

UNITED PARCEL SERVICE INC
Form 10-Q
November 04, 2011
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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, 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)

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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 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 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 (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

There were 241,362,361 Class A shares, and 723,626,266 Class B shares, with a par value of \$0.01 per share, outstanding at October 27, 2011.

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UNITED PARCEL SERVICE, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2011

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PART I. FINANCIAL INFORMATION

Cautionary Statement About Forward-Looking Statements

This report includes certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Statements in the future tense, and all statements accompanied by terms such as believe, project, expect, estimate, assume, intend, anticipate, and variations thereof and similar terms are intended to be forward-looking statements. We intend that all forward-looking statements we make will be subject to safe harbor protection of the federal securities laws pursuant to Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

Our disclosure and analysis in this report, in our Annual Report on Form 10-K for the year ended December 31, 2010 and in our other filings with the Securities and Exchange Commission contain some forward-looking statements regarding our intent, belief and current expectations about our strategic direction, prospects and future results. From time to time, we also provide forward-looking statements in other materials we release as well as oral forward-looking statements. Such statements give our current expectations or forecasts of future events; they do not relate strictly to historical or current facts. Management believes that these forward-looking statements are reasonable as and when made. However, caution should be taken not to place undue reliance on any such forward-looking statements because such statements speak only as of the date when made.

Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or anticipated results. These risks and uncertainties are described in Part I, Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2010 and may also be described from time to time in our future reports filed with the Securities and Exchange Commission. You should consider the limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of predictions contained in such forward-looking statements. We do not undertake any obligation to update forward-looking statements to reflect events, circumstances, changes in expectations, or the occurrence of unanticipated events after the date of those statements.

Table of Contents**Item 1. Financial Statements****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****September 30, 2011 (unaudited) and December 31, 2010****(In millions)**

	September 30, 2011	December 31, 2010
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 4,133	\$ 3,370
Marketable securities	1,320	711
Accounts receivable, net	5,418	5,627
Finance receivables, net	166	203
Deferred income tax assets	634	659
Other current assets	957	999
Total Current Assets	12,628	11,569
Property, Plant and Equipment, Net	17,581	17,387
Goodwill	2,066	2,081
Intangible Assets, Net	622	599
Non-Current Finance Receivables, Net	231	288
Non-Current Investments and Restricted Cash	303	458
Other Non-Current Assets	1,807	1,215
Total Assets	\$ 35,238	\$ 33,597
LIABILITIES AND SHAREOWNERS EQUITY		
Current Liabilities:		
Current maturities of long-term debt and commercial paper	\$ 1,310	\$ 355
Accounts payable	1,974	1,974
Accrued wages and withholdings	1,873	1,505
Self-insurance reserves	765	725
Other current liabilities	1,589	1,343
Total Current Liabilities	7,511	5,902
Long-Term Debt	11,092	10,491
Pension and Postretirement Benefit Obligations	3,744	4,663
Deferred Income Tax Liabilities	2,394	1,870
Self-Insurance Reserves	1,813	1,809
Other Non-Current Liabilities	815	815
Shareowners' Equity:		
Class A common stock (244 and 258 shares issued in 2011 and 2010)	3	3
Class B common stock (724 and 735 shares issued in 2011 and 2010)	7	7
Additional paid-in capital		
Retained earnings	13,828	14,164
Accumulated other comprehensive loss	(6,040)	(6,195)
Deferred compensation obligations	87	103
Less: Treasury stock (2 shares in 2011 and 2010)	(87)	(103)

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Total Equity for Controlling Interests	7,798	7,979
Total Equity for Non-Controlling Interests	71	68
Total Shareowners' Equity	7,869	8,047
Total Liabilities and Shareowners' Equity	\$ 35,238	\$ 33,597

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)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenue	\$ 13,166	\$ 12,192	\$ 38,939	\$ 36,124
Operating Expenses:				
Compensation and benefits	6,694	6,411	19,985	19,465
Repairs and maintenance	324	282	956	837
Depreciation and amortization	447	448	1,331	1,348
Purchased transportation	1,796	1,656	5,206	4,770
Fuel	1,015	724	2,980	2,119
Other occupancy	229	222	715	700
Other expenses	1,042	833	3,023	2,825
Total Operating Expenses	11,547	10,576	34,196	32,064
Operating Profit	1,619	1,616	4,743	4,060
Other Income and (Expense):				
Investment income (loss)	16	15	36	(7)
Interest expense	(84)	(91)	(252)	(260)
Total Other Income and (Expense)	(68)	(76)	(216)	(267)
Income Before Income Taxes	1,551	1,540	4,527	3,793
Income Tax Expense	509	549	1,537	1,424
Net Income	\$ 1,042	\$ 991	\$ 2,990	\$ 2,369
Basic Earnings Per Share	\$ 1.07	\$ 1.00	\$ 3.03	\$ 2.38
Diluted Earnings Per Share	\$ 1.06	\$ 0.99	\$ 3.00	\$ 2.36

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net income	\$ 1,042	\$ 991	\$ 2,990	\$ 2,369

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Change in foreign currency translation adjustment, net of tax	(179)	125	(47)	(95)
Change in unrealized gain (loss) on marketable securities, net of tax	2	9	(5)	44
Change in unrealized gain (loss) on cash flow hedges, net of tax	39	(113)	(29)	(101)
Change in unrecognized pension and postretirement benefit costs, net of tax	75	43	236	126
Comprehensive income	\$ 979	\$ 1,055	\$ 3,145	\$ 2,343

See notes to unaudited consolidated financial statements.

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

	Nine Months Ended September 30,	
	2011	2010
Cash Flows From Operating Activities:		
Net income	\$ 2,990	\$ 2,369
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,331	1,348
Pension and postretirement benefit expense	768	672
Pension and postretirement benefit contributions	(1,397)	(1,069)
Self-insurance reserves	44	17
Deferred taxes, credits and other	336	(24)
Stock compensation expense	402	349
Other (gains) losses	160	(15)
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	177	(43)
Other current assets	185	81
Accounts payable	(67)	62
Accrued wages and withholdings	367	390
Other current liabilities	88	(221)
Other operating activities	(22)	7
Net cash from operating activities	5,362	3,923
Cash Flows From Investing Activities:		
Capital expenditures	(1,557)	(1,011)
Proceeds from disposals of property, plant and equipment	29	294
Purchases of marketable securities	(3,830)	(1,751)
Sales and maturities of marketable securities	3,357	1,718
Net decrease in finance receivables	128	76
Other investing activities	(243)	181
Net cash used in investing activities	(2,116)	(493)
Cash Flows From Financing Activities:		
Net change in short-term debt	1,110	174
Proceeds from long-term borrowings	277	113
Repayments of long-term borrowings	(180)	(355)
Purchases of common stock	(2,173)	(599)
Issuances of common stock	220	151
Dividends	(1,500)	(1,363)
Other financing activities	(238)	(60)
Net cash used in financing activities	(2,484)	(1,939)
Effect Of Exchange Rate Changes On Cash And Cash Equivalents	1	(13)

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Net Increase In Cash And Cash Equivalents	763	1,478
Cash And Cash Equivalents:		
Beginning of period	3,370	1,542
End of period	\$ 4,133	\$ 3,020

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, 2011, our results of operations for the three and nine months ended September 30, 2011 and 2010, and cash flows for the nine months ended September 30, 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 September 30, 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 consolidated 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 nine months ended September 30, 2011 that had a material impact on our consolidated financial statements.

Standards Issued But Not Yet Effective

In September 2011, the Financial Accounting Standards Board (FASB) issued an accounting standard update regarding disclosure of an employer's participation in multiemployer pension plans. This new guidance requires companies to provide additional qualitative and quantitative disclosures about financial obligations, risks and commitments, as well as the level of participation in multiemployer plans. Companies will be required to disclose detailed information about significant multiemployer plans, including contributions made to the plans, financial health and funded status of the plans, and expiration of the collective-bargaining agreements that

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

require contributions to the plans. This accounting standards update will impact our disclosures only, and will not have any impact on our financial condition, results of operations or liquidity. The provisions of this guidance will be applied retrospectively beginning in our Form 10-K for the year ended December 31, 2011.

In September 2011, the FASB issued an accounting standard update that amends the accounting guidance on goodwill impairment testing. This accounting standard update is intended to reduce complexity and costs by allowing an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of a reporting unit. This accounting standard update also amends existing guidance by expanding upon the examples of events and circumstances that an entity should consider between annual impairment tests in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. We will adopt this accounting standard update and apply its provisions for our annual goodwill impairment testing as of October 1, 2011.

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. Additionally, our matching contributions to the primary employee defined contribution plan are made in shares of UPS class A common stock.

During the first quarter of 2011, we granted target restricted performance units (RPU) 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 RPUs 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 RPUs earned may be a percentage less than or more than 100% of the target RPUs 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; therefore the target RPUs grant was valued for stock compensation expense purposes using the closing New York Stock Exchange price of \$72.35 on that date.

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

During the second quarter of 2011, we granted stock option and RPU awards to eligible management employees under the UPS Long-Term Incentive Program. Stock options are granted to a limited group of senior management, while the entire eligible population receives awards 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). The options granted will expire ten years after the date of grant. In the second quarter of 2011, we granted 0.2 million stock options and 1.6 million RPUs at a grant price of \$74.25. In the second quarter of 2010, we granted 0.2 million stock options and 1.8 million RPUs at a grant price of \$67.18. The fair value of our employee stock options granted, as determined by the Black-Scholes valuation model, was \$15.92 and \$14.83 for 2011 and 2010, respectively, using the following assumptions:

	2011	2010
Expected life (in years)	7.5	7.5
Risk-free interest rate	2.90%	3.30%
Expected volatility	24.26%	23.59%
Expected dividend yield	2.77%	2.70%

Historically, awards granted under the Management Incentive Awards Program were normally granted during the fourth quarter of each year, while awards granted under the UPS Long-Term Incentive Program were granted during the second quarter of each year. The UPS Long-Term Incentive award granted in the second quarter of 2011 will be the last award made under that existing program. Prospectively, the compensation provided by the UPS Long-Term Incentive Program has been combined with the Management Incentive Awards Program, and we anticipate that the combined Management Incentive Awards grant will be made in the first quarter of 2012. The combined Management Incentive Awards Program will consist of cash and RPU awards, and the amount of the awards granted each year will be adjusted for the percentage of achievement of performance criteria targets. The Company's actual performance compared with the performance criteria can result in an award grant that is less than or more than 100% of the target grant. The RPU awards will 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).

Compensation expense for share-based awards recognized in net income for the three months ended September 30, 2011 and 2010 was \$130 and \$111 million pre-tax, respectively. Compensation expense for share-based awards recognized in net income for the nine months ended September 30, 2011 and 2010 was \$402 and \$349 million pre-tax, respectively.

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 4. CASH AND INVESTMENTS**

The following is a summary of marketable securities classified as available-for-sale as of September 30, 2011 and December 31, 2010 (in millions):

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
September 30, 2011				
Current marketable securities:				
U.S. government and agency debt securities	\$ 175	\$ 4	\$	\$ 179
Mortgage and asset-backed debt securities	226	4	(1)	229
Corporate debt securities	879	5	(3)	881
U.S. state and local municipal debt securities	15			15
Other debt and equity securities	15	1		16
Total marketable securities	\$ 1,310	\$ 14	\$ (4)	\$ 1,320
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:				
Mortgage and 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, which had been classified as non-current marketable securities as of December 31, 2010. These sales did not have a material impact on our statement of consolidated income.

Investment Other-Than-Temporary Impairments

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We have concluded that no other-than-temporary impairment losses existed as of September 30, 2011. In making this determination, we considered the financial condition and prospects of the issuers, 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 securities, the credit rating of the securities and our ability and intent to hold these investments until the anticipated recovery in market value occurs.

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

During the second quarter of 2010, we recorded impairment losses on certain asset-backed auction rate securities. The impairment charge resulted from provisions that allow the issuers of the securities to subordinate our holdings to newly issued debt or to tender for the securities at less than their par value. These securities, which had a cost basis of \$128 million, were written down to their fair value of \$107 million as of June 30, 2010, as an other-than-temporary impairment. The \$21 million total impairment charge during the second quarter was recorded in investment income (loss) on the statement of consolidated income.

Maturity Information

The amortized cost and estimated fair value of marketable securities at September 30, 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	\$ 686	\$ 685
Due after one year through three years	192	193
Due after three years through five years	85	85
Due after five years	346	356
	1,309	1,319
Equity securities	1	1
	\$ 1,310	\$ 1,320

Non-Current Investments and Restricted Cash

We had \$286 million of restricted cash related to our self-insurance requirements, as of September 30, 2011 and December 31, 2010, which is reported in **Non-Current Investments and Restricted Cash** on the consolidated balance sheets.

At September 30, 2011 we held a \$17 million investment in a variable life insurance policy to fund benefits for the UPS Excess Coordinating Benefit Plan. This investment is classified as **Non-Current Investments and Restricted Cash** in the consolidated balance sheets with the quarterly change in investment value recognized in the statements of consolidated income.

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.

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

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 September 30, 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 September 30, 2011
September 30, 2011				
Marketable Securities:				
U.S. government and agency debt securities	\$ 179	\$	\$	\$ 179
Mortgage and asset-backed debt securities		229		229
Corporate debt securities		881		881
U.S. state and local municipal debt securities		15		15
Other debt and equity securities		16		16
Total marketable securities	179	1,141		1,320
Other investments	17		228	245
Total	\$ 196	\$ 1,141	\$ 228	\$ 1,565

	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

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Total	\$	247	\$	498	\$	405	\$	1,150
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Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the three months ended September 30, 2011 (in millions):

	Marketable Securities	Other Investments	Total
Balance on July 1, 2011	\$	\$ 240	\$ 240
Transfers into (out of) Level 3			
Net realized and unrealized gains (losses):			
Included in earnings (in investment income)		(12)	(12)
Included in accumulated other comprehensive income (pre-tax)			
Purchases			
Sales			
Balance on September 30, 2011	\$	\$ 228	\$ 228

The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the nine months ended September 30, 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)		(39)	(39)
Included in accumulated other comprehensive income (pre-tax)			
Purchases			
Sales	(138)		(138)
Balance on September 30, 2011	\$	\$ 228	\$ 228

There were no transfers of investments between Level 1 and Level 2 during the three and nine months ended September 30, 2011 and 2010.

NOTE 5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of September 30, 2011 and December 31, 2010 consist of the following (in millions):

	2011	2010
Vehicles	\$ 5,678	\$ 5,519
Aircraft (including aircraft under capitalized leases)	14,608	14,063
Land	1,118	1,081
Buildings	3,085	3,102
Building and leasehold improvements	2,928	2,860
Plant equipment	6,755	6,656

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Technology equipment	1,582	1,552
Equipment under operating leases	102	122
Construction-in-progress	422	265
	36,278	35,220
Less: Accumulated depreciation and amortization	(18,697)	(17,833)
	\$ 17,581	\$ 17,387

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In the second quarter of 2011, we recognized a pre-tax loss from certain real estate transactions within our U.S. Domestic Package segment of \$15 million (\$11 million after-tax) and a pre-tax gain from real estate transactions within our Supply Chain & Freight segment of \$48 million (\$31 million after-tax). In the third quarter of 2010, we recognized a pre-tax gain of \$109 million (\$61 million after-tax) on the sale of real estate within our U.S. Domestic Package segment.

NOTE 6. EMPLOYEE BENEFIT PLANS

Information about net periodic benefit cost for our pension and postretirement benefit plans is as follows for the three and nine months ended September 30, 2011 and 2010 (in millions):

	U.S. Pension Benefits		U.S. Postretirement Medical Benefits		International Pension Benefits	
	2011	2010	2011	2010	2011	2010
Three Months Ended September 30:						
Service cost	\$ 218	\$ 181	\$ 22	\$ 22	\$ 9	\$ 6
Interest cost	327	300	52	53	10	9
Expected return on assets	(489)	(400)	(4)	(5)	(11)	(10)
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

	U.S. Pension Benefits		U.S. Postretirement Medical Benefits		International Pension Benefits	
	2011	2010	2011	2010	2011	2010
Nine Months Ended September 30:						
Service cost	\$ 654	\$ 542	\$ 66	\$ 65	\$ 27	\$ 18
Interest cost	981	899	156	160	30	26
Expected return on assets	(1,467)	(1,199)	(12)	(16)	(33)	(27)
Amortization of:						
Transition obligation						
Prior service cost	129	129	6	3		
Actuarial (gain) loss	213	58	15	12	3	2
Settlements / curtailments						
Net periodic benefit cost	\$ 510	\$ 429	\$ 231	\$ 224	\$ 27	\$ 19

During the first nine months of 2011, we contributed \$1.307 billion and \$90 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 during the first quarter 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. An additional accelerated contribution of \$60 million was made in the third quarter of 2011 to the UPS Pension

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Plan that would not have been required until after 2011. We also expect to contribute \$6 and \$25 million over the remainder of the year to the international pension and U.S. postretirement medical benefit plans, respectively.

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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 runs through 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. Our current collective bargaining agreements set forth the annual contribution increases allotted to the plans that we participate in, and we are in compliance with these contribution rates. These limitations will remain in effect throughout the terms of the existing collective bargaining agreements.

NOTE 7. GOODWILL AND INTANGIBLE ASSETS

The following table indicates the allocation of goodwill by reportable segment as of September 30, 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		(10)	(5)	(15)
September 30, 2011 balance		\$ 367	\$ 1,699	\$ 2,066

The decrease in goodwill in the International Package and Supply Chain & Freight segments was due to the impact of the strengthening U.S. Dollar on the translation of non-U.S. Dollar goodwill balances, as well as the reversal of acquisition-related restructuring reserves and the related deferred tax impact in the Supply Chain and Freight segment.

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The following is a summary of intangible assets as of September 30, 2011 and December 31, 2010 (in millions):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
September 30, 2011:			
Trademarks, licenses, patents, and other	\$ 240	\$ (88)	\$ 152
Customer lists	97	(65)	32
Franchise rights	109	(57)	52
Capitalized software	1,996	(1,610)	386
Total Intangible Assets, Net	\$ 2,442	\$ (1,820)	\$ 622
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

NOTE 8. DEBT AND FINANCING ARRANGEMENTS

The carrying value of our outstanding debt as of September 30, 2011 and December 31, 2010 consists of the following (in millions):

	Maturity	2011	2010
Commercial paper	2011	\$ 1,293	\$ 341
4.50% senior notes	2013	1,787	1,815
3.875% senior notes	2014	1,060	1,061
5.50% senior notes	2018	844	795
5.125% senior notes	2019	1,122	1,032
3.125% senior notes	2021	1,645	1,464
6.20% senior notes	2038	1,480	1,480
4.875% senior notes	2040	489	488
8.375% debentures	2020-2030	791	737
Floating rate senior notes	2049-2053	380	386
Facility notes and bonds	2015-2036	320	320
Pound Sterling notes	2031-2050	771	764
Capital lease obligations	2025-2034	420	160
Other debt			3
Total debt		12,402	10,846
Less current maturities		(1,310)	(355)
Long-term debt		\$ 11,092	\$ 10,491

Capital Lease Obligations

During the first nine months of 2011, we entered into five aircraft capital lease transactions, resulting in an increase in capital lease obligations of \$261 million.

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Sources of Credit

We are authorized to borrow up to \$10.0 billion under the U.S. commercial paper program we maintain. We had \$1.293 billion outstanding under this program as of September 30, 2011, with an average interest rate of 0.04%. As of September 30, 2011, we have classified the entire commercial paper balance as a current liability in our consolidated balance sheets. 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 September 30, 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. There were no amounts outstanding under this facility as of September 30, 2011.

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 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 and Moody's Investors Service. 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. There were no amounts outstanding under this facility as of September 30, 2011.

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 September 30, 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 September 30, 2011, 10% of net tangible assets is equivalent to \$2.504 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, 2011, our net worth, as defined, was equivalent to \$13.838 billion. We do not expect these covenants to have a material impact on our financial condition or liquidity.

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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 \$13.072 and \$11.355 billion as of September 30, 2011 and December 31, 2010, respectively.

NOTE 9. LEGAL PROCEEDINGS AND CONTINGENCIES

We are involved in a number of judicial proceedings and other matters arising from the conduct of our business activities.

Although there can be no assurance as to the ultimate outcome, we have generally denied, or believe we have a meritorious defense and will deny, liability in all litigation pending against us, including the matters described below, and we intend to defend vigorously each case. We have accrued for legal claims when, and to the extent that, amounts associated with the claims become probable and can be reasonably estimated. The actual costs of resolving legal claims may be substantially higher or lower than the amounts accrued for those claims.

For those matters as to which we are not able to estimate a possible loss or range of loss, we are not able to determine whether the loss will have a material adverse effect on our business, financial condition or results of operations or liquidity. For matters in this category, we have indicated in the descriptions that follow the reasons that we are unable to estimate the possible loss or range of loss.

Judicial Proceedings

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 of the class, plaintiffs filed 56 individual lawsuits raising the same allegations as in the underlying class action. As of September 30, 2011, 53 of the original 56 lawsuits have been favorably resolved by dismissal, summary judgment granted to us or trial defense verdict. Two cases resulted in a plaintiff's verdict for an immaterial amount, and one case remains pending. Of the 56 original lawsuits, plaintiffs have filed appeals in 7 of those cases. Accordingly, at this time, we do not believe that any loss associated with these matters, 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 two lawsuits about the rebranding or purchase of The UPS Store franchises Morgate and Samica. We prevailed at the trial court level in both cases, which are now on appeal. Morgate was filed in March 2003. The plaintiffs are 125 individual franchisees who did not rebrand and a certified class of all franchisees who did rebrand to The UPS Store. A bellwether trial for three individual plaintiffs was set for early 2010, but the trial court entered judgment against one of the three plaintiffs prior to trial. The trial court also granted our motion for summary judgment against the members of the certified class. The remainder of the case has been stayed pending appeal. Samica was filed in March 2006. The plaintiffs are 250 individual The UPS Store franchisees who either elected to rebrand or purchased new The UPS Store franchises. Summary judgment was granted in UPS's favor against all plaintiffs and has been appealed. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) three separate components of these cases are being appealed to federal and state courts following decisions favorable to UPS and we cannot predict the outcomes of these appeals; and (2) it

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remains uncertain what evidence of damages, if any, plaintiffs will be able to present if any aspects of these cases proceed forward. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, 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. On June 1, 2011, we reached an agreement in principle to settle the case for an immaterial amount. The settlement has been preliminarily approved, and remains subject to a final fairness hearing.

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 shipping consultation services. 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. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) AFMS may amend its complaint to include new legal theories, the scope of possible AFMS's claims is therefore unclear; (2) we believe that we have a number of meritorious legal defenses; (3) AFMS has not articulated any measure of damages; and (4) the DOJ investigation is at a very early stage. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

In Canada, three purported class-action cases were filed against us in British Columbia (2006); Ontario (2007) and Québec (2006). The cases each allege inadequate disclosure concerning the existence and cost of brokerage services provided by us under applicable provincial consumer protection legislation and infringement of interest restriction provisions under the Criminal Code of Canada. The British Columbia class-action was declared inappropriate for certification and dismissed by the trial judge. That decision was upheld by the British Columbia Court of Appeal in March 2010, which ended the case in our favor. The Ontario class action was certified in September 2011. Partial summary judgment was granted to us and the plaintiffs by the Ontario motions court. The complaint under the Criminal Code was dismissed. No appeal is being taken from that decision. The allegations of inadequate disclosure were granted and we are appealing that decision. The request to certify the case in Québec will be heard in February 2012. We have denied all liability and are vigorously defending the two outstanding cases. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters, including (1) we are vigorously defending ourselves and believe that we have a number of meritorious legal defenses and (2) there are unresolved questions of law and fact that could be important to the ultimate resolution of these matters. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operation or liquidity.

Other Matters

In May and December 2007 and August 2008 we received and responded to grand jury subpoenas from the DOJ in the Northern District of California in connection with an investigation by the Drug Enforcement Administration. We also have responded to informal requests for information in connection with this investigation, which relates to transportation of packages on behalf of on-line pharmacies that may have operated illegally. We are cooperating with this investigation and intend to continue to vigorously defend ourselves. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from

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this matter, including (1) we are vigorously defending ourselves and believe we have a number of meritorious legal defenses and (2) there are unresolved questions of law and fact that could be important to the ultimate resolution of this matter. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from this matter or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

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 prejudice 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 monetary fine; the range of any potential action by the Commission is not reasonably estimable. Any decision imposing a fine would be subject to appeal. UPS has responded to the Statement of Objections, including at a July 2010 Commission hearing, and we intend to continue to vigorously defend ourselves in this proceeding. We received additional information requests from the Commission in January and July 2011, and we have responded to those requests.

In August 2010, competition authorities in Brazil opened an administrative proceeding to investigate alleged anticompetitive behavior in the freight forwarding industry. Approximately 45 freight forwarding companies and individuals are named in the proceeding, including UPS, UPS SCS Transportes (Brasil) S.A., and a former employee in Brazil. UPS will have an opportunity to respond to these allegations.

We also received and responded to related information requests from competition authorities in other jurisdictions.

We are cooperating with each of these investigations, and intend to continue to vigorously defend ourselves. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including (1) we are vigorously defending each matter and believe that we have a number of meritorious legal defenses; (2) there are unresolved questions of law that could be of importance to the ultimate resolutions of these matters, including the calculation of any potential fine; and (3) there is uncertainty about the time period that is the subject of the investigations. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, 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. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) the magistrate judge recommended that the district court grant our motion to dismiss, with leave to amend, and the scope of the plaintiffs' claims is therefore unclear; (2) the scope and size of the proposed class is ill-defined; (3) there are significant legal questions about the adequacy and standing of the putative class representatives; and (4) we believe that we have a number of meritorious legal defenses. Accordingly, at this

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time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, 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 do not believe that the eventual resolution of these other lawsuits (either individually or in the aggregate), including any reasonably possible losses in excess of current accruals, will have a material adverse effect on our financial condition, results of operations or liquidity.

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 under the symbol `UPS`. Class A and B shares both have a \$0.01 par value, and as of September 30, 2011, 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, with a \$0.01 par value, authorized to be issued; as of September 30, 2011, no preferred shares had been issued.

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The following is a rollforward of our common stock, additional paid-in capital and retained earnings accounts for the nine months ended September 30, 2011 and 2010 (in millions, except per share amounts):

	2011		2010	
	Shares	Dollars	Shares	Dollars
Class A Common Stock				
Balance at beginning of period	258	\$ 3	285	\$ 3
Common stock purchases	(6)		(3)	
Stock award plans	4		2	
Common stock issuances	3		2	
Conversions of Class A to Class B common stock	(15)		(22)	
Class A shares issued at end of period	244	\$ 3	264	\$ 3
Class B Common Stock				
Balance at beginning of period	735	\$ 7	711	\$ 7
Common stock purchases	(26)		(6)	
Conversions of Class A to Class B common stock	15		22	
Class B shares issued at end of period	724	\$ 7	727	\$ 7
Additional Paid-In Capital				
Balance at beginning of period		\$		\$ 2
Stock award plans		375		324
Common stock purchases		(417)		(491)
Common stock issuances		192		165
Option premiums paid		(150)		
Balance at end of period		\$		\$
Retained Earnings				
Balance at beginning of period		\$ 14,164		\$ 12,745
Net income		2,990		2,369
Dividends (\$1.56 and \$1.41 per share)		(1,553)		(1,413)
Common stock purchases		(1,773)		(98)
Balance at end of period		\$ 13,828		\$ 13,603

From time to time, we enter into share repurchase programs with large financial institutions to assist in our buyback of company stock. These programs allow us to repurchase our shares at a price below the weighted average UPS share price for a given period. During the third quarter of 2011, we entered into an accelerated share repurchase program, which allowed us to repurchase \$350 million of shares (5.5 million shares). The program was completed in September 2011.

In total, we repurchased a total of 31.7 million shares of Class A and Class B common stock for \$2.190 billion during the nine months ended September 30, 2011, and 9.3 million shares for \$589 million for the nine months ended September 30, 2010. As of September 30, 2011, we had \$3.004 billion of our share repurchase authorization remaining.

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In order to lower the average cost of acquiring shares in our ongoing share repurchase program, we periodically enter into structured repurchase agreements involving the use of capped call options for the purchase of UPS class B shares. We pay a fixed sum of cash upon execution of each agreement in exchange for the right to

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receive either a pre-determined amount of cash or stock. Upon expiration of each agreement, if the closing market price of our common stock is above the pre-determined price, we will have our initial investment returned with a premium in either cash or shares (at our election). If the closing market price of our common stock is at or below the pre-determined price, we will receive the number of shares specified in the agreement. As of September 30, 2011, we had paid premiums of \$150 million on options for the purchase of 2.6 million shares that will settle in the fourth quarter 2011. During 2011, we have settled options that resulted in the repurchase of 0.8 million shares at \$65.11 per share, as well as the receipt of \$2 million in premiums (in excess of our initial investment).

Accumulated Other Comprehensive Income (Loss)

We experience 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, 2011 and 2010 is as follows (in millions):

	2011	2010
Foreign currency translation gain (loss):		
Balance at beginning of period	\$ (68)	\$ 37
Aggregate adjustment for the period (net of tax effect of \$4 and \$(36))	(47)	(95)
Balance at end of period	(115)	(58)
Unrealized gain (loss) on marketable securities, net of tax:		
Balance at beginning of period	12	(27)
Current period changes in fair value (net of tax effect of \$10, and \$20)	16	34
Reclassification to earnings (net of tax effect of \$(13) and \$6)	(21)	10
Balance at end of period	7	17
Unrealized gain (loss) on cash flow hedges, net of tax:		
Balance at beginning of period	(239)	(200)
Current period changes in fair value (net of tax effect of \$(47) and \$(34))	(80)	(55)
Reclassification to earnings (net of tax effect of \$30 and \$(27))	51	(46)
Balance at end of period	(268)	(301)
Unrecognized pension and postretirement benefit costs, net of tax:		
Balance at beginning of period	(5,900)	(4,937)
Reclassification to earnings (net of tax effect of \$138 and \$78)	228	126
Adjustment for Early Retirement Reinsurance Program (net of tax effect of \$4 and \$0)	8	
Balance at end of period	(5,664)	(4,811)
Accumulated other comprehensive income (loss) at end of period	\$ (6,040)	\$ (5,153)

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS***Deferred Compensation Obligations and Treasury Stock*

Activity in the deferred compensation program for the nine months ended September 30, 2011 and 2010 is as follows (in millions):

	2011		2010	
	Shares	Dollars	Shares	Dollars
Deferred Compensation Obligations				
Balance at beginning of period		\$ 103		\$ 108
Reinvested dividends		3		3
Benefit payments		(19)		(10)
Balance at end of period		\$ 87		\$ 101
Treasury Stock				
Balance at beginning of period	(2)	\$ (103)	(2)	\$ (108)
Reinvested dividends		(3)		(3)
Benefit payments		19		10
Balance at end of period	(2)	\$ (87)	(2)	\$ (101)

Noncontrolling Interests

We have noncontrolling interests in certain consolidated subsidiaries in our International Package and Supply Chain & Freight segments. The noncontrolling interests on our consolidated balance sheets primarily relate to a joint venture in Dubai that operates in the Middle East, Turkey and portions of the Central Asia region, which was formed in the third quarter of 2009. The activity related to our noncontrolling interests is presented below for the nine months ended September 30, 2011 and 2010 (in millions):

	2011	2010
Noncontrolling Interests		
Balance at beginning of period	\$ 68	\$ 66
Acquired noncontrolling interests	3	
Dividends attributable to noncontrolling interests		
Net income attributable to noncontrolling interests		
Balance at end of period	\$ 71	\$ 66

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

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

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

International Package operations include delivery to more than 220 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 operations, logistics operations, UPS Freight and other aggregated business units. Our forwarding and logistics business provides services in more than 195 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., Inc. (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 consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2010, with certain expenses allocated between the segments using activity-based costing methods. Unallocated assets are comprised primarily of cash, marketable securities and investments in limited partnerships.

Segment information for the three and nine months ended September 30, 2011 and 2010 is as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Revenue:				
U.S. Domestic Package	\$ 7,767	\$ 7,291	\$ 23,047	\$ 21,662
International Package	3,057	2,676	9,096	8,086
Supply Chain & Freight	2,342	2,225	6,796	6,376
Consolidated	\$ 13,166	\$ 12,192	\$ 38,939	\$ 36,124
Operating Profit:				
U.S. Domestic Package	\$ 1,015	\$ 1,020	\$ 2,830	\$ 2,330
International Package	409	419	1,352	1,367
Supply Chain & Freight	195	177	561	363
Consolidated	\$ 1,619	\$ 1,616	\$ 4,743	\$ 4,060

During the second quarter of 2011, operating profit was impacted by gains and losses on certain real estate transactions, including a \$15 million loss in the U.S. Domestic Package segment and a \$48 million gain in the Supply Chain & Freight segment. As discussed in Note 14, U.S. Domestic Package operating profit was adversely impacted by a \$98 million restructuring charge in the first quarter of 2010, while Supply Chain & Freight operating profit for that quarter was negatively impacted by a \$38 million loss on the sale of a specialized transportation business unit in Germany. In the third quarter of 2010, we recognized a gain of \$109 million on the sale of real estate within our U.S. Domestic Package segment.

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 12. 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, 2011 and 2010 (in millions, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Numerator:				
Net income attributable to common shareowners	\$ 1,042	\$ 991	\$ 2,990	\$ 2,369
Denominator:				
Weighted average shares	974	990	982	991
Deferred compensation obligations	1	2	2	2
Vested portion of restricted shares	2	2	2	1
Denominator for basic earnings per share	977	994	986	994
Effect of dilutive securities:				
Restricted performance units	2	3	3	3
Restricted stock units	7	6	6	6
Stock option plans	1	1	1	
Denominator for diluted earnings per share	987	1,004	996	1,003
Basic earnings per share	\$ 1.07	\$ 1.00	\$ 3.03	\$ 2.38
Diluted earnings per share	\$ 1.06	\$ 0.99	\$ 3.00	\$ 2.36

Diluted earnings per share for the three months ended September 30, 2011 and 2010 exclude the effect of 9.8 million shares of common stock each year (7.4 and 11.5 million for the nine months ended September 30, 2011 and 2010, respectively), that may be issued upon the exercise of employee stock options because such effect would be antidilutive.

NOTE 13. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT*Risk Management Policies*

We are exposed to market risk, primarily related to foreign exchange rates, commodity 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 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

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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.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

We have agreements with some of our counterparties containing early termination rights and bilateral collateral provisions, whereby security is required if market risk exposure exceeds a specified threshold amount or credit ratings fall below certain levels. As of September 30, 2011, we have received collateral of \$33 million under these contractual provisions. The remaining counterparty agreements contain early termination rights but no bilateral collateral provisions.

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

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets 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 cash flow hedge, a fair value 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 statements of consolidated income during the current period.

A fair value hedge refers to hedging the exposure to changes in the fair value of an existing asset or liability on the consolidated balance sheets 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 statements of consolidated income during the current period, as well as the offsetting gain or loss on the hedged item.

A net investment hedge refers to the use of cross currency swaps, forward contracts or foreign currency denominated debt to hedge portions of our net investments in foreign operations. For hedges that meet the effectiveness requirements, the net gains or losses attributable to changes in spot exchange rates are recorded in the cumulative translation adjustment within other AOCI. The remainder of the change in value of such instruments is recorded in earnings.

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.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 also hedge portions of our anticipated cash settlements of intercompany transactions subject to foreign currency remeasurement using foreign currency forward contracts. We have designated and account for these contracts as cash flow hedges of forecasted foreign currency denominated transactions, and therefore the resulting gains and losses from these hedges are recognized as a component of other operating expense when the underlying transactions are subject to currency remeasurement.

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 statements of consolidated income 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 date and maturity date 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 the majority of our 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 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 swaps 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.

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

As of September 30, 2011 and December 31, 2010, the notional amounts of our outstanding derivative positions were as follows (in millions):

	September 30, 2011 Notional Value	December 31, 2010 Notional Value
Currency Hedges:		
Euro	2,019	1,732
British Pound Sterling	£ 946	£ 871
Canadian Dollar	C\$ 397	C\$ 289
Interest Rate Hedges:		
Fixed to Floating Interest Rate Swaps	\$ 6,424	\$ 6,000
Floating to Fixed Interest Rate Swaps	\$ 798	\$ 53

As of September 30, 2011, we had no outstanding commodity hedge positions. The maximum term over which we are hedging exposures to the variability of cash flow is 39 years.

Balance Sheet Recognition and Fair Value Measurements

The following table indicates the location on the consolidated balance sheets in which our derivative assets and liabilities have been recognized, the fair value hierarchy level applicable to each derivative type, 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.

Asset Derivatives	Balance Sheet Location	Fair Value Hierarchy Level	September 30, 2011 Fair Value	December 31, 2010 Fair Value
Derivatives designated as hedges:				
Foreign exchange contracts	Other current assets	Level 2	\$ 92	\$ 36
Foreign exchange contracts	Other non-current assets	Level 2	49	
Interest rate contracts	Other non-current assets	Level 2	431	182
Derivatives not designated as hedges:				
Foreign exchange contracts	Other current assets	Level 2	1	
Interest rate contracts	Other non-current assets	Level 2	84	
Total Asset Derivatives			\$ 657	\$ 218

Liability Derivatives	Balance Sheet Location	Fair Value Hierarchy Level	September 30, 2011 Fair Value	December 31, 2010 Fair Value
Derivatives designated as hedges:				
Foreign exchange contracts	Other current liabilities	Level 2	\$ (15)	\$ (9)
Foreign exchange contracts	Other non-current liabilities	Level 2	(229)	(99)
Interest rate contracts	Other non-current liabilities	Level 2	(12)	(29)

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Derivatives not designated as hedges:				
Foreign exchange contracts	Other current liabilities	Level 2		(3)
Interest rate contracts	Other non-current liabilities	Level 2	(6)	(1)
Total Liability Derivatives			\$ (262)	\$ (141)

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

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.

Income Statement Recognition

The following table indicates the amount and location in the statements of consolidated income for the three and nine months ended September 30, 2011 and 2010 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:

	2011 Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	2010 Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	2011 Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	2010 Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
Derivative Instruments in Cash Flow Hedging Relationships					
Interest rate contracts	\$ (5)	\$ (2)	Interest Expense	\$ (4)	\$ (4)
Foreign exchange contracts	(117)	11	Interest Expense	(24)	42
Foreign exchange contracts	11		Other Operating Expense	(3)	
Foreign exchange contracts	118	(139)	Revenue	(25)	12
Commodity contracts			Fuel Expense		
Total	\$ 7	\$ (130)		\$ (56)	\$ 50

Nine Months Ended September 30:

	2011 Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	2010 Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	2011 Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	2010 Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
Derivative Instruments in Cash Flow Hedging Relationships					
Interest rate contracts	\$ (6)	\$ (3)	Interest Expense	\$ (14)	\$ (13)
Foreign exchange contracts	(120)	(100)	Interest Expense	7	(8)
Foreign exchange contracts	6		Other Operating Expense	(3)	
Foreign exchange contracts	(16)	14	Revenue	(80)	94
Commodity contracts	9		Fuel Expense	9	

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Total	\$	(127)	\$	(89)	\$	(81)	\$	73
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As of September 30, 2011, \$7 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, 2012. 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.

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

The amount of ineffectiveness recognized in income on derivative instruments designated in cash flow hedging relationships was immaterial for the three and nine months ended September 30, 2011 and 2010.

The following table indicates the amount and location in the statements of consolidated income 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 for the three and nine months ended September 30, 2011 and 2010 (in millions):

Derivative Instruments in Fair Value Hedging Relationships	Location of Gain (Loss) Recognized in Income	2011 Amount of Gain (Loss) Recognized in Income	2010 Amount of Gain (Loss) Recognized in Income	Hedged Items in Fair Value Hedging Relationships	Location of Gain (Loss) Recognized in Income	2011 Amount of Gain (Loss) Recognized in Income	2010 Amount of Gain (Loss) Recognized in Income
Three Months Ended September 30:							
Interest rate contracts	Interest Expense	\$ 237	\$ 52	Fixed-Rate Debt and Capital Leases	Interest Expense	\$ (237)	\$ (52)
Nine Months Ended September 30:							
Interest rate contracts	Interest Expense	\$ 350	\$ 224	Fixed-Rate Debt and Capital Leases	Interest Expense	\$ (350)	\$ (224)

Additionally, we maintain some interest rate swap and foreign exchange forward contracts that are not designated as hedges. These interest rate swap contracts are intended to provide an economic hedge of a portfolio of interest bearing receivables. These foreign exchange forward contracts are intended to provide an economic offset to foreign currency remeasurement risks for certain assets and liabilities in our consolidated balance sheets.

We also periodically terminate interest rate swaps and foreign currency options by entering into offsetting swap and foreign currency positions with different counterparties. As part of this process, we de-designate our original swap and foreign currency contracts. These transactions provide an economic offset that effectively eliminates the effects of changes in market valuation.

The following is a summary of the amounts recorded in the statements of consolidated income related to fair value changes and settlements of these foreign currency forward contracts not designated as hedges (in millions):

Derivative Instruments in Fair Value Hedging Relationships	Location of Gain (Loss) Recognized in Income	2011 Amount of Gain (Loss) Recognized in Income	2010 Amount of Gain (Loss) Recognized in Income
Three Months Ended September 30:			
Foreign Exchange Contracts	Other Operating Expenses	\$ 11	\$ (14)
Nine Months Ended September 30:			
Foreign Exchange Contracts	Other Operating Expenses	\$ (2)	\$ 11

NOTE 14. RESTRUCTURING COSTS AND RELATED EXPENSES

In the first quarter of 2010, we incurred restructuring costs associated with the termination of employees, facility consolidations and other costs directly related to restructuring initiatives. These initiatives have resulted from the rationalization of acquired companies, as well as restructuring activities associated with cost containment and operational efficiency programs.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

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Supply Chain & Freight Germany

In February 2010, we completed the sale of a specialized transportation and express freight business in Germany within our Supply Chain & Freight segment. As part of the sale transaction, we incurred certain costs associated with employee severance payments, other employee benefits, transition services and leases on operating facilities and equipment. Additionally, we have provided a guarantee for a period of two years for certain employee benefit payments being assumed by the buyer. We recorded a pre-tax loss of \$38 million (\$35 million after-tax) for this transaction in the first quarter of 2010, which included the costs associated with the sale transaction and the fair value of the guarantee.

U.S. Domestic Package Restructuring

In an effort to improve performance in the U.S. Domestic Package segment, we announced a program to streamline our domestic management structure in January 2010. As part of this restructuring, we reduced the number of domestic districts and regions in our U.S. small package operation, in order to better align our operations geographically and allow more local decision-making and resources to be deployed for our customers. Effective in April 2010, we reduced our U.S. regions from five to three and our U.S. districts from 46 to 20. The restructuring eliminated approximately 1,800 management and administrative positions in the U.S. Approximately 1,100 employees were offered voluntary severance packages, while other impacted employees received severance benefits and access to support programs based on length of service. We recorded a pre-tax charge of \$98 million (\$64 million after-tax) in the first quarter of 2010 related to the costs of this program, which reflected the value of voluntary retirement benefits, severance benefits and unvested stock compensation. In 2010, we incurred additional costs related to relocation of employees and other restructuring activities, however those costs were offset by savings from the staffing reductions.

NOTE 15. INCOME TAXES

Our effective tax rate declined to 32.8% in the third quarter of 2011 compared with 35.6% in the same period of 2010 (34.0% and 37.5% year-to-date 2011 and 2010, respectively), as a result of several factors. These factors included having a higher proportion of our total taxable income in non-U.S. jurisdictions, where corporate tax rates are generally lower, and the recognition of a reduction in income tax expense related to favorable developments with U.S. state tax audit and litigation matters and adjustments of estimated 2010 accruals upon filing the 2010 U.S. federal income tax return.

In the first quarter of 2010, we changed the tax status of a German subsidiary that was taxable in the U.S. and its local jurisdiction to one that is taxed solely in its local jurisdiction. This change was made primarily to allow for more flexibility in funding this subsidiary's operations with local liquidity sources, improve the cash flow position in the U.S., and help mitigate future currency re-measurement risk. As a result of this change in tax status, we recorded a non-cash charge of \$76 million, which resulted primarily from the write-off of related deferred tax assets which will not be realizable following the change in tax status.

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 IRS Appeals Office. 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.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

A number of years may elapse before an uncertain tax position is audited and ultimately settled. It is difficult to predict the ultimate outcome or the timing of resolution for uncertain tax positions. It is reasonably possible that the amount of unrecognized tax benefits could significantly increase or decrease within the next twelve months. Items that may cause changes to unrecognized tax benefits include the timing of interest deductions and the allocation of income and expense between tax jurisdictions. These changes could result from the settlement of ongoing litigation, the completion of ongoing examinations, the expiration of the statute of limitations, or other unforeseen circumstances. At this time, an estimate of the range of the reasonably possible change cannot be made.

In June 2011, we received IRS reports covering income taxes and excise taxes for tax years 2005 through 2007 and 2003 through 2007, respectively. The reports propose assessments related to amounts paid for software, research credit expenditures and deductibility of financing and post-acquisition integration costs as well as taxes on amounts paid for air transportation. Receipt of the reports represents only the conclusion of the examination process. We disagree with the proposed assessments related to these matters. Therefore, we have filed protests and protective tax refund claims. During the third quarter of 2011, the IRS responded to our protests and forwarded the cases to IRS Appeals. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) we are vigorously defending these matters and believe that we have a number of meritorious legal defenses; (2) we have filed refund claims in excess of the proposed assessments; (3) there are unresolved questions of law and fact that could be of importance to the ultimate resolutions of these matters, including the calculation of any additional taxes and/or tax refunds; and (4) these matters are at the initial stage of a multi-level administrative appeals process that may ultimately be resolved by litigation. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

The U.S. economic recovery continued on a pace of slow growth in the third quarter of 2011, which put pressure on volume and revenue growth in our U.S. Domestic Package segment, as well as U.S. import volume in our International Package and Supply Chain & Freight segments. Slower growth in industrial production has resulted in weakness in manufacturing shipments. Retail sales continue to show growth when compared to 2010; however, growth has slowed recently, which has negatively impacted business-to-consumer shipment activity.

Outside of the U.S., economic growth has slowed down due to volatility in world markets. Despite the overall slowdown, our volume and revenue were favorably impacted in our International Package segment due to continued growth in international trade and industrial production. This allowed us to leverage our international transportation network, and provided for solid international package volume and revenue growth in most regions of the world in the third quarter of 2011.

In 2011, we have continued to undertake initiatives to improve yield management, increase operational efficiency and contain costs, which has led to solid improvements in adjusted operating margin and profit in our U.S. Domestic Package and Supply Chain & Freight segments. During 2010, we opened the second phase of our Worldport expansion which has allowed the use of larger and more fuel-efficient aircraft, and further improved network efficiencies. We also streamlined our U.S. domestic management structure and continued to better align our cost structure with current volume levels.

In our International Package segment, we have continued to invest to support our growth initiatives. In 2010, we opened our new intra-Asia air hub in Shenzhen, China, which has allowed us to better serve our customers by reducing time in transit for shipments in the region. We have also continued to optimize our aircraft network, to leverage the new route authority we have gained over the last several years and to take full advantage of faster growing trade lanes. In Asia, we have expanded our air network during 2011 by adding flights from Hong Kong to Cologne, Germany, adding a daily flight from Chengdu, China to Cologne, and adding new routes from Japan, as well as increasing our capacity to serve the South Korea to U.S. trade lane by adding a flight to and from Incheon. In Europe, we announced a \$200 million expansion of our Cologne hub in Germany in the third quarter of 2011, which will increase the hub's sorting capacity from 110,000 to 190,000 packages per hour, when completed in 2013. In the Americas, we have expanded our air capacity more than 50% on 19 weekly flights into key markets in Central and South America during 2011.

Even though we continue to experience solid growth in our International Package business overall, we have recently seen weakness in the important Asia-to-U.S. trade lane. As a result, we have reduced our tonnage capacity in this lane by 13% since the second quarter of 2011, while retaining the network enhancements and service upgrades previously achieved.

Volatile fuel prices have continued to impact both revenue and expense in all three of our segments. Rising fuel prices have led to higher fuel surcharge rates and increased fuel and purchased transportation costs.

Our consolidated results are presented in the table below:

	Three Months Ended			Nine Months Ended		
	September 30,		Change %	September 30,		Change %
	2011	2010		2011	2010	
Revenue (in millions)	\$ 13,166	\$ 12,192	8.0%	\$ 38,939	\$ 36,124	7.8%
Operating Expenses (in millions)	11,547	10,576	9.2%	34,196	32,064	6.6%
Operating Profit (in millions)	\$ 1,619	\$ 1,616	0.2%	\$ 4,743	\$ 4,060	16.8%
Operating Margin	12.3%	13.3%		12.2%	11.2%	
Average Daily Package Volume (in thousands)	15,079	14,969	0.7%	14,994	14,898	0.6%
Average Revenue Per Piece	\$ 11.06	\$ 10.27	7.7%	\$ 11.01	\$ 10.32	6.7%
Net Income (in millions)	\$ 1,042	\$ 991	5.1%	\$ 2,990	\$ 2,369	26.2%
Basic Earnings Per Share	\$ 1.07	\$ 1.00	7.0%	\$ 3.03	\$ 2.38	27.3%
Diluted Earnings Per Share	\$ 1.06	\$ 0.99	7.1%	\$ 3.00	\$ 2.36	27.1%

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND

RESULTS OF OPERATIONS

Items Affecting Comparability

The year-over-year comparisons of our financial results were affected by the following items (amounts in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Operating Expenses:				
Restructuring charge				98
Loss on sale of business				38
Net gain on real estate transactions		(109)	(33)	(109)
Income Tax Expense:				
Income tax expense (benefit) from the items above		48	13	11
Change in tax filing status for German subsidiary				76

Restructuring Charge

In the first quarter of 2010, we began to reorganize the management structure in our U.S. Domestic Package segment, and incurred a restructuring charge associated with this reorganization. This pre-tax charge totaled \$98 million (\$64 million after-tax), and reflects the value of voluntary retirement benefits, severance benefits and unvested stock compensation.

Loss on Sale of Business

In the first quarter of 2010, we sold a specialized transportation business in Germany within our Supply Chain & Freight segment, and incurred a pre-tax loss on the sale of \$38 million (\$35 million after-tax).

Net Gain on Real Estate Transactions

In the third quarter of 2010, we recognized a pre-tax gain of \$109 million (\$61 million after-tax) on the sale of real estate within our U.S. Domestic Package segment.

In the second quarter of 2011, we recognized a pre-tax loss from certain real estate transactions within our U.S. Domestic Package segment of \$15 million (\$11 million after-tax) and a pre-tax gain from real estate transactions within our Supply Chain & Freight segment of \$48 million (\$31 million after-tax).

Income Tax Charge for the Change in Tax Filing Status for German Subsidiary

In the first quarter of 2010, we changed the tax status of a German subsidiary that was taxable in the U.S. and its local jurisdiction to one that is solely taxed in its local jurisdiction. As a result of this change in tax status, we recorded a non-cash charge of \$76 million to income tax expense, which resulted primarily from the write-off of related deferred tax assets which will not be realizable following the change in tax status.

Results of Operations - Segment Review

The results and discussions that follow are reflective of how our executive management monitors the performance of our reporting segments. We supplement the reporting of our financial information determined under generally accepted accounting principles (GAAP) with certain non-GAAP financial measures, including operating profit, operating margin, pre-tax income, effective tax rate, net income and earnings per

share adjusted

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for the non-comparable items discussed previously. We believe that these adjusted measures provide meaningful information to assist investors and analysts in understanding our financial results and assessing our prospects for future performance. We believe these adjusted financial measures are important indicators of our results of operations because they exclude items that may not be indicative of, or are unrelated to, our core operating results, and provide a better baseline for analyzing trends in our underlying businesses.

Certain operating expenses are allocated between our reporting segments based on activity-based costing methods. These activity-based costing methods require us to make estimates that impact the amount of each expense category that is attributed to each segment. Changes in these estimates will directly impact the amount of expense allocated to each segment, and therefore the operating profit of each reporting segment. There were no significant changes in our expense allocation methodology during 2011 or 2010.

U.S. Domestic Package Operations

	Three Months Ended September 30,		Change %	Nine Months Ended September 30,		Change %
	2011	2010		2011	2010	
Average Daily Package Volume (in thousands):						
Next Day Air	1,196	1,181	1.3%	1,174	1,169	0.4%
Deferred	852	856	(0.5)%	866	866	0.0%
Ground	10,688	10,693	0.0%	10,637	10,656	(0.2)%
Total Avg. Daily Package Volume	12,736	12,730	0.0%	12,677	12,691	(0.1)%
Average Revenue Per Piece:						
Next Day Air	\$ 20.75	\$ 19.40	7.0%	\$ 20.61	\$ 19.31	6.7%
Deferred	13.94	12.70	9.8%	13.69	12.62	8.5%
Ground	7.92	7.49	5.7%	7.90	7.50	5.3%
Total Avg. Revenue Per Piece	\$ 9.53	\$ 8.95	6.5%	\$ 9.47	\$ 8.94	5.9%
Operating Days in Period	64	64		192	191	
Revenue (in millions):						
Next Day Air	\$ 1,588	\$ 1,466	8.3%	\$ 4,645	\$ 4,311	7.7%
Deferred	760	696	9.2%	2,277	2,088	9.1%
Ground	5,419	5,129	5.7%	16,125	15,263	5.6%
Total Revenue	\$ 7,767	\$ 7,291	6.5%	\$ 23,047	\$ 21,662	6.4%
Operating Expenses (in millions)	\$ 6,752	\$ 6,271	7.7%	\$ 20,217	\$ 19,332	4.6%
Operating Profit (in millions):						
Operating Profit	\$ 1,015	\$ 1,020	(0.5)%	\$ 2,830	\$ 2,330	21.5%
Impact of Restructuring Charge					98	
Net Impact of Real Estate Transactions		(109)		15	(109)	
Adjusted Operating Profit	\$ 1,015	\$ 911	11.4%	\$ 2,845	\$ 2,319	22.7%
Operating Margin	13.1%	14.0%		12.3%	10.8%	
Adjusted Operating Margin	13.1%	12.5%		12.3%	10.7%	

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Revenue

The change in overall revenue was impacted by the following factors for the third quarter and year-to-date periods of 2011 compared with the corresponding periods of 2010:

	Volume	Rates / Product Mix	Fuel Surcharge	Total Revenue Change
Net Revenue Change Drivers:				
Third quarter 2011 vs 2010	0.0%	2.7%	3.8%	6.5%
Year-to-date 2011 vs 2010	0.4%	3.1%	2.9%	6.4%

Volume

Our overall volume was flat in the third quarter of 2011 compared with the same period in 2010, largely due to the slowing U.S. economy. Business-to-consumer shipments, which represent approximately one third of total U.S. Domestic Package volume, experienced stronger growth than commercial volume.

Among our air products, we experienced a 3.5% increase in Next Day and Second Day air package volume, as a result of retail sales growth, with particular growth in our Next Day Air Saver product. However, air letter volume declined, largely due to weakness in the financial and other service industries. Within ground, our light weight products, which target low-cost, non-urgent ground residential deliveries, experienced solid growth during the quarter.

Rates and Product Mix

Overall revenue per piece increased for our ground and air products during the third quarter of 2011 due to a combination of base price increases and fuel surcharge rate changes, which are discussed further below. The overall revenue per piece increase was also positively affected by our focus on higher-yielding customer segments and revenue management initiatives. In addition, the revenue per piece increase for our air products was positively impacted by the overall mix shift from letters to packages.

Revenue per piece for our ground and air products was also impacted by an increase in base rates that took effect on January 3, 2011. 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, while reducing our fuel surcharge indexes (discussed further below). Other pricing changes included an increase in the residential surcharge, and an increase 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.

Fuel Surcharges

UPS applies a fuel surcharge on our domestic air and ground services. The air fuel surcharge is based on the U.S. Department of Energy's (DOE) Gulf Coast spot price for a gallon of kerosene-type jet fuel, while the ground fuel surcharge is based on the DOE's On-Highway Diesel Fuel price. Based on published rates, the average fuel surcharge for domestic air and ground products was as follows:

Three Months Ended September 30,	Change	Nine Months Ended September 30,	Change
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	2011	2010	% Point	2011	2010	% Point
Next Day Air / Deferred	14.7%	7.5%	7.2%	13.1%	7.7%	5.4%
Ground	9.0%	5.7%	3.3%	7.8%	5.5%	2.3%

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On January 3, 2011, in connection with our base rate increase, we modified the fuel surcharge on air and ground services by reducing the index used to determine the fuel surcharge by 2% and 1%, respectively. The 2011 increase in the air and ground fuel surcharges was due to the significant increase in jet and diesel fuel prices, but partially offset by the reduction in the index on the air and ground surcharges. Total domestic fuel surcharge revenue increased by \$278 million in third quarter of 2011 (\$638 million year-to-date), primarily due to the higher fuel surcharge rates discussed above.

Operating Expenses

Overall adjusted operating expenses for the segment (excluding the gains and losses on real estate transactions in 2011 and 2010 and the 2010 restructuring charge) increased \$372 million for the third quarter (\$859 million year-to-date), while the total adjusted cost per piece increased 5.8% for the third quarter (4.0% year-to-date). A large component of this increase relates to the cost of operating our domestic integrated air and ground network, which increased \$163 million for the third quarter (\$437 million year-to-date) due largely to higher fuel costs, as well as an increase in aircraft repair and maintenance expenses and higher rates passed to us from outside transportation carriers, primarily railroads. Pickup and delivery costs increased \$186 million for the quarter (\$365 million year-to-date), primarily as a result of higher fuel prices and a 3.3% union contractual driver wage increase. Non-operating costs increased \$14 million for the quarter (\$48 million year-to-date), largely due to higher pension costs and the reinstatement of matching contributions to our primary employee defined contribution savings plan.

Cost increases have been mitigated due to network efficiencies that we have achieved, as we adjust our air and ground networks to better match volume levels, and utilize our expanded Worldport facility to operate larger aircraft and to increase package sorting efficiency. These network efficiency improvements resulted in a 1.6% reduction in direct labor hours, a 0.7% reduction in aircraft block hours and a 0.8% reduction in miles driven, in the third quarter of 2011 compared with the same period of 2010. Improved delivery densities as a result of improved planning and technology, particularly for our residential products, have also contained increases in cost.

Operating Profit and Margin

Higher adjusted operating profit during the third quarter and year-to-date periods was driven by the increased network efficiencies, combined with strong improvements in revenue per piece.

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	Three Months Ended September 30,		Change	Nine Months Ended September 30,		Change
	2011	2010	%	2011	2010	%
Average Daily Package Volume (in thousands):						
Domestic	1,424	1,376	3.5%	1,407	1,359	3.5%
Export	919	863	6.5%	910	848	7.3%
Total Avg. Daily Package Volume	2,343	2,239	4.6%	2,317	2,207	5.0%
Average Revenue Per Piece:						
Domestic	\$ 7.24	\$ 6.46	12.1%	\$ 7.26	\$ 6.60	10.0%
Export	38.27	35.76	7.0%	38.34	36.99	3.6%
Total Avg. Revenue Per Piece	\$ 19.41	\$ 17.75	9.4%	\$ 19.46	\$ 18.28	6.5%
Operating Days in Period	64	64		192	191	
Revenue (in millions):						
Domestic	\$ 660	\$ 569	16.0%	\$ 1,961	\$ 1,714	14.4%
Export	2,251	1,975	14.0%	6,698	5,992	11.8%
Cargo	146	132	10.6%	437	380	15.0%
Total Revenue	\$ 3,057	\$ 2,676	14.2%	\$ 9,096	\$ 8,086	12.5%
Operating Expenses (in millions)	\$ 2,648	\$ 2,257	17.3%	\$ 7,744	\$ 6,719	15.3%
Operating Profit (in millions)	\$ 409	\$ 419	(2.4)%	\$ 1,352	\$ 1,367	(1.1)%
Operating Margin	13.4%	15.7%		14.9%	16.9%	
Currency Translation Benefit / (Cost) (in millions)*:			\$			\$
Revenue			\$ 87			\$ 130
Operating Profit			\$ (5)			\$ (87)

* Net of currency hedging; amount represents the change compared to the prior year.

Revenue

The change in overall revenue was impacted by the following factors for the third quarter and year-to-date periods of 2011 compared with the corresponding periods of 2010:

	Volume	Rates / Product Mix	Fuel Surcharge	Currency	Total Revenue Change
Net Revenue Change Drivers:					
Third quarter 2011 vs 2010	4.4%	1.5%	5.0%	3.3%	14.2%
Year-to-date 2011 vs 2010	5.3%	1.3%	4.3%	1.6%	12.5%
<i>Volume</i>					

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Export volume increased in the third quarter of 2011 compared to the same period in 2010, primarily due to strong growth in key markets in Europe and the Americas. Our transborder products experienced strong growth, particularly in key countries within Europe. Our premium Worldwide Express and Worldwide Expedited products experienced volume growth as well, particularly in the Asia-to-Europe, Europe-to-Americas and Europe-to-Asia export trade lanes. Additionally, intra-Asia export volume experienced solid growth during the

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third quarter of 2011 compared with the prior year quarter, and has been impacted by the continued solid economic growth in Asia overall. We experienced export volume declines in the Asia-to-U.S. trade lane in the third quarter of 2011, due largely to economic weakness in the U.S.

Domestic volume increases were driven by continued strong growth in key markets, including Germany, France and Poland.

Rates and Product Mix

Total average revenue per piece increased 3.2% for the third quarter (3.8% year-to-date) on a currency-adjusted basis. Export revenue per piece increased, largely due to a combination of higher fuel surcharge rates and base rate increases, which are discussed further below. Currency-adjusted export revenue per piece increased 1.5% for the third quarter (2.1% year-to-date). Product mix adversely impacted export revenue per piece, due to strong growth among our lower-yielding Transborder and Trade Direct products. Revenue per piece was pressured as average trade lanes shortened, due to volume declines in the higher-yielding Asia-to-U.S. export lane, and higher volume growth among the relatively lower-yielding intra-Europe and intra-Asia export lanes. Domestic revenue per piece increased 4.3% on a currency-adjusted basis for third quarter (3.9% year-to-date), largely due to comparatively faster growth in our premium express products.

On January 3, 2011, 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), while reducing fuel surcharge indexes. Rate changes for shipments originating outside the U.S. are made throughout the year and vary by geographic market.

Fuel Surcharges

On January 3, 2011, in connection with our base rate increases, 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 surcharges for products originating outside the United States continue to be indexed to fuel prices in the international region where the shipment takes place. Total international fuel surcharge revenue increased by \$134 million for the third quarter of 2011 (\$346 million year-to-date), due to higher fuel surcharge rates caused by increased fuel prices as well as an increase in international air volume.

Operating Expenses

Overall operating expenses for the segment increased \$391 million for the third quarter (\$1.025 billion year-to-date). The impact of foreign currency exchange rate changes resulted in an adverse impact on operating expense comparisons between the third quarter of 2011 and the same period of 2010 of \$92 million (\$217 million year-to-date).

Excluding the impact of currency exchange rate changes, the total cost per piece for the segment increased 12.1% for the third quarter (9.2% year-to-date). The largest component of this increase (excluding the impact of currency) relates to the cost of operating our international integrated air and ground network, which increased \$233 million for the third quarter (\$635 million year-to-date) due largely to higher fuel costs and increased block hours, as well as an increase in aircraft repair and maintenance expenses. Pick-up and delivery costs increased \$51 million for the third quarter (\$134 million year-to-date), primarily as a result of higher fuel prices and increased package volume.

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The decline in operating profit and margin for the third quarter of 2011 compared with the same period of 2010 was primarily the result of excess capacity, the adverse impact of fuel prices and currency exchange rate movements. Volume declines in the Asia-to-U.S. trade lane resulted in us maintaining excess capacity for the level of package volume that occurred, which resulted in a decline in profit margins. Subsequent to the third quarter of 2011, we have reduced aircraft capacity in Asia approximately 13% to rationalize our cost base. Fluctuations in foreign currency exchange rates resulted in an adverse impact on operating profit comparisons between the third quarter of 2011 and the same period of 2010 of \$5 million (\$87 million year-to-date). Additionally, fuel prices adversely impacted the operating profit comparison between the third quarter of 2011 and 2010, as fuel expense increased at a faster pace than fuel surcharge revenue. The adverse operating profit impacts of fuel, currency, and excess air capacity were somewhat offset by the overall volume and revenue per piece increases.

Supply Chain & Freight Operations

	Three Months Ended September 30,		Change	Nine Months Ended September 30,		Change
	2011	2010	%	2011	2010	%
Freight LTL Statistics:						
Revenue (in millions)	\$ 596	\$ 527	13.1%	\$ 1,734	\$ 1,476	17.5%
Revenue Per Hundredweight	\$ 21.53	\$ 18.99	13.4%	\$ 21.00	\$ 18.91	11.1%
Shipments (in thousands)	2,617	2,647	(1.1)%	7,803	7,447	4.8%
Shipments Per Day (in thousands)	40.9	41.4	(1.1)%	40.6	39.0	4.1%
Gross Weight Hauled (in millions of lbs)	2,769	2,776	(0.3)%	8,258	7,805	5.8%
Weight Per Shipment (in lbs)	1,058	1,049	0.9%	1,058	1,048	1.0%
Operating Days in Period	64	64		192	191	
Revenue (in millions):						
Forwarding and Logistics	\$ 1,552	\$ 1,536	1.0%	\$ 4,520	\$ 4,425	2.1%
Freight	667	581	14.8%	1,931	1,628	18.6%
Other	123	108	13.9%	345	323	6.8%
Total Revenue	\$ 2,342	\$ 2,225	5.3%	\$ 6,796	\$ 6,376	6.6%
Operating Expenses (in millions)	\$ 2,147	\$ 2,048	4.8%	\$ 6,235	\$ 6,013	3.7%
Operating Profit (in millions):						
Operating Profit	\$ 195	\$ 177	10.2%	\$ 561	\$ 363	54.5%
Impact of Net Gain on Real Estate Transactions				(48)		
Impact of Loss on Sale of Business					38	
Adjusted Operating Profit	\$ 195	\$ 177	10.2%	\$ 513	\$ 401	27.9%
Operating Margin	8.3%	8.0%		8.3%	5.7%	
Adjusted Operating Margin	8.3%	8.0%		7.5%	6.3%	
Currency Translation Benefit / (Cost) (in millions)*:				\$		\$
Revenue				\$ 55		\$ 141
Operating Profit				5		9

* Net of currency hedging; amount represents the change compared to the prior year.

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Revenue

Forwarding and logistics revenue increased \$16 million in the third quarter of 2011 compared with the corresponding period in 2010 (\$95 million year-to-date). In our logistics products, revenue increased in the third quarter of 2011 and we experienced solid growth in our mail services, retail and healthcare solutions. Forwarding revenue decreased primarily due to volume and tonnage declines in our air and ocean forwarding businesses, as well as lower third-party transportation carrier rates. The tonnage decrease was mainly the result of revenue management initiatives that improve the matching of customer pricing with market conditions, as well as the impact of the economic slowdown.

Freight revenue increased \$86 million for the third quarter (\$303 million year-to-date), primarily due to a base rate increase and increased fuel surcharge rates. Shipments declined slightly in the third quarter, largely due to our focus on yield management and also due to the overall LTL market being adversely impacted by the slowing economy. LTL revenue per hundredweight increased, primarily as a result of a base rate increase that took effect during the quarter, as well as higher fuel surcharge rates, as total fuel surcharge revenue increased \$42 million for the third quarter (\$128 million year-to-date) driven by higher diesel fuel prices. An increase in base prices took effect on August 1, 2011, as our freight unit increased minimum charge, LTL and TL rates an average of 6.9%, covering non-contractual shipments in the United States, Canada and Mexico.

The other businesses within Supply Chain & Freight experienced an increase in revenue, primarily due to growth at UPS Capital, the UPS Store, UPS Customer Solutions and our contract to provide domestic air transportation services for the U.S. Postal Service.

Operating Expenses

Forwarding and logistics operating expenses increased \$27 million for the third quarter of 2011 compared with the same period of 2010 (\$41 million year-to-date on an adjusted basis, excluding the gain on real estate transactions), due to several factors. Volume growth in our mail services business resulted in an increase in transportation charges from third party transportation carriers of \$12 million for the quarter (\$24 million year-to-date). Compensation and benefit costs for the forwarding and logistics unit increased by \$5 million for the quarter (\$6 million year-to-date), largely due to higher pension expense.

Freight operating expenses increased \$68 million for the third quarter (\$263 million year-to-date), with the total cost per LTL shipment increasing 11.0% for the third quarter (9.6% year-to-date). The two largest components of this increase relate to the cost of operating our linehaul network which increased \$29 million for the third quarter (\$119 million year-to-date) and pick-up, delivery and dock costs which increased \$22 million for the third quarter (\$99 million year-to-date). We incurred higher fuel costs operating our vehicle fleet, as well as higher fuel surcharge rates passed to us from outside transportation carriers, as a result of higher diesel fuel prices and increased volume. Additionally, compensation and benefit costs increased primarily as a result of higher pension and health care costs, and wage increases of 3.9% for drivers and 3.4% for dock workers. These expense increases were somewhat offset by improved productivity measures, including pick-up and delivery stops per hour, dock bills per hour and improved linehaul network utilization.

Expenses for the other businesses within Supply Chain & Freight were slightly higher in the third quarter and year-to-date periods of 2011 compared to 2010.

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Operating Profit and Margin

The forwarding and logistics unit experienced an \$11 million decrease in operating profit in the third quarter of 2011 compared to the same period in 2010, while the adjusted year-to-date operating profit increased \$54 million. For the quarter, forwarding operating profit was flat with the prior year period; however, forwarding operating profit increased on a year-to-date basis largely due to revenue management initiatives and cost containment, which improved operating leverage. Additionally, excess market capacity, especially in the Asia-to-U.S. trade lane, has reduced our purchased transportation costs and improved the operating profitability in this business. Our logistics business had a small decrease in operating profit for the third quarter of 2011 primarily due to our continued investment in expanding our global healthcare capabilities.

The freight unit had an increase of \$18 million in operating profit in the third quarter of 2011 compared to the same period in 2010 (\$40 million year-to-date) primarily due to increased yields and improved productivity in our operations. Year-to-date operating profit was also impacted by improved volume in the first half of 2011 compared with the prior year.

The combined operating income for all of our other businesses in this segment increased during the quarter and year-to-date primarily due to improved results at our financial services business unit.

Consolidated Operating Expenses

	Three Months Ended September 30,		Change	Nine Months Ended September 30,		Change
	2011	2010	%	2011	2010	%
Operating Expenses (in millions):						
Compensation and Benefits	\$ 6,694	\$ 6,411	4.4%	\$ 19,985	\$ 19,465	2.7%
Impact of Restructuring Charge					(98)	
Adjusted Compensation and Benefits	6,694	6,411	4.4%	19,985	19,367	3.2%
Repairs and Maintenance	324	282	14.9%	956	837	14.2%
Depreciation and Amortization	447	448	(0.2)%	1,331	1,348	(1.3)%
Purchased Transportation	1,796	1,656	8.5%	5,206	4,770	9.1%
Fuel	1,015	724	40.2%	2,980	2,119	40.6%
Other Occupancy	229	222	3.2%	715	700	2.1%
Other Expenses	1,042	833	25.1%	3,023	2,825	7.0%
Impact of Net Gain on Real Estate Transactions		109		33	109	
Impact of Loss on Sale of Business					(38)	
Adjusted Other Expenses	1,042	942	10.6%	3,056	2,896	5.5%
Total Operating Expenses	\$ 11,547	\$ 10,576	9.2%	\$ 34,196	\$ 32,064	6.6%
Adjusted Total Operating Expenses	\$ 11,547	\$ 10,685	8.1%	\$ 34,229	\$ 32,037	6.8%
			\$			\$
Currency Translation (Benefit) Cost				\$ 142		\$ 349
<i>Compensation and Benefits</i>						

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Employee payroll costs increased \$81 million for the third quarter (\$223 million year-to-date), largely due to contractual union wage rate increases that took effect under our collective bargaining agreement with the Teamsters, but partially offset by a decline in union labor hours. Management payroll costs declined slightly as a result of a reduction in the total number of management employees through attrition, combined with voluntary and involuntary workforce reductions throughout 2010.

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Benefits expense increased \$202 million for the third quarter (\$395 million as-adjusted year-to-date), primarily due to higher pension expense, employee health and welfare costs, and expense associated with our self-insurance for worker's compensation claims, as follows:

Pension expense increased \$54 million for the quarter (\$188 million year-to-date) resulting from higher union contribution rates for multi-employer pension plans, combined with increased service and interest costs, and the amortization of actuarial losses for company-sponsored plans. The service and interest cost grew due to continued service accruals and lower discount rates, while the actuarial losses were primarily due to the negative asset returns experienced in 2008 and lower discount rates at December 31, 2010. Additionally, expense increased due to the reinstatement of matching contributions to our primary employee defined contribution savings plan.

Employee health and welfare program costs increased \$61 million for the third quarter (\$142 million year-to-date), and were impacted by higher required union plan contribution rates and general healthcare inflation.

The expense associated with our self-insurance programs for worker's compensation claims increased by \$41 million for the third quarter (\$53 million year-to-date). Insurance reserves are established for estimates of the loss that we will ultimately incur on reported claims, as well as estimates of claims that have been incurred but not reported, and take into account a number of factors including our history of claim losses, payroll growth and the impact of safety improvement initiatives. In 2010, we experienced more favorable actuarial expense adjustments compared with 2011, thus leading to the increase in expense.

Repairs and Maintenance

The increase in repairs and maintenance expense was largely due to aircraft maintenance costs, which increased \$30 million for the third quarter of 2011 compared with 2010 (\$91 million year-to-date). This increase resulted from an increase in flight hours due to higher air volume, additional scheduled maintenance checks and higher contractual maintenance rates. The remaining increase in repairs and maintenance expense primarily relates to higher maintenance costs on our office buildings and operating facilities.

Depreciation and Amortization

The decrease in depreciation and amortization expense was primarily the result of a reduction in depreciation expense on technology equipment and software. This decline was primarily related to certain technology hardware becoming fully depreciated and fewer capitalized software projects.

Purchased Transportation

The increase in purchased transportation was impacted by a combination of higher volume, as well as increased fuel surcharges and base rates charged to us by third-party air, ocean and truck carriers across all segments. The combination of these factors increased expense by \$93 million for the third quarter of 2011 (\$262 million year-to-date). Additionally, we incurred a \$28 million increase in expense in the third quarter (\$70 million year-to-date) for the use of rail carriers, which was due primarily to higher rates and fuel surcharges. The remaining increase in expense for the third quarter and year-to-date periods was primarily due to foreign currency exchange rate changes.

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Fuel

The increase in fuel expense was primarily caused by higher prices for jet-A fuel, diesel and unleaded gasoline, which increased expense by \$278 million for the third quarter of 2011 compared with 2010 (\$780 million year-to-date). Higher usage of these products in our operations accounted for the remaining increase in expense of \$13 million for the third quarter (\$81 million year-to-date).

Other Occupancy

Other occupancy expense increased primarily due to an increase in utilities expense resulting from increased electricity costs in our facilities. The remainder of the increase is primarily due to higher rent expense resulting from increased rates on warehouses.

Other Expenses

The increase in adjusted other expenses in the third quarter of 2011 was largely due to foreign currency remeasurement losses, advertising costs, employee expense reimbursements, equipment rentals, air cargo handling costs and data processing fees. These increases were partially offset by a decrease in bad debt and employee relocation expense.

Investment Income and Interest Expense

	Three Months Ended		Change	Nine Months Ended		Change
	September 30, 2011	2010		September 30, 2011	2010	
(in millions)						
Investment Income (Loss)	\$ 16	\$ 15	6.7%	\$ 36	\$ (7)	N/A
Interest Expense	\$ (84)	\$ (91)	(7.7)%	\$ (252)	\$ (260)	(3.1)%
<i>Investment Income</i>						

The increase in investment income for the year-to-date period of 2011 compared with 2010 was caused by a combination of factors. During the first nine months of 2011, we realized \$19 million in net gains on the sales of auction rate securities, preferred equity securities and an S&P 500 index fund, as well as a mark-to-market gain on investments. In the first nine months of 2010, we recorded a \$21 million impairment on certain asset-backed auction rate securities, which resulted from provisions that allowed the issuers of the securities to subordinate our holdings to newly-issued debt or to tender for the securities at less than their par value. Additionally in 2010, we recorded an \$8 million loss on the sale of auction rate securities.

The remaining increases in investment income were impacted by a higher average balance of interest-earning investments in our portfolio in the third quarter and year-to-date periods of 2011 compared to 2010. These factors were partially offset by a lower yield earned on our invested assets.

Interest Expense

Interest expense declined slightly due to a lower average interest rate incurred on variable rate debt and interest rate swaps, which reduced expense by \$23 million for the third quarter (\$59 million decrease year-to-date). However, this was largely offset as a result of a higher average balance of outstanding debt in 2011.

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Income Tax Expense

	Three Months Ended September 30,		Change	Nine Months Ended September 30,		Change
	2011	2010	%	2011	2010	%
(in millions)						
Income Tax Expense	\$ 509	\$ 549	(7.3)%	\$ 1,537	\$ 1,424	7.9%
Impact of Net Gain on Real Estate Transactions		(48)		(13)	(48)	
Impact of Change in Tax Filing Status for German Subsidiary					(76)	
Impact of Sale of Business					3	
Impact of Restructuring Charge					34	
Adjusted Income Tax Expense	\$ 509	\$ 501	1.6%	\$ 1,524	\$ 1,337	14.0%
Effective Tax Rate	32.8%	35.6%		34.0%	37.5%	
Adjusted Effective Tax Rate	32.8%	35.0%		33.9%	35.0%	

Adjusted income tax expense increased primarily due to higher pre-tax income. Our adjusted effective tax rate declined in the third quarter of 2011 compared with the third quarter and year-to-date periods of 2010 as a result of several factors. These factors included having a higher proportion of our total taxable income in non-U.S. jurisdictions, where corporate tax rates are generally lower, and the recognition of a reduction in income tax expense related to favorable developments with U.S. state tax audit and litigation matters and adjustments of estimated 2010 accruals upon filing the 2010 U.S. federal income tax return.

Liquidity and Capital Resources*Net Cash From Operating Activities*

The following is a summary of the significant sources (uses) of cash from operating activities (amounts in millions):

	Nine months ended September 30,	
	2011	2010
Net income	\$ 2,990	\$ 2,369
Non-cash operating activities (a)	3,041	2,347
Pension and postretirement plan contributions (UPS-sponsored plans)	(1,397)	(1,069)
Income tax receivables and payables	269	19
Changes in working capital and other noncurrent assets and liabilities	481	250
Other sources (uses) of cash from operating activities	(22)	7
Net cash from operating activities	\$ 5,362	\$ 3,923

(a)

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Represents depreciation and amortization, gains and losses on derivative transactions and foreign exchange, deferred income taxes, provisions for uncollectible accounts, pension and postretirement benefit expense, stock compensation expense, impairment charges, and other non-cash items.

Contributions to our company-sponsored pension plans have varied based primarily on whether any minimum funding requirements are present for individual pension plans. In the first quarter of 2011, we made a \$1.2 billion 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

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would not have been required until after 2011. As discussed in Note 6 to the unaudited consolidated financial statements, we expect to contribute \$31 million to our company-sponsored international pension and U.S. postretirement medical benefit plans over the remainder of 2011.

Operating cash flow was favorably impacted in 2011, compared with 2010, by higher net income and changes in our working capital position. The favorable changes in working capital were largely a result of the timing of income tax payments relative to accruals, as well as improved collections of receivables, in 2011 compared with the same period of 2010.

Net Cash Used In Investing Activities

Our primary sources (uses) of cash for investing activities were as follows (amounts in millions):

	Nine months ended September 30,	
	2011	2010
Net cash used in investing activities	\$ (2,116)	\$ (493)
Capital Expenditures:		
Buildings and facilities	\$ (247)	\$ (254)
Aircraft and parts	(569)	(345)
Vehicles	(463)	(204)
Information technology	(278)	(208)
	\$ (1,557)	\$ (1,011)
Capital Expenditures as a % of Revenue	4.0%	2.8%
Other Investing Activities:		
Proceeds from disposals of property, plant and equipment	\$ 29	\$ 294
Net (increase) decrease in finance receivables	\$ 128	\$ 76
Net (purchases) sales of marketable securities	\$ (473)	\$ (33)
Other sources (uses) of cash from investing activities	\$ (243)	\$ 181

We have commitments for the purchase of aircraft, vehicles, equipment and real estate to provide for the replacement of existing capacity and anticipated future growth. We generally fund our capital expenditures with our cash from operations. In 2011, capital spending on aircraft increased as a result of the delivery of two Boeing 747-400s and five Boeing 767-300s, as well as contract deposits on our Boeing 767-300 order. Future capital spending for anticipated growth and replacement assets will depend on a variety of factors, including economic and industry conditions.

The net change in finance receivables is primarily due to customer paydowns and new loan origination activity, primarily in our commercial lending, asset-based lending and leasing portfolios. The purchases and sales of marketable securities are largely determined by liquidity needs and the periodic rebalancing of investment types, and will therefore fluctuate from period to period. Other investing activities include the cash settlement of derivative contracts used in our currency hedging programs, the timing of aircraft purchase contract deposits on our Boeing 767-300 aircraft order, and the equity investments in the five new leveraged aircraft leases.

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Net Cash Used In Financing Activities

Our primary sources (uses) of cash for financing activities are as follows (amounts in millions, except per share data):

	Nine months ended September 30,	
	2011	2010
Net cash provided by (used in) financing activities	\$ (2,484)	\$ (1,939)
Share Repurchases:		
Cash expended for shares repurchased	\$ (2,173)	\$ (599)
Number of shares repurchased	(31.7)	(9.3)
Shares outstanding at period end	966	989
Percent reduction in shares outstanding	(2.5)%	(0.5)%
Dividends:		
Dividends declared per share	\$ 1.56	\$ 1.41
Cash expended for dividend payments	\$ (1,500)	\$ (1,363)
Borrowings:		
Net borrowings (repayments) of debt principal	\$ 1,207	\$ (68)
Other Financing Activities:		
Cash received for common stock issuances	\$ 220	\$ 151
Other sources (uses) of cash from financing activities	\$ (238)	\$ (60)
Capitalization (as of September 30 each year):		
Total debt outstanding at period end	\$ 12,402	\$ 9,642
Total shareowners' equity at period end	7,869	8,526
Total capitalization	\$ 20,271	\$ 18,168
Debt to Total Capitalization %	61.2%	53.1%

In 2011, we anticipate repurchasing approximately \$2.7 billion of shares. In 2010, we had slowed our share repurchase activity as a result of the uncertain economic environment. We repurchased a total of 31.7 million shares of class A and class B common stock for \$2.190 billion during the nine months ended September 30, 2011, and 9.3 million shares for \$589 million for the nine months ended September 30, 2010 (\$2.173 billion and \$599 million in repurchases for 2011 and 2010, respectively, are reported on the cash flow statement due to the timing of settlements). As of September 30, 2011, we had \$3.004 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 increased our quarterly cash dividend payment to \$0.52 per share in 2011, compared with the previous \$0.47 quarterly dividend rate in 2010. We expect to continue the practice of paying regular cash dividends.

Issuances of debt in 2011 and 2010 consisted primarily of commercial paper. Repayments of debt in 2011 and 2010 consisted primarily of paydowns of commercial paper, redemptions of certain floating rate notes, and scheduled principal payments on our capitalized lease obligations. Additionally, in 2010 we called for the early

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redemption of the remaining 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.

The cash outflows in other financing activities were primarily due to premiums paid on capped call options for the purchase of UPS class B shares, and tax withholdings on vested employee stock awards.

Sources of Credit

We are authorized to borrow up to \$10.0 billion under the U.S. commercial paper program we maintain. We had \$1.293 billion outstanding under this program as of September 30, 2011, with an average interest rate of 0.04%. As of September 30, 2011, we have classified the entire commercial paper balance as a current liability in our consolidated balance sheets. 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 September 30, 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. There were no amounts outstanding under this facility as of September 30, 2011.

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 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 and Moody's Investors Service. 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. There were no amounts outstanding under this facility as of September 30, 2011.

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 Moody's and Standard & Poor's.

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, 2011

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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, 2011, 10% of net tangible assets is equivalent to \$2.504 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, 2011, our net worth, as defined, was equivalent to \$13.838 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, 2011 have not materially changed from those described in our Annual Report on Form 10-K for the year ended December 31, 2010.

We believe that funds from operations and borrowing programs will provide adequate sources of liquidity and capital resources to meet our expected long-term needs for the operation of our business, including anticipated capital expenditures, such as commitments for aircraft purchases, for the foreseeable future.

Guarantees and Other Off-Balance Sheet Arrangements

We do not have guarantees or other off-balance sheet financing arrangements, including variable interest entities, which we believe could have a material impact on our financial condition or liquidity.

Contingencies

We are involved in a number of judicial proceedings and other matters arising from the conduct of our business activities.

Although there can be no assurance as to the ultimate outcome, we have generally denied, or believe we have a meritorious defense and will deny, liability in all litigation pending against us, including the matters described below, and we intend to defend vigorously each case. We have accrued for legal claims when, and to the extent that, amounts associated with the claims become probable and can be reasonably estimated. The actual costs of resolving legal claims may be substantially higher or lower than the amounts accrued for those claims.

For those matters as to which we are not able to estimate a possible loss or range of loss, we are not able to determine whether the loss will have a material adverse effect on our business, financial condition or results of operations or liquidity. For matters in this category, we have indicated in the descriptions that follow the reasons that we are unable to estimate the possible loss or range of loss.

Judicial Proceedings

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 of the class, plaintiffs filed 56 individual lawsuits raising the same allegations as in the underlying class action. As of September 30, 2011, 53 of the original 56 lawsuits have been favorably resolved by dismissal, summary

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judgment granted to us or trial defense verdict. Two cases resulted in a plaintiff's verdict for an immaterial amount, and one case remains pending. Of the 56 original lawsuits, plaintiffs have filed appeals in 7 of those cases. Accordingly, at this time, we do not believe that any loss associated with these matters, 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 two lawsuits about the rebranding or purchase of The UPS Store franchises Morgate and Samica. We prevailed at the trial court level in both cases, which are now on appeal. Morgate was filed in March 2003. The plaintiffs are 125 individual franchisees who did not rebrand and a certified class of all franchisees who did rebrand to The UPS Store. A bellwether trial for three individual plaintiffs was set for early 2010, but the trial court entered judgment against one of the three plaintiffs prior to trial. The trial court also granted our motion for summary judgment against the members of the certified class. The remainder of the case has been stayed pending appeal. Samica was filed in March 2006. The plaintiffs are 250 individual The UPS Store franchisees who either elected to rebrand or purchased new The UPS Store franchises. Summary judgment was granted in UPS's favor against all plaintiffs and has been appealed. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) three separate components of these cases are being appealed to federal and state courts following decisions favorable to UPS and we cannot predict the outcomes of these appeals; and (2) it remains uncertain what evidence of damages, if any, plaintiffs will be able to present if any aspects of these cases proceed forward. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, 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. On June 1, 2011, we reached an agreement in principle to settle the case for an immaterial amount. The settlement has been preliminarily approved, and remains subject to a final fairness hearing.

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 shipping consultation services. 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. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) AFMS may amend its complaint to include new legal theories, the scope of possible AFMS's claims is therefore unclear; (2) we believe that we have a number of meritorious legal defenses; (3) AFMS has not articulated any measure of damages; and (4) the DOJ investigation is at a very early stage. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

In Canada, three purported class-action cases were filed against us in British Columbia (2006); Ontario (2007) and Québec (2006). The cases each allege inadequate disclosure concerning the existence and cost of brokerage services provided by us under applicable provincial consumer protection legislation and infringement of interest restriction provisions under the Criminal Code of Canada. The British Columbia class-action was declared inappropriate for certification and dismissed by the trial judge. That decision was upheld by the British Columbia Court of Appeal in March 2010, which ended the case in our favor. The Ontario class action was certified in September 2011. Partial summary judgment was granted to us and the plaintiffs by the Ontario

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motions court. The complaint under the Criminal Code was dismissed. No appeal is being taken from that decision. The allegations of inadequate disclosure were granted and we are appealing that decision. The request to certify the case in Québec will be heard in February 2012. We have denied all liability and are vigorously defending the two outstanding cases. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters, including (1) we are vigorously defending ourselves and believe that we have a number of meritorious legal defenses and (2) there are unresolved questions of law and fact that could be important to the ultimate resolution of these matters. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operation or liquidity.

Other Matters

In May and December 2007 and August 2008 we received and responded to grand jury subpoenas from the Department of Justice in the Northern District of California in connection with an investigation by the Drug Enforcement Administration. We also have responded to informal requests for information in connection with this investigation, which relates to transportation of packages on behalf of on-line pharmacies that may have operated illegally. We are cooperating with this investigation and intend to continue to vigorously defend ourselves. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from this matter, including (1) we are vigorously defending ourselves and believe we have a number of meritorious legal defenses and (2) there are unresolved questions of law and fact that could be important to the ultimate resolution of this matter. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from this matter or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

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 monetary fine; the range of any potential action by the Commission is not reasonably estimable. Any decision imposing a fine would be subject to appeal. UPS has responded to the Statement of Objections, including at a July 2010 Commission hearing, and we intend to continue to vigorously defend ourselves in this proceeding. We received additional information requests from the Commission in January and July 2011, and we have responded to those requests.

In August 2010, competition authorities in Brazil opened an administrative proceeding to investigate alleged anticompetitive behavior in the freight forwarding industry. Approximately 45 freight forwarding companies and individuals are named in the proceeding, including UPS, UPS SCS Transportes (Brasil) S.A., and a former employee in Brazil. UPS will have an opportunity to respond to these allegations.

We also received and responded to related information requests from competition authorities in other jurisdictions.

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We are cooperating with each of these investigations, and intend to continue to vigorously defend ourselves. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including (1) we are vigorously defending each matter and believe that we have a number of meritorious legal defenses; (2) there are unresolved questions of law that could be of importance to the ultimate resolutions of these matters, including the calculation of any potential fine; and (3) there is uncertainty about the time period that is the subject of the investigations. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, 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. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) the magistrate judge recommended that the district court grant our motion to dismiss, with leave to amend, and the scope of the plaintiffs' claims is therefore unclear; (2) the scope and size of the proposed class is ill-defined; (3) there are significant legal questions about the adequacy and standing of the putative class representatives; and (4) we believe that we have a number of meritorious legal defenses. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, 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 do not believe that the eventual resolution of these other lawsuits (either individually or in the aggregate), including any reasonably possible losses in excess of current accruals, will have a material adverse effect on our financial condition, results of operations or liquidity.

In June 2011, we received IRS reports covering income taxes and excise taxes for tax years 2005 through 2007 and 2003 through 2007, respectively. The reports propose assessments related to amounts paid for software, research credit expenditures and deductibility of financing and post-acquisition integration costs as well as taxes on amounts paid for air transportation. Receipt of the reports represents only the conclusion of the examination process. We disagree with the proposed assessments related to these matters. Therefore, we have filed protests and protective tax refund claims. During the third quarter of 2011, the IRS responded to our protests and forwarded the cases to IRS Appeals. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) we are vigorously defending these matters and believe that we have a number of meritorious legal defenses; (2) we have filed refund claims in excess of the proposed assessments; (3) there are unresolved questions of law and fact that could be of importance to the ultimate resolutions of these matters, including the calculation of any additional taxes and/or tax refunds; and (4) these matters are at the initial stage of a multi-level administrative appeals process that may ultimately be resolved by litigation. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

Collective Bargaining Agreements

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

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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 runs through 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. Our current collective bargaining agreements set forth the annual contribution increases allotted to the plans that we participate in, and we are in compliance with these contribution rates. These limitations will remain in effect throughout the terms of the existing collective bargaining agreements.

Recent Accounting Pronouncements

Adoption of New Accounting Standards

There were no accounting standards adopted during the nine months ended September 30, 2011 that had a material impact on our consolidated financial statements.

Standards Issued But Not Yet Effective

In September 2011, the Financial Accounting Standards Board (FASB) issued an accounting standard update regarding disclosure of an employer's participation in multiemployer pension plans. This new guidance requires companies to provide additional qualitative and quantitative disclosures about financial obligations, risks and commitments, as well as the level of participation in multiemployer plans. Companies will be required to disclose detailed information about significant multiemployer plans, including contributions made to the plans, financial health and funded status of the plans, and expiration of the collective-bargaining agreements that require contributions to the plans. This accounting standards update will impact our disclosures only, and will not have any impact on our financial condition, results of operations or liquidity. The provisions of this guidance will be applied retrospectively beginning in our Form 10-K for the year ended December 31, 2011.

In September 2011, the FASB issued an accounting standard update that amends the accounting guidance on goodwill impairment testing. This accounting standard update is intended to reduce complexity and costs by allowing an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of a reporting unit. This accounting standard update also amends existing guidance by expanding upon the examples of events and circumstances that an entity should consider between annual impairment tests in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. We will adopt this accounting standard update and apply its provisions for our annual goodwill impairment testing as of October 1, 2011.

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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, 2011	December 31, 2010
Currency Derivatives	\$ (102)	\$ (75)
Interest Rate Derivatives	497	152
	\$ 395	\$ 77

Our market risks, hedging strategies and financial instrument positions at September 30, 2011 have not materially changed from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010. In 2011, we entered into interest rate swaps on our 8.38% fixed rate notes due in 2020, which effectively converted the fixed interest rates on the notes to variable LIBOR-based interest rates. Additionally, we entered into floating-to-fixed interest rate swaps on a portion of our previously swapped 3.125% fixed rate notes due in 2021, effectively converting the debt back to a fixed interest rate. We also entered into new currency options on the Euro, British Pound Sterling and Canadian Dollar, as well as terminated positions that expired during the first nine months of 2011. The remaining fair value changes between December 31, 2010 and September 30, 2011 in the table above are primarily due to interest rate and foreign currency exchange rate changes between those dates.

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 have agreements with some of our counterparties containing early termination rights and bilateral collateral provisions, whereby security is required if market risk exposure exceeds a specified threshold amount or credit ratings fall below certain levels. As of September 30, 2011, we have received collateral of \$33 million under these contractual provisions. The remaining counterparty agreements contain early termination rights but no bilateral collateral provisions.

We have not historically incurred, and do not expect to incur in the future, 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 50-52 of our consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2010, is hereby incorporated by reference in this report.

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

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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, 2011 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, 2010.

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 2011 is as follows (in millions, except per share amounts):

	Total Number of Shares Purchased(1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program
July 1 - July 31, 2011	2.7	\$ 71.57	2.6	\$ 3,954
August 1 - August 31, 2011	11.5	65.64	11.5	3,203
September 1 - September 30, 2011	3.2	61.49	3.2	3,004
Total July 1 - September 30, 2011	17.4	\$ 65.75	17.3	

(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.

In January 2008, the Board of Directors authorized an increase in our share repurchase authorization to \$10.0 billion. 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 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:

- 3.1 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, 2002).
- 3.2 Form of Bylaws of United Parcel Service, Inc. (incorporated by reference to Exhibit 3.1 to Form 8-K, filed on November 12, 2008).
- 11 Statement regarding Computation of per Share Earnings (incorporated by reference to Note 12 to Item 1. Financial Statements of this quarterly report on Form 10-Q).
- 12 Computation of Ratio of Earnings to Fixed Charges.
- 31.1 Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification 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.
- 32.2 Certification 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.
- 101 The following financial information from the Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, 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.

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 4, 2011

By:

/s/ KURT P. KUEHN
Kurt P. Kuehn
Senior Vice President and
Chief Financial Officer
(Duly Authorized Officer and
Principal Accounting Officer)

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