   |
| Current marketable securities                  | 535    | 14               | 3                 | 546                  |
| Non-current marketable securities:             |        |                  |                   |                      |
| Asset-backed debt securities                   | 150    |                  | 41                | 109                  |
| U.S. state and local municipal debt securities | 115    |                  | 24                | 91                   |
| Preferred equity securities                    | 12     |                  |                   | 12                   |
| Common equity securities                       | 18     | 10               |                   | 28                   |
| Non-current marketable securities              | 295    | 10               | 65                | 240                  |
| Total marketable securities                    | \$ 830 | \$ 24            | \$ 68             | \$ 786               |



**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

|                                                | Cost   | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|------------------------------------------------|--------|---------------------|----------------------|-------------------------|
| <b>December 31, 2008</b>                       |        |                     |                      |                         |
| Current marketable securities:                 |        |                     |                      |                         |
| U.S. government and agency debt securities     | \$ 93  | \$ 2                | \$                   | \$ 95                   |
| Mortgage and asset-backed debt securities      | 278    | 3                   | 11                   | 270                     |
| Corporate debt securities                      | 158    | 5                   | 3                    | 160                     |
| Other debt and equity securities               | 30     |                     | 13                   | 17                      |
|                                                | 559    | 10                  | 27                   | 542                     |
| Non-current marketable securities:             |        |                     |                      |                         |
| Asset-backed debt securities                   | 150    |                     | 34                   | 116                     |
| U.S. state and local municipal debt securities | 116    |                     | 29                   | 87                      |
| Preferred equity securities                    | 21     |                     | 8                    | 13                      |
| Common equity securities                       | 25     | 3                   |                      | 28                      |
|                                                | 312    | 3                   | 71                   | 244                     |
| Total marketable securities                    | \$ 871 | \$ 13               | \$ 98                | \$ 786                  |

At September 30, 2009, we have investments in auction rate securities with a carrying value of \$277 million. Some of these investments take the form of debt securities, and are structured as direct obligations of local governments or agencies (classified as U.S. state and local municipal securities). Other auction rate security investments are structured as obligations of asset-backed trusts (classified as Asset-backed debt securities), generally all of which are collateralized by student loans and are guaranteed by the U.S. Government or through private insurance. The remaining auction rate securities take the form of preferred stock, and are collateralized by securities issued directly by large corporations or money market securities. Substantially all of our investments in auction rate securities maintain investment-grade ratings of BBB / Baa or higher by Standard & Poor's Rating Service (Standard & Poor's) and Moody's Investors Service (Moody's), respectively.

During the first quarter of 2008, market auctions, including auctions for substantially our entire auction rate securities portfolio, began to fail due to insufficient buyers. As a result of the persistent failed auctions, and the uncertainty of when these investments could successfully be liquidated at par, we have continued to classify all of our investments in auction rate securities as non-current marketable securities (which are reported in Other Non-Current Assets on the consolidated balance sheet), as noted in the table above, as of September 30, 2009. The securities for which auctions have failed will continue to accrue interest and be auctioned at each respective reset date until the auction succeeds, the issuer redeems the securities, or the securities mature.

Historically, the par value of the auction rate securities approximated fair value due to the frequent resetting of the interest rate. While we will continue to earn interest on these investments in failed auction rate securities (often at the maximum contractual interest rate), the estimated fair value of the auction rate securities no longer approximates par value due to the lack of liquidity. We estimated the fair value of these securities after considering several factors, including the credit quality of the securities, the rate of interest received since the failed auctions began, the yields of securities similar to the underlying auction rate securities, and the input of broker-dealers in these securities. As a result, we have recorded a cumulative after-tax unrealized loss of approximately \$41 million (\$65 million pre-tax) on these securities as of September 30, 2009 in accumulated other comprehensive income (AOCI), reflecting the decline in the estimated fair value of these securities.

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During the second quarter of 2009, we recorded impairment losses on certain perpetual preferred securities, and an auction rate security collateralized by preferred securities, issued by large financial institutions. The impairment charge results from conversion offers from the issuers of these securities at prices well below the stated redemption value of the preferred shares. These securities, which had a cost basis of \$42 million, were written down to their fair value of \$25 million as of June 30, 2009, as an other-than-temporary impairment. The \$17 million total impairment charge during the second quarter was recorded in investment income (loss) on the income statement.

During the third quarter of 2008, we recorded impairment losses on two auction rate securities that were collateralized by preferred stock issued by the Federal National Mortgage Association ( FNMA ) and the Federal Home Loan Mortgage Corporation ( FHLMC ). The impairment resulted from actions by the U.S. Treasury Department and the Federal Housing Finance Agency with respect to FNMA and FHLMC. Additionally, we recorded impairment losses on a municipal auction rate security and on holdings of several medium term notes issued by Lehman Brothers Inc., which declared bankruptcy during the third quarter of 2008. The total of these credit-related impairment losses during the quarter was \$23 million, which was recorded in investment income (loss) on the income statement.

For the remaining auction rate securities, and equity and debt securities, we have concluded that no additional other-than-temporary impairment losses existed as of September 30, 2009. In making this determination, we considered the financial condition and prospects of the issuer, the magnitude of the losses in market value compared with the investments' cost, the length of time the investments have been in an unrealized loss position, the probability that we will be unable to collect all amounts due according to the contractual terms of the security, the credit rating of the security, and our ability and intent to hold these investments until the anticipated recovery in market value or maturity occurs.

The amortized cost and estimated fair value of marketable securities at September 30, 2009, by contractual maturity, are shown below (in millions). Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

|                                          | Cost   | Estimated<br>Fair Value |
|------------------------------------------|--------|-------------------------|
| Due in one year or less                  | \$ 22  | \$ 23                   |
| Due after one year through three years   | 199    | 202                     |
| Due after three years through five years | 67     | 69                      |
| Due after five years                     | 492    | 431                     |
|                                          | 780    | 725                     |
| Equity securities                        | 50     | 61                      |
|                                          | \$ 830 | \$ 786                  |

We had \$192 and \$191 million of restricted cash related to our self-insurance requirements, as of September 30, 2009 and December 31, 2008, respectively, which is reported in Other Non-Current Assets on the consolidated balance sheet.



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Property, plant and equipment as of September 30, 2009 and December 31, 2008 consists of the following (in millions):

|                                                        | <b>2009</b> | <b>2008</b> |
|--------------------------------------------------------|-------------|-------------|
| Vehicles                                               | \$ 5,458    | \$ 5,508    |
| Aircraft (including aircraft under capitalized leases) | 13,692      | 14,564      |
| Land                                                   | 1,085       | 1,068       |
| Buildings                                              | 3,001       | 2,836       |
| Building and leasehold improvements                    | 2,792       | 2,702       |
| Plant equipment                                        | 6,328       | 5,720       |
| Technology equipment                                   | 1,643       | 1,620       |
| Equipment under operating leases                       | 156         | 136         |
| Construction-in-progress                               | 553         | 944         |
|                                                        | 34,708      | 35,098      |
| Less: Accumulated depreciation and amortization        | (16,616)    | (16,833)    |
|                                                        | \$ 18,092   | \$ 18,265   |

We continually monitor our aircraft fleet utilization in light of current and projected volume levels, aircraft fuel prices, and other factors. In 2008, we had announced that we were in negotiations with DHL to provide air transportation services for all of DHL's express, deferred and international package volume within the United States, as well as air transportation services between the United States, Canada and Mexico. In early April 2009, UPS and DHL mutually agreed to terminate further discussions on providing these services. Additionally, our U.S. Domestic Package air delivery volume had declined for several quarters as a result of persistent economic weakness and shifts in product mix from our premium air services to our lower cost ground services. As a result of these factors, the utilization of certain aircraft fleet types had declined and was expected to be lower in the future.

Based on the factors noted above, as well as FAA aging aircraft directives that would require significant future maintenance expenditures, we determined that a triggering event had occurred that required an impairment assessment of our McDonnell-Douglas DC-8-71 and DC-8-73 aircraft fleets. We conducted an impairment analysis as of March 31, 2009, and determined that the cost basis of these fleets was not recoverable due to the accelerated expected retirement dates of the aircraft. Based on anticipated residual values for the airframes, engines, and parts, we recognized an impairment charge of \$181 million in the first quarter of 2009. This charge is included in the caption "Other expenses" in the Statement of Consolidated Income, and impacted our U.S. Domestic Package segment. The DC-8 fleets were subsequently retired from service. We currently continue to utilize and operate all of our other aircraft fleets.

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Information about net periodic benefit cost for our pension and postretirement benefit plans is as follows for the three and nine month period ended September 30, 2009 and 2008 (in millions):

**Three Months Ended September 30,**

|                            | U.S. Pension Benefits |        | U.S. Postretirement Medical Benefits |       | International Pension Benefits |      |
|----------------------------|-----------------------|--------|--------------------------------------|-------|--------------------------------|------|
|                            | 2009                  | 2008   | 2009                                 | 2008  | 2009                           | 2008 |
| <b>Net Periodic Cost:</b>  |                       |        |                                      |       |                                |      |
| Service cost               | \$ 172                | \$ 176 | \$ 21                                | \$ 24 | \$ 5                           | \$ 7 |
| Interest cost              | 283                   | 263    | 52                                   | 50    | 8                              | 8    |
| Expected return on assets  | (372)                 | (379)  | (6)                                  | (12)  | (8)                            | (9)  |
| Amortization of:           |                       |        |                                      |       |                                |      |
| Transition obligation      | 1                     | 1      |                                      |       |                                |      |
| Prior service cost         | 45                    | 46     | 2                                    | (1)   | 1                              |      |
| Actuarial (gain) loss      | 11                    | 2      | 3                                    | 5     |                                |      |
| Settlements / curtailments |                       |        |                                      |       |                                |      |
| Net periodic benefit cost  | \$ 140                | \$ 109 | \$ 72                                | \$ 66 | \$ 6                           | \$ 6 |

**Nine Months Ended September 30,**

|                            | U.S. Pension Benefits |         | U.S. Postretirement Medical Benefits |        | International Pension Benefits |       |
|----------------------------|-----------------------|---------|--------------------------------------|--------|--------------------------------|-------|
|                            | 2009                  | 2008    | 2009                                 | 2008   | 2009                           | 2008  |
| <b>Net Periodic Cost:</b>  |                       |         |                                      |        |                                |       |
| Service cost               | \$ 517                | \$ 530  | \$ 64                                | \$ 71  | \$ 15                          | \$ 21 |
| Interest cost              | 848                   | 789     | 158                                  | 150    | 22                             | 24    |
| Expected return on assets  | (1,116)               | (1,138) | (20)                                 | (37)   | (20)                           | (27)  |
| Amortization of:           |                       |         |                                      |        |                                |       |
| Transition obligation      | 3                     | 3       |                                      |        |                                |       |
| Prior service cost         | 134                   | 139     | 5                                    | (3)    | 1                              |       |
| Actuarial (gain) loss      | 34                    | 6       | 10                                   | 14     | 1                              |       |
| Settlements / curtailments | 3                     |         |                                      |        |                                |       |
| Net periodic benefit cost  | \$ 423                | \$ 329  | \$ 217                               | \$ 195 | \$ 19                          | \$ 18 |

During the first nine months of 2009, we contributed \$691 and \$67 million to our company-sponsored pension and postretirement medical benefit plans, respectively. We expect to contribute \$125 and \$24 million over the remainder of the year to the pension and postretirement medical benefit plans, respectively.

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The following table indicates the allocation of goodwill by reportable segment as of September 30, 2009 and December 31, 2008 (in millions):

|                            | <b>U.S. Domestic<br/>Package</b> | <b>International<br/>Package</b> | <b>Supply Chain &amp;<br/>Freight</b> | <b>Consolidated</b> |
|----------------------------|----------------------------------|----------------------------------|---------------------------------------|---------------------|
| December 31, 2008 balance  | \$                               | \$ 288                           | \$ 1,698                              | \$ 1,986            |
| Acquired                   |                                  | 102                              |                                       | 102                 |
| Disposed of                |                                  |                                  | (6)                                   | (6)                 |
| Currency / Other           |                                  | 4                                | 25                                    | 29                  |
| September 30, 2009 balance | \$                               | \$ 394                           | \$ 1,717                              | \$ 2,111            |

The goodwill acquired in the International Package segment was primarily due to the acquisition of an agent in Turkey, as discussed further below. We also acquired an agent in Slovenia during the second quarter of 2009. The increase in goodwill in the Supply Chain & Freight segment was due to the impact of fluctuations in the U.S. Dollar with other currencies on the translation of non-U.S. Dollar goodwill balances, partially offset by the allocation of goodwill to the sale of certain non-U.S. Mail Boxes Etc. franchise relationships.

In August 2009, we completed the formation of a new joint venture headquartered in Dubai to develop and grow UPS express package, freight forwarding and contract logistics services across the Middle East, Turkey and portions of Central Asia. We own 80% of this joint venture, and we consolidate the financial statements of the joint venture. In conjunction with the formation of this joint venture, the joint venture acquired the small package operations of Unsped Paket Servisi San ve Ticaret A.S. ( Unsped ), our existing service agent in Turkey. We are contributing certain existing UPS operations in the region to the new joint venture, along with cash consideration of \$40 million and an additional \$40 million that will be due on a deferred basis. We maintain an option to purchase the remaining 20% of the joint venture, and the joint venture partner maintains a put option to require us to purchase the remaining 20% interest. Upon exercise of the call or put option, a payment of \$20 million will be required. An additional payment may be due depending upon the earnings of the joint venture. The 20% portion of the joint venture that we do not own, which represents temporary equity, is recorded as a noncontrolling interest in shareowners' equity.

The express package business operations of Unsped are included in our International Package segment, while the freight forwarding business of Unsped is included in our Supply Chain & Freight segment. Pro forma results of operations have not been presented for this acquisition, because the effects of this transaction were not material. The results of operations of Unsped have been included in our statements of consolidated income from the date of acquisition. As of September 30, 2009, the purchase price allocation is preliminary, and we anticipate changes to the purchase price allocation upon completion of fair market value appraisals and similar information.

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The following is a summary of intangible assets as of September 30, 2009 and December 31, 2008 (in millions):

|                                          | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net Carrying<br>Value |
|------------------------------------------|--------------------------|-----------------------------|-----------------------|
| <b>September 30, 2009:</b>               |                          |                             |                       |
| Trademarks, licenses, patents, and other | \$ 72                    | \$ (43)                     | \$ 29                 |
| Customer lists                           | 113                      | (58)                        | 55                    |
| Franchise rights                         | 109                      | (45)                        | 64                    |
| Capitalized software                     | 1,788                    | (1,427)                     | 361                   |
| <b>Total Intangible Assets, Net</b>      | <b>\$ 2,082</b>          | <b>\$ (1,573)</b>           | <b>\$ 509</b>         |
| <b>December 31, 2008:</b>                |                          |                             |                       |
| Trademarks, licenses, patents, and other | \$ 47                    | \$ (40)                     | \$ 7                  |
| Customer lists                           | 113                      | (48)                        | 65                    |
| Franchise rights                         | 110                      | (41)                        | 69                    |
| Capitalized software                     | 1,728                    | (1,358)                     | 370                   |
| <b>Total Intangible Assets, Net</b>      | <b>\$ 1,998</b>          | <b>\$ (1,487)</b>           | <b>\$ 511</b>         |

**NOTE 8. DEBT AND FINANCING ARRANGEMENTS**

The carrying value of our outstanding debt as of September 30, 2009 and December 31, 2008 consists of the following (in millions):

|                                | Maturity  | 2009            | 2008            |
|--------------------------------|-----------|-----------------|-----------------|
| Commercial paper               | 2009-2010 | \$ 1,231        | \$ 2,922        |
| 4.50% senior notes             | 2013      | 1,768           | 1,739           |
| 3.875% senior notes            | 2014      | 1,030           |                 |
| 5.50% senior notes             | 2018      | 774             | 745             |
| 5.125% senior notes            | 2019      | 1,000           |                 |
| 8.38% debentures               | 2020-2030 | 740             | 741             |
| 6.20% senior notes             | 2038      | 1,480           | 1,479           |
| Floating rate senior notes     | 2049-2053 | 431             | 438             |
| Facility notes and bonds       | 2009-2036 | 431             | 433             |
| Pound Sterling notes           | 2031-2050 | 792             | 730             |
| Capital lease obligations      | 2009-2021 | 400             | 425             |
| UPS Notes                      | 2009-2027 | 174             | 198             |
| Other debt                     | 2009-2014 | 54              | 21              |
| <b>Total debt</b>              |           | <b>10,305</b>   | <b>9,871</b>    |
| <b>Less current maturities</b> |           | <b>(1,397)</b>  | <b>(2,074)</b>  |
| <b>Long-term debt</b>          |           | <b>\$ 8,908</b> | <b>\$ 7,797</b> |

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We are authorized to borrow up to \$10.0 billion under the U.S. commercial paper program we maintain. We had \$1.231 billion outstanding under this program as of September 30, 2009, with an average interest rate of 0.12%. As of September 30, 2009, we have classified the entire commercial paper balance as a current liability in our consolidated balance sheet. As of December 31, 2008, \$1.0 billion of commercial paper was classified as long-term debt in anticipation of the subsequent issuance of fixed rate notes, as discussed further below. We also

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maintain a European commercial paper program under which we are authorized to borrow up to 1.0 billion in a variety of currencies, however there were no amounts outstanding under this program as of September 30, 2009.

We maintain two credit agreements with a consortium of banks. One of these agreements provides revolving credit facilities of \$3.0 billion, and expires on April 15, 2010. Interest on any amounts we borrow under this facility would be charged at 90-day LIBOR plus a percentage determined by quotations from Markit Group Ltd. for our 1-year credit default swap spread, subject to certain minimum rates and maximum rates based on our public debt ratings from Standard & Poor's and Moody's. If our public debt ratings are A / A2 or above, the minimum applicable margin is 1.00% and the maximum applicable margin is 2.00%; if our public debt ratings are lower than A / A2, the minimum applicable margin is 1.50% and the maximum applicable margin is 3.00%.

The second agreement provides revolving credit facilities of \$1.0 billion, and expires on April 19, 2012. Interest on any amounts we borrow under this facility would be charged at 90-day LIBOR plus 15 basis points. At September 30, 2009, there were no outstanding borrowings under either of these facilities.

In addition to these credit facilities, we have an automatically effective registration statement on Form S-3 filed with the SEC that is available for registered offerings of short or long-term debt securities.

In March 2009, we completed an offering of \$1.0 billion of 3.875% senior notes due April 2014 and \$1.0 billion of 5.125% senior notes due April 2019. These notes pay interest semiannually, and we may redeem the notes at any time by paying the greater of the principal amount or a make-whole amount, plus accrued interest. After pricing and underwriting discounts, we received a total of \$1.989 billion in cash proceeds from the offering. The proceeds from the offering were used for general corporate purposes, including the reduction of our outstanding commercial paper balance.

In October 2009, \$62 million in facility notes and bonds matured, and an additional \$46 million that were originally scheduled to mature in 2018 were called for early redemption.

Our existing debt instruments and credit facilities do not have cross-default or ratings triggers, however these debt instruments and credit facilities do subject us to certain financial covenants. As of September 30, 2009 and for all prior periods, we have satisfied these financial covenants. These covenants limit the amount of secured indebtedness that we may incur, and limit the amount of attributable debt in sale-leaseback transactions, to 10% of net tangible assets. As of September 30, 2009, 10% of net tangible assets is equivalent to \$2.281 billion, however we have no covered sale-leaseback transactions or secured indebtedness outstanding. Additionally, we are required to maintain a minimum net worth, as defined, of \$5.0 billion on a quarterly basis. As of September 30, 2009, our net worth, as defined, was equivalent to \$12.512 billion. We do not expect these covenants to have a material impact on our financial condition or liquidity.

**NOTE 9. LEGAL PROCEEDINGS AND CONTINGENCIES**

We are a defendant in a number of lawsuits filed in state and federal courts containing various class-action allegations under state wage-and-hour laws. In one of these cases, Marlo v. UPS, which was certified as a class action in a California federal court in September 2004, plaintiffs allege that they improperly were denied overtime, and seek penalties for missed meal and rest periods, and interest and attorneys' fees. Plaintiffs purport to represent a class of 1,300 full-time supervisors. In August 2005, the court granted summary judgment in favor of UPS on all claims, and plaintiffs appealed the ruling. In October 2007, the appeals court reversed the lower court's ruling. In April 2008, the Court decertified the class and vacated the trial scheduled for April 29, 2008. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

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In another case, *Hohider v. UPS*, which in July 2007 was certified as a class action in a Pennsylvania federal court, plaintiffs have challenged certain aspects of the Company's interactive process for assessing requests for reasonable accommodation under the Americans with Disabilities Act. Plaintiffs purport to represent a class of over 35,000 current and former employees, and seek back-pay, and compensatory and punitive damages, as well as attorneys' fees. In August 2007, the Third Circuit Court of Appeals granted our petition to hear the appeal of the trial court's certification order. In July 2009, the Third Circuit issued its decision decertifying the class and remanding the case to the trial court for further proceedings. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

UPS and Mail Boxes Etc., Inc. are defendants in various lawsuits brought by franchisees who operate Mail Boxes Etc. centers and The UPS Store locations. These lawsuits relate to the rebranding of Mail Boxes Etc. centers to The UPS Store, The UPS Store business model, the representations made in connection with the rebranding and the sale of The UPS Store franchises, and UPS's sale of services in the franchisees territories. In one of the actions, which is pending in California state court, the court recently certified a class consisting of all Mail Boxes Etc. branded stores that rebranded to The UPS Store in March 2003. We have denied any liability with respect to these claims and intend to defend ourselves vigorously. At this time, we have not determined the amount of any liability that may result from these matters or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

In January 2008, a class action complaint was filed in the United States District Court for the Eastern District of New York alleging price-fixing activities relating to the provision of freight forwarding services. UPS was not named in this case. On July 21, 2009, the plaintiffs filed a first amended complaint naming numerous global freight forwarders as defendants. UPS and UPS Supply Chain Solutions are among the 60 defendants named in the amended complaint. We intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from these matters or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

In *Barber Auto Sales v. UPS*, which a federal court in Alabama certified as a class action in September 2009, the plaintiff asserts a breach of contract claim arising from UPS's assessment of shipping charge corrections when UPS determines that the dimensional weight of packages is greater than reported by the shipper. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

We are a defendant in various other lawsuits that arose in the normal course of business. We believe that the eventual resolution of these cases will not have a material adverse effect on our financial condition, results of operations, or liquidity.

We file income tax returns in the U.S. federal jurisdiction, most U.S. state and local jurisdictions, and many non-U.S. jurisdictions. We have substantially resolved all U.S. federal income tax matters for tax years prior to 2003. During the third quarter of 2009, we received a refund of \$271 million as a result of the resolution of tax years 1999 through 2002 with the Internal Revenue Service (IRS) Appeals Office. For the tax years 2003 through 2004, we anticipate concluding the limited number of unagreed issues with the IRS Appeals Office by the end of the second quarter of 2010. Along with the audit for tax years 2005 through 2007, the IRS is currently examining non-income based taxes, including employment and excise taxes, which could lead to proposed assessments. The IRS has not presented an official position with regard to these taxes at this time, and therefore

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we are not able to determine the technical merit of any potential assessment. We have filed all required U.S. state and local returns reporting the result of the resolution of the U.S. federal income tax audit of the tax years 1999 through 2002. A limited number of U.S. state and local matters are the subject of ongoing audits, administrative appeals or litigation.

Certain foreign jurisdictions are reviewing transfer pricing transactions between U.S. and related foreign companies and the Italian Guardia di Finanza is reviewing whether certain entities have a permanent establishment within Italy, which could result in an undetermined amount of tax liabilities, interest and penalties. No final reports or assessments have been issued. We continue to cooperate during these audits while defending the positions taken on the filed returns including the exercise of rights afforded under international treaties as appropriate.

It is reasonably possible that the amount of unrecognized tax benefits could change within the next 12 months. At this time, we do not expect any of the above matters to have a material adverse effect on our financial condition, results of operations, or liquidity.

As of December 31, 2008, we had approximately 260,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters ( Teamsters ). These agreements run through July 31, 2013. We have approximately 2,900 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association, which becomes amendable at the end of 2011. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which became amendable in November 2006. We began formal negotiations with Teamsters Local 2727 in October 2006. In addition, the majority (approximately 3,000) of our ground mechanics who are not employed under agreements with the Teamsters are employed under collective bargaining agreements with the International Association of Machinists and Aerospace Workers ( IAM ). In June of 2009, we reached a new agreement with the IAM, which was subsequently ratified in July 2009. The new agreement runs through July 31, 2014.

We participate in a number of trustee-managed multi-employer pension and health and welfare plans for employees covered under collective bargaining agreements. Several factors could cause us to make significantly higher future contributions to these plans, including unfavorable investment performance, changes in demographics, and increased benefits to participants. At this time, we are unable to determine the amount of additional future contributions, if any, or whether any material adverse effect on our financial condition, results of operations, or liquidity would result from our participation in these plans.

**NOTE 10. SHAREOWNERS EQUITY**

*Capital Stock, Additional Paid-In Capital, and Retained Earnings*

We maintain two classes of common stock, which are distinguished from each other primarily by their respective voting rights. Class A shares are entitled to 10 votes per share, whereas Class B shares are entitled to one vote per share. Class A shares are primarily held by UPS employees and retirees, and these shares are fully convertible into Class B shares at any time. Class B shares are publicly traded on the New York Stock Exchange (NYSE) under the symbol UPS . Class A and B shares both have a \$0.01 par value, and as of September 30, 2009, there were 4.6 billion Class A shares and 5.6 billion Class B shares authorized to be issued. Additionally, there are 200 million preferred shares authorized to be issued, with a par value of \$0.01 per share; as of September 30, 2009, no preferred shares had been issued.



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The following is a roll-forward of our common stock, additional paid-in capital, and retained earnings accounts for the nine months ended September 30, 2009 and 2008 (in millions, except per share amounts):

|                                                  | 2009   |           | 2008   |           |
|--------------------------------------------------|--------|-----------|--------|-----------|
|                                                  | Shares | Dollars   | Shares | Dollars   |
| <b>Class A Common Stock</b>                      |        |           |        |           |
| Balance at beginning of period                   | 314    | \$ 3      | 349    | \$ 3      |
| Common stock purchases                           | (7)    |           | (9)    |           |
| Stock award plans                                | 2      |           | 3      |           |
| Common stock issuances                           | 3      |           | 2      |           |
| Conversions of Class A to Class B common stock   | (22)   |           | (21)   |           |
| Class A shares issued at end of period           | 290    | \$ 3      | 324    | \$ 3      |
| <b>Class B Common Stock</b>                      |        |           |        |           |
| Balance at beginning of period                   | 684    | \$ 7      | 694    | \$ 7      |
| Common stock purchases                           | (1)    |           | (39)   |           |
| Conversions of Class A to Class B common stock   | 22     |           | 21     |           |
| Class B shares issued at end of period           | 705    | \$ 7      | 676    | \$ 7      |
| <b>Additional Paid-In Capital</b>                |        |           |        |           |
| Balance at beginning of period                   |        | \$        |        | \$        |
| Stock award plans                                |        | 311       |        | 386       |
| Common stock purchases                           |        | (396)     |        | (516)     |
| Common stock issuances                           |        | 134       |        | 130       |
| Balance at end of period                         |        | \$ 49     |        | \$        |
| <b>Retained Earnings</b>                         |        |           |        |           |
| Balance at beginning of period                   |        | \$ 12,412 |        | \$ 14,186 |
| Net income attributable to controlling interests |        | 1,395     |        | 2,749     |
| Cumulative adjustment for accounting changes     |        |           |        | (60)      |
| Dividends (\$1.35 and \$1.35 per share)          |        | (1,354)   |        | (1,381)   |
| Common stock purchases                           |        |           |        | (2,783)   |
| Balance at end of period                         |        | \$ 12,453 |        | \$ 12,711 |

On January 1, 2008, we recognized a \$44 million reduction to retained earnings as a result of changing our measurement date under ASC 715, *Compensation-Retirement Benefits*. Also on January 1, 2008, we recognized a \$16 million reduction to retained earnings as a result of adopting provisions of ASC 825, *Financial Instruments*, which is discussed further in Note 12.

As a result of the uncertain economic environment, we have slowed our share repurchase activity. We currently intend to repurchase shares in 2009 at a rate that should approximately offset the dilution from our stock compensation programs. We repurchased a total of 7.8 million shares of Class A and Class B common stock for \$396 million during the nine months ended September 30, 2009, and 48.5 million shares for \$3.299 billion for the nine months ended September 30, 2008. As of September 30, 2009, we had \$6.176 billion of our share repurchase authorization remaining.



**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS***Accumulated Other Comprehensive Income (Loss)*

We incur activity in AOCI for unrealized holding gains and losses on available-for-sale securities, foreign currency translation adjustments, unrealized gains and losses from derivatives that qualify as hedges of cash flows, and unrecognized pension and postretirement benefit costs. The activity in AOCI for the nine months ended September 30, 2009 and 2008 is as follows (in millions):

|                                                                                                                                                  | 2009       | 2008       |
|--------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|
| <b>Foreign currency translation gain (loss):</b>                                                                                                 |            |            |
| Balance at beginning of period                                                                                                                   | \$ (38)    | \$ 81      |
| Aggregate adjustment for the period                                                                                                              | 126        | 80         |
| Balance at end of period                                                                                                                         | 88         | 161        |
| <b>Unrealized gain (loss) on marketable securities, net of tax:</b>                                                                              |            |            |
| Balance at beginning of period                                                                                                                   | (60)       | 9          |
| Current period changes in fair value (net of tax effect of \$2, and \$(32))                                                                      | 23         | (62)       |
| Reclassification to earnings (net of tax effect of \$6 and \$7)                                                                                  | 10         | 12         |
| Balance at end of period                                                                                                                         | (27)       | (41)       |
| <b>Unrealized gain (loss) on cash flow hedges, net of tax:</b>                                                                                   |            |            |
| Balance at beginning of period                                                                                                                   | (107)      | (250)      |
| Current period changes in fair value (net of tax effect of \$(26) and \$24)                                                                      | (43)       | 40         |
| Reclassification to earnings (net of tax effect of \$(74) and \$128)                                                                             | (123)      | 213        |
| Balance at end of period                                                                                                                         | (273)      | 3          |
| <b>Unrecognized pension and postretirement benefit costs, net of tax:</b>                                                                        |            |            |
| Balance at beginning of period                                                                                                                   | (5,437)    | (1,853)    |
| Reclassification to earnings (net of tax effect of \$70 and \$61)                                                                                | 118        | 98         |
| Net actuarial gain / loss and prior service cost resulting from remeasurements of plan assets and liabilities (net of tax effect of \$0 and \$8) |            | 13         |
| Balance at end of period                                                                                                                         | (5,319)    | (1,742)    |
| Accumulated other comprehensive income (loss) at end of period                                                                                   | \$ (5,531) | \$ (1,619) |

*Deferred Compensation Obligations and Treasury Stock*

Activity in the deferred compensation program for the nine months ended September 30, 2009 and 2008 is as follows (in millions):

|                                          | 2009   |         | 2008   |         |
|------------------------------------------|--------|---------|--------|---------|
|                                          | Shares | Dollars | Shares | Dollars |
| <b>Deferred Compensation Obligations</b> |        |         |        |         |

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|                                |  |        |  |        |
|--------------------------------|--|--------|--|--------|
| Balance at beginning of period |  | \$ 121 |  | \$ 137 |
| Reinvested dividends           |  | 3      |  | 4      |
| Benefit payments               |  | (16)   |  | (21)   |
| Balance at end of period       |  | \$ 108 |  | \$ 120 |

**Treasury Stock**

|                                |     |          |     |          |
|--------------------------------|-----|----------|-----|----------|
| Balance at beginning of period | (2) | \$ (121) | (2) | \$ (137) |
| Reinvested dividends           |     | (3)      |     | (4)      |
| Benefit payments               |     | 16       |     | 21       |
| Balance at end of period       | (2) | \$ (108) | (2) | \$ (120) |

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS***Noncontrolling Interests*

We have noncontrolling interests in certain consolidated subsidiaries in our International Package and Supply Chain & Freight segments. The noncontrolling interests acquired in 2009 primarily relate to the formation of a joint venture in Dubai that will operate in the Middle East, Turkey, and portions of the Central Asia region (discussed further in Note 7). The activity related to our noncontrolling interests is presented below:

|                                                     | 2009  | 2008 |
|-----------------------------------------------------|-------|------|
| <b>Noncontrolling Interests</b>                     |       |      |
| Balance at beginning of period                      | \$    | \$   |
| Acquired noncontrolling interests                   | 65    |      |
| Dividends attributable to noncontrolling interests  |       |      |
| Net income attributable to noncontrolling interests |       |      |
| Balance at end of period                            | \$ 65 | \$   |

**NOTE 11. SEGMENT INFORMATION**

We report our operations in three segments: U.S. Domestic Package operations, International Package operations, and Supply Chain & Freight operations. Package operations represent our most significant business and are broken down into regional operations around the world. Regional operations managers are responsible for both domestic and export operations within their geographic area.

*U.S. Domestic Package*

Domestic Package operations include the time-definite delivery of letters, documents, and packages throughout the United States.

*International Package*

International Package operations include delivery to more than 200 countries and territories worldwide, including shipments wholly outside the United States, as well as shipments with either origin or distribution outside the United States. Our International Package reporting segment includes the operations of our Europe, Asia, and Americas operating segments.

*Supply Chain & Freight*

Supply Chain & Freight includes our forwarding and logistics operations, UPS Freight, and other aggregated business units. Our forwarding and logistics business provides services in more than 175 countries and territories worldwide, and includes supply chain design and management, freight distribution, customs brokerage, mail and consulting services. UPS Freight offers a variety of less-than-truckload ( LTL ) and truckload ( TL ) services to customers in North America. Other aggregated business units within this segment include Mail Boxes, Etc. (the franchisor of Mail Boxes, Etc. and The UPS Store) and UPS Capital.

In evaluating financial performance, we focus on operating profit as a segment's measure of profit or loss. Operating profit is before investment income, interest expense, and income taxes. The accounting policies of the reportable segments are the same as those described in the summary of accounting policies included in the financial statements in our Annual Report on Form 10-K for the year ended December 31, 2008, with certain expenses allocated between the segments using activity-based costing methods.



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Segment information for the three and nine months ended September 30, 2009 and 2008 is as follows (in millions):

|                          | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                  |
|--------------------------|-------------------------------------|------------------|------------------------------------|------------------|
|                          | 2009                                | 2008             | 2009                               | 2008             |
| <b>Revenue:</b>          |                                     |                  |                                    |                  |
| U.S. Domestic Package    | \$ 6,868                            | \$ 7,841         | \$ 20,606                          | \$ 23,290        |
| International Package    | 2,422                               | 2,949            | 6,908                              | 8,656            |
| Supply Chain & Freight   | 1,863                               | 2,323            | 5,406                              | 6,843            |
| <b>Consolidated</b>      | <b>\$ 11,153</b>                    | <b>\$ 13,113</b> | <b>\$ 32,920</b>                   | <b>\$ 38,789</b> |
| <b>Operating Profit:</b> |                                     |                  |                                    |                  |
| U.S. Domestic Package    | \$ 514                              | \$ 1,117         | \$ 1,374                           | \$ 2,975         |
| International Package    | 313                                 | 386              | 900                                | 1,214            |
| Supply Chain & Freight   | 102                                 | 129              | 268                                | 390              |
| <b>Consolidated</b>      | <b>\$ 929</b>                       | <b>\$ 1,632</b>  | <b>\$ 2,542</b>                    | <b>\$ 4,579</b>  |

As discussed in Note 5, the U.S. Domestic Package segment operating profit was adversely impacted by a \$181 million impairment charge in the first quarter of 2009, related to our McDonnell-Douglas DC-8-71 and DC-8-73 airframes, engines, and related parts.

**NOTE 12. FAIR VALUE DISCLOSURES**

Effective January 1, 2008, we adopted provisions of ASC 820, *Fair Value Measurements and Disclosures*, that requires disclosures about our assets and liabilities that are measured at fair value. Further information about such assets and liabilities is presented below. We began to apply these provisions of ASC 820 to non-financial assets and liabilities beginning January 1, 2009.

Provisions of ASC 825, *Financial Instruments*, were issued in February 2007 that give entities the option to measure eligible financial assets, financial liabilities and firm commitments at fair value (i.e., the fair value option), on an instrument-by-instrument basis, that are otherwise not accounted for at fair value under other accounting standards. The election to use the fair value option is available at specified election dates, such as when an entity first recognizes a financial asset or financial liability or upon entering into a firm commitment. Subsequent changes in fair value must be recorded in earnings. Additionally, ASC 825 allowed for a one-time election for existing positions upon adoption, with the transition adjustment recorded to beginning retained earnings. We adopted these provisions of ASC 825 on January 1, 2008, and elected to apply the fair value option to our investment in certain investment partnerships that were previously accounted for under the equity method. Accordingly, we recorded a \$16 million reduction to retained earnings as of January 1, 2008. These investments are reported in other non-current assets on the consolidated balance sheet.

Our assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy in accordance with ASC 820. Level 1 inputs utilize quoted prices in active markets for identical assets or liabilities. Level 2 inputs are based on other observable market data, such as quoted prices for similar assets and liabilities, and inputs other than quoted prices that are observable, such as interest rates and yield curves. Level 3 inputs are developed from unobservable data reflecting our own assumptions, and include situations where there is little or no market activity for the asset or liability.

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

The following is a general description of the valuation methodologies used for financial assets and liabilities measured at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy.

*Marketable Securities*

Marketable securities utilizing Level 1 inputs include active exchange-traded equity securities and equity index funds, and most U.S. Government debt securities, as these securities all have quoted prices in active markets. Marketable securities utilizing Level 2 inputs include non-auction rate asset-backed securities, corporate bonds, and municipal bonds. These securities are valued using market corroborated pricing, matrix pricing, or other models that utilize observable inputs such as yield curves.

We have classified our auction rate securities portfolio as utilizing Level 3 inputs, as their valuation requires substantial judgment and estimation of factors that are not currently observable in the market due to the lack of trading in the securities. Valuations may be revised in future periods as market conditions evolve. These securities were valued as of September 30, 2009 considering several factors, including the credit quality of the securities, the rate of interest received since the failed auctions began, the yields of securities similar to the underlying auction rate securities, and the input of broker-dealers in these securities.

*Derivative Contracts*

Our foreign currency, interest rate, and energy derivatives are largely comprised of over-the-counter derivatives, which are primarily valued using pricing models that rely on market observable inputs such as yield curves, currency exchange rates, and commodity forward prices, and therefore are classified as Level 2.

*Other Investments*

Financial assets and liabilities utilizing Level 3 inputs include our holdings in certain investment partnerships. These partnership holdings do not have any quoted prices, nor can they be valued using inputs based on observable market data. These investments are valued internally using a discounted cash flow model based on each partnership's financial statements and cash flow projections.



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The following table presents information about our assets and liabilities measured at fair value on a recurring basis as of September 30, 2009, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value (in millions).

|                                                | Quoted Prices in<br>Active Markets for<br>Identical Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Balance as<br>of<br>September 30,<br>2009 |
|------------------------------------------------|-------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|-------------------------------------------|
| <b>Assets</b>                                  |                                                                         |                                                     |                                                    |                                           |
| Marketable securities:                         |                                                                         |                                                     |                                                    |                                           |
| U.S. government and agency debt securities     | \$ 125                                                                  | \$ 5                                                | \$                                                 | \$ 130                                    |
| Mortgage and asset-backed debt securities      |                                                                         | 152                                                 | 109                                                | 261                                       |
| Corporate debt securities                      |                                                                         | 219                                                 |                                                    | 219                                       |
| U.S. state and local municipal debt securities |                                                                         | 22                                                  | 91                                                 | 113                                       |
| Other debt and equity securities               | 50                                                                      | 1                                                   | 12                                                 | 63                                        |
| Total marketable securities                    | 175                                                                     | 399                                                 | 212                                                | 786                                       |
| Derivative contracts                           |                                                                         | 142                                                 |                                                    | 142                                       |
| Other investments                              |                                                                         |                                                     | 305                                                | 305                                       |
| Total                                          | \$ 175                                                                  | \$ 541                                              | \$ 517                                             | \$ 1,233                                  |
| <b>Liabilities</b>                             |                                                                         |                                                     |                                                    |                                           |
| Derivative contracts                           | \$                                                                      | \$ 127                                              | \$                                                 | \$ 127                                    |
| Total                                          | \$                                                                      | \$ 127                                              | \$                                                 | \$ 127                                    |

The following table presents the changes in Level 3 instruments measured on a recurring basis for the three and nine months ended September 30, 2009 (in millions).

**Three Months Ended September 30, 2009:**

|                                             | Marketable<br>Securities | Other<br>Investments | Total  |
|---------------------------------------------|--------------------------|----------------------|--------|
| Balance on July 1, 2009                     | \$ 208                   | \$ 312               | \$ 520 |
| Transfers into (out of) Level 3             |                          |                      |        |
| Net realized and unrealized gains (losses): |                          |                      |        |
| Included in earnings (in investment income) |                          | (7)                  | (7)    |
| Included in AOCI (pre-tax)                  | 5                        |                      | 5      |
| Purchases, issuances, and settlements       | (1)                      |                      | (1)    |
| Balance on September 30, 2009               | \$ 212                   | \$ 305               | \$ 517 |

**Nine Months Ended September 30, 2009:****Total**

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|                                             | <b>Marketable<br/>Securities</b> | <b>Other<br/>Investments</b> |        |
|---------------------------------------------|----------------------------------|------------------------------|--------|
| Balance on January 1, 2009                  | \$ 216                           | \$ 331                       | \$ 547 |
| Transfers into (out of) Level 3             | (3)                              |                              | (3)    |
| Net realized and unrealized gains (losses): |                                  |                              |        |
| Included in earnings (in investment income) | (5)                              | (26)                         | (31)   |
| Included in AOCI (pre-tax)                  | 5                                |                              | 5      |
| Purchases, issuances, and settlements       | (1)                              |                              | (1)    |
| Balance on September 30, 2009               | \$ 212                           | \$ 305                       | \$ 517 |

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Certain assets are measured at fair value on a nonrecurring basis. For the nine months ended September 30, 2009, impaired airframes, engines, and parts with a net carrying value of \$192 million were written down to an aggregate fair value of \$11 million, as discussed further in Note 5. The fair values for the impaired airframes, engines, and parts were determined using unobservable inputs (Level 3). Additionally, impaired finance receivables with a carrying amount of \$13 million were written down to a net fair value of \$8 million, based on the fair value for the related collateral which was determined using unobservable inputs (Level 3). No assets were measured at fair value on a nonrecurring basis for the three months ended September 30, 2009.

The carrying value of cash and cash equivalents, accounts receivable, and accounts payable contained in the consolidated balance sheet approximates fair value. The following table sets forth our financial assets and liabilities that were not carried at fair value as of September 30, 2009 and December 31, 2008 (in millions):

|                          | As of September 30,<br>2009 |               | As of December 31,<br>2008 |               |
|--------------------------|-----------------------------|---------------|----------------------------|---------------|
|                          | Carrying<br>Value           | Fair<br>Value | Carrying<br>Value          | Fair<br>Value |
| Finance receivables      | \$ 667                      | \$ 665        | \$ 956                     | \$ 957        |
| Short and long-term debt | 10,305                      | 10,700        | 9,871                      | 10,287        |

The above fair values were computed based on comparable transactions, quoted market prices, discounted future cash flows or an estimate of the amount to be received or paid to terminate or settle the agreement, as applicable. Differences from carrying amounts are attributable to interest and or credit rate changes subsequent to when the transaction occurred.

**NOTE 13. EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2009 and 2008 (in millions, except per share amounts):

|                                               | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |          |
|-----------------------------------------------|-------------------------------------|--------|------------------------------------|----------|
|                                               | 2009                                | 2008   | 2009                               | 2008     |
| <b>Numerator:</b>                             |                                     |        |                                    |          |
| Net income attributable to common shareowners | \$ 549                              | \$ 970 | \$ 1,395                           | \$ 2,749 |
| <b>Denominator:</b>                           |                                     |        |                                    |          |
| Weighted average shares                       | 994                                 | 1,004  | 995                                | 1,019    |
| Deferred compensation obligations             | 2                                   | 2      | 2                                  | 2        |
| Vested portion of restricted shares           | 1                                   |        | 1                                  |          |
| Denominator for basic earnings per share      | 997                                 | 1,006  | 998                                | 1,021    |
| <b>Effect of dilutive securities:</b>         |                                     |        |                                    |          |
| Restricted performance units                  | 2                                   | 2      | 2                                  | 3        |
| Restricted stock units                        | 5                                   | 4      | 4                                  | 3        |
| Stock option plans                            |                                     | 1      |                                    | 1        |
| Denominator for diluted earnings per share    | 1,004                               | 1,013  | 1,004                              | 1,028    |

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|                            |         |         |         |         |
|----------------------------|---------|---------|---------|---------|
| Basic earnings per share   | \$ 0.55 | \$ 0.96 | \$ 1.40 | \$ 2.69 |
| Diluted earnings per share | \$ 0.55 | \$ 0.96 | \$ 1.39 | \$ 2.67 |

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**

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Diluted earnings per share for the three months ended September 30, 2009 and 2008 exclude the effect of 17.3 and 9.9 million shares of common stock (17.5 and 9.8 million for the nine months ended September 30, 2009 and 2008), respectively, that may be issued upon the exercise of employee stock options because such effect would be antidilutive.

**NOTE 14. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT**

*Risk Management Policies*

We are exposed to market risk, primarily related to foreign exchange rates, commodity prices, equity prices, and interest rates. These exposures are actively monitored by management. To manage the volatility relating to certain of these exposures, we enter into a variety of derivative financial instruments. Our objective is to reduce, where it is deemed appropriate to do so, fluctuations in earnings and cash flows associated with changes in foreign currency rates, commodity prices, equity prices, and interest rates. It is our policy and practice to use derivative financial instruments only to the extent necessary to manage exposures. As we use price sensitive instruments to hedge a certain portion of our existing and anticipated transactions, we expect that any loss in value for those instruments generally would be offset by increases in the value of those hedged transactions. We do not hold or issue derivative financial instruments for trading or speculative purposes.

*Credit Risk Management*

The forward contracts, swaps, and options discussed below contain an element of risk that the counterparties may be unable to meet the terms of the agreements. However, we minimize such risk exposures for these instruments by limiting the counterparties to banks and financial institutions that meet established credit guidelines, and monitoring counterparty credit risk to prevent concentrations of credit risk with any single counterparty. Additionally, the majority of our master agreements for derivatives provide for the early termination of any derivative transactions in the event that either the bank counterparty or UPS receives a credit rating below BBB by Standard & Poor's or Baa2 by Moody's, or ceases to be rated by either firm. We do not have any credit-risk triggers in our outstanding master agreements that require UPS or the bank counterparties to post collateral.

We have not historically incurred, and do not expect to incur in the future, any losses as a result of counterparty default.

*Accounting Policy for Derivative Instruments*

ASC 815, *Derivatives and Hedging*, requires companies to recognize all derivative instruments as assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the derivative, based upon the exposure being hedged, as a fair value hedge, a cash flow hedge, or a hedge of a net investment in a foreign operation.

A cash flow hedge refers to hedging the exposure to variability in expected future cash flows that is attributable to a particular risk. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of AOCI, and reclassified into earnings in the same period during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, or hedge components excluded from the assessment of effectiveness, are recognized in the income statement during the current period.

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A fair value hedge refers to hedging the exposure to changes in the fair value of an existing asset or a liability on the balance sheet that is attributable to a particular risk. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument is recognized in the income statement during the current period, as well as the offsetting gain or loss on the hedged item.

*Types of Hedges:*

*Commodity Risk Management:*

Currently, the fuel surcharges that we apply to our domestic and international package and LTL services are the primary means of reducing the risk of adverse fuel price changes on our business. We periodically enter into option contracts on energy commodity products to manage the price risk associated with forecasted transactions involving refined fuels, principally jet-A, diesel, and unleaded gasoline. The objective of the hedges is to reduce the variability of cash flows, due to changing fuel prices, associated with the forecasted transactions involving those products. We have designated and account for these contracts as cash flow hedges of the underlying forecasted transactions involving these fuel products and, therefore, the resulting gains and losses from these hedges are recognized as a component of fuel expense or revenue when the underlying transactions occur.

*Foreign Currency Risk Management:*

To protect against the reduction in value of forecasted foreign currency cash flows from our international package business, we maintain a foreign currency cash flow hedging program. Our most significant foreign currency exposures relate to the Euro, the British Pound Sterling, and the Canadian Dollar. We hedge portions of our forecasted revenue denominated in foreign currencies with option contracts. We have designated and account for these contracts as cash flow hedges of anticipated foreign currency denominated revenue and, therefore, the resulting gains and losses from these hedges are recognized as a component of international package revenue when the underlying sales transactions occur.

We have foreign currency denominated debt obligations and capital lease obligations associated with our aircraft. For some of these debt obligations and leases, we hedge the foreign currency denominated contractual payments using cross-currency interest rate swaps, which effectively convert the foreign currency denominated contractual payments into U.S. Dollar denominated payments. We have designated and account for these swaps as cash flow hedges of the forecasted contractual payments and, therefore, the resulting gains and losses from these hedges are recognized in the income statement when the currency remeasurement gains and losses on the underlying debt obligations and leases are incurred.

*Interest Rate Risk Management:*

Our indebtedness under our various financing arrangements creates interest rate risk. We use a combination of derivative instruments, including interest rate swaps and cross-currency interest rate swaps, as part of our program to manage the fixed and floating interest rate mix of our total debt portfolio and related overall cost of borrowing. The notional amount, interest payment, and maturity dates of the swaps match the terms of the associated debt being hedged. Interest rate swaps allow us to maintain a target range of floating rate debt within our capital structure.

We have designated and account for interest rate swaps that convert fixed rate interest payments into floating rate interest payments as hedges of the fair value of the associated debt instruments. Therefore, the gains and losses resulting from fair value adjustments to the interest rate swaps and fair value adjustments to the associated debt instruments are recorded to interest expense in the period in which the gains and losses occur. We

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have designated and account for interest rate swaps that convert floating rate interest payments into fixed rate interest payments as cash flow hedges of the forecasted payment obligations. The gains and losses resulting from fair value adjustments to the interest rate swap are recorded to AOCI.

We periodically hedge the forecasted fixed-coupon interest payments associated with anticipated debt offerings, using forward starting interest rate swaps, interest rate locks, or similar derivatives. These agreements effectively lock a portion of our interest rate exposure between the time the agreement is entered into and the date when the debt offering is completed, thereby mitigating the impact of interest rate changes on future interest expense. These derivatives are settled commensurate with the issuance of the debt, and any gain or loss upon settlement is amortized as an adjustment to the effective interest yield on the debt.

*Outstanding Positions:*

As of September 30, 2009, the notional amounts of our outstanding derivative positions were as follows:

|                                       | <b>Notional Value<br/>(in millions)</b> |
|---------------------------------------|-----------------------------------------|
| <b>Currency Hedges:</b>               |                                         |
| Euro                                  | 1,357                                   |
| British Pound Sterling                | £ 747                                   |
| Canadian Dollar                       | C\$ 309                                 |
| Japanese Yen                          | ¥ 1,619                                 |
| <b>Interest Rate Hedges:</b>          |                                         |
| Fixed to Floating Interest Rate Swaps | \$ 3,772                                |
| Floating to Fixed Interest Rate Swaps | \$ 28                                   |

As of September 30, 2009, we had no outstanding commodity hedge positions. The maximum term over which we are hedging exposures to the variability of cash flow is 41 years.

*Balance Sheet Recognition:*

The following table indicates the location on the balance sheet in which our derivative assets and liabilities have been recognized, and the related fair values of those derivatives (in millions). The table is segregated between those derivative instruments that qualify and are designated as hedging instruments and those that are not, as well as by type of contract and whether the derivative is in an asset or liability position.

| <b>Asset Derivatives</b>                 | <b>Balance Sheet Location</b> | <b>September 30, 2009<br/>Fair Value</b> |
|------------------------------------------|-------------------------------|------------------------------------------|
| <b>Derivatives designated as hedges:</b> |                               |                                          |
| Foreign exchange contracts               | Other current assets          | \$ 46                                    |
| Foreign exchange contracts               | Other non-current assets      | 1                                        |
| Interest rate contracts                  | Other non-current assets      | 95                                       |
| <b>Total Asset Derivatives</b>           |                               | <b>\$ 142</b>                            |





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| Liability Derivatives                        | Balance Sheet Location        | September 30, 2009<br>Fair Value |
|----------------------------------------------|-------------------------------|----------------------------------|
| <b>Derivatives designated as hedges:</b>     |                               |                                  |
| Foreign exchange contracts                   | Other current liabilities     | \$ (5)                           |
| Foreign exchange contracts                   | Other non-current liabilities | (111)                            |
| Interest rate contracts                      | Other non-current liabilities | (9)                              |
| <b>Derivatives not designated as hedges:</b> |                               |                                  |
| Interest rate contracts                      | Other non-current liabilities | (2)                              |
| <b>Total Liability Derivatives</b>           |                               | <b>\$ (127)</b>                  |

*Income Statement Recognition:*

The following tables indicates the amount and location in the income statement for the three and nine months ended September 30, 2009 in which derivative gains and losses, as well as the related amounts reclassified from AOCI, have been recognized for those derivatives designated as cash flow hedges (in millions).

**Three Months Ended September 30, 2009:**

| Derivative Instruments in Cash Flow Hedging Relationships | Amount of Gain<br>(Loss)<br>Recognized<br>in<br>OCI on<br>Derivative<br>(Effective<br>Portion) | Location of Gain<br>(Loss) Reclassified<br>from Accumulated<br>OCI into Income<br>(Effective Portion) | Amount of Gain<br>(Loss)<br>Reclassified from<br>Accumulated<br>OCI into<br>Income<br>(Effective<br>Portion) |
|-----------------------------------------------------------|------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| Interest rate contracts                                   | \$ (2)                                                                                         | Interest Expense                                                                                      | \$ (4)                                                                                                       |
| Foreign exchange contracts                                | (103)                                                                                          | Interest Expense                                                                                      | 24                                                                                                           |
| Foreign exchange contracts                                | (65)                                                                                           | Revenue                                                                                               | (2)                                                                                                          |
| Commodity contracts                                       |                                                                                                | Revenue                                                                                               |                                                                                                              |
| <b>Total</b>                                              | <b>\$ (170)</b>                                                                                |                                                                                                       | <b>\$ 18</b>                                                                                                 |

**Nine Months Ended September 30, 2009:**

| Derivative Instruments in Cash Flow Hedging Relationships | Amount of Gain<br>(Loss)<br>Recognized<br>in<br>OCI on<br>Derivative<br>(Effective<br>Portion) | Location of Gain<br>(Loss) Reclassified<br>from Accumulated<br>OCI into Income<br>(Effective Portion) | Amount of Gain<br>(Loss)<br>Reclassified from<br>Accumulated<br>OCI into<br>Income<br>(Effective<br>Portion) |
|-----------------------------------------------------------|------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| Interest rate contracts                                   | \$ 125                                                                                         | Interest Expense                                                                                      | \$ (10)                                                                                                      |
| Foreign exchange contracts                                | (104)                                                                                          | Interest Expense                                                                                      | 23                                                                                                           |
| Foreign exchange contracts                                | (90)                                                                                           | Revenue                                                                                               | 102                                                                                                          |
| Commodity contracts                                       |                                                                                                | Revenue                                                                                               | 82                                                                                                           |

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|       |    |      |    |     |
|-------|----|------|----|-----|
| Total | \$ | (69) | \$ | 197 |
|-------|----|------|----|-----|

As of September 30, 2009, \$11 million of pre-tax losses related to cash flow hedges that are currently deferred in AOCI are expected to be reclassified to income over the 12 month period ended September 30, 2010. The actual amounts that will be reclassified to income over the next 12 months will vary from this amount as a result of changes in market conditions. The amount of ineffectiveness recognized in income on derivative instruments designated in cash flow hedging relationships was immaterial for the nine months ended September 30, 2009.

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

The following table indicates the amount and location in the income statement in which derivative gains and losses, as well as the associated gains and losses on the underlying exposure, have been recognized for those derivatives designated as fair value hedges (in millions).

| <b>Derivative Instruments in Fair Value Hedging Relationships</b> | <b>Location of Gain (Loss) Recognized in Income</b> | <b>Amount Recognized in Income</b> | <b>Hedged Items in Fair Value Hedging Relationships</b> | <b>Location of Gain (Loss) Recognized in Income</b> | <b>Amount Recognized in Income</b> |
|-------------------------------------------------------------------|-----------------------------------------------------|------------------------------------|---------------------------------------------------------|-----------------------------------------------------|------------------------------------|
| <b>Three Months Ended September 30, 2009:</b>                     |                                                     |                                    |                                                         |                                                     |                                    |
| Interest rate contracts                                           | Interest Expense                                    | \$ 69                              | Fixed-Rate Debt and Capital Leases                      | Interest Expense                                    | \$ (69)                            |
| <b>Nine Months Ended September 30, 2009:</b>                      |                                                     |                                    |                                                         |                                                     |                                    |
| Interest rate contracts                                           | Interest Expense                                    | \$ 95                              | Fixed-Rate Debt and Capital Leases                      | Interest Expense                                    | \$ (95)                            |

Additionally, we maintain some interest rate swap and foreign exchange forward contracts that are not designated as hedges under the provisions of ASC 815. The interest rate swap contracts are intended to provide an economic hedge of a portfolio of interest bearing receivables. The foreign exchange forward contracts are intended to provide an economic offset to foreign currency remeasurement risks for certain assets and liabilities in our balance sheet. For the three and nine months ended September 30, 2009, we recognized \$12 and \$21 million in losses, respectively, on the fair value of the foreign exchange forward contracts, which were reported in other operating expenses in the consolidated income statement, while the impact of the interest rate swap contracts was not material. The foreign exchange forward contracts are settled at the end of each month, and therefore no asset or liability was recorded on the balance sheet at September 30, 2009.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations***Revenue, Volume and Revenue Per Piece*

The following tables set forth information showing the change in revenue, average daily package volume, and average revenue per piece, both in dollars or amounts and in percentage terms:

|                                                     | Three Months Ended |                    | Change     |         |
|-----------------------------------------------------|--------------------|--------------------|------------|---------|
|                                                     | September 30, 2009 | September 30, 2008 | \$         | %       |
| <b>Revenue (in millions):</b>                       |                    |                    |            |         |
| <b>U.S. Domestic Package:</b>                       |                    |                    |            |         |
| Next Day Air                                        | \$ 1,348           | \$ 1,696           | \$ (348)   | (20.5)% |
| Deferred                                            | 664                | 818                | (154)      | (18.8)  |
| Ground                                              | 4,856              | 5,327              | (471)      | (8.8)   |
| Total U.S. Domestic Package                         | 6,868              | 7,841              | (973)      | (12.4)  |
| <b>International Package:</b>                       |                    |                    |            |         |
| Domestic                                            | 536                | 598                | (62)       | (10.4)  |
| Export                                              | 1,770              | 2,165              | (395)      | (18.2)  |
| Cargo                                               | 116                | 186                | (70)       | (37.6)  |
| Total International Package                         | 2,422              | 2,949              | (527)      | (17.9)  |
| <b>Supply Chain &amp; Freight:</b>                  |                    |                    |            |         |
| Forwarding and Logistics                            | 1,250              | 1,619              | (369)      | (22.8)  |
| Freight                                             | 509                | 598                | (89)       | (14.9)  |
| Other                                               | 104                | 106                | (2)        | (1.9)   |
| Total Supply Chain & Freight                        | 1,863              | 2,323              | (460)      | (19.8)  |
| Consolidated                                        | \$ 11,153          | \$ 13,113          | \$ (1,960) | (14.9)% |
| #                                                   |                    |                    |            |         |
| <b>Average Daily Package Volume (in thousands):</b> |                    |                    |            |         |
| <b>U.S. Domestic Package:</b>                       |                    |                    |            |         |
| Next Day Air                                        | 1,144              | 1,117              | 27         | 2.4%    |
| Deferred                                            | 856                | 859                | (3)        | (0.3)   |
| Ground                                              | 10,287             | 10,971             | (684)      | (6.2)   |
| Total U.S. Domestic Package                         | 12,287             | 12,947             | (660)      | (5.1)   |
| <b>International Package:</b>                       |                    |                    |            |         |
| Domestic                                            | 1,207              | 1,106              | 101        | 9.1     |
| Export                                              | 767                | 792                | (25)       | (3.2)   |
| Total International Package                         | 1,974              | 1,898              | 76         | 4.0     |
| Consolidated                                        | 14,261             | 14,845             | (584)      | (3.9)%  |
| Operating days in period                            | 65                 | 64                 |            |         |
| \$                                                  |                    |                    |            |         |
| <b>Average Revenue Per Piece:</b>                   |                    |                    |            |         |
| <b>U.S. Domestic Package:</b>                       |                    |                    |            |         |
| Next Day Air                                        | \$ 18.13           | \$ 23.72           | \$ (5.59)  | (23.6)% |
| Deferred                                            | 11.93              | 14.88              | (2.95)     | (19.8)  |

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|                             |         |          |           |         |
|-----------------------------|---------|----------|-----------|---------|
| Ground                      | 7.26    | 7.59     | (0.33)    | (4.3)   |
| Total U.S. Domestic Package | 8.60    | 9.46     | (0.86)    | (9.1)   |
| International Package:      |         |          |           |         |
| Domestic                    | 6.83    | 8.45     | (1.62)    | (19.2)  |
| Export                      | 35.50   | 42.71    | (7.21)    | (16.9)  |
| Total International Package | 17.97   | 22.75    | (4.78)    | (21.0)  |
| Consolidated                | \$ 9.90 | \$ 11.16 | \$ (1.26) | (11.3)% |

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|                                                     | Nine Months Ended     |                  | Change            |                |
|-----------------------------------------------------|-----------------------|------------------|-------------------|----------------|
|                                                     | September 30,<br>2009 | 2008             | \$                | %              |
| <b>Revenue (in millions):</b>                       |                       |                  |                   |                |
| <b>U.S. Domestic Package:</b>                       |                       |                  |                   |                |
| Next Day Air                                        | \$ 4,044              | \$ 4,982         | \$ (938)          | (18.8)%        |
| Deferred                                            | 2,009                 | 2,412            | (403)             | (16.7)         |
| Ground                                              | 14,553                | 15,896           | (1,343)           | (8.4)          |
| <b>Total U.S. Domestic Package</b>                  | <b>20,606</b>         | <b>23,290</b>    | <b>(2,684)</b>    | <b>(11.5)</b>  |
| <b>International Package:</b>                       |                       |                  |                   |                |
| Domestic                                            | 1,478                 | 1,803            | (325)             | (18.0)         |
| Export                                              | 5,133                 | 6,332            | (1,199)           | (18.9)         |
| Cargo                                               | 297                   | 521              | (224)             | (43.0)         |
| <b>Total International Package</b>                  | <b>6,908</b>          | <b>8,656</b>     | <b>(1,748)</b>    | <b>(20.2)</b>  |
| <b>Supply Chain &amp; Freight:</b>                  |                       |                  |                   |                |
| Forwarding and Logistics                            | 3,630                 | 4,817            | (1,187)           | (24.6)         |
| Freight                                             | 1,470                 | 1,707            | (237)             | (13.9)         |
| Other                                               | 306                   | 319              | (13)              | (4.1)          |
| <b>Total Supply Chain &amp; Freight</b>             | <b>5,406</b>          | <b>6,843</b>     | <b>(1,437)</b>    | <b>(21.0)</b>  |
| <b>Consolidated</b>                                 | <b>\$ 32,920</b>      | <b>\$ 38,789</b> | <b>\$ (5,869)</b> | <b>(15.1)%</b> |
| <b>#</b>                                            |                       |                  |                   |                |
| <b>Average Daily Package Volume (in thousands):</b> |                       |                  |                   |                |
| <b>U.S. Domestic Package:</b>                       |                       |                  |                   |                |
| Next Day Air                                        | 1,171                 | 1,166            | 5                 | 0.4%           |
| Deferred                                            | 878                   | 882              | (4)               | (0.5)          |
| Ground                                              | 10,424                | 11,036           | (612)             | (5.5)          |
| <b>Total U.S. Domestic Package</b>                  | <b>12,473</b>         | <b>13,084</b>    | <b>(611)</b>      | <b>(4.7)</b>   |
| <b>International Package:</b>                       |                       |                  |                   |                |
| Domestic                                            | 1,128                 | 1,111            | 17                | 1.5            |
| Export                                              | 757                   | 789              | (32)              | (4.1)          |
| <b>Total International Package</b>                  | <b>1,885</b>          | <b>1,900</b>     | <b>(15)</b>       | <b>(0.8)</b>   |
| <b>Consolidated</b>                                 | <b>14,358</b>         | <b>14,984</b>    | <b>(626)</b>      | <b>(4.2)%</b>  |
| Operating days in period                            | 192                   | 192              |                   |                |
| <b>\$</b>                                           |                       |                  |                   |                |
| <b>Average Revenue Per Piece:</b>                   |                       |                  |                   |                |
| <b>U.S. Domestic Package:</b>                       |                       |                  |                   |                |
| Next Day Air                                        | \$ 17.99              | \$ 22.25         | \$ (4.26)         | (19.1)%        |
| Deferred                                            | 11.92                 | 14.24            | (2.32)            | (16.3)         |

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|                             |         |          |           |        |
|-----------------------------|---------|----------|-----------|--------|
| Ground                      | 7.27    | 7.50     | (0.23)    | (3.1)  |
| Total U.S. Domestic Package | 8.60    | 9.27     | (0.67)    | (7.2)  |
| International Package:      |         |          |           |        |
| Domestic                    | 6.82    | 8.45     | (1.63)    | (19.3) |
| Export                      | 35.32   | 41.80    | (6.48)    | (15.5) |
| Total International Package | 18.27   | 22.30    | (4.03)    | (18.1) |
| Consolidated                | \$ 9.87 | \$ 10.92 | \$ (1.05) | (9.6)% |

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The following table sets forth information showing the change in UPS Freight's less-than-truckload revenue, shipments, and weight hauled, both in dollars or amounts and in percentage terms:

|                                                 | <b>Three Months Ended</b> |             | <b>Change</b> |          |
|-------------------------------------------------|---------------------------|-------------|---------------|----------|
|                                                 | <b>September 30,</b>      |             | <b>\$</b>     | <b>%</b> |
|                                                 | <b>2009</b>               | <b>2008</b> |               |          |
| LTL revenue (in millions)                       | \$ 474                    | \$ 562      | \$ (88)       | (15.7)%  |
| LTL revenue per LTL hundredweight               | \$ 17.91                  | \$ 19.06    | \$ (1.15)     | (6.0)%   |
| LTL shipments (in thousands)                    | 2,599                     | 2,646       | (47)          | (1.7)%   |
| LTL shipments per day (in thousands)            | 40.6                      | 41.3        | (0.7)         | (1.7)%   |
| LTL gross weight hauled (in millions of pounds) | 2,647                     | 2,949       | (302)         | (10.2)%  |
| LTL weight per shipment (in pounds)             | 1,019                     | 1,115       | (96)          | (8.6)%   |
| Operating days in period                        | 64                        | 64          |               |          |

|                                                 | <b>Nine Months Ended</b> |             | <b>Change</b> |          |
|-------------------------------------------------|--------------------------|-------------|---------------|----------|
|                                                 | <b>September 30,</b>     |             | <b>\$</b>     | <b>%</b> |
|                                                 | <b>2009</b>              | <b>2008</b> |               |          |
| LTL revenue (in millions)                       | \$ 1,369                 | \$ 1,610    | \$ (241)      | (15.0)%  |
| LTL revenue per LTL hundredweight               | \$ 17.49                 | \$ 18.93    | \$ (1.44)     | (7.6)%   |
| LTL shipments (in thousands)                    | 7,553                    | 7,703       | (150)         | (1.9)%   |
| LTL shipments per day (in thousands)            | 39.5                     | 40.1        | (0.6)         | (1.5)%   |
| LTL gross weight hauled (in millions of pounds) | 7,824                    | 8,508       | (684)         | (8.0)%   |
| LTL weight per shipment (in pounds)             | 1,036                    | 1,105       | (69)          | (6.2)%   |
| Operating days in period                        | 191                      | 192         |               |          |

*Operating Profit and Operating Margin*

The following tables set forth information showing the change in operating profit, both in dollars (in millions) and in percentage terms, as well as the operating margin for each reporting segment:

| <i>Reporting Segment</i>      | <b>Three Months Ended</b> |             | <b>Change</b> |          |
|-------------------------------|---------------------------|-------------|---------------|----------|
|                               | <b>September 30,</b>      |             | <b>\$</b>     | <b>%</b> |
|                               | <b>2009</b>               | <b>2008</b> |               |          |
| U.S. Domestic Package         | \$ 514                    | \$ 1,117    | \$ (603)      | (54.0)%  |
| International Package         | 313                       | 386         | (73)          | (18.9)%  |
| Supply Chain & Freight        | 102                       | 129         | (27)          | (20.9)%  |
| Consolidated Operating Profit | \$ 929                    | \$ 1,632    | \$ (703)      | (43.1)%  |



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| <i>Reporting Segment</i>      | <b>Three Months Ended<br/>September 30,</b> |             |
|-------------------------------|---------------------------------------------|-------------|
|                               | <b>2009</b>                                 | <b>2008</b> |
| U.S. Domestic Package         | 7.5%                                        | 14.2%       |
| International Package         | 12.9%                                       | 13.1%       |
| Supply Chain & Freight        | 5.5%                                        | 5.6%        |
| Consolidated Operating Margin | 8.3%                                        | 12.4%       |

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| <i>Reporting Segment</i>      | Nine Months Ended<br>September 30, |          | Change     |         |
|-------------------------------|------------------------------------|----------|------------|---------|
|                               | 2009                               | 2008     | \$         | %       |
| U.S. Domestic Package         | \$ 1,374                           | \$ 2,975 | \$ (1,601) | (53.8)% |
| International Package         | 900                                | 1,214    | (314)      | (25.9)% |
| Supply Chain & Freight        | 268                                | 390      | (122)      | (31.3)% |
| Consolidated Operating Profit | \$ 2,542                           | \$ 4,579 | \$ (2,037) | (44.5)% |

| <i>Reporting Segment</i>                | Nine Months Ended<br>September 30, |       |
|-----------------------------------------|------------------------------------|-------|
|                                         | 2009                               | 2008  |
| U.S. Domestic Package                   | 6.7%                               | 12.8% |
| International Package                   | 13.0%                              | 14.0% |
| Supply Chain & Freight                  | 5.0%                               | 5.7%  |
| Consolidated Operating Margin           | 7.7%                               | 11.8% |
| <i>U.S. Domestic Package Operations</i> |                                    |       |

U.S. domestic package revenue decreased \$973 million, or 12.4%, for the quarter (\$2.684 billion, or 11.5%, year-to-date), due to decreases in average daily package volume and revenue per piece.

Ground volume declined 6.2% during the quarter (5.5% year-to-date), primarily as a result of weakness in the U.S. economy. Continued declines in industrial production and retail sales have reduced overall demand in the U.S. small package market, resulting in decreased package volume in our domestic package operations. Our air product volume was relatively stronger, as Next Day Air volume increased 2.4% and Deferred air volume decreased only 0.3% (growth of 0.4% and a decline of 0.5%, respectively, year-to-date). While our air products were also impacted by the economic recession, air volume benefitted from market share gains, as a result of the recent departure of a competitor in the U.S. market.

The decrease in overall revenue per piece of 9.1% (7.2% year-to-date) resulted primarily from lower fuel surcharge rates, lower package weights, and unfavorable shifts in product mix. Next Day Air and Deferred revenue per piece decreased 23.6% and 19.8%, respectively (19.1% and 16.3%, respectively, year-to-date), and were negatively affected by a 29.1% decline in the fuel surcharge rate for air products (discussed further below). Additionally, the revenue per piece decline for our air products was impacted by lower average package weights and a mix shift toward lower yielding products, reflecting the economic recession in the United States. Ground revenue per piece decreased 4.3% (3.1% year-to-date), primarily due to a lower fuel surcharge rate (down 6.8% in the third quarter of 2009 compared to 2008). The factors decreasing revenue per piece for our ground and air products were partially offset by an increase in base rates that took effect during the first quarter.

In October 2008, we announced a base rate increase and a change in the fuel surcharge that took effect on January 5, 2009. We increased the base rates 6.9% on UPS Next Day Air, UPS 2nd Day Air, and UPS 3 Day Select, and 5.9% on UPS Ground. Other pricing changes included a \$0.10 increase in the residential surcharge, and an increase of \$0.10 in the delivery area surcharge on both residential and commercial services to certain ZIP codes. These rate changes are customary and occur on an annual basis.

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We also modified the fuel surcharge on domestic air services by reducing the index used to determine the fuel surcharge by 2%. This fuel surcharge continues to be based on the U.S. Energy Department's Gulf Coast spot price for a gallon of kerosene-type jet fuel. Based on published rates, the average fuel surcharge on domestic air products was 4.76% in the third quarter of 2009, a decrease from the 33.81% in the third quarter of 2008, due to the significant decrease in jet fuel prices, in addition to the 2% reduction in the index. On a year-to-date basis, the average fuel surcharge on domestic air products declined to 2.94% in 2009 from 25.64% in 2008. The ground fuel surcharge rate continues to fluctuate based on the U.S. Energy Department's On-Highway Diesel Fuel Price. Based on published rates, the average fuel surcharge on domestic ground products decreased to 3.32% in the third quarter of 2009 from 10.07% in the third quarter of 2008, due to significantly lower diesel fuel prices. On a year-to-date basis, the average fuel surcharge on domestic ground products decreased to 3.13% in 2009 from 7.91% in 2008. Total domestic fuel surcharge revenue, net of the impact of hedging, decreased by \$716 million in the third quarter of 2009 compared with the same period of 2008 (\$1.491 billion year-to-date), primarily due to the lower fuel surcharge rates discussed above, as well as the decline in volume for our air and ground products.

U.S. Domestic Package operating profit decreased \$603 million, or 54.0%, in the third quarter of 2009 compared with the same period in 2008 (\$1.601 billion, or 53.8%, year-to-date). Operating profit in 2009 was adversely impacted by the U.S. economic recession, decreased network efficiencies due to the decline in volume, changes in package characteristics, and a shift in product mix away from our premium services. Operating profit was also negatively impacted as we incurred a larger decline in fuel surcharge revenue compared with the decline in fuel expense. Additionally, year-to-date operating profit was adversely impacted by a \$181 million impairment charge on our McDonnell-Douglas DC-8-71 and DC-8-73 aircraft fleets in the first quarter of 2009 (discussed further in the Operating Expenses section).

*International Package Operations*

International Package revenue declined \$527 million, or 17.9%, for the quarter (\$1.748 billion, or 20.2%, year-to-date), primarily as a result of a decrease in total revenue per piece along with a decline in export volume, but partially offset by an increase in non-U.S. domestic package volume.

Export volume declined 3.2% for the quarter (4.1% year-to-date), primarily due to weakness in the Asia and U.S. export lanes, as the worldwide economic recession and slowdown in world trade more than offset market share gains. Transborder export volume was relatively stronger within the European Union and North American trade areas. Non-U.S. domestic volume increased 9.1% for the quarter (1.5% year-to-date), largely due to the acquisition of Unsped Paket Servisi San ve Ticaret A.S. in Turkey, as well as volume growth in the United Kingdom, Germany, France, Poland and Canada.

Overall revenue per piece decreased 21.0% for the quarter (18.1% year-to-date), primarily as a result of foreign currency exchange rate movements, decreased fuel surcharge rates, and shifts in product mix. Export revenue per piece decreased 16.9% for the quarter (15.5% year-to-date), largely due to the adverse impact of currency exchange rates, lower fuel surcharge rates, and the relatively stronger volume performance of lower revenue per piece transborder products, but was partially offset by base rate increases that took effect in the first quarter of 2009. Domestic revenue per piece decreased 19.2% for the quarter (19.3% year-to-date), which was primarily caused by adverse currency exchange rate fluctuations (currency-adjusted domestic revenue per piece declined 11.6% for the quarter), as well as the impact of lower fuel surcharge rates. Total average revenue per piece decreased 17.5% for the quarter on a currency-adjusted basis (12.9% year-to-date), and the overall quarterly change in segment revenue was negatively affected by \$119 million due to currency fluctuations, net of hedging activity (\$484 million year-to-date).

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On January 5, 2009, we increased the base rates 6.9% for international shipments originating in the United States (Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard service). Rate changes for shipments originating outside the U.S. are made throughout the year and vary by geographic market.

Additionally, we modified the fuel surcharge on certain U.S.-related international air services by reducing the index used to determine the fuel surcharge by 2%. The fuel surcharge for products originating outside the United States continues to be indexed to fuel prices in our different international regions, depending upon where the shipment takes place. Total international fuel surcharge revenue decreased by \$292 million in the third quarter (\$682 million year-to-date), due to lower fuel surcharge rates caused by decreased fuel prices as well as a decrease in international air volume.

International Package operating profit decreased \$73 million, or 18.9%, in the third quarter of 2009 compared with the same period of 2008 (\$314 million, or 25.9%, year-to-date). The decline in operating profit was affected by a shift in product mix away from our premium services, volume declines in some of the longer export trade lanes, and a larger decline in fuel surcharge revenue compared with the decline in fuel expense. The change in operating profit was negatively affected by \$28 million during the quarter due to currency exchange rate fluctuations, net of hedging activity (\$26 million year-to-date).

*Supply Chain & Freight Operations*

Supply Chain & Freight revenue decreased \$460 million, or 19.8%, for the quarter (\$1.437 billion, or 21.0%, year-to-date). Forwarding and logistics revenue decreased \$369 million, or 22.8%, for the quarter (\$1.187 billion, or 24.6%, year-to-date), and was impacted by weakness in demand for freight forwarding due to global economic weakness and declines in international trade. Forwarding revenue declined in all major transportation modes, including domestic and international air freight and ocean freight, and was impacted by lower volumes, lower fuel surcharges, and lower security and other accessorial charges. Additionally, the overall change in forwarding and logistics revenue was negatively affected by \$19 million during the quarter (\$145 million year-to-date) due to the strengthening of the U.S. Dollar against foreign currencies.

UPS Freight revenue declined \$89 million, or 14.9%, for the quarter (\$237 million, or 13.9%, year-to-date), primarily due to lower fuel surcharge rates and a decline in average daily LTL shipments. Total LTL weight per shipment declined 8.6% for the quarter (6.2% year-to-date), reflecting the weak LTL market and the ongoing economic recession in the United States in 2009. Average LTL shipments per day also declined 1.7% for the quarter (1.5% year-to-date), as market share gains were more than offset by the impact of the weak economy.

LTL revenue per hundredweight decreased 6.0% for the quarter (7.6% year-to-date), primarily as a result of the lower fuel surcharge rates, as total fuel surcharge revenue declined \$62 million for the quarter (\$175 million year-to-date) primarily resulting from lower diesel fuel prices. However, this decline was partially offset by an increase in base prices that took effect in the first quarter of 2009. On January 5, 2009, UPS Freight increased minimum charge, LTL, and TL rates an average of 5.9%, covering non-contractual shipments in the United States and Canada.

The other businesses within Supply Chain & Freight, which include our retail franchising business and our financial business, experienced a decline in revenue of 1.9% during the quarter (4.1% year-to-date). This decline in revenue was primarily in our financial business, and was impacted by lower interest rates and decreased loan volume.

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Operating profit for the Supply Chain & Freight segment decreased by \$27 million, or 20.9%, for the quarter (\$122 million, or 31.3%, year-to-date), primarily due to lower operating profit in the forwarding and logistics business. The lower operating profit in the forwarding and logistics unit was impacted by the weak demand for forwarding services, as well as the loss incurred on the sale of some non-core European logistics operations. However, the operating margin in this business experienced only a small decline (excluding the loss on sale) as costs were reduced commensurate with the decline in revenues.

Our UPS Freight unit reported improved profitability for the third quarter, due to a reduction in vacation accruals resulting from modifications in vacation policies and changes in the workforce coverage of our individual plans. Excluding this reduction in vacation liabilities, the UPS Freight unit reported a small operating loss due to the economic recession and difficult LTL market in the United States.

The combined operating income for all of our other businesses in this segment increased during the quarter and year-to-date periods. The year-to-date increase was primarily driven by a gain on sale of substantially all of our international Mail Boxes Etc operations during the second quarter. The change in operating profit for the segment was also negatively affected by \$3 million in the quarter (\$15 million year-to-date) due to the strengthening of the U.S. Dollar against foreign currencies.

*Operating Expenses*

Consolidated operating expenses decreased by \$1.257 billion, or 10.9%, for the quarter (\$3.832 billion, or 11.2%, year-to-date), of which approximately \$107 million (\$588 million year-to-date) was due to currency fluctuations in our International Package and Supply Chain & Freight segments.

Compensation and benefits expense decreased by \$84 million, or 1.3%, for the quarter (\$444 million, or 2.3%, year-to-date), and was impacted by several items. A large component of this decrease was related to employee payroll costs, as union labor hours declined approximately 7.1% as a result of lower U.S. Domestic Package volume, and management payroll declined as a result of a reduction in the total number of management employees through attrition combined with a wage freeze. Benefits expense increased due to higher employee health and welfare program costs, which were impacted by higher union contribution rates, and increased pension expense. Pension expense increases resulted from higher union contribution rates for multiemployer pension plans, combined with increased interest costs, a decrease in our expected return on plan assets and the amortization of actuarial losses for company-sponsored plans (see Note 6 to the unaudited consolidated financial statements). The increase in interest costs was impacted by changes in discount rates, while the decrease in expected return on plan assets and the actuarial losses were primarily due to the negative asset returns experienced in 2008.

Repairs and maintenance expense declined \$24 million, or 8.3%, for the quarter (\$76 million, or 8.5%, year-to-date), largely due to reduced vehicle maintenance expense resulting from a reduction in miles driven. Depreciation and amortization expense decreased \$15 million, or 3.3%, for the quarter (\$63 million, or 4.6%, year-to-date), and was influenced by several factors, including lower depreciation expense on equipment and facilities, as certain assets became fully depreciated, as well as lower software amortization resulting from fewer new capitalized software projects. This was partially offset by higher depreciation expense on aircraft and vehicles, resulting from new deliveries. The \$382 million, or 22.7%, quarterly decrease in purchased transportation (\$1.256 billion, or 25.4%, year-to-date) was driven by a combination of lower volume in our international package and forwarding businesses, the impact of currency exchange rates, and decreased fuel surcharge rates charged to us by third-party carriers. The \$574 million, or 47.5%, quarterly decrease in fuel expense (\$1.656 billion, or 49.8%, year-to-date) was impacted by significantly lower prices for jet-A fuel, diesel,

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and unleaded gasoline, as well as lower usage of these products in our operations. Other occupancy expense decreased by \$6 million, or 2.4% (\$33 million, or 4.3%, year-to-date), for the quarter and was influenced by lower electricity and natural gas costs, as well as lower rent expense.

Other operating expenses declined \$172 million, or 14.6%, in the third quarter of 2009 compared with the same period of 2008 (\$304 million, or 8.8%, year-to-date). The decline for the quarter and year-to-date periods was partially due to certain variable costs that declined as a result of lower package volume, such as the expense associated with customer claims for lost or damaged packages, rent expense for transportation equipment, cargo handling costs, and aircraft landing fees. Additionally, certain other costs declined primarily as a result of cost containment programs, such as employee expense reimbursements, office supplies, professional services, and advertising costs.

The \$304 million, or 8.8%, year-to-date decline in other operating expenses was partially offset by a \$181 million impairment charge on certain of our aircraft. We continually monitor our aircraft fleet utilization in light of current and projected volume levels, aircraft fuel prices, and other factors. In 2008, we had announced that we were in negotiations with DHL to provide air transportation services for all of DHL's express, deferred and international package volume within the United States, as well as air transportation services between the United States, Canada and Mexico. In early April 2009, UPS and DHL mutually agreed to terminate further discussions on providing these services. Additionally, our U.S. Domestic Package air delivery volume had experienced declines for several quarters as a result of persistent economic weakness and shifts in product mix from our premium air services to our lower cost ground services. As a result of these factors, the utilization of certain aircraft fleet types had declined and was expected to be lower in the future.

Based on the factors noted above, as well as FAA aging aircraft directives that would require significant future maintenance expenditures, we determined that a triggering event had occurred that required an impairment assessment of our McDonnell-Douglas DC-8-71 and DC-8-73 aircraft fleets. We conducted an impairment analysis as of March 31, 2009, and determined that the cost basis of these fleets was not recoverable due to the accelerated expected retirement dates of the aircraft. Based on anticipated residual values for the airframes, engines, and parts, we recognized an impairment charge of \$181 million in the first quarter of 2009. This charge is included in the caption "Other expenses" in the Statement of Consolidated Income, and impacted our U.S. Domestic Package segment. The DC-8 fleets were subsequently retired from service. We currently continue to utilize and operate all of our other aircraft fleets.

*Investment Income and Interest Expense*

In the third quarter of 2009, we recorded investment income of \$6 million, compared with an investment loss of \$13 million in the third quarter of 2008. During the third quarter of 2008, we recorded impairment losses on two auction rate securities that were collateralized by preferred stock issued by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). The impairment resulted from actions by the U.S. Treasury Department and the Federal Housing Finance Agency with respect to FNMA and FHLMC. Additionally, we recorded impairment losses on a municipal auction rate security and on holdings of several medium term notes issued by Lehman Brothers Inc., which declared bankruptcy during the third quarter of 2008. The total of these credit-related impairment losses during the quarter was \$23 million.

We incurred an investment loss of \$3 million for the year-to-date 2009 period, compared with \$58 million of investment income for the same period of 2008. This decline was largely due to a lower average balance of interest-earning investments, a significantly lower yield earned on our invested assets as a result of declines in short-term interest rates in the United States, and a loss on the fair value adjustments of certain real estate

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investment partnerships. Additionally, during the second quarter of 2009, we recorded impairment losses on certain perpetual preferred securities, and an auction rate security collateralized by preferred securities, issued by large financial institutions. The impairment charge results from conversion offers from the issuers of these securities at prices well below the stated redemption value of the preferred shares. These securities, which had a cost basis of \$42 million, were written down to their fair value of \$25 million as of June 30, 2009, resulting in an other-than-temporary impairment of \$17 million.

For the remaining auction rate securities, and equity and debt securities, we have concluded that no additional other-than-temporary impairment losses existed as of September 30, 2009. In making this determination, we considered the financial condition and prospects of the issuer, the magnitude of the losses in market value compared with the investments' cost, the length of time the investments have been in an unrealized loss position, the probability that we will be unable to collect all amounts due according to the contractual terms of the security, the credit rating of the security, and our ability and intent to hold these investments until the anticipated recovery in market value or maturity occurs.

The \$11 million, or 10.6%, decrease in interest expense during the quarter was primarily due to a lower average debt balance and a lower average interest rate incurred on our variable rate debt and interest rate swap agreements as a result of recent declines in short-term interest rates in the United States. Year-to-date, interest expense increased by \$14 million, or 4.1% in 2009 compared with the same period in 2008. This increase was primarily due to a \$77 million non-cash, pre-tax currency remeasurement charge on certain foreign currency denominated obligations, and was partially offset by the lower average debt balances and lower average interest rates incurred discussed previously.

*Income Tax Expense*

Income tax expense declined by \$252 million, or 46.2%, for the quarter (\$758 million, or 49.0%, year-to-date), primarily due to lower pre-tax income. For the year-to-date 2009 period, our effective tax rate increased to 36.1% compared with 36.0% in the comparable period of 2008, due to an increase in our first quarter 2009 income tax provision as a result of providing a valuation allowance of \$14 million against certain deferred tax assets in our International Package business.

*Net Income and Earnings Per Share*

Net income for the third quarter of 2009 was \$549 million, a 43.4% decrease from the \$970 million earned in the third quarter of 2008, resulting in a 42.7% decrease in diluted earnings per share to \$0.55 in 2009 from \$0.96 in the third quarter of 2008. Net income for the year-to-date period of 2009 was \$1.395 billion, a 49.3% decrease from the \$2.749 billion recorded in the comparable period of 2008, resulting in a 47.9% decrease in diluted earnings per share to \$1.39 in 2009 from the \$2.67 earned in the comparable period of 2008. The decline in net income for the quarter and year-to-date periods was primarily caused by the decline in operating profits in all three of our business segments, as previously discussed. Year-to-date 2009 net income was reduced by \$116 million due to the after-tax effect of the aircraft impairment charge, and by \$48 million due to the after-tax effect of the currency remeasurement charge. These two charges reduced year-to-date 2009 diluted earnings per share by \$0.16. Earnings per share in the third quarter and year-to-date periods of 2009 was favorably impacted by a reduction in the weighted average shares outstanding of 0.9% and 2.3%, respectively, compared to the same periods of 2008, as a result of our ongoing share repurchase program.

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*Liquidity and Capital Resources*

*Net Cash From Operating Activities*

Net cash provided by operating activities decreased to \$4.233 billion in the first nine months of 2009 from \$6.948 billion during the same period of 2008. The decrease in operating cash flow was impacted by approximately \$1.035 billion in cash tax benefits received in 2008 (including an \$850 million tax refund) resulting from a U.S. Federal tax deduction for the payment made to withdraw from the Central States Pension Fund in 2007. The absence of these tax benefits in 2009 adversely affected the comparison with 2008. Operating cash flow also decreased as a result of lower net income in 2009 compared with 2008.

Partially offsetting these factors were changes in our working capital position, as the collection of accounts receivable had a larger impact in the first nine months of 2009 compared with the same period in 2008, primarily as a result of the decrease in revenue among all three of our business segments.

The contributions to our company-sponsored pension plans have increased significantly in 2009, compared with 2008, primarily as a result of required minimum pension fundings for the UPS-IBT Pension Plan. As discussed in Note 6 to the unaudited consolidated financial statements, we contributed \$758 million to our pension and postretirement medical benefit plans for the first nine months of 2009, an increase of \$639 million from the same period of 2008. We expect to contribute \$125 million and \$24 million over the remainder of the year to our company-sponsored pension and postretirement medical benefit plans, respectively.

*Net Cash Used In Investing Activities*

Net cash used in investing activities decreased to \$879 million in the first nine months of 2009 from \$2.693 billion during the same period of 2008, primarily due to reduced capital expenditures. We had capital expenditures of \$1.185 billion in the first nine months of 2009, a decrease from the \$2.108 billion in the same period of 2008. We fund our capital expenditures with our cash from operations. We have commitments for the purchase of aircraft, vehicles, technology equipment and other fixed assets to provide for the replacement of existing capacity and anticipated future growth. Capital expenditures on aircraft declined primarily as a result of fewer deliveries of new aircraft, as we took delivery of one Boeing 747-400 in the first nine months of 2009, compared with five Boeing 747-400 deliveries in 2008. Vehicle deliveries and spending on information technology also declined, as a result of reduced investment needs and initiatives to reduce our capital spending. Capital expenditures on facilities and equipment decreased in 2009, primarily resulting from the completion of work on portions of our Worldport hub expansion.

In the first nine months of 2009, we had net purchases of \$12 million of marketable securities, a decline from the \$286 million of net purchases in the comparable period of 2008, as a result of the timing of debt issuances and repayments, income tax refunds, and certain other cash receipts and disbursements. Other investing activities reflected a cash inflow of \$72 million in the first nine months of 2009 as compared with a \$271 million outflow in the same period of 2008, largely due to cash settlements of derivative contracts used in our energy and currency hedging programs, as well as the timing of aircraft purchase contract deposits on our Boeing 767-300 and Boeing 747-400 aircraft orders.

*Net Cash Used In Financing Activities*

Net cash used in financing activities decreased to \$1.661 billion in the first nine months of 2009 from \$5.037 billion during the same period in 2008. Our primary use of cash in financing activities is to repurchase shares, pay dividends, and repay debt obligations.



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We had net issuances of debt of \$226 million in the first nine months of 2009, compared with \$5 million in the first nine months of 2008. Issuances of debt in each period consisted primarily of commercial paper and offerings of fixed rate senior notes. Repayments of debt consisted primarily of paydowns of commercial paper, scheduled principal payments on our capitalized lease obligations and early redemptions of certain tranches of UPS Notes. We consider the overall fixed and floating interest rate mix of our portfolio and the related overall cost of borrowing when planning for future issuances and non-scheduled repayments of debt.

In March 2009, we completed an offering of \$1.0 billion of 3.875% senior notes due April 2014 and \$1.0 billion of 5.125% senior notes due April 2019. These notes pay interest semiannually, and we may redeem the notes at any time by paying the greater of the principal amount or a make-whole amount, plus accrued interest. After pricing and underwriting discounts, we received a total of \$1.989 billion in cash proceeds from the offering. The proceeds from the offering are being used for general corporate purposes, including the reduction of our outstanding commercial paper balance.

In January 2008, we completed an offering of \$1.750 billion of 4.50% senior notes due January 2013, \$750 million of 5.50% senior notes due January 2018, and \$1.500 billion of 6.20% senior notes due January 2038. After pricing and underwriting discounts, we received a total of \$3.961 billion in cash proceeds from the offering. Our debt balance increased at the end of 2007 as a result of commercial paper issuances used to fund our withdrawal from the Central States Pension Fund. In the first nine months of 2008, we repaid most of this commercial paper with the proceeds from the senior notes offering, as well as the \$850 million U.S. federal tax refund received.

As a result of the uncertain economic environment, we have slowed our share repurchase activity. We currently intend to repurchase shares in 2009 at a rate that should approximately offset the dilution from our stock compensation programs. We repurchased a total of 7.8 million shares of Class A and Class B common stock for \$396 million for the first nine months of 2009, compared with repurchases of 48.5 million shares for \$3.299 billion for the comparable period of 2008 (\$395 million and \$3.284 billion are reported on the cash flow statement for 2009 and 2008, respectively, due to the timing of settlements). As of September 30, 2009, we had \$6.176 billion of our share repurchase authorization remaining.

The declaration of dividends is subject to the discretion of the Board of Directors and will depend on various factors, including our net income, financial condition, cash requirements, future prospects, and other relevant factors. We maintained our quarterly cash dividend payment at \$0.45 per share in 2009, consistent with the rate in 2008. We expect to continue the practice of paying regular cash dividends.

Our total cash dividends paid for the first nine months of 2009 declined to \$1.313 billion from \$1.781 billion in 2008. This decline was primarily a result of four dividend payments being made in the first nine months of 2008, compared with only three dividend payments being made in the first nine months of 2009, due to a change in our dividend payment schedule. We also had a reduction in the number of outstanding shares on which dividends are paid, as a result of our share repurchase program.

The cash outflows in other financing activities primarily relate to hedging activities. In conjunction with the senior fixed rate debt offerings in the first quarter of 2009 and 2008, we settled several interest rate derivatives that were designated as hedges of these debt offerings, which resulted in cash outflows of \$243 and \$84 million in 2009 and 2008, respectively.

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*Sources of Credit*

We are authorized to borrow up to \$10.0 billion under our U.S. commercial paper program. We had \$1.231 billion outstanding under this program as of September 30, 2009, with an average interest rate of 0.12%. All of this commercial paper was classified as a current liability as of September 30, 2009. At December 31, 2008, we classified \$1.0 billion of our commercial paper as long-term debt on our balance sheet, based on our intent and ability to refinance this debt on a long-term basis in the future. We also maintain a European commercial paper program under which we are authorized to borrow up to 1.0 billion in a variety of currencies, however no amounts were outstanding under this program as of September 30, 2009.

We maintain two credit agreements with a consortium of banks. One of these agreements provides revolving credit facilities of \$3.0 billion, and expires on April 15, 2010. Interest on any amounts we borrow under this facility would be charged at 90-day LIBOR plus a percentage determined by quotations from Markit Group Ltd. for our 1-year credit default swap spread, subject to certain minimum rates and maximum rates based on our public debt ratings from Standard & Poor's and Moody's. If our public debt ratings are A / A2 or above, the minimum applicable margin is 1.00% and the maximum applicable margin is 2.00%; if our public debt ratings are lower than A / A2, the minimum applicable margin is 1.50% and the maximum applicable margin is 3.00%.

The second agreement provides revolving credit facilities of \$1.0 billion, and expires on April 19, 2012. Interest on any amounts we borrow under this facility would be charged at 90-day LIBOR plus 15 basis points. At September 30, 2009, there were no outstanding borrowings under either of these facilities.

In addition to these credit facilities, we have an automatically effective registration statement on Form S-3 filed with the SEC that is available for registered offerings of short or long-term debt securities.

Our Moody's and Standard & Poor's short-term credit ratings are P-1 and A-1+, respectively. Our Moody's and Standard & Poor's long-term credit ratings are Aa3 and AA-, respectively. We have a stable outlook from both of these credit rating agencies.

Our existing debt instruments and credit facilities do not have cross-default or ratings triggers, however these debt instruments and credit facilities do subject us to certain financial covenants. As of September 30, 2009 and for all prior periods, we have satisfied these financial covenants. These covenants limit the amount of secured indebtedness that we may incur, and limit the amount of attributable debt in sale-leaseback transactions, to 10% of net tangible assets. As of September 30, 2009, 10% of net tangible assets is equivalent to \$2.281 billion, however we have no covered sale-leaseback transactions or secured indebtedness outstanding. Additionally, we are required to maintain a minimum net worth, as defined, of \$5.0 billion on a quarterly basis. As of September 30, 2009, our net worth, as defined, was equivalent to \$12.512 billion. We do not expect these covenants to have a material impact on our financial condition or liquidity.

Except as described in this quarterly report, the nature and amounts of our payment obligations under our debt, capital and operating lease agreements, purchase commitments, and other liabilities as of September 30, 2009 have not materially changed from those at December 31, 2008, as described in our Annual Report on Form 10-K for the year ended December 31, 2008.

*Contingencies*

We are a defendant in a number of lawsuits filed in state and federal courts containing various class-action allegations under state wage-and-hour laws. In one of these cases, Marlo v. UPS, which was certified as a class action in a California federal court in September 2004, plaintiffs allege that they improperly were denied

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overtime, and seek penalties for missed meal and rest periods, and interest and attorneys' fees. Plaintiffs purport to represent a class of 1,300 full-time supervisors. In August 2005, the court granted summary judgment in favor of UPS on all claims, and plaintiffs appealed the ruling. In October 2007, the appeals court reversed the lower court's ruling. In April 2008, the Court decertified the class and vacated the trial scheduled for April 29, 2008. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

In another case, *Hohider v. UPS*, which in July 2007 was certified as a class action in a Pennsylvania federal court, plaintiffs have challenged certain aspects of the Company's interactive process for assessing requests for reasonable accommodation under the Americans with Disabilities Act. Plaintiffs purport to represent a class of over 35,000 current and former employees, and seek back-pay, and compensatory and punitive damages, as well as attorneys' fees. In August 2007, the Third Circuit Court of Appeals granted our petition to hear the appeal of the trial court's certification order. In July 2009, the Third Circuit issued its decision decertifying the class and remanding the case to the trial court for further proceedings. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

UPS and Mail Boxes Etc., Inc. are defendants in various lawsuits brought by franchisees who operate Mail Boxes Etc. centers and The UPS Store locations. These lawsuits relate to the rebranding of Mail Boxes Etc. centers to The UPS Store, The UPS Store business model, the representations made in connection with the rebranding and the sale of The UPS Store franchises, and UPS's sale of services in the franchisees territories. In one of the actions, which is pending in California state court, the court recently certified a class consisting of all Mail Boxes Etc. branded stores that rebranded to The UPS Store in March 2003. We have denied any liability with respect to these claims and intend to defend ourselves vigorously. At this time, we have not determined the amount of any liability that may result from these matters or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

In January 2008, a class action complaint was filed in the United States District Court for the Eastern District of New York alleging price-fixing activities relating to the provision of freight forwarding services. UPS was not named in this case. On July 21, 2009, the plaintiffs filed a first amended complaint naming numerous global freight forwarders as defendants. UPS and UPS Supply Chain Solutions are among the 60 defendants named in the amended complaint. We intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from these matters or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

In *Barber Auto Sales v. UPS*, which a federal court in Alabama certified as a class action in September 2009, the plaintiff asserts a breach of contract claim arising from UPS's assessment of shipping charge corrections when UPS determines that the dimensional weight of packages is greater than reported by the shipper. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

We are a defendant in various other lawsuits that arose in the normal course of business. We believe that the eventual resolution of these cases will not have a material adverse effect on our financial condition, results of operations, or liquidity.

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We file income tax returns in the U.S. federal jurisdiction, most U.S. state and local jurisdictions, and many non-U.S. jurisdictions. We have substantially resolved all U.S. federal income tax matters for tax years prior to 2003. During the third quarter of 2009, we received a refund of \$271 million as a result of the resolution of tax years 1999 through 2002 with the Internal Revenue Service ( IRS ) Appeals Office. For the tax years 2003 through 2004, we anticipate concluding the limited number of unagreed issues with the IRS Appeals Office by the end of the second quarter of 2010. Along with the audit for tax years 2005 through 2007, the IRS is currently examining non-income based taxes, including employment and excise taxes, which could lead to proposed assessments. The IRS has not presented an official position with regard to these taxes at this time, and therefore we are not able to determine the technical merit of any potential assessment. We have filed all required U.S. state and local returns reporting the result of the resolution of the U.S. federal income tax audit of the tax years 1999 through 2002. A limited number of U.S. state and local matters are the subject of ongoing audits, administrative appeals or litigation.

Certain foreign jurisdictions are reviewing transfer pricing transactions between U.S. and related foreign companies and the Italian Guardia di Finanza is reviewing whether certain entities have a permanent establishment within Italy, which could result in an undetermined amount of tax liabilities, interest and penalties. No final reports or assessments have been issued. We continue to cooperate during these audits while defending the positions taken on the filed returns including the exercise of rights afforded under international treaties as appropriate.

It is reasonably possible that the amount of unrecognized tax benefits could change within the next 12 months. At this time, we do not expect any of the above matters to have a material adverse effect on our financial condition, results of operations, or liquidity.

As of December 31, 2008, we had approximately 260,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters ( Teamsters ). These agreements run through July 31, 2013. We have approximately 2,900 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association, which becomes amendable at the end of 2011. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which became amendable in November 2006. We began formal negotiations with Teamsters Local 2727 in October 2006. In addition, the majority (approximately 3,000) of our ground mechanics who are not employed under agreements with the Teamsters are employed under collective bargaining agreements with the International Association of Machinists and Aerospace Workers ( IAM ). In June of 2009, we reached a new agreement with the IAM, which was subsequently ratified in July 2009. The new agreement runs through July 31, 2014.

We participate in a number of trustee-managed multi-employer pension and health and welfare plans for employees covered under collective bargaining agreements. Several factors could cause us to make significantly higher future contributions to these plans, including unfavorable investment performance, changes in demographics, and increased benefits to participants. At this time, we are unable to determine the amount of additional future contributions, if any, or whether any material adverse effect on our financial condition, results of operations, or liquidity would result from our participation in these plans.

*Other Matters*

We received grand jury subpoenas from the Antitrust Division of the U.S. Department of Justice ( DOJ ) regarding the DOJ's investigations into certain pricing practices in the air cargo industry in July 2006, and into certain pricing practices in the freight forwarding industry in December 2007. In October 2007, June 2008, and

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February 2009, we received information requests from the European Commission relating to its investigation of certain pricing practices in the freight forwarding industry. We also received and responded to related information requests from competition authorities in other jurisdictions. We are cooperating with these inquiries.

*Recent Accounting Pronouncements*

In June 2009, the FASB issued Statement No. 168, *The FASB Accounting Standards Codification and the Hierarchy of GAAP* (FAS 168), which replaces Statement No. 162, *The Hierarchy of GAAP* and establishes the Accounting Standards Codification (ASC) as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. SEC rules and interpretive releases are also sources of authoritative GAAP for SEC registrants. The codification was developed to organize GAAP pronouncements by topic so that users can more easily access authoritative accounting guidance. FAS 168 became effective for the third quarter of 2009, and all accounting standard references have been updated in this report with ASC references.

*Adoption of New Accounting Standards*

Certain disclosure requirements of ASC 820, *Fair Value Measurements and Disclosures*, took effect on January 1, 2008 and are presented in Notes 4 and 12. On January 1, 2009, we implemented the previously deferred provisions of ASC 820 for nonfinancial assets and liabilities recorded at fair value. The accounting requirements for determining fair value when the volume and level of activity for an asset or liability have significantly decreased, and for identifying transactions that are not orderly, contained in ASC 820 were adopted on April 1, 2009, but had an immaterial impact on our financial statements.

Certain disclosure requirements of ASC 815, *Derivatives and Hedging*, took effect on January 1, 2009 and are presented in Note 14.

The new accounting requirements of ASC 805, *Business Combinations*, which took effect on January 1, 2009, were adopted but had no impact on our financial statements.

The accounting and presentation requirements for noncontrolling interests in ASC 810, *Consolidation*, which took effect on January 1, 2009, had an immaterial impact on the financial statements.

The disclosure requirements of ASC 825, *Financial Instruments*, are presented in Note 12.

*Standards Issued But Not Yet Effective*

Beginning in the fourth quarter of 2009, provisions of ASC 715, *Compensation-Retirement Benefits*, will be adopted that require disclosures about plan assets of a defined benefit pension or other postretirement plan, investment policies and strategies, major categories of plan assets, inputs and valuation techniques used to measure the fair value of plan assets and significant concentrations of risk within plan assets.

Other new pronouncements issued but not effective until after September 30, 2009, are not expected to have a significant effect on our consolidated financial position or results of operations.



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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND**  
**RESULTS OF OPERATIONS**

*Forward-Looking Statements*

Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this report contain forward-looking statements about matters that inherently are difficult to predict. The words believes, expects, anticipates, and similar expressions are intended to identify forward-looking statements. These statements include statements regarding our intent, belief and current expectations about our strategic direction, prospects and future results. We have described some of the important factors that affect these statements as we discussed each subject. Forward-looking statements involve risks and uncertainties, and certain factors may cause actual results to differ materially from those contained in the forward-looking statements. Some of the factors that could cause our actual results to differ materially from the expected results are described in our Annual Report on Form 10-K for the year ended December 31, 2008.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk from changes in foreign currency exchange rates, interest rates, equity prices, and certain commodity prices. This market risk arises in the normal course of business, as we do not engage in speculative trading activities. In order to manage the risk arising from these exposures, we utilize a variety of foreign exchange, interest rate, equity and commodity forward contracts, options, and swaps.

The total fair value asset (liability) of our derivative financial instruments is summarized in the following table (in millions):

|                           | September 30,<br>2009 | December 31,<br>2008 |
|---------------------------|-----------------------|----------------------|
| Energy Derivatives        | \$                    | \$                   |
| Currency Derivatives      | (69)                  | 241                  |
| Interest Rate Derivatives | 84                    | (388)                |
|                           | \$ 15                 | \$ (147)             |

Other than noted below, our market risks, hedging strategies, and financial instrument positions at September 30, 2009 have not materially changed from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008. In the first quarter of 2009, we settled several interest rate hedges in conjunction with issuing five and ten year notes and made a cash payment of \$243 million. In 2009, we entered into interest rate swap agreements for a notional amount of \$3.750 billion that effectively converted the fixed interest rate on the associated debt instruments to a variable interest rate. The potential change in annual interest expense resulting from a hypothetical 100 basis point change in short-term interest rates applied to our floating rate debt (including commercial paper) and swap instruments as of September 30, 2009 would be approximately \$58 million. Also in 2009, we entered into several cross-currency swaps to hedge certain foreign currency denominated obligations, as well as entered into additional currency options to hedge foreign currency denominated revenue. The potential loss in the fair value for these instruments resulting from a hypothetical 10% adverse change in quoted foreign currency exchange rates as of September 30, 2009 would be approximately \$18 million.

The forward contracts, swaps, and options previously discussed contain an element of risk that the counterparties may be unable to meet the terms of the agreements. However, we minimize such risk exposures for these instruments by limiting the counterparties to banks and financial institutions that meet established credit guidelines. We do not expect to incur any losses as a result of counterparty default.

The information concerning market risk under the caption *Quantitative and Qualitative Disclosures about Market Risk* on pages 47-48 of our consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2008, is hereby incorporated by reference in this Quarterly Report on Form 10-Q.

**Item 4. Controls and Procedures***Evaluation of Disclosure Controls and Procedures:*

As of the end of the period covered by this report, management, including our chief executive officer and chief financial officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 ( *Exchange Act* )). Based upon that evaluation, our chief executive officer and chief financial officer concluded that the disclosure controls and procedures were effective to ensure that information required to be disclosed in reports we file or submit under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (2) accumulated and communicated to our management to allow their timely decisions regarding required disclosure.

*Changes in Internal Control over Financial Reporting:*

There were no changes in the Company's internal controls over financial reporting during the quarter ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.





**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

For a discussion of legal proceedings affecting us and our subsidiaries, please see the information under the sub-caption "Contingencies" of the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this report.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors described in Part I, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2008.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

(c) A summary of our repurchases of our Class A and Class B common stock during the third quarter of 2009 is as follows (in millions, except per share amounts):

|                                   | Total Number<br>of Shares<br>Purchased(1) | Average<br>Price Paid<br>Per Share | Total Number<br>of Shares Purchased<br>as Part of Publicly<br>Announced Program | Approximate Dollar<br>Value of Shares that<br>May Yet be Purchased<br>Under the<br>Program |
|-----------------------------------|-------------------------------------------|------------------------------------|---------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| July 1 - July 31, 2009            | 0.8                                       | \$ 51.85                           | 0.8                                                                             | \$ 6,284                                                                                   |
| August 1 - August 31, 2009        | 0.9                                       | 53.78                              | 0.8                                                                             | 6,240                                                                                      |
| September 1 - September 30, 2009  | 1.3                                       | 56.83                              | 1.1                                                                             | 6,176                                                                                      |
| Total July 1 - September 30, 2009 | 3.0                                       | \$ 54.48                           | 2.7                                                                             |                                                                                            |

(1) Includes shares repurchased through our publicly announced share repurchase program and shares tendered to pay the exercise price and tax withholding on employee stock options.

The Board of Directors authorized an increase in our share repurchase authorization to \$10.0 billion in January 2008. Share repurchases may take the form of accelerated share repurchases, open market purchases, or other such methods as we deem appropriate. The timing of our share repurchases will depend upon market conditions. Unless terminated earlier by the resolution of our Board, the program will expire when we have purchased all shares authorized for repurchase under the program.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 5. Other Information**

None.

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**Item 6. Exhibits**

These exhibits are either incorporated by reference into this report or filed with this report as indicated below.

Index to Exhibits:

Form of Restated Certificate of Incorporation of United Parcel Service, Inc. (incorporated by reference to Exhibit 3.2 to Form 10-Q for the Quarter Ended September 30, 2009).  
Form of Bylaws of United Parcel Service, Inc. (incorporated by reference to Exhibit 3.1 to Form 8-K, filed on November 12, 2008).

Underwriting agreement relating to 3.875% Senior Notes due April 1, 2014 and 5.125% Senior Notes due April 1, 2019 (incorporated by reference to Exhibit 1.1 to Form 10-Q for the Quarter Ended March 31, 2009).

Form of Note for 3.875% Senior Notes due April 1, 2014 (incorporated by reference to Exhibit 4.1 to Form 8-K, filed on March 24, 2009).

Form of Note for 5.125% Senior Notes due April 1, 2019 (incorporated by reference to Exhibit 4.2 to Form 8-K, filed on March 24, 2009).

Facility Agreement (364-Day Facility) dated April 16, 2009 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Chase Bank, N.A. as joint arrangers and book managers, Barclays Bank PLC and BNP Paribas as co-documentation agents, Citibank, N.A. as administrative agent, and JPMorgan Chase Bank, N.A., as syndication agent (incorporated by reference to Exhibit 10.1 to Form 10-Q for the Quarter Ended March 31, 2009).

Facility Agreement (5-Year Facility) dated April 19, 2007 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Chase Bank, N.A. as joint arrangers and book managers, Barclays Bank PLC, BNP Paribas, Mellon Bank N.A., and Wells Fargo Bank, N.A. as co-documentation agents, Citibank, N.A. as administrative agent, and JPMorgan Chase Bank, N.A., as syndication agent (incorporated by reference to Exhibit 10.2 to Form 10-Q for the Quarter Ended March 31, 2009).

Form of Restricted Stock Unit Award Agreement for the 2009 Long-Term Incentive Performance (LTIP) Awards (incorporated by reference to Exhibit 10.1 to Form 8-K, filed on February 17, 2009).

Methodology regarding Computation of per Share Earnings (incorporated by reference to Note 13 to Item 1. Financial Statements of this quarterly report on Form 10-Q).  
Methodology regarding Computation of Ratio of Earnings to Fixed Charges.

Resignation of the Chief Executive Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Resignation of the Chief Financial Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Resignation of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Resignation of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

The following financial information from the Quarterly Report on Form 10-Q for the quarter ended September 30, 2009, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Cash Flows, and (v) the Notes to the Consolidated Financial Statements, tagged as blocks of text.

Filed herewith.

Furnished electronically herewith.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

UNITED PARCEL SERVICE, INC.

(Registrant)

Date: November 6, 2009

By:

/s/ KURT P. KUEHN  
**Kurt P. Kuehn**

*Senior Vice President,*

*Chief Financial Officer and Treasurer*

*(Duly Authorized Officer and*

*Principal Accounting Officer)*