UNITED PARCEL SERVICE INC
Form 10-Q
May 05, 2011
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United States

Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2011, 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)

Delaware	**58-2480149**
(State or Other Jurisdiction of	*(IRS Employer*
Incorporation or Organization)	*Identification No.)*
55 Glenlake Parkway, NE Atlanta, Georgia	**30328**
(Address of Principal Executive Offices)	*(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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 þ 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 þ Accelerated filer ¨ Non-accelerated filer ¨ (Do not check if a smaller reporting company) 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 þ

There were 248,422,793 Class A shares, and 737,791,369 Class B shares, with a par value of $0.01 per share, outstanding at April 26, 2011.

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UNITED PARCEL SERVICE, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2011

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

March 31, 2011 (unaudited) and December 31, 2010

(In millions)

	March 31, 2011	December 31, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 4,657	$ 3,370
Marketable securities	787	711
Accounts receivable, net	5,462	5,627
Finance receivables, net	196	203
Deferred income tax assets	695	659
Income tax receivable	123	287
Other current assets	698	712
Total Current Assets	12,618	11,569
Property, Plant and Equipment, Net	17,407	17,387
Goodwill	2,107	2,081
Intangible Assets, Net	599	599
Non-Current Finance Receivables, Net	275	288
Non-Current Investments and Restricted Cash	303	458
Other Non-Current Assets	1,285	1,215
Total Assets	$ 34,594	$ 33,597
LIABILITIES AND SHAREOWNERS EQUITY		
Current Liabilities:		
Current maturities of long-term debt and commercial paper	$ 1,554	$ 355
Accounts payable	2,017	1,974
Accrued wages and withholdings	1,660	1,505
Self-insurance reserves	752	725
Income taxes accrued	307	
Other current liabilities	1,315	1,343
Total Current Liabilities	7,605	5,902
Long-Term Debt	10,504	10,491
Pension and Postretirement Benefit Obligations	3,648	4,663
Deferred Income Tax Liabilities	2,024	1,870
Self-Insurance Reserves	1,776	1,809
Other Non-Current Liabilities	803	815
Shareowners Equity:		
Class A common stock (252 and 258 shares issued in 2011 and 2010)	3	3
Class B common stock (736 and 735 shares issued in 2011 and 2010)	7	7
Additional paid-in capital		

Retained earnings	14,206	14,164
Accumulated other comprehensive loss	(6,052)	(6,195)
Deferred compensation obligations	85	103
Less: Treasury stock (2 shares in 2011 and 2010)	(85)	(103)
Total Equity for Controlling Interests	8,164	7,979
Total Equity for Non-Controlling Interests	70	68
Total Shareowners Equity	8,234	8,047
Total Liabilities and Shareowners Equity	$ 34,594	$ 33,597

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED INCOME

(In millions, except per share amounts)

(unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Revenue	$ 12,582	$ 11,728
Operating Expenses:		
Compensation and benefits	6,608	6,539
Repairs and maintenance	315	274
Depreciation and amortization	441	451
Purchased transportation	1,648	1,501
Fuel	908	678
Other occupancy	261	262
Other expenses	975	981
Total Operating Expenses	11,156	10,686
Operating Profit	1,426	1,042
Other Income and (Expense):		
Investment income (loss)	11	(4)
Interest expense	(85)	(85)
Total Other Income and (Expense)	(74)	(89)
Income Before Income Taxes	1,352	953
Income Tax Expense	467	420
Net Income	$ 885	$ 533
Basic Earnings Per Share	$ 0.89	$ 0.54
Diluted Earnings Per Share	$ 0.88	$ 0.53

STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME

(In millions)

(unaudited)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Net income	$ 885	$ 533

Change in foreign currency translation adjustment	125	(128)
Change in unrealized gain (loss) on marketable securities, net of tax	(4)	19
Change in unrealized gain (loss) on cash flow hedges, net of tax	(63)	39
Change in unrecognized pension and postretirement benefit costs, net of tax	85	42
Comprehensive income	$ 1,028	$ 505

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED CASH FLOWS

(In millions)

(unaudited)

	Three Months Ended March 31, 2011	2010
Cash Flows From Operating Activities:		
Net income	$ 885	$ 533
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	441	451
Pension and postretirement benefit expense	256	224
Pension and postretirement benefit contributions	(1,252)	(656)
Self-insurance reserves	(6)	(13)
Deferred taxes, credits and other	112	139
Stock compensation expense	120	100
Other (gains) losses	23	97
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	312	177
Other current assets	137	(20)
Accounts payable	(81)	48
Accrued wages and withholdings	144	379
Other current liabilities	182	89
Other operating activities	8	1
Net cash from operating activities	1,281	1,549
Cash Flows From Investing Activities:		
Capital expenditures	(402)	(283)
Proceeds from disposals of property, plant and equipment	11	20
Purchases of marketable securities and short-term investments	(1,042)	(310)
Sales and maturities of marketable securities and short-term investments	1,141	334
Net (increase) decrease in finance receivables	26	
Other investing activities	(16)	(11)
Net cash used in investing activities	(282)	(250)
Cash Flows From Financing Activities:		
Net change in short-term debt	1,297	628
Proceeds from long-term borrowings	12	52
Repayments of long-term borrowings	(113)	(206)
Purchases of common stock	(505)	(278)
Issuances of common stock	104	45
Dividends	(503)	(456)
Other financing activities	(45)	(42)
Net cash provided by (used in) financing activities	247	(257)
Effect Of Exchange Rate Changes On Cash And Cash Equivalents	41	(40)

Net Increase In Cash And Cash Equivalents	1,287	1,002
Cash And Cash Equivalents:		
Beginning of period	3,370	1,542
End of period	$ 4,657	$ 2,544

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 March 31, 2011, our results of operations for the three months ended March 31, 2011 and 2010, and cash flows for the three months ended March 31, 2011 and 2010. 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, 2010.

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.

Fair Value of Financial Instruments

The carrying amount of our cash and cash equivalents, accounts receivable, finance receivables and accounts payable approximate fair value as of March 31, 2011. The fair value of our investment securities is disclosed in Note 4, our short and long-term debt in Note 8 and our derivative instruments in Note 13.

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.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

Adoption of New Accounting Standards

There were no accounting standards adopted during the three months ended March 31, 2011 that had a material impact on our consolidated financial statements.

Standards Issued But Not Yet Effective

Other new pronouncements issued but not effective until after March 31, 2011, 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,

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 2011, we granted target restricted stock units (RSUs) under the UPS Long-Term Incentive Performance Award program to eligible management. Of the total 2011 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 2011 to 2013, using performance criteria targets established each year. For 2011, those targets consist of consolidated operating return on invested capital and growth in consolidated revenue. The remaining 10% of the total 2011 target award will be based upon our achievement of adjusted earnings per share for the year ending 2013 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 2011 performance tranches, we determined the award measurement date to be March 1, 2011, and therefore the target RSU grant was valued for stock compensation expense purposes using the closing New York Stock Exchange price of $72.35 on that date.

Awards granted under the UPS Long-Term Incentive program are normally granted during the second quarter of each year, and awards granted under the Management Incentive Awards program have previously been granted during the fourth quarter of each year. The timing of the awards granted under the Management Incentive Awards program has changed, and we anticipate that the 2011 awards will be granted in the first quarter of 2012. Compensation expense for share-based awards recognized in net income for the three months ended March 31, 2011 and 2010 was $120 and $100 million pre-tax, respectively.

NOTE 4. CASH AND INVESTMENTS

The following is a summary of marketable securities classified as available-for-sale as of March 31, 2011 and December 31, 2010 (in millions):

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
March 31, 2011				
Current marketable securities:				
U.S. government and agency debt securities	$ 209	$ 1	$ (1)	$ 209
Mortgage and asset-backed debt securities	216	2	(1)	217
Corporate debt securities	277	4	(1)	280
U.S. state and local municipal debt securities	14			14
Other debt and equity securities	66	1		67
Current marketable securities	782	8	(3)	787
Non-current marketable securities:				
Common equity securities	10	7		17
Non-current marketable securities	10	7		17
Total marketable securities	$ 792	$ 15	$ (3)	$ 804

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
December 31, 2010				
Current marketable securities:				
U.S. government and agency debt securities	$ 207	$ 1	$ (2)	$ 206
Mortgage and asset-backed debt securities	220	3	(1)	222
Corporate debt securities	179	5	(1)	183
U.S. state and local municipal debt securities	33			33
Other debt and equity securities	62	5		67
Current marketable securities	701	14	(4)	711
Non-current marketable securities:				
Asset-backed debt securities	79	2	(2)	79
U.S. state and local municipal debt securities	49	2	(6)	45
Common equity securities	20	14		34
Preferred equity securities	16	1	(3)	14
Non-current marketable securities	164	19	(11)	172
Total marketable securities	$ 865	$ 33	$ (15)	$ 883

Auction Rate Securities

During first quarter 2011, we sold all remaining investments in auction rate securities. These sales did not have a material impact on our statement of consolidated income.

Investment Other-Than-Temporary Impairments

We have concluded that no other-than-temporary impairment losses existed as of March 31, 2011. In making this determination, we considered the financial condition and prospects of the issuer, the magnitude of the losses 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 occurs.

Maturity Information

The amortized cost and estimated fair value of marketable securities at March 31, 2011, 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 Fair Value
Due in one year or less	$ 184	$ 184
Due after one year through three years	207	209
Due after three years through five years	51	51
Due after five years	338	341

	780	785
Equity securities	12	19
	$ 792	$ 804

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Restricted Cash

We had $286 million of restricted cash related to our self-insurance requirements, as of March 31, 2011 and December 31, 2010, which is reported in Non-Current Investments and Restricted Cash on the consolidated balance sheets.

Fair Value Measurements

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 classified our auction rate securities portfolio as utilizing Level 3 inputs, as their valuation required substantial judgment and estimation of factors that were not observable in the market due to the lack of trading in the securities. These securities were valued as of December 31, 2010 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.

We maintain holdings in certain investment partnerships that are measured at fair value utilizing Level 3 inputs (classified as other investments in the tables below, and as Other Non-Current Assets in the consolidated balance sheets). These partnership holdings do not have 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.

The following table presents information about our investments measured at fair value on a recurring basis as of March 31, 2011 and December 31, 2010, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value (in millions).

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of March 31, 2011
March 31, 2011				
Marketable Securities:				
U.S. government and agency debt securities	$ 209	$	$	$ 209
Mortgage and asset-backed debt securities		217		217
Corporate debt securities		280		280
U.S. state and local municipal debt securities		14		14
Other debt and equity securities	5	79		84
Total marketable securities	214	590		804
Other investments			254	254
Total	$ 214	$ 590	$ 254	$ 1,058

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2010
December 31, 2010				
Marketable Securities:				
U.S. government and agency debt securities	$ 206	$	$	$ 206
Mortgage and asset-backed debt securities		222	79	301
Corporate debt securities		183		183
U.S. state and local municipal debt securities		33	45	78
Other debt and equity securities	41	60	14	115
Total marketable securities	247	498	138	883
Other investments			267	267
Total	$ 247	$ 498	$ 405	$ 1,150

The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the three months ended March 31, 2011 (in millions).

	Marketable Securities	Other Investments	Total
Balance on January 1, 2011	$ 138	$ 267	$ 405
Transfers into (out of) Level 3			
Net realized and unrealized gains (losses):			
Included in earnings (in investment income)		(13)	(13)
Included in accumulated other comprehensive income (pre-tax)			
Purchases			
Sales	(138)		(138)
Balance on March 31, 2011	$	$ 254	$ 254

There were no transfers of investments between Level 1 and Level 2 during the three months ended March 31, 2011.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of March 31, 2011 and December 31, 2010 consists of the following (in millions):

	2011	2010
Vehicles	$ 5,556	$ 5,519
Aircraft (including aircraft under capitalized leases)	14,161	14,063
Land	1,093	1,081
Buildings	3,144	3,102
Building and leasehold improvements	2,886	2,860
Plant equipment	6,719	6,656
Technology equipment	1,579	1,552
Equipment under operating leases	119	122
Construction-in-progress	388	265
	35,645	35,220
Less: Accumulated depreciation and amortization	(18,238)	(17,833)
	$ 17,407	$ 17,387

NOTE 6. EMPLOYEE BENEFIT PLANS

Information about net periodic benefit cost for our pension and postretirement benefit plans is as follows for the three months ended March 31, 2011 and 2010 (in millions):

	U.S. Pension Benefits		U.S. Postretirement Medical Benefits		International Pension Benefits	
	2011	2010	2011	2010	2011	2010
Net Periodic Cost:						
Service cost	$ 218	$ 181	$ 22	$ 22	$ 9	$ 6
Interest cost	327	300	52	53	10	8
Expected return on assets	(489)	(400)	(4)	(5)	(11)	(9)
Amortization of:						
Transition obligation						
Prior service cost	43	43	2	1		
Actuarial (gain) loss	71	19	5	4	1	1
Settlements / curtailments						
Net periodic benefit cost	$ 170	$ 143	$ 77	$ 75	$ 9	$ 6

During the first three months of 2011, we contributed $1.215 billion and $37 million to our company-sponsored pension and postretirement medical benefit plans, respectively. Included in the contribution to the postretirement medical benefit plans is $12 million that UPS received under the Early Retiree Reinsurance Program authorized in the Patient Protection and Affordable Care Act. Included in the contribution to the pension plans is a $1.2 billion accelerated contribution to the UPS IBT Pension Plan, which represented an acceleration of contributions that would have been required over the remainder of 2011 and approximately $440 million in contributions that would not have been required until after 2011. We expect to contribute $40 and $78 million over the remainder of the year to the pension and postretirement medical benefit plans, respectively.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7. GOODWILL AND INTANGIBLE ASSETS

The following table indicates the allocation of goodwill by reportable segment as of March 31, 2011 and December 31, 2010 (in millions):

	U.S. Domestic Package	International Package	Supply Chain & Freight	Consolidated
December 31, 2010 balance	$	$ 377	$ 1,704	$ 2,081
Acquired				
Currency / Other		6	20	26
March 31, 2011 balance	$	$ 383	$ 1,724	$ 2,107

The increase in goodwill in the International Package and Supply Chain & Freight segments was due to the impact of the weakening U.S. Dollar on the translation of non-U.S. Dollar goodwill balances.

The following is a summary of intangible assets as of March 31, 2011 and December 31, 2010 (in millions):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
March 31, 2011:			
Trademarks, licenses, patents, and other	$ 200	$ (63)	$ 137
Customer lists	100	(61)	39
Franchise rights	109	(54)	55
Capitalized software	1,907	(1,539)	368
Total Intangible Assets, Net	$ 2,316	$ (1,717)	$ 599
December 31, 2010:			
Trademarks, licenses, patents, and other	$ 187	$ (50)	$ 137
Customer lists	99	(59)	40
Franchise rights	109	(52)	57
Capitalized software	1,927	(1,562)	365
Total Intangible Assets, Net	$ 2,322	$ (1,723)	$ 599

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. DEBT AND FINANCING ARRANGEMENTS

The carrying value of our outstanding debt as of March 31, 2011 and December 31, 2010 consists of the following (in millions):

	Maturity	2011	2010
Commercial paper	2011	$ 1,539	$ 341
4.50% senior notes	2013	1,800	1,815
3.875% senior notes	2014	1,059	1,061
5.50% senior notes	2018	783	795
5.125% senior notes	2019	1,027	1,032
6.20% senior notes	2038	1,480	1,480
8.375% debentures	2020	458	453
3.125% senior notes	2021	1,465	1,464
8.375% debentures	2030	284	284
4.875% senior notes	2040	488	488
Floating rate senior notes	2049-2053	381	386
Facility notes and bonds	2015-2036	320	320
Pound Sterling notes	2031/2050	798	764
Capital lease obligations	2011-2021	172	160
Other debt	2011-2012	4	3
Total debt		12,058	10,846
Less current maturities		(1,554)	(355)
Long-term debt		$ 10,504	$ 10,491

Sources of Credit

We are authorized to borrow up to $10.0 billion under the U.S. commercial paper program we maintain. We had $1.539 billion outstanding under this program as of March 31, 2011, with an average interest rate of 0.12%. As of March 31, 2011, we have classified the entire commercial paper balance as a current liability in our consolidated balance sheet. 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, there were no amounts outstanding under this program as of March 31, 2011.

We maintain two credit agreements with a consortium of banks. One of these agreements provides revolving credit facilities of $1.5 billion, and expires on April 12, 2012. Generally, amounts outstanding under this facility bear interest at a periodic fixed rate equal to LIBOR for the applicable interest period and currency denomination, plus an applicable margin. Alternatively, a fluctuating rate of interest equal to Citibank s publicly announced base rate, plus an applicable margin, may be used at our discretion. In each case, the applicable margin for advances bearing interest based on LIBOR is a percentage determined by quotations from Markit Group Ltd. for our 1-year credit default swap spread, subject to a minimum rate of 0.15% and a maximum rate of 0.75%. The applicable margin for advances bearing interest based on the base rate is 1.00% below the applicable margin for LIBOR advances (but not lower than 0.00%). We are also able to request advances under this facility based on competitive bids for the applicable interest rate.

The second agreement provides revolving credit facilities of $1.0 billion, and expires on April 14, 2015. Generally, amounts outstanding under this facility bear interest at a periodic fixed rate equal to LIBOR for the applicable interest period and currency denomination, plus an applicable margin. Alternatively, a fluctuating rate of interest equal to Citibank s publicly announced base rate, plus an applicable margin, may be used at our

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

discretion. In each case, the applicable margin for advances bearing interest based on LIBOR is a percentage determined by quotations from Markit Group Ltd. for our credit default swap spread, interpolated for a period from the date of determination of such credit default swap spread in connection with a new interest period until the latest maturity date of this facility then in effect (but not less than a period of one year). The applicable margin is subject to certain minimum rates and maximum rates based on our public debt ratings from Standard & Poor s Rating Service (S&P) and Moody s Investors Service (Moody s). The minimum applicable margin rates range from 0.250% to 0.500%, and the maximum applicable margin rates range from 1.000% to 1.500%. The applicable margin for advances bearing interest based on the base rate is 1.00% below the applicable margin for LIBOR advances (but not less than 0.00%). We are also able to request advances under this facility based on competitive bids.

Debt Covenants

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 March 31, 2011 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 March 31, 2011, 10% of net tangible assets is equivalent to $2.428 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 March 31, 2011, our net worth, as defined, was equivalent to $14.216 billion. We do not expect these covenants to have a material impact on our financial condition or liquidity.

Fair Value of Debt

Based on the borrowing rates currently available to the Company for long-term debt with similar terms and maturities, the fair value of long-term debt, including current maturities, is approximately $12.485 and $11.355 billion as of March 31, 2011 and December 31, 2010, respectively.

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 plaintiffs appealed. After decertification and while the appeal was pending, some plaintiffs filed individual lawsuits raising the same allegations as in the underlying class action. These individual lawsuits are in various stages. On April 28, 2011, the appeals court upheld the decertification decision. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in these cases. 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.

UPS and our subsidiary 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

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territories. In one of the actions, which is pending in California state court, the court 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 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.

In AFMS LLC v. UPS and FedEx Corporation, a lawsuit filed in federal court in the Central District of California in August 2010, the plaintiff asserts that UPS and FedEx violated U.S. antitrust law by conspiring to refuse to negotiate with third party negotiators retained by shippers and/or to monopolize a so-called market for the time sensitive delivery of letters and packages. The Antitrust Division of the U.S. Department of Justice (DOJ) has informed us that it has opened a civil investigation of our policies and practices for dealing with third party negotiators. We are cooperating with this investigation. We deny any liability with respect to these matters and intend to vigorously defend ourselves. 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.

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 fourth quarter of 2010, we received a refund of $139 million as a result of the resolution of tax years 2003 through 2004 with the Internal Revenue Service (IRS) Appeals Office. 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 anticipate receipt of the IRS reports on these matters by the end of the second quarter of 2011. 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 2003 and 2004. A limited number of U.S. state and local matters are the subject of ongoing audits, administrative appeals or litigation.

As of December 31, 2010, we had approximately 250,000 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 2,800 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association (IPA), 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 January 2011, we reached an agreement with Teamsters Local 2727 which was ratified by its members in April 2011. The agreement will run through

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November 1, 2013. In addition, the majority (approximately 3,300) 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). Our agreement with the IAM 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.

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.

Other Matters

We received a grand jury subpoena from the Antitrust Division of the DOJ regarding the DOJ s investigation into certain pricing practices in the freight forwarding industry in December 2007.

In October 2007, June 2008 and February 2009, we received information requests from the European Commission (Commission) relating to its investigation of certain pricing practices in the freight forwarding industry, and subsequently responded to each request. On February 9, 2010, UPS received a Statement of Objections by the Commission. This document contains the Commission s preliminary view with respect to alleged anticompetitive behavior in the freight forwarding industry by 18 freight forwarders, including UPS. Although it alleges anticompetitive behavior, it does not prejudge the Commission s final decision, as to facts or law (which is subject to appeal to the European courts). The options available to the Commission include taking no action or imposing a monetar