

UNITED PARCEL SERVICE INC  
Form 10-K  
February 27, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

**FOR ANNUAL AND TRANSITION REPORTS**

**PURSUANT TO SECTIONS 13 OR 15(d) OF THE**

**SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended December 31, 2011

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-15451

# United Parcel Service, Inc.

*(Exact Name of Registrant as Specified in Its Charter)*

**Delaware**  
*(State or Other Jurisdiction of  
Incorporation or Organization)*  
55 Glenlake Parkway, N.E. Atlanta, Georgia  
*(Address of Principal Executive Offices)*

(404) 828-6000

58-2480149  
*(I.R.S. Employer  
Identification No.)*  
30328  
*(Zip Code)*

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

## Securities registered pursuant to Section 12(b) of the Act:

| <b>Title of Each Class</b>                      | <b>Name of Each Exchange on Which Registered</b> |
|---|--|
| Class B common stock, par value \$.01 per share | New York Stock Exchange                          |

## Securities registered pursuant to Section 12(g) of the Act:

Class A common stock, par value \$.01 per share

**(Title of Class)**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Check one:

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Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The aggregate market value of the class B common stock held by non-affiliates of the registrant was \$53,668,942,247 as of June 30, 2011. The registrant's class A common stock is not listed on a national securities exchange or traded in an organized over-the-counter market, but each share of the registrant's class A common stock is convertible into one share of the registrant's class B common stock.

As of February 10, 2012, there were 236,015,165 outstanding shares of class A common stock and 722,705,229 outstanding shares of class B common stock.

### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for its annual meeting of shareowners scheduled for May 3, 2012 are incorporated by reference into Part III of this report.

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**UNITED PARCEL SERVICE, INC.**

**ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2011**

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**PART I**

**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 to Shareholders and in our other filings with the Securities and Exchange Commission ( SEC ) contain 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 and may also be described from time to time in our future reports filed with the SEC. 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.

**Item 1. Business Overview**

United Parcel Service, Inc. ( UPS ) was founded in 1907 as a private messenger and delivery service in Seattle, Washington. Today, UPS is the world's largest package delivery company, a leader in the U.S. less-than-truckload industry and the premier provider of global supply chain management solutions. We deliver packages each business day for 1.1 million shipping customers to 7.7 million consignees in over 220 countries and territories. In 2011, we delivered an average of 15.8 million pieces per day worldwide, or a total of 4.01 billion packages. Total revenue in 2011 was \$53.1 billion.

We are a global leader in logistics, and we create value for our customers through solutions that lower costs, improve service and provide highly customizable supply chain control and visibility. Customers are attracted to our broad set of services that are delivered as promised through our integrated ground, air and ocean global network.

Our services and integrated network allow shippers to simplify their supply chains by using fewer carriers and to adapt their transportation requirements and spend as their businesses evolve. Across our service portfolio, we also provide control and visibility of customers' inventories and supply chains via our UPS technology platform. The information flow from UPS technology drives improvements for our customers, as well as for UPS, in reliability, flexibility, productivity and efficiency.

Particularly over the last decade, UPS has significantly expanded the scope of our capabilities to include more than package delivery. Our logistics and distribution capabilities give companies the power to easily expand their businesses to new markets around the world. By leveraging our international infrastructure, UPS

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enables our customers to bridge time zones, cultures, distances and languages to keep the entire supply chain moving smoothly. We operate approximately 800 logistics facilities, in more than 120 countries, offering warehouse space of 35 million square feet.

We serve the global market for logistics services, which include transportation, distribution, forwarding, ground, ocean and air freight, brokerage and financing. Our technology seamlessly binds our service portfolio. We have three reportable segments: U.S. Domestic Package, International Package and Supply Chain & Freight, all of which are described below. For financial information concerning our reportable segments and geographic regions, refer to note 12 of our consolidated financial statements.

### **Business Strategy**

Customers leverage our broad array of services; balanced global presence in North America, Europe, Asia and Latin America; reliability; and industry leading technology for competitive advantage in markets where they choose to compete. We prudently invest to expand our integrated network and our service portfolio. Technology investments create user-friendly shipping, e-commerce, logistics management and visibility tools for our customers, while supporting UPS' ongoing efforts to increase operational efficiencies.

Our service portfolio and investments are rewarded with among the best returns on invested capital and operating margins in the industry. We have a long history of sound financial management. Our balance sheet reflects financial strength that few companies can match. As of December 31, 2011, we had a balance of cash and marketable securities of approximately \$4.275 billion and shareowners' equity of \$7.108 billion. Our Moody's and Standard & Poor's short-term credit ratings are P-1 and A-1+, respectively, and our Moody's and Standard & Poor's long-term credit ratings are Aa3 and AA-, respectively. We have a stable outlook from both of these credit rating agencies. Cash generation is a significant strength of UPS. This gives us strong capacity to service our obligations and allows for distributions to shareowners, reinvestment in our businesses and the pursuit of growth opportunities.

We enable and are the beneficiaries of the following trends:

#### *Expansion of Global Trade*

Trade across borders is predicted to grow at rates that are at least double the growth rates of U.S. and global domestic production for the foreseeable future. As a result, U.S. and international economies are becoming more inter-connected and dependent on foreign trade.

UPS plays an important role in global trade and is uniquely positioned to take advantage of trade growth, wherever it emerges. Our balanced global presence and productivity enhancing technologies allow customers to effortlessly expand to new markets. We advocate the expansion of free trade, including the passage of regional trade pacts and the removal of trade barriers. Free trade is a catalyst for job creation, economic growth and improved living standards; additionally, it propels our growth.

#### *Emerging Market Growth*

As our current and prospective customers seek growth outside of developed markets, they look to emerging markets for expansion. We make long-term, measured investments in markets where our customers choose to grow. Our investments are scaled to the local opportunity. We typically follow a pattern of entering a market through importing and exporting, expanding domestically with a partner or alliance, and then ultimately acquiring domestic operations where we see value and return. China is a prime example of this strategy as we continue to clear hurdles that will enable us to realize this vision. Our two key air hubs in Shanghai and Shenzhen support market expansion through increased cargo capacity and faster intra-Asia transit times, while enabling our customers to ship later in the day. We link Asia to Europe with overnight flights from Hong Kong through our air hub in Cologne, Germany.

Taken together, these two trends (expanding global trade and emerging market growth) underscore why our international business is a catalyst for UPS' growth.

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### *Increasing need for vertical expertise in the integrated carrier space*

We provide repeatable, scalable sector solutions for our customers. We invest in global capabilities and create value propositions for certain industries where there is a fit between our customers' needs and our offerings. Segments where we bring unique value propositions include health care, high-tech, automotive & industrial manufacturing, retail, government and professional services.

The health care industry faces complex challenges, including the continuing expiration of drug patents and the shifting landscape of regulatory requirements and drug pricing controls that differ by country. To counter these threats, many pharmaceutical companies have embarked on global expansion strategies that require infrastructure. UPS has aligned our resources to serve these needs through a well-developed supply chain management capability that is designed to satisfy regulatory and compliance requirements. We have built 33 dedicated health care facilities with over 5 million square feet of distribution space. These facilities allow us to provide reliable, secure, cost-effective warehousing and distribution for pharmaceutical firms' supply chains, which, in turn, allow them to easily navigate across and within borders.

We will continue to expand our vertical offerings, growing not only our physical and market footprint, but also our expertise and technology to support industry specific needs. Our growth strategy is to increase the number of customers benefitting from these vertical solutions and gain their associated small package and freight transportation.

### *Outsourcing*

Outsourcing supply chain management is becoming more prevalent, as customers increasingly view professional management and operation of their supply chains as a strategic advantage. This trend enables companies to focus on what they do best. We can meet our customers' needs for outsourced logistics with our global capabilities in customized forwarding, warehousing, distribution, delivery and post-sales services. As we move deeper into customers' supply chains, we do so with a shared vision on how to best serve those who rely on our customers. We integrate our technology for efficiencies, visibility and control to ensure that we execute as promised.

### *Retail e-Commerce Growth*

Throughout much of the world, e-commerce growth continues to outpace traditional lines of business. We continue to create new services, supported by UPS technology, that complement the traditional UPS premium home delivery service to address the needs of e-commerce shippers and receivers (consignees). Our offerings span a broad spectrum from cost-sensitive solutions such as SurePost, for shipments where economy takes precedence over speed, up to feature-rich solutions, including our new UPS My Choice service that provides consignees with revolutionary visibility and control of their inbound shipments.

With UPS My Choice, consignees direct the timing and location of their deliveries before a delivery attempt is made. Premium features include online delivery planners, detailed driver instructions, alternate delivery locations and a two-hour delivery window. Delivery alerts come via the channel chosen by the consignee: email, SMS text, etc. We strive to give our customers that ship using UPS My Choice the best delivery experience in the industry: delivery on the first attempt, where and when their customers want it.

## **Technology**

Technology powers logistics. We bring industry leading UPS technology to our customers who, in turn, realize increased productivity, greater control of their supply chains and improved customer experience when they integrate with our technology. Customers benefit through offerings such as:

UPS Quantum View which can speed up the revenue cycle (i.e. faster transit times, coupled with confirmation of delivery, allow shippers to collect accounts receivable more quickly), allow for inbound volume planning, manage third party shipping costs, automatically notify customers of incoming shipments, and of course, track shipments and let the customer react if a specific shipment status changes.

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Flex Global View which provides customs alerts, supplier key performance indicators and inventory monitoring.

UPS Paperless Invoice which enables customers to submit a commercial invoice electronically when shipping internationally. This eliminates redundant data entry and errors, while reducing customs holds and paper waste.

UPS Import Control which gives our customers the ability to initiate their import shipments, define billing terms and assign accounts to charge, and remove commercial invoices prior to delivery to a third-party.

UPS Mobile apps, which allow our customers to track, ship and find UPS locations from mobile devices, are among the top downloaded applications for businesses.

UPS My Choice which focuses on the consignee and transforms the residential delivery experience. Receivers direct the timing and circumstances of their deliveries. This innovative service, which is unmatched in our industry, is powered by the complex integration of real-time route optimization and other technologies with our delivery network. We believe that UPS My Choice gives us a substantial lead over the competition.

Technology, coupled with high-quality UPS employees, forms the foundation of our reliability and allows us to take customer experience to a higher level. Technology delivers value to our customers and returns to our shareholders. Recent advancements that evidence further gains in UPS' operational efficiency, flexibility, reliability and customer experience include:

Continuing to rollout telematics to our delivery and tractor-trailer fleet. Telematics helps UPS determine a truck's performance and condition by capturing data on more than 200 elements, including speed, RPM, oil pressure, seat belt use, number of times the truck is placed in reverse and idling time. Together, improved data and driver coaching help reduce fuel consumption, emissions and maintenance costs, while improving driver safety. Moreover, customers experience more consistent pickup times and more reliable deliveries, thereby enhancing their profitability and competitiveness.

Implementing our On Road Integrated Optimization and Navigation (ORION) system, which employs advanced algorithms to determine the optimal route for each delivery while meeting service commitments.

Converting our package cars to keyless entry, where drivers will be able to remotely turn the engine off with a button that will unlock the bulkhead door at the same time.

Ramping up installations of our Next Generation Small Sort (NGSS) technology, which reduces the amount of memorization required to sort a package, thereby improving productivity and quality. Employees sort packages to bins tagged with flashing lights, rather than memorizing addresses, allowing us to dramatically reduce training time.

## **Reporting Segments and Products & Services**

As a global leader in logistics, UPS offers a broad range of domestic and export delivery services; the facilitation of international trade; and the deployment of advanced technology to more efficiently manage the world of business. We seek to streamline our customers' shipment processing and integrate critical transportation information into their own business processes, helping them to create supply chain efficiencies, better serve their customers and improve their cash flows.

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### ***Global Small Package***

UPS's global small package operations provide time-definite delivery services for express letters, documents and small packages via air and ground services. We provide domestic delivery services within 56 countries and export services to more than 220 countries and territories around the world. We handle packages that weigh up to 150 pounds and are up to 165 inches in combined length and girth. All of our package services are supported by numerous shipping, visibility and billing technologies.

UPS handles all levels of service (air, ground, domestic, international, commercial, residential) through one global integrated pickup and delivery network. All packages are commingled throughout their journey in our network, except when necessary to meet their specific service commitments. This enables one UPS driver to pick up our customers' shipments, for any of our services, at the same scheduled time, day after day. Compared to companies with single service network designs, our integrated network uniquely provides operational and capital efficiencies while being easier on the environment.

Upon request, we offer same-day pickup of air and ground packages. Based on their needs, customers can schedule pickups for one to five days a week. Additionally, we provide our customers with easy access to UPS, with over 150,000 domestic and international entry points including: 40,000 drop boxes, 1,000 customer centers, 4,700 independently owned and operated locations of The UPS Store worldwide, 13,000 authorized shipping outlets and commercial counters, 6,300 alliance locations and 86,300 UPS drivers who can accept packages provided to them.

With the growth of online shopping, our customers' needs for efficient and reliable returns have increased. To this end, we have developed a robust selection of returns services that are available in over 100 countries. Options vary based on customer needs and country, and range from cost-effective solutions such as UPS Returns, which simply enables shippers to provide their customers with a return shipping label, to services as specialized as UPS Returns Exchange. In this new service, the UPS driver simplifies product exchanges by delivering a replacement item and picking up a return item in the same stop, and assisting with the re-packaging process.

We operate a global ground fleet of approximately 101,000 vehicles, of which our U.S. ground fleet serves all business and residential zip codes in the contiguous U.S. We operate a global air fleet of 523 aircraft, and we are one of the largest airlines in the world. Our global air network is centered at our Worldport hub in Louisville, Kentucky. Worldport sort capacity, currently at 416,000 packages per hour, has expanded over the years due to volume growth and a centralization effort. This facility is supplemented by our regional U.S. air hubs in Hartford, Connecticut; Ontario, California; Philadelphia, Pennsylvania; and Rockford, Illinois. This network design allows for cost-effective package processing in our most technology-enabled facility while enabling us to use fewer, larger and more fuel-efficient aircraft. Our largest international air hub is in Cologne, Germany, with other regional international hubs in Miami, Florida; Canada; Hong Kong; Singapore; Taiwan; and China.

### ***U.S. Domestic Package Reporting Segment***

UPS is a leader in time-definite, money-back guaranteed, small package delivery services. We offer a full spectrum of U.S. domestic guaranteed ground and air package transportation services. Depending on the delivery speed needed, customers can select from a range of guaranteed time and day definite delivery options.

Customers can select from same day, next day, two day and three day delivery alternatives. Many of these services offer options that enable customers to specify a time of day cut-off for their delivery (e.g. by 8:30, 10:30, noon, end of day, etc.)

Customers can also leverage our extensive ground network to ship using our day-definite guaranteed ground service that serves every U.S. business and residential address. UPS delivers more ground packages than any other carrier, with over 11 million ground packages delivered on time every day in the U.S., most within one to three business days.

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UPS also offers UPS SurePost, an economy residential ground service for customers with non-urgent, light weight residential shipments. UPS SurePost is a contractual residential ground service that combines the consistency and reliability of the UPS Ground network with final delivery provided by the U.S. Postal Service.

### *International Package Reporting Segment*

Our International Package reporting segment includes the small package operations in Europe, Asia, Canada and Latin America. UPS offers a wide selection of guaranteed, day and time-definite international shipping services.

We offer three guaranteed time-definite express options (Express Plus, Express and Express Saver) to more locations than any other carrier.

For international shipments that do not require express services, UPS Worldwide Expedited offers a reliable, deferred, guaranteed day-definite service option.

For cross-border ground package delivery, we offer UPS Transborder Standard delivery services within Europe, between the U.S. and Canada and between the U.S. and Mexico.

Europe, our largest region outside of the U.S., accounts for roughly half of international revenue and is one of our growth engines. Factors contributing to this are the highly fragmented nature of the market and the fact that exports make up a significant part of Europe's GDP. Given our well-known, trusted brand and distinctive integrated network, we believe there is continued strong potential for growth in small package exports in Germany, the U.K., France, Italy, Spain and the Netherlands. Due to our strong growth, we are expanding our main European air hub in Cologne by 70% to a capacity of 190,000 packages per hour. Expansion will come in stages; the first stage was completed in the fourth quarter of 2011 with the final stage targeted for 2013.

Asia is another growth engine due to attractive growth rates in intra-Asian trade and the dynamic Chinese economy. We are bringing faster time-in-transit to customers focused on intra-Asian trade, reducing transit days from Asia to Europe, and continuing to build our China presence. Our recent China investments include:

Material outlays to add capabilities, facilities and quality employees. We are building awareness and relevance while demonstrating superior UPS performance.

Opened an air hub in Shenzhen in mid-2010.

Added intra-Asia and around-the-world flight frequencies allowing customers to reach more of Europe the next day, guaranteed, than any other express carrier.

We serve more than 40 Asia-Pacific countries and territories through more than two dozen alliances with local delivery companies that supplement company-owned operations. In Vietnam, our volume has doubled since entering into an alliance with a local partner in 2010.

Additional International highlights include the following:

Since our 2009 acquisition of Unsped Paket Servisi San ve Ticaret A.S. in Turkey, we have seen double-digit export and domestic growth in that country.

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In South and Central America, we benefit from the strong regional economy. Our offerings include express package delivery in major cities as well as distribution and forwarding.

We continue to grow our business organically in Mexico. We are well positioned with freight, domestic, international and distribution services.

In February 2012 we broadened our European business-to-consumer service portfolio by acquiring Kiala S.A., a Belgium-based developer of a platform that enables e-commerce retailers to offer consumers the option of having goods delivered to a convenient retail location.

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### ***Supply Chain & Freight Reporting Segment***

The Supply Chain & Freight segment consists of our forwarding and logistics services, our UPS Freight business, and our financial offerings through UPS Capital. We manage supply chains in over 195 countries and territories, with approximately 35 million square feet of distribution space worldwide. Supply chain complexity creates demand for a global service offering that incorporates transportation, distribution and international trade and brokerage services, with financial and information services. We meet this demand by offering a broad array of services, which are described below.

The 2011 acquisition of Italy-based Pieffe Group ( *Pieffe* ) supports our global health care strategy, which has seen us make investments to better serve our growing customer base in the pharmaceutical, biotech and medical device industries. Previously family-owned, *Pieffe* is a pharmaceutical logistics business with more than 35 years of experience offering high-quality storage, distribution and cold chain solutions to some of the world's leading pharmaceutical brands.

### ***Freight Forwarding***

UPS is the second largest U.S. domestic air freight carrier and among the top six international air freight forwarders globally. UPS offers a portfolio of guaranteed and non-guaranteed global air freight services. Additionally, as one of the world's leading non-vessel operating common carriers, UPS also provides ocean freight full-container load and less-than container load shipments between most major ports around the world.

### ***Customs Brokerage***

UPS is among the world's largest customs brokers by both the number of shipments processed annually and by the number of dedicated brokerage employees worldwide. With decades of customs brokerage experience, we provide our customers with customs clearance, trade management and international trade consulting services.

### ***Logistics and Distribution***

UPS Logistics offers the following:

**Distribution Services:** UPS's comprehensive distribution services are provided through a global network of distribution centers that manage the flow of goods from receiving to storage and order processing to shipment, allowing companies to save time and money by minimizing their capital investment and positioning products closer to their customers.

**Post Sales:** Post Sales services support goods after they have been delivered or installed in the field. The four core service offerings within Post Sales include: 1) Critical Parts Fulfillment; 2) Reverse Logistics; 3) Test, Repair, and Refurbish; and 4) Network and Parts Planning. We leverage our global distribution network of 600+ field stocking locations to ensure that the right type and quantity of our customers' stock is in the right locations to meet the needs of their end-customers. Our customers are able to minimize spend and maximize service.

**UPS Mail Innovations:** UPS Mail Innovations offers an efficient, cost-effective method for sending lightweight parcels and flat mail to global addresses from the U.S. We pick up customers' domestic and international mail, sort, post, manifest and then expedite the secured mail containers to the destination postal service for last-mile delivery.

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### *UPS Freight*

UPS Freight offers regional, inter-regional and long-haul less-than-truckload ( LTL ) services, as well as full truckload services, in all 50 states, Canada, Puerto Rico, Guam, the U.S. Virgin Islands and Mexico. UPS Freight provides reliable LTL service backed by a day-definite, on-time guarantee at no additional cost. Additionally, many user-friendly small package technology offerings are also available for freight. Applications such as UPS WorldShip, Billing Center, and Quantum View allow customers to process and track LTL shipments, create electronic bills of lading and reconcile billing.

### *UPS Capital*

UPS Capital offers a range of services, including export and import financing to help improve cash flow, risk mitigation offerings to protect goods, as well as payment solutions that help speed the conversion cycle of payments.

## **Sustainability**

UPS' s business and corporate responsibility strategies pursue a common interest to increase the vitality and environmental sustainability of the global economy by aggregating the shipping activity of millions of businesses and individuals worldwide into a single, highly efficient logistics network. This provides benefits to:

UPS, by ensuring strong demand for our services.

The economy, by making global supply chains more efficient and less expensive.

The environment, by enabling our global customers to leverage UPS' s carbon efficiency and thereby reduce the carbon intensity of their supply chains.

We pursue sustainable business practices worldwide through operational efficiency, fleet advances, facility engineering projects and conservation enabling technology and service offerings. We help our customers to do the same.

Sustainability highlights in 2011 include:

Rated 1<sup>st</sup> in Social Responsibility in Fortune Magazine' s 2011 World' s Most Admired for the Delivery Industry.

One of Corporate Responsibility' s 100 Best Corporate Citizens and one of The Best Corporate Citizens in Government Contracting .

Recognized by Ethisphere Institute as one of the World' s Most Ethical Companies .

Named to Interbrands' Best Global Brands for the 7th consecutive year. We ranked in the Top 100 in brand value around the world (#27) and were the only company in the transportation sector to make the list in 2011.

Recognized as a constituent of the Dow Jones Sustainability Index for the 10th consecutive year.

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One of America's Top Organizations for Multicultural Business Opportunities by DiversityBusiness.com.

Achieved a score of 99% in response to the Carbon Disclosure Project. Our Carbon Disclosure Leadership Index score is the highest in the U.S. and ties with only three other companies globally.

Recognized by ClimateCounts.org as best company in the consumer shipping sector for the 3rd consecutive year. More information is available on the UPS Sustainability website.

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### **Community**

We believe that strong communities are vital to the success of our company. By combining our philanthropy with the volunteer time and talents of our employees, UPS helps drive positive change for organizations and communities in need across the globe. The highlights of our corporate citizenship efforts in 2011 include:

Local non-profits around the world received more than 1.6 million hours of volunteer service from UPS employees participating in our Neighbor-to-Neighbor program.

The UPS Foundation, our charitable organization, oversaw \$97 million in donations of cash and in-kind services to global causes primarily in four focus areas – community safety, environmental sustainability, diversity and volunteerism.

UPS led all U.S. companies in United Way donations last year with more than \$55 million, and surpassed \$1 billion in cumulative donations to United Way.

UPS continued to help save lives through our UPS Humanitarian Relief program by providing our logistics expertise and resources to aid the famine-stricken Horn of Africa and areas impacted by the Japan earthquake.

Thousands of teenagers and novice drivers in the U.S., Canada, the U.K., and Germany participated in UPS Road Code. This safety program for new drivers features UPS employees as instructors – a role where they get to share driving knowledge and safety tips amassed over our 104-year history of safe driving.

### **Reputation**

Many of our customers trust UPS to extend their brand. We were pleased that UPS earned the top rating in our industry on the American Customer Satisfaction Index in 2011. As noted in Millward Brown's and Interbrand's top brand rankings, we have one of the most valuable brands in the world. UPS also has been named to industry leading positions in Fortune Magazine's Most Admired and Harris Interactive's Reputation Quotient surveys.

### **Employees**

The strength of our company is our people, working together with a common purpose. We had approximately 398,000 employees as of December 31, 2011, of which 323,000 are in the U.S. and 75,000 are located internationally. Our global workforce includes approximately 71,000 management employees (36% of whom are part-time) and 327,000 hourly employees (46% of whom are part-time).

As of December 31, 2011, we had approximately 245,000 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 2,700 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association ( IPA ), which became 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, approximately 3,200 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.

The experience of our management team continues to be an organizational strength. Nearly 40% of our full-time managers have more than 20 years of service with UPS.



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We believe that our relations with our employees are good. We periodically survey all our employees to determine their level of job satisfaction. Areas of concern receive management attention as we strive to keep UPS the employer of choice among our employees. We consistently receive numerous awards and wide recognition as an employer-of-choice, resulting in part from our emphasis on diversity and corporate citizenship.

### **Safety**

We promote safety throughout our operations. Our Automotive Fleet Safety Program is built with the following components:

*Selection.* Five out of every six drivers come from our part-time ranks. Therefore, many of our new drivers are familiar with our philosophies, policies, practices and training programs.

*Training.* Training is the cornerstone of our Fleet Safety Program. Our approach starts with training the trainer. All trainers are certified to ensure that they have the skills and motivation to effectively train novice drivers. A new driver's employment includes extensive classroom and online training as well as on-road training, followed by three safety training rides integrated into his or her training cycle.

*Responsibility.* Our operations managers are responsible for their drivers' safety records. We investigate every accident. If we determine that an accident could have been prevented, we retrain the driver.

*Preventive Maintenance.* An integral part of our Fleet Safety Program is a comprehensive Preventive Maintenance Program. Our fleet is tracked electronically to ensure that each vehicle is serviced before a breakdown or accident is likely to occur.

*Honor Plan.* A well-defined safe driver honor plan recognizes and rewards our drivers when they achieve success. We have over 4,000 drivers who have driven for 25 years or more without an avoidable accident.

Our workplace safety program is built upon a comprehensive health and safety process. The foundation of this process is our employee-management health and safety committees. The workplace safety process focuses on employee conditioning and safety-related habits. Our employee co-chaired health and safety committees complete comprehensive facility audits and injury analyses, and recommend facility and work process changes.

### **Competition**

We are the largest package delivery company in the world, in terms of both revenue and volume. We offer a broad array of services in the package and freight delivery industry and, therefore, compete with many different local, regional, national and international companies. Our competitors include worldwide postal services, various motor carriers, express companies, freight forwarders, air couriers and others. Through our supply chain service offerings, we compete with a number of participants in the supply chain, financial services and information technology industries.

### **Competitive Strengths**

Our competitive strengths include:

*Integrated Global Network.* We believe that our integrated global ground and air network is the most extensive in the industry. We handle all levels of service (air, ground, domestic, international, commercial, residential) through a single pickup and delivery service network.

Our sophisticated engineering systems allow us to optimize our network efficiency and asset utilization on a daily basis. This unique, integrated global business model creates consistent and superior returns.



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We believe we have the most comprehensive integrated delivery and information services portfolio of any carrier in Europe. In other regions of the world, we rely on both our own and local service providers' capabilities to meet our service commitments.

*Global Presence.* UPS serves more than 220 countries and territories around the world. We have a presence in all of the world's major economies.

*Leading-edge Technology.* We are a global leader in developing technology that helps our customers optimize their shipping and logistics business processes to lower costs, improve service and increase efficiency.

Technology powers virtually every service we offer and every operation we perform. Our technology offerings are initiated by our customers needs. We offer a variety of on-line service options that enable our customers to integrate UPS functionality into their own businesses not only to conveniently send, manage and track their shipments, but also to provide their customers with better information services. We provide the infrastructure for an Internet presence that extends to tens of thousands of customers who have integrated UPS tools directly into their own web sites.

*Broad Portfolio of Services.* Our portfolio of services enables customers to choose the delivery option that is most appropriate for their requirements. Increasingly, our customers benefit from business solutions that integrate many UPS services in addition to package delivery. For example, our supply chain services such as freight forwarding, customs brokerage, order fulfillment, and returns management help improve the efficiency of the supply chain management process.

*Customer Relationships.* We focus on building and maintaining long-term customer relationships. We serve 1.1 million pick-up customers and 7.7 million delivery customers daily. Cross-selling small package, supply chain and freight services across our customer base is an important growth mechanism for UPS.

*Brand Equity.* We have built a leading and trusted brand that stands for quality service, reliability and product innovation. The distinctive appearance of our vehicles and the friendliness and helpfulness of our drivers are major contributors to our brand equity.

*Distinctive Culture.* We believe that the dedication of our employees results in large part from our distinctive employee-owner concept. Our employee stock ownership tradition dates from 1927, when our founders, who believed that employee stock ownership was a vital foundation for successful business, first offered stock to employees. To facilitate employee stock ownership, we maintain several stock-based compensation programs.

Our long-standing policy of promotion from within complements our tradition of employee ownership, and this policy reduces the need for us to hire managers and executive officers from outside UPS. The majority of our management team began their careers as full-time or part-time hourly UPS employees, and have spent their entire careers with us. Many of our executive officers have more than 30 years of service with UPS and have accumulated a meaningful ownership stake in our company. Therefore, our executive officers have a strong incentive to effectively manage UPS, which benefits all our shareowners.

*Financial Strength.* Our balance sheet reflects financial strength that few companies can match. Our financial strength gives us the resources to achieve global scale; to invest in employee development, technology, transportation equipment and buildings; to pursue strategic opportunities that facilitate our growth; to service our obligations; and to return value to our shareowners in the form of dividends and share repurchases.

## **Government Regulation**

### *Air Operations*

The U.S. Department of Transportation ( DOT ), the Federal Aviation Administration ( FAA ), and the U.S. Department of Homeland Security, through the Transportation Security Administration ( TSA ), have

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regulatory authority over United Parcel Service Co. s ( UPS Airlines ) air transportation services. The Federal Aviation Act of 1958, as amended, is the statutory basis for DOT and FAA authority and the Aviation and Transportation Security Act of 2001, as amended, is the basis for TSA aviation security authority.

The DOT s authority primarily relates to economic aspects of air transportation, such as discriminatory pricing, non-competitive practices, interlocking relations and cooperative agreements. The DOT also regulates, subject to the authority of the President of the United States, international routes, fares, rates and practices, and is authorized to investigate and take action against discriminatory treatment of U.S. air carriers abroad. International operating rights for U.S. airlines are usually subject to bilateral agreement between the U.S. and foreign governments. UPS Airlines has international route operating rights granted by the DOT and we may apply for additional authorities when those operating rights are available and are required for the efficient operation of our international network. The efficiency and flexibility of our international air transportation network is dependent on DOT and foreign government regulations and operating restrictions.

The FAA s authority primarily relates to safety aspects of air transportation, including aircraft operating procedures, transportation of hazardous materials, record keeping standards and maintenance activities, personnel and ground facilities. In 1988, the FAA granted us an operating certificate, which remains in effect so long as we meet the safety and operational requirements of the applicable FAA regulations. In addition, we are subject to non-U.S. government regulation of aviation rights involving non-U.S. jurisdictions, and non-U.S. customs regulation.

FAA regulations mandate an aircraft corrosion control program, along with aircraft inspection and repair at periodic intervals specified by approved programs and procedures, for all aircraft. Our total expenditures under these programs for 2011 were not material. The future cost of repairs pursuant to these programs may fluctuate according to aircraft condition, age and the enactment of additional FAA regulatory requirements.

The TSA regulates various security aspects of air cargo transportation in a manner consistent with the TSA mission statement to protect the Nation s transportation systems to ensure freedom of movement for people and commerce. UPS Airlines, and specified airport and off airport locations, are regulated under TSA regulations applicable to the transportation of cargo in an air network. In addition, personnel, facilities and procedures involved in air cargo transportation must comply with TSA regulations.

UPS Airlines, along with a number of other domestic airlines, participates in the Civil Reserve Air Fleet ( CRAF ) program. Our participation in the CRAF program allows the U.S. Department of Defense ( DOD ) to requisition specified UPS Airlines wide-body aircraft for military use during a national defense emergency. The DOD compensates us for the use of aircraft under the CRAF program. In addition, participation in CRAF entitles UPS Airlines to bid for military cargo charter operations.

### *Ground Operations*

Our ground transportation of packages in the U.S. is subject to the DOT s jurisdiction with respect to the regulation of routes and to both the DOT s and the states jurisdiction with respect to the regulation of safety, insurance and hazardous materials. We are subject to similar regulation in many non-U.S. jurisdictions.

The Postal Reorganization Act of 1970 created the U.S. Postal Service as an independent establishment of the executive branch of the federal government, and created the Postal Rate Commission, an independent agency, to recommend postal rates. The Postal Accountability and Enhancement Act of 2006 amended the 1970 Act to give the re-named Postal Regulatory Commission revised oversight authority over many aspects of the Postal Service, including postal rates, product offerings and service standards. We sometimes participate in the proceedings before the Postal Regulatory Commission in an attempt to secure fair postal rates for competitive services.

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### *Customs*

We are subject to the customs laws in the countries in which we operate, regarding the import and export of shipments, including those related to the filing of documents on behalf of client importers and exporters.

### *Environmental*

We are subject to federal, state and local environmental laws and regulations across all of our business units. These laws and regulations cover a variety of processes, including, but not limited to: proper storage, handling, and disposal of hazardous and other waste; managing wastewater and stormwater; monitoring and maintaining the integrity of underground storage tanks; complying with laws regarding clean air, including those governing emissions; protecting against and appropriately responding to spills and releases; and communicating the presence of reportable quantities of hazardous materials to local responders. UPS has established site- and activity-specific environmental compliance and pollution prevention programs to address our environmental responsibilities and remain compliant. In addition, UPS has created numerous programs which seek to minimize waste and prevent pollution within our operations.

### *Other Regulations*

We are subject to numerous other U.S. federal and state laws and regulations, in addition to applicable foreign laws, in connection with our package and non-package businesses in the countries in which we operate. These laws and regulations include those enforced by U.S. Customs and Border Protection and other agencies of the U.S. Department of Homeland Security, the U.S. Department of Treasury, the Federal Maritime Commission, the U.S. Drug Enforcement Administration, the U.S. Food and Drug Administration and the U.S. Department of Agriculture.

## **Where You Can Find More Information**

UPS maintains a website at [www.ups.com](http://www.ups.com). Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 are made available through our website [www.investors.ups.com](http://www.investors.ups.com) as soon as reasonably practical after we electronically file or furnish the reports to the SEC. Also available on the Corporation's website are the Company's Corporate Governance Guidelines and Committee Charters. Information on these websites, however, is not incorporated by reference into this report or any other report filed with or furnished to the SEC.

We have adopted a written Code of Business Conduct that applies to all of our directors, officers and employees, including our principal executive officer and senior financial officers. It is available in the governance section of the investor relations website, located at [www.investors.ups.com](http://www.investors.ups.com). In the event that we make changes in, or provide waivers from, the provisions of the Code of Business Conduct that the SEC requires us to disclose, we intend to disclose these events in the governance section of our investor relations website.

Our Corporate Governance Guidelines and the charters for our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are also available in the governance section of the investor relations website.

Our sustainability report, which describes our activities that support our commitment to acting responsibly and contributing to society, is available at [www.sustainability.ups.com](http://www.sustainability.ups.com). We provide the addresses to our internet sites solely for the information of investors. We do not intend any addresses to be active links or to otherwise incorporate the contents of any website into this report.

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### **Item 1A. Risk Factors**

You should carefully consider the following factors, which could materially affect our business, financial condition or results of operations. You should read these Risk Factors in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and our Consolidated Financial Statements and related notes in Item 8.

#### ***General economic conditions, both in the U.S. and internationally, may adversely affect our results of operations.***

We conduct operations in over 220 countries and territories. Our U.S. and international operations are subject to normal cycles affecting the economy in general, as well as the local economic environments in which we operate. The factors that create cyclical changes to the economy and to our business are beyond our control, and it may be difficult for us to adjust our business model to mitigate the impact of these factors. In particular, our business is affected by levels of industrial production, consumer spending and retail activity, and our business, financial position and results of operations could be materially affected by adverse developments in these aspects of the economy.

#### ***We face significant competition which could adversely affect our business, financial position and results of operations.***

We face significant competition on a local, regional, national and international basis. Our competitors include the postal services of the U.S. and other nations, various motor carriers, express companies, freight forwarders, air couriers and others. Competition may also come from other sources in the future. Some of our competitors have cost and organizational structures that differ from ours and may offer services and pricing terms that we may not be willing or able to offer. If we are unable to timely and appropriately respond to competitive pressures, our business, financial position and results of operations could be adversely affected.

The transportation industry continues to consolidate and competition remains strong. As a result of consolidation, our competitors may increase their market share and improve their financial capacity, and may strengthen their competitive positions. Business combinations could also result in competitors providing a wider variety of services and products at competitive prices, which could adversely affect our financial performance.

#### ***Our business is subject to complex and stringent regulation in the U.S. and internationally.***

We are subject to complex and stringent aviation, transportation, environmental, security, labor, employment and other governmental laws and regulations, both in the U.S. and in the other countries in which we operate. In addition, our business is impacted by laws and regulations that affect global trade, including tariff and trade policies, export requirements, taxes and other restrictions and charges. Changes in laws, regulations and the related interpretations may alter the landscape in which we do business and may affect our costs of doing business. The impact of new laws and regulations cannot be predicted. Compliance with new laws and regulations may increase our operating costs or require significant capital expenditures. Any failure to comply with applicable laws or regulations in the U.S. or in any of the countries in which we operate could result in substantial fines or possible revocation of our authority to conduct our operations, which could adversely affect our financial performance.

#### ***Increased security requirements could impose substantial costs on us and we could be the target of an attack or have a security breach.***

As a result of concerns about global terrorism and homeland security, governments around the world have adopted or may adopt stricter security requirements that will result in increased operating costs for businesses in

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the transportation industry. These requirements may change periodically as a result of regulatory and legislative requirements and in response to evolving threats. We cannot determine the effect that these new requirements will have on our cost structure or our operating results, and these rules or other future security requirements may increase our costs of operations and reduce operating efficiencies. Regardless of our compliance with security requirements or the steps we take to secure our facilities or fleet, we could be the target of an attack or security breaches could occur, which could adversely affect our operations or our reputation.

### ***We may be affected by global climate change or by legal, regulatory or market responses to such potential change.***

Concern over climate change, including the impact of global warming, has led to significant federal, state and international legislative and regulatory efforts to limit greenhouse gas ( GHG ) emissions. For example, in the past several years, the U.S. Congress has considered various bills that would regulate GHG emissions. While these bills have not yet received sufficient Congressional support for enactment, some form of federal climate change legislation is possible in the future. Even in the absence of such legislation, the Environmental Protection Agency, spurred by judicial interpretation of the Clean Air Act, may regulate GHG emissions, especially aircraft or diesel engine emissions, and this could impose substantial costs on us. These costs include an increase in the cost of the fuel and other energy we purchase and capital costs associated with updating or replacing our aircraft or vehicles prematurely. Until the timing, scope and extent of any future regulation becomes known, we cannot predict its effect on our cost structure or our operating results. It is reasonably possible that such legislation or regulation could impose material costs on us. Moreover, even without such legislation or regulation, increased awareness and any adverse publicity in the global marketplace about the GHGs emitted by companies in the airline and transportation industries could harm our reputation and reduce customer demand for our services, especially our air services.

### ***Strikes, work stoppages and slowdowns by our employees could adversely affect our business, financial position and results of operations.***

A significant number of our employees are employed under a national master agreement and various supplemental agreements with local unions affiliated with the Teamsters and our airline pilots, airline mechanics, ground mechanics and certain other employees are employed under other collective bargaining agreements. Strikes, work stoppages and slowdowns by our employees could adversely affect our ability to meet our customers' needs, and customers may do more business with competitors if they believe that such actions or threatened actions may adversely affect our ability to provide services. We may face permanent loss of customers if we are unable to provide uninterrupted service, and this could adversely affect our business, financial position and results of operations. The terms of future collective bargaining agreements also may affect our competitive position and results of operations.

### ***We are exposed to the effects of changing prices of energy, including gasoline, diesel and jet fuel, and interruptions in supplies of these commodities.***

Changing fuel and energy costs may have a significant impact on our operations. We require significant quantities of fuel for our aircraft and delivery vehicles and are exposed to the risk associated with variations in the market price for petroleum products, including gasoline, diesel and jet fuel. We mitigate our exposure to changing fuel prices through our indexed fuel surcharges and we may also enter into hedging transactions from time to time. If we are unable to maintain or increase our fuel surcharges, higher fuel costs could adversely impact our operating results. Even if we are able to offset the cost of fuel with our surcharges, high fuel surcharges may result in a mix shift from our higher yielding air products to lower yielding ground products or an overall reduction in volume. If fuel prices rise sharply, even if we are successful in increasing our fuel surcharge, we could experience a lag time in implementing the surcharge, which could adversely affect our short-term operating results. There can be no assurance that our hedging transactions will be effective to protect us

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from changes in fuel prices. Moreover, we could experience a disruption in energy supplies, including our supply of gasoline, diesel and jet fuel, as a result of war, actions by producers, or other factors which are beyond our control, which could have an adverse effect on our business.

### ***Changes in exchange rates or interest rates may have an adverse effect on our results.***

We conduct business across the globe with a significant portion of our revenue derived from operations outside the United States. Our operations in international markets are affected by changes in the exchange rates for local currencies, and in particular the Euro, British Pound Sterling and Canadian Dollar.

We are exposed to changes in interest rates, primarily on our short-term debt and that portion of our long-term debt that carries floating interest rates. The impact of a 100-basis-point change in interest rates affecting our debt is discussed in the Quantitative and Qualitative Disclosures about Market Risk section of this report.

We monitor and manage our exposures to changes in currency exchange rates and interest rates, and make limited use of currency exchange contracts, over the counter option contracts, commodity forwards, swaps and futures contracts to mitigate the impact of changes in currency values, but changes in exchange rates and interest rates cannot always be predicted or hedged.

### ***If we are unable to maintain our brand image and corporate reputation, our business may suffer.***

Our success depends in part on our ability to maintain the image of the UPS brand and our reputation for providing excellent service to our customers. Service quality issues, actual or perceived, even when false or unfounded, could tarnish the image of our brand and may cause customers to use other companies. Also, adverse publicity surrounding labor relations, environmental concerns, security matters, political activities and the like, or attempts to connect our company to these sorts of issues, either in the United States or other countries in which we operate, could negatively affect our overall reputation and acceptance of our services by customers. Damage to our reputation and loss of brand equity could reduce demand for our services and thus have an adverse effect on our business, financial position and results of operations, and could require additional resources to rebuild our reputation and restore the value of our brand.

### ***A significant privacy breach or IT system disruption could adversely affect our business and we may be required to increase our spending on data and system security.***

We rely on information technology networks and systems, including the Internet, to process, transmit and store electronic information, and to manage or support a variety of business processes and activities. In addition, the provision of service to our customers and the operation of our network involve the storage and transmission of proprietary information and sensitive or confidential data, including personal information of customers, employees and others. Our information technology systems, some of which are managed by third-parties, may be susceptible to damage, disruptions or shutdowns due to failures during the process of upgrading or replacing software, databases or components thereof, power outages, hardware failures, computer viruses, attacks by computer hackers, telecommunication failures, user errors or catastrophic events. Groups of hackers may also act in a coordinated manner to launch distributed denial of service attacks or other coordinated attacks that may cause service outages or other interruptions. In addition, breaches in security could expose us, our customers or the individuals affected to a risk of loss or misuse of proprietary information and sensitive or confidential data. Any of these occurrences could result in disruptions in our operations, the loss of existing or potential customers, damage to our brand and reputation, and litigation and potential liability for the company. In addition, the cost and operational consequences of implementing further data or system protection measures could be significant.

### ***Severe weather or other natural or manmade disasters could adversely affect our business.***

Severe weather conditions and other natural or manmade disasters, including storms, floods, fires and earthquakes, may result in decreased revenues, as our customers reduce their shipments, or increased costs to

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operate our business, which could have an adverse effect on our results of operations for a quarter or year. Any such event affecting one of our major facilities could result in a significant interruption in or disruption of our business.

*We make significant capital investments in our business of which a significant portion is tied to projected volume levels.*

We require significant capital investments in our business consisting of aircraft, vehicles, technology, facilities and sorting and other types of equipment to support both our existing business and anticipated growth. Forecasting projected volume involves many factors which are subject to uncertainty, such as general economic trends, changes in governmental regulation and competition. If we do not accurately forecast our future capital investment needs, we could have excess capacity or insufficient capacity, either of which would negatively affect our revenues and profitability. In addition to forecasting our capital investment requirements, we adjust other elements of our operations and cost structure in response to adverse economic conditions; however, these adjustments may not be sufficient to allow us to maintain our operating margins in an adverse economy.

*We derive a significant portion of our revenues from our international operations and are subject to the risks of doing business in emerging markets.*

We have significant international operations and while the geographical diversity of our international operations helps ensure that we are not overly reliant on a single region or country, we are continually exposed to changing economic, political and social developments beyond our control. Emerging markets are typically more volatile than those in the developed world, and any broad-based downturn in these markets could reduce our revenues and adversely affect our business, financial position and results of operations.

*We are subject to changes in markets and our business plans that have resulted, and may in the future result, in substantial write-downs of the carrying value of our assets, thereby reducing our net income.*

Our regular review of the carrying value of our assets has resulted, from time to time, in significant impairments, and we may in the future be required to recognize additional impairment charges. Changes in business strategy, government regulations, or economic or market conditions have resulted and may result in further substantial impairments of our intangible or other assets at any time in the future. In addition, we have been and may be required in the future to recognize increased depreciation and amortization charges if we determine that the useful lives of our fixed assets are shorter than we originally estimated. Such changes could reduce our net income.

*Employee health and retiree health and pension benefit costs represent a significant expense to us.*

With approximately 398,000 employees, including approximately 323,000 in the U.S., our expenses relating to employee health and retiree health and pension benefits are significant. In recent years, we have experienced significant increases in certain of these costs, largely as a result of economic factors beyond our control, including, in particular, ongoing increases in health care costs well in excess of the rate of inflation. Continued increasing health care costs, volatility in investment returns and discount rates, as well as changes in laws, regulations and assumptions used to calculate retiree health and pension benefit expenses, may adversely affect our business, financial position, results of operations or require significant contributions to our pension plans.

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

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*We may be subject to various claims and lawsuits that could result in significant expenditures.*

The nature of our business exposes us to the potential for various claims and litigation related to labor and employment, personal injury, property damage, business practices, environmental liability and other matters. Any material litigation or a catastrophic accident or series of accidents could have a material adverse effect on our business, financial position and results of operations.

*We may not realize the anticipated benefits of acquisitions, joint ventures or strategic alliances.*

As part of our business strategy, we may acquire businesses and form joint ventures or strategic alliances. Whether we realize the anticipated benefits from these transactions depends, in part, upon the successful integration between the businesses involved, the performance of the underlying operation, capabilities or technologies and the management of the transacted operations. Accordingly, our financial results could be adversely affected by our failure to effectively integrate the acquired operations, unanticipated performance issues, transaction-related charges or charges for impairment of long-term assets that we acquire.

*Insurance and claims expenses could have a material adverse effect on our business, financial condition and results of operations.*

We have a combination of both self-insurance and high-deductible insurance programs for the risks arising out of the services we provide and the nature of our global operations, including claims exposure resulting from cargo loss, personal injury, property damage, aircraft and related liabilities, business interruption and workers compensation. Workers compensation, automobile and general liabilities are determined using actuarial estimates of the aggregate liability for claims incurred and an estimate of incurred but not reported claims, on an undiscounted basis. Our accruals for insurance reserves reflect certain actuarial assumptions and management judgments, which are subject to a high degree of variability. If the number or severity of claims for which we are retaining risk increases, our financial condition and results of operations could be adversely affected. If we lose our ability to self-insure these risks, our insurance costs could materially increase and we may find it difficult to obtain adequate levels of insurance coverage.

### **Item 1B. *Unresolved Staff Comments***

Not applicable.

### **Item 2. *Properties* Operating Facilities**

We own our headquarters, which are located in Atlanta, Georgia and consist of about 735,000 square feet of office space on an office campus, and our UPS Supply Chain Solutions group's headquarters, which are located in Alpharetta, Georgia, and consist of about 310,000 square feet of office space.

We also own our 27 principal U.S. package operating facilities, which have floor spaces that range from approximately 310,000 to 693,000 square feet. In addition, we have a 1.9 million square foot operating facility near Chicago, Illinois, which is designed to streamline shipments between East Coast and West Coast destinations, and we own or lease over 1,000 additional smaller package operating facilities in the U.S. The smaller of these facilities have vehicles and drivers stationed for the pickup of packages and facilities for the sorting, transfer and delivery of packages. The larger of these facilities also service our vehicles and equipment and employ specialized mechanical installations for the sorting and handling of packages.

We own or lease almost 800 facilities that support our international package operations and an additional 800 facilities that support our freight forwarding and logistics operations. Our freight forwarding and logistics operations maintain facilities with approximately 35 million square feet of floor space. We own and operate a logistics campus consisting of approximately 3.1 million square feet in Louisville, Kentucky.

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UPS Freight operates 196 service centers with a total of 5.9 million square feet of floor space. UPS Freight owns 148 of these service centers, while the remainder are occupied under operating lease agreements. The main offices of UPS Freight are located in Richmond, Virginia and consist of about 240,000 square feet of office space.

Our aircraft are operated in a hub and spokes pattern in the U.S. Our principal air hub in the U.S., known as Worldport, is located in Louisville, Kentucky. The Worldport facility consists of over 5.2 million square feet and the site includes approximately 596 acres. Between 2009 and 2010, we completed an expansion of our Worldport facility, which increased the sorting capacity to approximately 416,000 packages per hour. The expansion, which cost over \$1 billion, involved the addition of two aircraft load / unload wings to the hub building, followed by the installation of high-speed conveyor and computer control systems.

We also have regional air hubs in Hartford, Connecticut; Ontario, California; Philadelphia, Pennsylvania; and Rockford, Illinois. These hubs house facilities for the sorting, transfer and delivery of packages. Our European air hub is located in Cologne, Germany, and we maintain Asia-Pacific air hubs in Shanghai, China; Shenzhen, China; Taipei, Taiwan; Hong Kong; and Singapore. Our regional air hub in Canada is located in Hamilton, Ontario, and our regional air hub for Latin America and the Caribbean is in Miami, Florida.

In 2011, we announced plans to significantly expand our European air hub in Cologne, Germany. The expansion project, due to be completed by the end of 2013, will equip the existing facility with additional state-of-art technology and will include a major extension to the existing building. This extension would be partially dedicated to processing larger freight shipments. Together these initiatives will significantly increase the hub's package sorting capacity from today's 110,000 to 190,000 packages per hour. The total cost of the expansion is estimated to be approximately \$200 million.

Over the past several years, UPS has made a successful transition to become the first wholly-owned foreign express carrier in China. In 2008, we opened the UPS International Air Hub at Pudong International Airport, which was built on a parcel totaling 2.4 million square feet with a planned sorting capacity of 17,000 packages per hour. The hub links all of China via Shanghai to UPS's international network with direct service to the Americas, Europe and Asia. It also connects points served in China by UPS through a dedicated service provided by Yangtze River Express, a Chinese all-cargo airline.

In February 2010, we opened a new intra-Asia air hub at Shenzhen Baoan International Airport in China. The Shenzhen facility replaced our intra-Asia air hub at Clark Air Force Base in the Philippines, and serves as our primary transit hub in Asia. The facility was built on a parcel of almost 1 million square feet, and has a sorting capacity of 18,000 packages per hour.

Our primary information technology operations are consolidated in a 435,000 square foot owned facility, the Ramapo Ridge facility, which is located on a 39-acre site in Mahwah, New Jersey. We also own a 175,000 square foot facility located on a 25-acre site in Alpharetta, Georgia, which serves as a backup to the main information technology operations facility in New Jersey. This facility provides production functions and backup capacity in the event that a power outage or other disaster incapacitates the main data center. It also helps to meet our internal communication needs.

We believe that our facilities are adequate to support our current operations.

**Table of Contents****Fleet***Aircraft*

The following table shows information about our aircraft fleet as of December 31, 2011:

| Description       | Owned and<br>Capital<br>Leases | Short-term<br>Leased or<br>Chartered<br>From<br>Others | On<br>Order | Under<br>Option |
|-------------------|--------------------------------|--|-------------|-----------------|
| Boeing 747-400F   | 11                             |  |             |                 |
| Boeing 747-400BCF | 2                              |  |             |                 |
| Boeing 757-200    | 75                             |  |             |                 |
| Boeing 767-300    | 44                             |  | 15          |                 |
| Boeing MD-11      | 38                             |  |             |                 |
| Airbus A300-600   | 53                             |  |             |                 |
| Other             |                                | 300  |             |                 |
| Total             | 223                            | 300  | 15          |                 |

We maintain an inventory of spare engines and parts for each aircraft.

All of the aircraft we own meet Stage IV federal noise regulations and can operate at airports that have aircraft noise restrictions.

During 2011, we took delivery of five Boeing 767-300F aircraft and two Boeing 747-400F aircraft. We have firm commitments to purchase 15 Boeing 767-300ER freighters to be delivered between 2012 and 2013. We sold the remainder of our McDonnell-Douglas DC-8-73 and Boeing 747-100 aircraft fleets during 2011.

*Vehicles*

We operate a global ground fleet of approximately 101,000 package cars, vans, tractors and motorcycles. Our ground support fleet consists of 31,800 pieces of equipment designed specifically to support our aircraft fleet, ranging from non-powered container dollies and racks to powered aircraft main deck loaders and cargo tractors. We also have 35,000 containers used to transport cargo in our aircraft.

**Item 3. 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 4. Mine Safety Disclosures**

Not applicable.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our class A common stock is not listed on a national securities exchange or traded in an organized over-the-counter market, but each share of our class A common stock is convertible into one share of our class B common stock.

The following is a summary of our class B common stock price activity and dividend information for 2011 and 2010. Our class B common stock is listed on the New York Stock Exchange under the symbol UPS.

|                | High     | Low      | Close    | Dividends Declared |
|----------------|----------|----------|----------|--------------------|
| <b>2011:</b>   |          |          |          |                    |
| First Quarter  | \$ 76.99 | \$ 70.22 | \$ 74.32 | \$ 0.52            |
| Second Quarter | \$ 75.58 | \$ 68.14 | \$ 72.93 | \$ 0.52            |
| Third Quarter  | \$ 75.79 | \$ 60.75 | \$ 63.15 | \$ 0.52            |
| Fourth Quarter | \$ 73.80 | \$ 61.27 | \$ 73.19 | \$ 0.52            |
| <b>2010:</b>   |          |          |          |                    |
| First Quarter  | \$ 64.95 | \$ 55.77 | \$ 64.41 | \$ 0.47            |
| Second Quarter | \$ 70.89 | \$ 56.70 | \$ 56.89 | \$ 0.47            |
| Third Quarter  | \$ 69.50 | \$ 56.47 | \$ 66.69 | \$ 0.47            |
| Fourth Quarter | \$ 73.94 | \$ 65.44 | \$ 72.58 | \$ 0.47            |

As of January 31, 2012, there were 157,455 and 18,024 record holders of class A and class B common stock, respectively.

The policy of our Board of Directors is to declare dividends out of current earnings. 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.

On February 9, 2012, our Board declared a dividend of \$0.57 per share, which is payable on March 7, 2012 to shareowners of record on February 21, 2012. This represents a 10% increase from the previous \$0.52 quarterly dividend in 2011.

In January 2008, the Board of Directors approved 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.

A summary of repurchases of our class A and class B common stock during the fourth quarter of 2011 is as follows (in millions, except per share amounts):

|                          | Total Number of Shares Purchased(1) | Average Price Paid Per Share(1) | Total Number of Shares Purchased as Part of Publicly Announced Program | Approximate Dollar Value of Shares that May Yet be Purchased Under the Program (as of month-end) |
|--------------------------|-------------------------------------|---------------------------------|--|--|
| October 1 - October 31   | 1.5                                 | \$ 67.78                        | 1.5  | \$ 2,895   |
| November 1 - November 30 | 4.2                                 | 68.72                           | 4.0  | 2,615  |
| December 1 - December 31 | 1.4                                 | 70.18                           | 1.3  | 2,525  |

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|                 |             |     |          |     |
|-----------------|-------------|-----|----------|-----|
| Total October 1 | December 31 | 7.1 | \$ 68.79 | 6.8 |
|-----------------|-------------|-----|----------|-----|

- (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.

**Table of Contents****Shareowner Return Performance Graph**

*The following performance graph and related information shall not be deemed soliciting material or to be filed with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent that the Company specifically incorporates such information by reference into such filing.*

The following graph shows a five year comparison of cumulative total shareowners' returns for our class B common stock, the Standard & Poor's 500 Index, and the Dow Jones Transportation Average. The comparison of the total cumulative return on investment, which is the change in the quarterly stock price plus reinvested dividends for each of the quarterly periods, assumes that \$100 was invested on December 31, 2006 in the Standard & Poor's 500 Index, the Dow Jones Transportation Average, and our class B common stock.

|                                  | 12/31/06  | 12/31/07  | 12/31/08 | 12/31/09 | 12/31/10  | 12/31/11  |
|----------------------------------|-----------|-----------|----------|----------|-----------|-----------|
| United Parcel Service, Inc.      | \$ 100.00 | \$ 96.50  | \$ 77.40 | \$ 83.40 | \$ 108.66 | \$ 112.88 |
| Standard & Poor's 500 Index      | \$ 100.00 | \$ 105.49 | \$ 66.46 | \$ 84.05 | \$ 96.71  | \$ 98.76  |
| Dow Jones Transportation Average | \$ 100.00 | \$ 101.43 | \$ 79.70 | \$ 94.51 | \$ 119.83 | \$ 119.84 |

**Table of Contents****Item 6. Selected Financial Data**

Information in Items 6, 7, 8 and Exhibit 12 of this report for the years ended December 31, 2011, 2010, 2009, 2008 and 2007 have been revised, as applicable, for the retrospective application of our changes in accounting policies for recognizing the expense associated with our pension and postretirement benefit plans. These changes in accounting policies are further discussed in Note 1 to the audited consolidated financial statements.

The following table sets forth selected financial data for each of the five years in the period ended December 31, 2011 (in millions, except per share amounts). This financial data should be read together with our consolidated financial statements and related notes, Management's Discussion and Analysis of Financial Condition and Results of Operations, and other financial data appearing elsewhere in this report.

|                                       | Years Ended December 31, |           |           |           |           |
|---------------------------------------|--------------------------|-----------|-----------|-----------|-----------|
|                                       | 2011                     | 2010      | 2009      | 2008      | 2007      |
| <b>Selected Income Statement Data</b> |                          |           |           |           |           |
| Revenue:                              |                          |           |           |           |           |
| U.S. Domestic Package                 | \$ 31,717                | \$ 29,742 | \$ 28,158 | \$ 31,278 | \$ 30,985 |
| International Package                 | 12,249                   | 11,133    | 9,699     | 11,293    | 10,281    |
| Supply Chain & Freight                | 9,139                    | 8,670     | 7,440     | 8,915     | 8,426     |
| Total revenue                         | 53,105                   | 49,545    | 45,297    | 51,486    | 49,692    |
| Operating expenses:                   |                          |           |           |           |           |
| Compensation and benefits             | 27,575                   | 26,557    | 25,933    | 29,826    | 31,565    |
| Other                                 | 19,450                   | 17,347    | 15,856    | 20,041    | 17,369    |
| Total operating expenses              | 47,025                   | 43,904    | 41,789    | 49,867    | 48,934    |
| Operating profit (loss):              |                          |           |           |           |           |
| U.S. Domestic Package                 | 3,764                    | 3,238     | 1,919     | 823       | (1,406)   |
| International Package                 | 1,709                    | 1,831     | 1,279     | 1,246     | 1,870     |
| Supply Chain and Freight              | 607                      | 572       | 310       | (450)     | 294       |
| Total operating profit                | 6,080                    | 5,641     | 3,508     | 1,619     | 758       |
| Other income (expense):               |                          |           |           |           |           |
| Investment income                     | 44                       | 3         | 10        | 75        | 99        |
| Interest expense                      | (348)                    | (354)     | (445)     | (442)     | (246)     |
| Income before income taxes            | 5,776                    | 5,290     | 3,073     | 1,252     | 611       |
| Income tax expense                    | (1,972)                  | (1,952)   | (1,105)   | (597)     | (115)     |
| Net income                            | \$ 3,804                 | \$ 3,338  | \$ 1,968  | \$ 655    | \$ 496    |
| Per share amounts:                    |                          |           |           |           |           |
| Basic earnings per share              | \$ 3.88                  | \$ 3.36   | \$ 1.97   | \$ 0.64   | \$ 0.47   |
| Diluted earnings per share            | \$ 3.84                  | \$ 3.33   | \$ 1.96   | \$ 0.64   | \$ 0.47   |
| Dividends declared per share          | \$ 2.08                  | \$ 1.88   | \$ 1.80   | \$ 1.80   | \$ 1.68   |
| Weighted average shares outstanding:  |                          |           |           |           |           |
| Basic                                 | 981                      | 994       | 998       | 1,016     | 1,057     |
| Diluted                               | 991                      | 1,003     | 1,004     | 1,022     | 1,063     |
|                                       | As of December 31,       |           |           |           |           |
|                                       | 2011                     | 2010      | 2009      | 2008      | 2007      |
| <b>Selected Balance Sheet Data</b>    |                          |           |           |           |           |
| Cash and marketable securities        | \$ 4,275                 | \$ 4,081  | \$ 2,100  | \$ 1,049  | \$ 2,604  |
| Total assets                          | 34,701                   | 33,597    | 31,883    | 31,879    | 39,042    |
| Long-term debt                        | 11,095                   | 10,491    | 8,668     | 7,797     | 7,506     |
| Shareowners' equity                   | 7,108                    | 8,047     | 7,696     | 6,780     | 12,183    |



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**Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations***

**Overview**

The slow pace of the U.S. economic recovery in 2011 put pressure during the first three quarters of the year 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 and the lack of significant inventory rebuilding also pressured our volume in certain industrial sectors; however, overall growth in retail sales, particularly in e-commerce, resulted in solid business-to-consumer shipment activity during the year. Growth accelerated in the fourth quarter of 2011 due in large part to a strong holiday season for e-commerce sales, which resulted in higher volume and revenue for our deferred and ground residential products.

Outside of the U.S., economic growth slowed throughout 2011 due to volatility in world markets. Despite this sluggish economic environment, we experienced favorable volume and revenue growth for most of the year, although the growth trend slowed during the latter half of 2011.

In 2011, we continued to undertake initiatives to improve yield management, increase operational efficiency and contain costs, which led to solid improvements in operating margin and profit in our U.S. Domestic Package and Supply Chain & Freight segments. During 2010, we completed 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 prevailing 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 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 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 overall growth in our International Package business, in the latter half of 2011, we experienced weakness in the important Asia-to-U.S. trade lane. To align our capacity and cost structure with prevailing volume levels, we reduced our tonnage capacity in this lane, while retaining the network enhancements and service upgrades previously implemented.

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.

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Our consolidated results are presented in the table below:

|   | Year Ended December 31, |           |           | % Change    |             |
|---|-------------------------|-----------|-----------|-------------|-------------|
|   | 2011                    | 2010      | 2009      | 2011 / 2010 | 2010 / 2009 |
| Revenue (in millions)                       | \$ 53,105               | \$ 49,545 | \$ 45,297 | 7.2%        | 9.4%        |
| Operating Expenses (in millions)            | 47,025                  | 43,904    | 41,789    | 7.1%        | 5.1%        |
| Operating Profit (in millions)              | \$ 6,080                | \$ 5,641  | \$ 3,508  | 7.8%        | 60.8%       |
| Operating Margin                            | 11.4%                   | 11.4%     | 7.7%      |             |             |
| Average Daily Package Volume (in thousands) | 15,797                  | 15,574    | 15,064    | 1.4%        | 3.4%        |
| Average Revenue Per Piece                   | \$ 10.82                | \$ 10.24  | \$ 9.83   | 5.7%        | 4.2%        |
| Net Income (in millions)                    | \$ 3,804                | \$ 3,338  | \$ 1,968  | 14.0%       | 69.6%       |
| Basic Earnings Per Share                    | \$ 3.88                 | \$ 3.36   | \$ 1.97   | 15.5%       | 70.6%       |
| Diluted Earnings Per Share                  | \$ 3.84                 | \$ 3.33   | \$ 1.96   | 15.3%       | 69.9%       |

**Items Affecting Comparability**

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

|  | Year Ended December 31, |        |       |
|--|-------------------------|--------|-------|
|  | 2011                    | 2010   | 2009  |
| <b>Operating Expenses:</b>                                     |                         |        |       |
| Pension and Postretirement Benefit Plans Mark-to-Market Charge | \$ 827                  | \$ 112 | \$ 16 |
| Restructuring Charge   |                         | 98     |       |
| Gain on Sales of Businesses                                    |                         | (20)   |       |
| Gains on Real Estate Transactions                              | (33)                    | (109)  |       |
| Aircraft Impairment Charge                                     |                         |        | 181   |
| <b>Interest Expense:</b>                                       |                         |        |       |
| Currency Remeasurement Charge                                  |                         |        | 77    |
| Income Tax Expense (Benefit) from the Items Above              | (287)                   |        | (99)  |
| Charge for Change in Tax Filing Status for German Subsidiary   |                         | 76     |       |

*Pension and Postretirement Benefit Plans Mark-to-Market Charge*

In 2011, 2010 and 2009, we incurred pre-tax mark-to-market losses on our pension and postretirement benefit plans related to the remeasurement of plan assets and liabilities recognized outside of a 10% corridor of \$827, \$112 and \$16 million, respectively, on a consolidated basis (\$527, \$75 and \$11 million after-tax, respectively). These mark-to-market losses for 2011, 2010 and 2009 primarily resulted from decreases in the discount rates used to value our projected benefit obligations in each year. These charges impacted each of our three reporting segments in 2011 and 2010, and our International Package segment in 2009.

*Restructuring Charge*

In 2010, we streamlined 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.

*Gain on Sales of Businesses*

In 2010, we sold our UPS Logistics Technologies business unit within our Supply Chain & Freight segment, and recognized a pre-tax gain of \$71 million (\$44 million after-tax). Also in 2010, we sold a specialized



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transportation business in Germany within our Supply Chain & Freight segment, and incurred a pre-tax loss on the sale of \$51 million (\$47 million after-tax), which includes a fair value adjustment loss due to a financial guarantee associated with this business sale.

### *Gains on Real Estate Transactions*

In 2011, we recognized a net \$33 million pre-tax gain (\$20 million after-tax) on a consolidated basis on certain real estate transactions (consisting of a \$48 million pre-tax gain in our Supply Chain & Freight segment, and a \$15 million pre-tax loss in our U.S. Domestic Package segment). In 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.

### *Aircraft Impairment Charges*

In 2009, we completed an impairment assessment of our McDonnell-Douglas DC-8 aircraft fleet, and recorded an impairment charge of \$181 million (\$116 million after-tax), which affected our U.S. Domestic Package segment. This charge, as well as our accounting policies pertaining to long-lived assets, is discussed further in *Critical Accounting Policies and Estimates*.

### *Currency Remeasurement Charge*

During 2009, we incurred a \$77 million non-cash, pre-tax currency remeasurement charge (\$48 million after-tax) on certain foreign currency denominated obligations.

### *Charge for Change in Tax Filing Status for German Subsidiary*

In 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, net income and earnings per share adjusted 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 recurring 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.

**Table of Contents****U.S. Domestic Package Operations**

|  | Year Ended December 31, |                  |                  | % Change    |             |
|--|-------------------------|------------------|------------------|-------------|-------------|
|  | 2011                    | 2010             | 2009             | 2011 / 2010 | 2010 / 2009 |
| Average Daily Package Volume (in thousands):                   |                         |                  |                  |             |             |
| Next Day Air   | 1,206                   | 1,205            | 1,198            | 0.1%        | 0.6%        |
| Deferred   | 975                     | 941              | 957              | 3.6%        | (1.7)%      |
| Ground   | 11,230                  | 11,140           | 10,895           | 0.8%        | 2.2%        |
| <b>Total Avg. Daily Package Volume</b>                         | <b>13,411</b>           | <b>13,286</b>    | <b>13,050</b>    | <b>0.9%</b> | <b>1.8%</b> |
| Average Revenue Per Piece:                                     |                         |                  |                  |             |             |
| Next Day Air   | \$ 20.33                | \$ 19.14         | \$ 18.00         | 6.2%        | 6.3%        |
| Deferred   | 13.32                   | 12.50            | 11.81            | 6.6%        | 5.8%        |
| Ground   | 7.78                    | 7.43             | 7.20             | 4.7%        | 3.2%        |
| <b>Total Avg. Revenue Per Piece</b>                            | <b>\$ 9.31</b>          | <b>\$ 8.85</b>   | <b>\$ 8.53</b>   | <b>5.2%</b> | <b>3.8%</b> |
| Operating Days in Period                                       | 254                     | 253              | 253              |             |             |
| Revenue (in millions):   |                         |                  |                  |             |             |
| Next Day Air   | \$ 6,229                | \$ 5,835         | \$ 5,456         | 6.8%        | 6.9%        |
| Deferred   | 3,299                   | 2,975            | 2,859            | 10.9%       | 4.1%        |
| Ground   | 22,189                  | 20,932           | 19,843           | 6.0%        | 5.5%        |
| <b>Total Revenue</b>   | <b>\$ 31,717</b>        | <b>\$ 29,742</b> | <b>\$ 28,158</b> | <b>6.6%</b> | <b>5.6%</b> |
| Operating Expenses (in millions):                              |                         |                  |                  |             |             |
| Operating Expenses   | \$ 27,953               | \$ 26,504        | \$ 26,239        | 5.5%        | 1.0%        |
| Pension and Postretirement Benefit Plans Mark-to-Market Charge | (479)                   | (31)             |                  |             |             |
| Restructuring Charge   |                         | (98)             |                  |             |             |
| Gains (Losses) on Real Estate Transactions                     | (15)                    | 109              |                  |             |             |
| Aircraft Impairment Charge                                     |                         |                  | (181)            |             |             |
| <b>Adjusted Operating Expenses</b>                             | <b>\$ 27,459</b>        | <b>\$ 26,484</b> | <b>\$ 26,058</b> | <b>3.7%</b> | <b>1.6%</b> |
| Operating Profit (in millions) and Operating Margin:           |                         |                  |                  |             |             |
| Operating Profit   | \$ 3,764                | \$ 3,238         | \$ 1,919         | 16.2%       | 68.7%       |
| Adjusted Operating Profit                                      | \$ 4,258                | \$ 3,258         | \$ 2,100         | 30.7%       | 55.1%       |
| Operating Margin   | 11.9%                   | 10.9%            | 6.8%             |             |             |
| Adjusted Operating Margin                                      | 13.4%                   | 11.0%            | 7.5%             |             |             |

**Revenue**

The change in overall revenue was impacted by the following factors for the years ended December 31, 2011 and 2010, compared with the prior years:

|                                | Volume | Rates / Product Mix | Fuel Surcharge | Total Revenue Change |
|--------------------------------|--------|---------------------|----------------|----------------------|
| <b>Revenue Change Drivers:</b> |        |                     |                |                      |
| 2011 vs 2010                   | 1.3%   | 2.3%                | 3.0%           | 6.6%                 |
| 2010 vs 2009                   | 1.8%   | 1.7%                | 2.1%           | 5.6%                 |

**Volume**

2011 compared to 2010

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Our overall volume increased slightly in 2011 compared with 2010, and was largely impacted by the slowing U.S. economy during the first three quarters of the year. Business-to-consumer shipments, which

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represent approximately 40% of total U.S. Domestic Package volume, experienced stronger growth than commercial volume. Volume growth accelerated in the fourth quarter, with average daily volume increasing 3.8% over the fourth quarter of 2010.

Among our air products, we experienced a 4.8% 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. 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 2011. During the fourth quarter of 2011, volume growth accelerated to 12.3% and 3.5% in our deferred and ground products, respectively, compared with the fourth quarter of 2010. These increases were primarily driven by higher business-to-consumer shipment growth during the holiday season.

### *2010 compared to 2009*

In 2010, our overall volume increased as improvements in industrial production and retail sales increased overall demand in the U.S. small package market. Among our air products, Next Day and Second Day air package volume increased 2.1% as inventory rebuilding in the manufacturing and retailing sectors contributed to growth. However, our letter volume declined largely due to weakness in the financial and other service industries. The growth in ground volume was driven by increased volume from the manufacturing and retailing sectors.

### ***Rates and Product Mix***

#### *2011 compared to 2010*

Overall revenue per piece increased for our ground and air products during 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 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. Comparing the fourth quarter of 2011 with 2010, the average revenue per piece increase slowed to 3.4% due to the higher volume of lighter-weight business-to-consumer 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.

#### *2010 compared to 2009*

Overall revenue per piece increased for our ground and air products in 2010, largely due to a combination of base price increases and fuel surcharge rate changes, which are discussed further below. The revenue per piece for our air products also improved as a result of higher average package weights and the overall mix shift from letters to packages. For both our air and ground products, revenue per piece was negatively affected by a shift in product mix to our less premium services, such as Next Day Air Saver and Ground Basic.

Revenue per piece for our ground and air products was impacted by an increase in base rates that took effect on January 4, 2010. We increased the base rates 6.9% on UPS Next Day Air, UPS 2nd Day Air, and UPS 3 Day Select, and 4.9% on UPS Ground. 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.

**Table of Contents****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:

|                         | Year Ended December 31, |      |      | % Point Change |             |
|-------------------------|-------------------------|------|------|----------------|-------------|
|                         | 2011                    | 2010 | 2009 | 2011 / 2010    | 2010 / 2009 |
| Next Day Air / Deferred | 13.3%                   | 8.0% | 4.0% | 5.3%           | 4.0%        |
| Ground                  | 8.0%                    | 5.6% | 3.3% | 2.4%           | 2.3%        |

In connection with our base rate increase on January 3, 2011, 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. In connection with a base rate increase on January 4, 2010, we modified the fuel surcharge on air services by reducing the index used to determine the fuel surcharge by 2%. The 2011 and 2010 increases in the air and ground fuel surcharges were due to the significant increases in jet and diesel fuel prices each year, but partially offset by the reductions in the index on the air and ground surcharges in 2011 and the index on the air surcharge in 2010. Total domestic fuel surcharge revenue increased by \$884 and \$592 million in 2011 and 2010, respectively, primarily due to the higher fuel surcharge rates discussed above.

**Operating Expenses***2011 compared to 2010*

Overall adjusted operating expenses for the segment increased \$975 million in 2011 compared with 2010, while the total adjusted cost per piece increased 2.3% for the year. A large component of this increase relates to the cost of operating our domestic integrated air and ground network, which increased \$579 million in 2011 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 \$354 million in 2011 compared to 2010, primarily as a result of higher fuel prices and a 3.1% union contractual driver wage increase.

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 continued to utilize our expanded Worldport facility to operate larger aircraft and to increase package sorting efficiency. These network efficiency improvements resulted in a 0.8% reduction in total labor hours and a 0.8% reduction in miles driven in 2011 compared with 2010. Increased delivery densities as a result of improved planning and technology, and growth in our SurePost product, have also contained increases in cost.

*2010 compared to 2009*

Overall adjusted operating expenses for the segment increased \$426 million in 2010 compared with 2009, while the total adjusted cost per piece decreased 0.2% for the year. Network costs increased \$167 million in 2010 due largely to higher fuel costs. Pickup and delivery costs increased \$148 million for the year, primarily as a result of higher fuel prices and a 3.5% union contractual driver wage increase. Sort costs increased \$59 million for the year, largely due to contractual union wage increases as well as higher depreciation expense for certain operating facilities, including our Worldport Hub.

Network efficiencies were achieved in 2010, as we adjusted our air and ground networks to better match volume levels, and increased our package sorting efficiency. Improved pick-up and delivery densities also increased productivity in our operations. These network efficiency improvements resulted in a 1.8% reduction in direct labor hours, a 6.7% reduction in aircraft block hours and a 1.4% reduction in miles driven in 2010 compared with 2009. In addition to these factors, management salary costs declined as a result of a decrease in the total number of management employees through attrition combined with voluntary and involuntary workforce reductions.

**Table of Contents****Operating Profit and Margin***2011 compared to 2010*

Higher adjusted operating profit during 2011 compared with 2010 was driven by the increased network efficiencies, combined with strong improvements in revenue per piece and a small increase in volume. Fourth quarter 2011 adjusted operating profit was particularly strong, with adjusted operating margins of 15.2% in comparison to 12.6% in the fourth quarter of 2010. Strong volume growth in the business-to-consumer sector, along with solid cost control and strong network efficiencies, were the primary factors for the fourth quarter 2011 performance.

*2010 compared to 2009*

Adjusted operating profit in 2010 was positively impacted by the overall economic growth in the U.S., which drove increased volume and yields. We achieved strong operating leverage through increased network efficiencies and cost containment initiatives, leading to an increase in the operating margin in 2010 compared with 2009.

**International Package Operations**

|   | Year Ended December 31, |           |          | % Change    |             |
|---|-------------------------|-----------|----------|-------------|-------------|
|   | 2011                    | 2010      | 2009     | 2011 / 2010 | 2010 / 2009 |
| Average Daily Package Volume (in thousands):                  |                         |           |          |             |             |
| Domestic  | 1,444                   | 1,403     | 1,218    | 2.9%        | 15.2%       |
| Export  | 942                     | 885       | 796      | 6.4%        | 11.2%       |
| Total Avg. Daily Package Volume                               | 2,386                   | 2,288     | 2,014    | 4.3%        | 13.6%       |
| Average Revenue Per Piece:                                    |                         |           |          |             |             |
| Domestic  | \$ 7.17                 | \$ 6.66   | \$ 6.85  | 7.7%        | (2.8)%      |
| Export  | 37.85                   | 36.77     | 35.63    | 2.9%        | 3.2%        |
| Total Avg. Revenue Per Piece                                  | \$ 19.28                | \$ 18.31  | \$ 18.23 | 5.3%        | 0.4%        |
| Operating Days in Period                                      | 254                     | 253       | 253      |             |             |
| Revenue (in millions):  |                         |           |          |             |             |
| Domestic  | \$ 2,628                | \$ 2,365  | \$ 2,111 | 11.1%       | 12.0%       |
| Export  | 9,056                   | 8,234     | 7,176    | 10.0%       | 14.7%       |
| Cargo   | 565                     | 534       | 412      | 5.8%        | 29.6%       |
| Total Revenue   | \$ 12,249               | \$ 11,133 | \$ 9,699 | 10.0%       | 14.8%       |
| Operating Expenses (in millions):                             |                         |           |          |             |             |
| Operating Expenses  | \$ 10,540               | \$ 9,302  | \$ 8,420 | 13.3%       | 10.5%       |
| Pension and Postretirement Benefit Plan Mark-to-Market Charge | (171)                   | (42)      | (16)     |             |             |
| Adjusted Operating Expenses                                   | \$ 10,369               | \$ 9,260  | \$ 8,404 | 12.0%       | 10.2%       |
| Operating Profit (in millions) and Operating Margin:          |                         |           |          |             |             |
| Operating Profit  | \$ 1,709                | \$ 1,831  | \$ 1,279 | (6.7)%      | 43.2%       |
| Adjusted Operating Profit                                     | \$ 1,880                | \$ 1,873  | \$ 1,295 | 0.4%        | 44.6%       |
| Operating Margin  | 14.0%                   | 16.4%     | 13.2%    |             |             |
| Adjusted Operating Margin                                     | 15.3%                   | 16.8%     | 13.4%    |             |             |
| Currency Translation Benefit / (Cost) (in millions)*:         |                         |           |          |             |             |
| Revenue   | \$ 75                   | \$ (24)   |          |             |             |
| Operating Profit  | (123)                   | 6         |          |             |             |

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



**Table of Contents****Revenue**

The change in overall revenue was impacted by the following factors for the years ended December 31, 2011 and 2010, compared with the prior years:

|                                | Volume | Rates /<br>Product Mix | Fuel<br>Surcharge | Currency | Total<br>Revenue<br>Change |
|--------------------------------|--------|------------------------|-------------------|----------|----------------------------|
| <b>Revenue Change Drivers:</b> |        |                        |                   |          |                            |
| 2011 vs 2010                   | 4.7%   | 0.6%                   | 4.0%              | 0.7%     | 10.0%                      |
| 2010 vs 2009                   | 13.6%  | (1.7)%                 | 3.1%              | (0.2)%   | 14.8%                      |

**Volume***2011 compared to 2010*

Export volume increased in 2011 compared to 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. Volume for our premium Worldwide Express and Worldwide Expedited products increased 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 2011 compared with 2010, and was impacted by the continued economic growth in Asia overall. Our export volume growth slowed in the latter half of 2011, largely due to decelerating growth in exports out of China and the rest of Asia, as well as difficult comparisons with a relatively strong latter half of 2010.

Non-U.S. domestic volume increases were driven by continued strong growth in key markets, including Germany, France and Poland.

*2010 compared to 2009*

Export volume increased for 2010, as the worldwide economy and world trade continued to improve. We experienced strong growth in Asia, where volume grew 28% due to a combination of regional economic growth and geographic expansion of our service offerings. European export volume also had strong growth for 2010, increasing 10% compared with 2009, due to market share gains, economic growth in certain key markets, and an overall expansion of trade in the European Union. U.S. origin export volume also had solid growth during 2010. Our premium Worldwide Express and Expedited products grew at a relatively faster rate than our standard transborder and trade direct products.

Non-U.S. domestic volume increased 15.2% for 2010, due in part to the acquisition of Unsped Paket Servisi San ve Ticaret A.S. ( Unsped ) in Turkey in the third quarter of 2009. Excluding the acquisition of Unsped, non-U.S. domestic volume increased 9.7%, led by the strength in core European markets, Canada and Mexico.

**Rates and Product Mix***2011 compared to 2010*

Total average revenue per piece increased 4.6% for 2011 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 3.0% for 2011 compared with 2010. Product mix adversely impacted export revenue per piece, due to strong growth among our lower-yielding Transborder 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 3.9% on a currency-adjusted basis for 2011, largely due to comparatively faster growth in our premium express products.

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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.

### *2010 compared to 2009*

Export revenue per piece increased during 2010, largely due to higher fuel surcharge rates, base rate increases and product mix. Export revenue per piece increased as higher-yielding products (such as Worldwide Express and Worldwide Expedited) grew at a relatively faster pace. In 2010, we experienced an overall lengthening of trade lanes, as inter-regional trade increased (especially in our Asia-to-Europe and Asia-to-U.S. export lanes), leading to relatively stronger growth for our premium products. The impact of currency, net of hedging, resulted in a decrease to revenue growth during the year. Domestic revenue per piece decreased, primarily due to the impact of lower-yielding domestic packages from the Unsped acquisition. Total average revenue per piece increased 0.7% for the year on a currency-adjusted basis.

On January 4, 2010, we increased the base rates 6.9% for international shipments originating in the United States (Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard service). Rate changes for shipments originating outside the U.S. were made throughout the year and varied by geographic market.

### ***Fuel Surcharges***

In connection with our base rate increases on January 3, 2011 and January 4, 2010, we modified the fuel surcharges on certain U.S.-related international air services by reducing the index used to determine the fuel surcharge by 2% in each of the two years. 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 \$449 and \$299 million in 2011 and 2010, respectively, due to higher fuel surcharge rates caused by increased fuel prices as well as an increase in international air volume.

### ***Operating Expenses***

#### *2011 compared to 2010*

Overall adjusted operating expenses for the segment increased \$1.109 billion in 2011 compared with 2010. The impact of foreign currency exchange rate changes resulted in an adverse impact on operating expense comparisons between 2011 and 2010 of \$198 million. Excluding the impact of currency exchange rate changes, the total adjusted cost per piece for the segment increased 4.7% for the year.

The increase in adjusted operating expenses, excluding the impact of currency, was largely due to the increased cost of operating our international integrated air and ground network, and also higher pick-up and delivery costs. Network costs increased \$745 million for the year, largely due 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 \$123 million for the year, primarily as a result of higher fuel prices and increased package volume.

#### *2010 compared to 2009*

Overall adjusted operating expenses for the segment increased \$856 million in 2010 compared with 2009. The impact of foreign currency exchange rate changes resulted in a favorable impact on operating expense comparisons between 2010 and 2009 of \$30 million. Excluding the impact of currency exchange rate changes, the total adjusted cost per piece for the segment decreased 2.6% for the year.

The increase in adjusted operating expenses, excluding the impact of currency, was primarily due to the cost of operating our international integrated air and ground network, as well as pick-up and delivery costs and

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package sort expenses. Network costs increased \$498 million for the year due largely to higher fuel costs and increased block hours. Pick-up and delivery costs increased \$270 million for the year, primarily as a result of higher fuel prices and increased package volume. Package sorting expenses increased \$61 million, and were impacted by higher labor costs and increased depreciation on certain operating facilities.

***Operating Profit and Margin***

*2011 compared to 2010*

Adjusted operating profit increased slightly in 2011 compared with 2010, while the segment operating margin declined for the year due to several factors. The overall increase in adjusted operating profit was largely due to the volume and revenue per piece increases previously discussed; however, the impact of these items was largely offset by excess capacity and the adverse impact of fuel prices and currency exchange rate movements. Volume softness in the Asia-to-U.S. trade lane in the latter half of 2011 resulted in excess transportation capacity, which pressured margins while our transportation network was being adjusted for the slowing demand. Fluctuations in foreign currency exchange rates (net of our hedging programs) resulted in an adverse impact on operating profit comparisons between 2011 and 2010 of \$123 million. Additionally, fuel prices adversely impacted the operating profit comparison between 2011 and 2010, as fuel expense increased at a faster pace than fuel surcharge revenue. These factors resulted in a decrease in the operating margin in 2011 compared with 2010.

*2010 compared to 2009*

The increase in operating profit for 2010 was primarily driven by volume increases in all major regions and trade lanes worldwide. The shift in product mix to our higher-margin premium services also contributed to the increase in operating profits. Additionally, network efficiencies and cost containment initiatives created operating leverage throughout our operations. These factors led to an increase in the operating margin in 2010 compared with 2009.

**Table of Contents****Supply Chain & Freight Operations**

|  | Year Ended December 31, |                 |                 | % Change    |              |
|--|-------------------------|-----------------|-----------------|-------------|--------------|
|  | 2011                    | 2010            | 2009            | 2011 / 2010 | 2010 / 2009  |
| <b>Freight LTL Statistics:</b>                                 |                         |                 |                 |             |              |
| Revenue (in millions)  | \$ 2,299                | \$ 2,002        | \$ 1,807        | 14.8%       | 10.8%        |
| Revenue Per Hundredweight                                      | \$ 21.17                | \$ 19.18        | \$ 17.69        | 10.4%       | 8.4%         |
| Shipments (in thousands)                                       | 10,247                  | 9,952           | 9,880           | 3.0%        | 0.7%         |
| Shipments Per Day (in thousands)                               | 40.5                    | 39.5            | 39.1            | 2.5%        | 1.0%         |
| Gross Weight Hauled (in millions of lbs)                       | 10,858                  | 10,440          | 10,211          | 4.0%        | 2.2%         |
| Weight Per Shipment (in lbs)                                   | 1,060                   | 1,049           | 1,033           | 1.0%        | 1.5%         |
| Operating Days in Period                                       | 253                     | 252             | 253             |             |              |
| <b>Revenue (in millions):</b>                                  |                         |                 |                 |             |              |
| Forwarding and Logistics                                       | \$ 6,103                | \$ 6,022        | \$ 5,080        | 1.3%        | 18.5%        |
| Freight  | 2,563                   | 2,208           | 1,943           | 16.1%       | 13.6%        |
| Other  | 473                     | 440             | 417             | 7.5%        | 5.5%         |
| <b>Total Revenue</b>   | <b>\$ 9,139</b>         | <b>\$ 8,670</b> | <b>\$ 7,440</b> | <b>5.4%</b> | <b>16.5%</b> |
| <b>Operating Expenses (in millions):</b>                       |                         |                 |                 |             |              |
| Operating Expenses   | \$ 8,532                | \$ 8,098        | \$ 7,130        | 5.4%        | 13.6%        |
| Pension and Postretirement Benefit Plans Mark-to-Market Charge | (177)                   | (39)            |                 |             |              |
| Gain on Real Estate Transactions                               | 48                      |                 |                 |             |              |
| Gain on Sales of Businesses                                    |                         | 20              |                 |             |              |
| <b>Adjusted Operating Expenses</b>                             | <b>\$ 8,403</b>         | <b>\$ 8,079</b> | <b>\$ 7,130</b> | <b>4.0%</b> | <b>13.3%</b> |
| <b>Operating Profit (in millions) and Operating Margins:</b>   |                         |                 |                 |             |              |
| Operating Profit   | \$ 607                  | \$ 572          | \$ 310          | 6.1%        | 84.5%        |
| Adjusted Operating Profit                                      | \$ 736                  | \$ 591          | \$ 310          | 24.5%       | 90.6%        |
| Operating Margin   | 6.6%                    | 6.6%            | 4.2%            |             |              |
| Adjusted Operating Margin                                      | 8.1%                    | 6.8%            | 4.2%            |             |              |
| <b>Currency Translation Benefit / (Cost) (in millions)*:</b>   |                         |                 |                 |             |              |
| Revenue  | \$ 139                  | \$ 48           |                 |             |              |
| Operating Profit   | 7                       | 7               |                 |             |              |

\* Amount represents the change compared to the prior year.

**Revenue***2011 compared to 2010*

Forwarding and logistics revenue increased in 2011 compared with 2010, primarily due to growth in our logistics services, where we experienced solid growth in our mail services, retail and health care 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 global economic slowdown.

Freight revenue increased in 2011, primarily due to growth in LTL shipments, an increase in base rates, and increased fuel surcharge rates. LTL shipments per day increased in 2011, largely due to improving LTL market conditions in the first half of the year and an increase in market share. However, volume declined in the latter half of the year, and was impacted by 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 year, negotiated increases on existing contract rates and



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higher fuel surcharge rates, as total fuel surcharge revenue increased \$159 million for the year 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.

### *2010 compared to 2009*

Forwarding and logistics revenue increased in 2010, primarily due to growth in the demand for forwarding as a result of the continued expansion of the worldwide economy, inventory rebuilding and world trade. In our forwarding business, both air freight and ocean freight experienced solid revenue growth, due primarily to higher volumes, fuel surcharges, and other accessorial charges. International air freight tonnage increased 19% for 2010 compared with the prior year. In our logistics products, we experienced growth in mail services and distribution revenue, with solid increases being achieved in the health care and technology sectors.

Freight revenue increased, primarily due to higher fuel surcharge rates and a base rate increase that took effect in January 2010. Average LTL shipments per day, weight per shipment and LTL revenue per hundredweight all increased during the year, largely due to our strategy of maintaining our focus on yields and targeting certain customer segments. The increase in LTL revenue per hundredweight was primarily due to an increase in base prices that took effect in January 2010, as UPS Freight increased minimum charge, LTL and TL rates an average of 5.7%, covering non-contractual shipments in the United States, Canada, and Mexico. An additional 5.9% rate increase took effect October 18, 2010. Additionally, LTL revenue per hundredweight increased as a result of higher fuel surcharge rates, as total fuel surcharge revenue increased \$105 million for the year primarily resulting from higher diesel fuel prices.

The other businesses within Supply Chain & Freight experienced an increase in revenue. A primary driver of this increase was our UPS Customer Solutions business, which provides a range of services (e.g. project management, industrial engineering, transportation fleet services, distribution network analysis, package engineering, and package visibility).

## ***Operating Expenses***

### *2011 compared to 2010*

Forwarding and logistics adjusted operating expenses were flat in 2011 compared with 2010. Purchased transportation expense declined by \$87 million in 2011, due to lower air freight volume as well as lower rates passed to us from third-party transportation carriers. The reduction in third-party carrier rates was largely due to over-capacity in the Asia-to-U.S. trade lane that began in the latter half of 2010 and continued into the first half of 2011. This reduction in purchased transportation costs was offset by increases in several other expense categories, including other occupancy costs, depreciation and amortization, repairs and maintenance, and other expenses.

Freight operating expenses increased \$317 million for 2011 on an adjusted basis, with the total cost per LTL shipment increasing 10.0% for the year. The two largest components of this increase relate to the cost of operating our linehaul network, which increased \$134 million in 2011, and pick-up, delivery and dock costs, which increased \$112 million for the year. 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 effective wage increases of 4.1% for drivers in our linehaul network.

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and 3.5% for drivers and dock workers in our pick-up and delivery network. 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 increased \$6 million in 2011 compared to 2010, and the increases were spread among several operating expense categories and business units.

### *2010 compared to 2009*

Forwarding and logistics adjusted operating expenses increased \$697 million in 2010 compared with 2009, due to several factors. Purchased transportation costs increased by \$843 million in 2010, largely due to a strong increase in tonnage in our air and ocean forwarding businesses, as well as rapidly escalating rates on air freight due to capacity constraints from outside carriers in the first half of 2010. The capacity constraints in the air freight business began to recede in the second half of 2010, and the increases in purchased transportation costs lessened. Cost controls partly offset the purchased transportation expense growth, as total compensation and benefits expense declined \$73 million and other occupancy expense declined by \$23 million, among other factors. The decrease in compensation and benefits expense was impacted by reduced pension expense, while the decline in other occupancy expense was largely due to lower rent expense on warehouses and other facilities.

Freight adjusted operating expenses increased \$240 million in 2010 compared with 2009, while the total cost per LTL shipment increased 8.8% for year. The two largest components of this increase relate to the cost of operating our linehaul network which increased \$73 million in 2010 compared with 2009, and pick-up, delivery and dock costs which increased \$98 million for the year. 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 effective wage increases of 2.0% for drivers in our linehaul network and 3.3% for drivers and dock workers in our pick-up and delivery network. 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.

Adjusted operating expenses for the other businesses within Supply Chain & Freight increased by \$12 million for 2010 compared with 2009, largely due to a gain recorded in 2009 (recorded as a reduction to operating expenses) on the sale of substantially all our international Mail Boxes Etc. operations.

## ***Operating Profit and Margin***

### *2011 compared to 2010*

The forwarding and logistics unit experienced an \$80 million increase in adjusted operating profit in 2011 compared with 2010, largely due to revenue management initiatives and cost containment in our forwarding unit, which improved operating leverage. Additionally, excess market capacity, especially in the Asia-to-U.S. trade lane, reduced our purchased transportation costs and improved the operating profitability in this business. Our logistics business had a small decrease in operating profit in 2011, primarily due to our continued investment in expanding our global health care capabilities.

Our freight unit had an increase of \$38 million in adjusted operating profit in 2011 compared with 2010, primarily due to increased yields, volume growth and improved productivity in our operations.

The combined operating income for all of our other businesses in this segment increased \$27 million in 2011, primarily due to improved results at our UPS Capital unit.

### *2010 compared to 2009*

Adjusted operating profit in the forwarding and logistics units increased by \$245 million in 2010 compared with 2009 as a result of several factors. The operating profit increase in the forwarding unit was largely due to a

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strong increase in tonnage in our air and ocean forwarding businesses, but was partially offset by capacity constraints from outside carriers in the first half of 2010. Capacity constraints led to rapidly escalating rates on air freight which could not be passed on to customers in a timely manner, resulting in a negative impact to our operating profit and margin. This situation improved during the second half of 2010, as capacity constraints lessened and we were able to implement revenue management plans which better matched customer pricing with market conditions. Our logistics unit had a solid increase in profitability in 2010, which was driven primarily by an expansion of operating margins due to operating efficiencies and a focus on higher margin industry sectors.

Adjusted operating profit for our UPS Freight unit increased by \$25 million in 2010 compared with the prior year, largely due to better productivity, and increases in base pricing and volume. Productivity metrics increased, including increases in pickup and delivery stops per hour and linehaul utilization.

All of the remaining businesses combined within this segment increased adjusted operating profit by \$11 million during the year, primarily due to improved results in our UPS Capital business unit.

**Operating Expenses**

|  | Year Ended December 31, |           |           | % Change    |             |
|--|-------------------------|-----------|-----------|-------------|-------------|
|  | 2011                    | 2010      | 2009      | 2011 / 2010 | 2010 / 2009 |
| Operating Expenses (in millions):                              |                         |           |           |             |             |
| Compensation and Benefits                                      | \$ 27,575               | \$ 26,557 | \$ 25,933 | 3.8%        | 2.4%        |
| Pension and Postretirement Benefit Plans Mark-to-Market Charge | (827)                   | (112)     | (16)      |             |             |
| Restructuring Charge   |                         | (98)      |           |             |             |
| Adjusted Compensation and Benefits                             | 26,748                  | 26,347    | 25,917    | 1.5%        | 1.7%        |
| Repairs and Maintenance  | 1,286                   | 1,131     | 1,075     | 13.7%       | 5.2%        |
| Depreciation and Amortization                                  | 1,782                   | 1,792     | 1,747     | (0.6)%      | 2.6%        |
| Purchased Transportation                                       | 7,232                   | 6,640     | 5,379     | 8.9%        | 23.4%       |
| Fuel   | 4,046                   | 2,972     | 2,365     | 36.1%       | 25.7%       |
| Other Occupancy  | 943                     | 939       | 985       | 0.4%        | (4.7)%      |
| Other Expenses   | 4,161                   | 3,873     | 4,305     | 7.4%        | (10.0)%     |
| Gain on Real Estate Transactions                               | 33                      | 109       |           |             |             |
| Gain on Sales of Businesses                                    |                         | 20        |           |             |             |
| Aircraft Impairment Charge                                     |                         |           | (181)     |             |             |
| Adjusted Other Expenses  | 4,194                   | 4,002     | 4,124     | 4.8%        | (3.0)%      |
| Total Operating Expenses                                       | \$ 47,025               | \$ 43,904 | \$ 41,789 | 7.1%        | 5.1%        |
| Adjusted Total Operating Expenses                              | 46,231                  | 43,823    | 41,592    | 5.5%        | 5.4%        |
| Currency Translation Cost                                      | \$ 330                  | \$ 11     |           |             |             |
| <b>Compensation and Benefits</b>                               |                         |           |           |             |             |

*2011 compared to 2010*

Employee payroll costs increased \$237 million in 2011 compared with 2010, 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 primarily due to a lower management incentive award.

Adjusted benefits expense increased \$164 million in 2011 compared with 2010, primarily due to higher employee health and welfare costs and expense associated with our self-insurance for worker's compensation claims, but partially offset by a decline in pension expense. These factors are discussed further as follows:

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Employee health and welfare program costs increased \$132 million in 2011, and were impacted by higher required union plan contribution rates and general health care inflation.

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The expense associated with our self-insurance programs for worker's compensation claims increased by \$48 million in 2011. 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. Insurance reserves also 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 in 2011.

Adjusted pension expense decreased \$50 million in 2011 due to several factors. Most significantly, contributions to the company-sponsored pension plans in 2011 increased the expected return on assets used for expense calculation purposes. The increase in the expected return on assets more than offset increased service and interest costs (due to a decline in discount rates), resulting in a net reduction in pension expense. This was partially offset by higher contribution rates for multiemployer pension plans, as well as the reinstatement of matching contributions to our primary employee defined contribution savings plan.

*2010 compared to 2009*

The increase in adjusted compensation and benefits expense in 2010 compared with 2009 was impacted by several items. Payroll costs increased \$416 million, largely due to higher accruals for management incentive compensation plans resulting from improved company financial results. Union payroll costs also increased due to contractual wage increases. These factors were partially offset by a decline in union labor hours, as well as a reduction in management salary costs resulting from a decrease in the total number of management employees through attrition combined with voluntary and involuntary workforce reductions.

Adjusted benefits expense increased \$14 million in 2010 compared with 2009, due largely to increases in health and welfare costs and relocation-related benefits for management employees. The increase in health and welfare costs, which was primarily driven by health cost inflation, was somewhat mitigated by reductions in the total number of management employees and union employees covered by UPS-sponsored health and welfare benefit plans. The relocation benefit costs relate to the restructuring of our domestic package operations that occurred in the first quarter of 2010. These increases were largely offset by a reduction in pension expense, due to an increase in the expected return on assets more than offsetting increasing service and interest costs. The increased expected return on assets was largely due to significant contributions to company-sponsored pension plans in 2010.

## ***Repairs and Maintenance***

*2011 compared to 2010*

The increase in repairs and maintenance expense was largely due to aircraft maintenance costs, which increased \$121 million in 2011 compared with 2010. 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.

*2010 compared to 2009*

The increase in repairs and maintenance expense in 2010 compared with 2009 was largely due to maintenance costs on our vehicle fleet, which increased by \$35 million during the year. The remaining increase in repairs and maintenance expense was largely due to higher maintenance costs on our aircraft fleet and operating facilities.

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### ***Depreciation and Amortization***

#### *2011 compared to 2010*

The decrease in depreciation and amortization expense in 2011 was primarily the result of a reduction in depreciation expense on technology equipment and software. This decline was primarily related to certain technology hardware and capitalized software becoming fully depreciated.

#### *2010 compared to 2009*

Depreciation and amortization expense increased in 2010, primarily as a result of depreciation expense on equipment and facilities capitalized in conjunction with the recent Worldport expansion. Amortization of intangible assets also increased as a result of new intangibles recognized related to the Unsped acquisition in Turkey in the third quarter of 2009, as well as corporate sponsorships entered into in 2010.

### ***Purchased Transportation***

#### *2011 compared to 2010*

The increase in purchased transportation in 2011 was caused 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 \$387 million in 2011. Additionally, we incurred a \$97 million increase in expense in 2011 for the use of rail carriers, which was due primarily to higher rates and fuel surcharges, as well as increased volumes. The remaining increase in expense for 2011 was primarily due to foreign currency exchange rate changes.

#### *2010 compared to 2009*

The increase in purchased transportation in 2010 was caused by several factors, including higher volume, as well as increased fuel surcharges and base rates charged to us by third-party air, ocean and truck carriers. The combination of these factors increased expense by \$1.224 billion in 2010 compared with 2009. Additionally, the expense for the use of rail carriers increased \$53 million, which was due primarily to higher rates and fuel surcharges, as well as increased volumes. Partially offsetting these increases in expense for 2010 was the impact of foreign currency exchange rate changes.

### ***Fuel***

#### *2011 compared to 2010*

The increase in fuel expense in 2011 compared with 2010 was primarily caused by higher prices for jet-A fuel, diesel and unleaded gasoline, which increased expense by \$982 million. Higher usage of these products in our operations accounted for the remaining increase in expense of \$92 million in 2011.

#### *2010 compared to 2009*

In 2010, higher prices for jet-A fuel, diesel, and unleaded gasoline increased fuel expense by \$564 million compared with 2009, while greater fuel usage increased expense by \$43 million.

### ***Other Occupancy***

#### *2011 compared to 2010*

Other occupancy expense increased in 2011 compared with 2010, 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.



**Table of Contents***2010 compared to 2009*

The decrease in other occupancy expense in 2010 compared with 2009 was primarily due to decreased labor and overhead expenses, and lower rent expense on leased facilities.

**Other Expenses***2011 compared to 2010*

The increase in adjusted other expenses in 2011 compared with 2010 was caused by several factors, including 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 reduction in bad debt and employee relocation expenses.

*2010 compared to 2009*

The decrease in adjusted other expenses in 2010 compared with 2009 was largely due to reductions in bad debt expense and foreign currency transaction expense, which reflected gains during 2010 compared to losses in 2009. Additionally, we incurred a loss on the sale of a French repair business in 2009. Additional expense reductions in 2010 were due to cost containment programs, including reductions in telecom costs, office supplies, and outside professional fees. We also incurred lower expenses associated with auto liability insurance and customer claims for lost or damaged packages.

**Investment Income and Interest Expense**

The following table sets forth investment income and interest expense for the years ended December 31, 2011, 2010 and 2009 (in millions):

|   | Year Ended December 31, |          |          | % Change    |             |
|---|-------------------------|----------|----------|-------------|-------------|
|   | 2011                    | 2010     | 2009     | 2011 / 2010 | 2010 / 2009 |
| Investment Income                       | \$ 44                   | \$ 3     | \$ 10    | N/A         | (70.0)%     |
| Interest Expense                        | \$ (348)                | \$ (354) | \$ (445) | (1.7)%      | (20.4)%     |
| Impact of Currency Remeasurement Charge |                         |          | 77       |             |             |
| Adjusted Interest Expense               | \$ (348)                | \$ (354) | \$ (368) | (1.7)%      | (3.8)%      |
| <i>Investment Income</i>                |                         |          |          |             |             |

The increase in investment income in 2011 compared with 2010 was caused by a combination of factors. During 2011, we realized \$20 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 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 change in investment income was caused by a lower yield earned on our invested assets; however, this was largely offset by a higher average balance of interest-earning investments in our portfolio.

The decrease in investment income in 2010 was primarily due to a lower yield earned on our invested assets as a result of declines in short-term interest rates in the United States, as well as higher impairment losses on our holdings of auction rate and preferred securities.

*Interest Expense*

Interest expense declined slightly in 2011 due to a lower average interest rate incurred on variable rate debt and interest rate swaps, which reduced expense by \$60 million for 2011 compared with 2010. However, this was largely offset as a result of a higher average balance of outstanding debt in 2011 compared with 2010.



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The decrease in adjusted interest expense in 2010 compared with 2009 was primarily due to lower average debt balances, but this was partially offset by lower capitalized interest, due to the recent completion of several large construction projects, including our Worldport expansion.

**Income Tax Expense**

The following table sets forth income tax expense and our effective tax rate for the years ended December 31, 2011, 2010 and 2009 (in millions):

|   | Year Ended December 31, |          |          | % Change    |             |
|---|-------------------------|----------|----------|-------------|-------------|
|   | 2011                    | 2010     | 2009     | 2011 / 2010 | 2010 / 2009 |
| Income Tax Expense                                | \$ 1,972                | \$ 1,952 | \$ 1,105 | 1.0%        | 76.7%       |
| Income Tax Impact of:                             |                         |          |          |             |             |
| Pension and Postretirement Benefit Plans          |                         |          |          |             |             |
| Mark-to-Market Charge                             | 300                     | 37       | 5        |             |             |
| Change in Tax Filing Status for German Subsidiary |                         | (76)     |          |             |             |
| Restructuring Charge                              |                         | 34       |          |             |             |
| Gain on Sales of Businesses                       |                         | (23)     |          |             |             |
| Gain on Real Estate Transactions                  | (13)                    | (48)     |          |             |             |
| Aircraft Impairment Charge                        |                         |          | 65       |             |             |
| Currency Remeasurement Charge                     |                         |          | 29       |             |             |
| Adjusted Income Tax Expense                       | \$ 2,259                | \$ 1,876 | \$ 1,204 | 20.4%       | 55.8%       |
| Effective Tax Rate                                | 34.1%                   | 36.9%    | 36.0%    |             |             |
| Adjusted Effective Tax Rate                       | 34.4%                   | 34.9%    | 36.0%    |             |             |

*2011 compared to 2010*

Adjusted income tax expense increased primarily due to higher pre-tax income. Our adjusted effective tax rate declined in 2011 compared with 2010 as a result of several factors, including changes in deferred tax asset valuation allowances, the relative proportion of taxable income in certain non-U.S. jurisdictions, and favorable developments with U.S. state tax audit and litigation matters.

*2010 compared to 2009*

The increase in our effective tax rate in 2010 compared with 2009 was attributable to the higher marginal tax rate applied to the gain on the sale of real estate, as well as the change in the tax filing status of a German subsidiary that occurred in the first quarter of 2010. Additionally, we were unable to recognize the entire potential tax benefit of tax loss carryforwards generated from the sale of a Supply Chain & Freight business in Germany in the first quarter of 2010.

Excluding these items, our adjusted effective tax rate decreased in 2010 compared to 2009 primarily due to the effect of having a higher proportion of our taxable income in 2010 being subject to tax outside the United States, where statutory tax rates are generally lower.

**Table of Contents****Liquidity and Capital Resources***Operating Activities*

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

|  | <b>2011</b>     | <b>2010</b>     | <b>2009</b>     |
|--|-----------------|-----------------|-----------------|
| Net income   | \$ 3,804        | \$ 3,338        | \$ 1,968        |
| Non-cash operating activities(a)                                       | 4,505           | 4,398           | 4,047           |
| Pension and postretirement plan contributions (UPS-sponsored plans)    | (1,436)         | (3,240)         | (924)           |
| Income tax receivables and payables                                    | 236             | (319)           | 245             |
| Changes in working capital and other noncurrent assets and liabilities | (12)            | (340)           | (137)           |
| Other operating activities   | (24)            | (2)             | 86              |
| <b>Net cash from operating activities</b>                              | <b>\$ 7,073</b> | <b>\$ 3,835</b> | <b>\$ 5,285</b> |

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

Cash from operating activities remained strong throughout the 2009 to 2011 time period. Operating cash flow was favorably impacted in 2011, compared with 2010, by higher net income, changes in our working capital position, the timing of income tax payments and the amount of contributions into our defined benefit pension and postretirement benefit plans. The favorable changes in working capital were impacted by the change in the timing of the elective awards under our management incentive awards program, which shifted the payout of \$253 million in awards from 2011 to the first quarter of 2012. The change in the cash flows for income tax receivables and payables in 2011 and 2010 was primarily related to the timing of discretionary pension contributions during 2010, as discussed further in the following paragraph.

Except for discretionary or accelerated fundings of our plans, contributions to our company-sponsored pension plans have largely varied based on whether any minimum funding requirements are present for individual pension plans.

In 2011, we made a \$1.2 billion contribution to the UPS IBT Pension Plan, which satisfied our 2011 contribution requirements and also approximately \$440 million in contributions that would not have been required until after 2011.

In 2010, operating cash flow was reduced by \$2.0 billion in discretionary contributions to our UPS Retirement and UPS Pension Plans, and \$980 million in required contributions to our UPS IBT Pension Plan.

In 2009, operating cash flow was reduced by \$778 million in required contributions to our UPS IBT Pension Plan.

The remaining contributions in the 2009 through 2011 period were largely due to contributions to our international pension plans and U.S. postretirement medical benefit plans.

As discussed further in the Contractual Commitments section, we have minimum funding requirements in the next several years, primarily related to the UPS IBT Pension, UPS Retirement and UPS Pension plans.

**Table of Contents***Investing Activities*

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

|   | 2011       | 2010       | 2009       |
|---|------------|------------|------------|
| Net cash used in investing activities                           | \$ (2,537) | \$ (654)   | \$ (1,248) |
| <b>Capital Expenditures:</b>                                    |            |            |            |
| Buildings and facilities  | \$ (373)   | \$ (352)   | \$ (568)   |
| Aircraft and parts  | (598)      | (416)      | (611)      |
| Vehicles  | (659)      | (339)      | (209)      |
| Information technology  | (375)      | (282)      | (214)      |
|   | \$ (2,005) | \$ (1,389) | \$ (1,602) |
| Capital Expenditures as a % of Revenue                          | 3.8%       | 2.8%       | 3.5%       |
| <b>Other Investing Activities:</b>                              |            |            |            |
| Proceeds from disposals of property, plant and equipment        | \$ 27      | \$ 304     | \$ 60      |
| Net decrease in finance receivables                             | \$ 184     | \$ 108     | \$ 261     |
| Net (purchases) sales of marketable securities                  | \$ (413)   | \$ 30      | \$ (11)    |
| Cash received (paid) for business acquisitions and dispositions | \$ (73)    | \$ 63      | \$ (9)     |
| Other investing activities                                      | \$ (257)   | \$ 230     | \$ 53      |

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. Capital spending increased in 2011 to support several growth initiatives. In 2010 and 2009, we had reduced capital spending to a level commensurate with our operating needs in the economic environment at that time. Future capital spending for anticipated growth and replacement assets will depend on a variety of factors, including economic and industry conditions. We anticipate that our capital expenditures for 2012 will be approximately \$2.2 billion, or approximately 4% of revenue.

Capital spending on aircraft over the 2009 to 2011 period was largely due to scheduled deliveries of previous orders for the Boeing 767-300 and 747-400 aircraft. Capital spending on vehicles increased during 2010 and 2011 in our U.S. and international package businesses and our freight unit, due to vehicle replacements, technology enhancements and new vehicle orders to support volume growth.

Capital expenditures on buildings and facilities declined over the 2009 through 2011 period, primarily resulting from the completion of several large hub construction and expansion projects, including our Worldport hub expansion. In 2009, we completed the first phase of our Worldport expansion, which increased the sorting capacity by 15%. The final phase of the Worldport expansion was completed in 2010, with an additional sorting capacity of approximately 20%. We anticipate that capital spending on buildings and facilities will increase in 2012, due to expansion and new construction projects at facilities in Europe and Asia, including a \$200 million expansion at our European air hub in Cologne, Germany during 2012 and 2013.

The 2010 increase in proceeds from the disposal of property, plant and equipment is largely due to real estate sales and the proceeds from insurance recoveries. The net decline in finance receivables in the 2009 through 2011 period is primarily due to customer paydowns and loan sales 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.

The cash paid for business acquisitions in 2011 was largely due to the acquisition of Pieffe Group in Italy. The cash received from business dispositions in 2010 was largely due to the sale of UPS Logistics Technologies, Inc. In 2009, the cash outflow for the purchase of Unsped Paket Servisi San ve Ticaret A.S. was largely offset by the cash received from the sale of the international franchise operations of our Mail Boxes Etc. unit.

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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 and Boeing 747-400 aircraft orders, and the equity investments in five new leveraged aircraft leases. We received (paid) cash related to purchases and settlements of energy and currency derivative contracts used in our hedging programs of \$(78), \$111 and \$117 million during 2011, 2010 and 2009, respectively.

*Financing Activities*

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

|   | 2011       | 2010       | 2009       |
|---|------------|------------|------------|
| Net cash used in financing activities         | \$ (4,862) | \$ (1,346) | \$ (3,045) |
| <b>Share Repurchases:</b>                     |            |            |            |
| Cash expended for shares repurchased          | \$ (2,665) | \$ (817)   | \$ (561)   |
| Number of shares repurchased                  | (38.7)     | (12.4)     | (10.9)     |
| Shares outstanding at year-end                | 963        | 991        | 994        |
| Percent reduction in shares outstanding       | (2.8)%     | (0.3)%     | (0.2)%     |
| <b>Dividends:</b>                             |            |            |            |
| Dividends declared per share                  | \$ 2.08    | \$ 1.88    | \$ 1.80    |
| Cash expended for dividend payments           | \$ (1,997) | \$ (1,818) | \$ (1,751) |
| <b>Borrowings:</b>                            |            |            |            |
| Net borrowings (repayments) of debt principal | \$ (95)    | \$ 1,246   | \$ (522)   |
| <b>Other Financing Activities:</b>            |            |            |            |
| Cash received for common stock issuances      | \$ 290     | \$ 218     | \$ 149     |
| Other financing activities                    | \$ (395)   | \$ (175)   | \$ (360)   |
| <b>Capitalization:</b>                        |            |            |            |
| Total debt outstanding at year-end            | \$ 11,128  | \$ 10,846  | \$ 9,521   |
| Total shareholders' equity at year-end        | 7,108      | 8,047      | 7,696      |
| Total capitalization                          | \$ 18,236  | \$ 18,893  | \$ 17,217  |
| Debt to Total Capitalization %                | 61.0%      | 57.4%      | 55.3%      |

In January 2008, the Board of Directors approved 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. As a result of the uncertain economic environment in 2010 and 2009, we slowed our share repurchase activity, and repurchased shares at a rate that approximately offset the dilution from our stock compensation programs. 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. As of December 31, 2011, we had \$2.525 billion of our share repurchase authorization remaining. In 2012, pending Board of Directors approval of an additional share repurchase authorization, we anticipate repurchasing approximately \$2.7 billion in shares.

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 expect to continue the practice of paying regular cash dividends. In February 2012, we increased our quarterly dividend payment from \$0.52 to \$0.57 per share, a 10% increase.

Issuances of debt in 2011 consisted primarily of commercial paper and five new aircraft leases. In 2010 and 2009, we completed senior fixed rate note offerings of \$2.0 billion in each year. These note offerings were used for various purposes, including discretionary contributions to UPS-sponsored pension plans, the retirement of existing debt instruments and other general corporate purposes.

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Repayments of debt in 2011, 2010 and 2009 consisted primarily of paydowns of commercial paper, early redemptions of our UPS Notes program and certain facilities bonds, and scheduled principal payments on our capitalized lease obligations. 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.

We had no commercial paper outstanding at December 31, 2011 and \$341 million outstanding at December 31, 2010. The amount of commercial paper outstanding fluctuates throughout each year based on daily liquidity needs. The average commercial paper balance was \$849 million and the average interest rate paid was 0.08% in 2011 (\$947 million and 0.14% in 2010, respectively).

Cash received from common stock issuances to employees increased primarily due to additional stock option exercises in 2011 and 2010. The cash outflows in other financing activities are largely due to repurchases of shares from employees to satisfy tax withholding obligations, as well as certain hedging activities on forecasted debt issuances and premiums paid on capped call options for the purchase of UPS class B shares. In conjunction with the senior fixed rate debt offerings in 2010 and 2009, we settled several interest rate derivatives that were designated as hedges of these debt offerings, which resulted in cash inflows (outflows) of \$7 and \$(243) million, respectively. As of December 31, 2011, we had paid premiums of \$200 million on capped call options for the purchase of 3.3 million class B shares that will settle in the first half of 2012.

*Sources of Credit*

We are authorized to borrow up to \$10.0 billion under our U.S. commercial paper program. As of December 31, 2011, we had no commercial paper outstanding. The amount of commercial paper outstanding in 2012 is expected to fluctuate. We also maintain a European commercial paper program under which we are authorized to borrow up to 1.0 billion in a variety of currencies, however no amounts were outstanding under this program as of December 31, 2011.

We maintain two credit agreements with a consortium of banks. One of these agreements provides revolving credit facilities of \$1.5 billion, and expires on April 12, 2012. Generally, amounts outstanding under this facility bear interest at a periodic fixed rate equal to LIBOR for the applicable interest period and currency denomination, plus an applicable margin. Alternatively, a fluctuating rate of interest equal to Citibank's publicly announced base rate, plus an applicable margin, may be used at our discretion. In each case, the applicable margin for advances bearing interest based on LIBOR is a percentage determined by quotations from Markit Group Ltd. for our 1-year credit default swap spread, subject to a minimum rate of 0.15% and a maximum rate of 0.75%. The applicable margin for advances bearing interest based on the base rate is 1.00% below the applicable margin for LIBOR advances (but not lower than 0.00%). We are also able to request advances under this facility based on competitive bids for the applicable interest rate. There were no amounts outstanding under this facility as of December 31, 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 December 31, 2011.

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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 December 31, 2011 and for all prior periods presented, 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 December 31, 2011, 10% of net tangible assets is equivalent to \$2.550 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 December 31, 2011, our net worth, as defined, was equivalent to \$10.138 billion. We do not expect these covenants to have a material impact on our financial condition or liquidity.

*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 financial condition or liquidity.

*Contractual Commitments*

We have contractual obligations and commitments in the form of capital leases, operating leases, debt obligations, purchase commitments, and certain other liabilities. We intend to satisfy these obligations through the use of cash flow from operations. The following table summarizes the expected cash outflow to satisfy our contractual obligations and commitments as of December 31, 2011 (in millions):

| <b>Commitment Type</b> | <b>2012</b>     | <b>2013</b>     | <b>2014</b>     | <b>2015</b>     | <b>2016</b>     | <b>After 2016</b> | <b>Total</b>     |
|------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-------------------|------------------|
| Capital Leases         | \$ 59           | \$ 56           | \$ 51           | \$ 50           | \$ 48           | \$ 474            | \$ 738           |
| Operating Leases       | 329             | 257             | 192             | 140             | 97              | 393               | 1,408            |
| Debt Principal         |                 | 1,750           | 1,000           | 100             |                 | 7,366             | 10,216           |
| Debt Interest          | 315             | 292             | 263             | 257             | 257             | 4,622             | 6,006            |
| Purchase Commitments   | 517             | 453             | 32              | 16              | 34              |                   | 1,052            |
| Pension Fundings       | 355             | 738             | 1,081           | 702             | 1,161           | 1,818             | 5,855            |
| Other Liabilities      | 67              | 64              | 58              | 43              | 23              | 15                | 270              |
| <b>Total</b>           | <b>\$ 1,642</b> | <b>\$ 3,610</b> | <b>\$ 2,677</b> | <b>\$ 1,308</b> | <b>\$ 1,620</b> | <b>\$ 14,688</b>  | <b>\$ 25,545</b> |

Our capital lease obligations relate primarily to leases on aircraft. Capital leases, operating leases, and purchase commitments, as well as our debt principal obligations, are discussed further in Note 8 to our consolidated financial statements. The amount of interest on our debt was calculated as the contractual interest payments due on our fixed-rate debt, in addition to interest on variable rate debt that was calculated based on interest rates as of December 31, 2011. The calculations of debt interest take into account the effect of interest rate swap agreements. For debt denominated in a foreign currency, the U.S. Dollar equivalent principal amount of the debt at the end of the year was used as the basis to calculate future interest payments.

Purchase commitments represent contractual agreements to purchase goods or services that are legally binding, the largest of which are orders for aircraft, engines, and parts. As of December 31, 2011, we have firm commitments to purchase 15 Boeing 767-300ER freighters to be delivered between 2012 and 2013. These aircraft purchase orders will provide for anticipated future growth.

Pension fundings represent the anticipated required cash contributions that will be made to our qualified pension plans. These contributions include those to the UPS IBT Pension Plan, the UPS Pension Plan and the UPS Retirement Plan. These plans are discussed further in Note 5 to the consolidated financial statements. The pension funding requirements were estimated under the provisions of the Pension Protection Act of 2006 and the Employee Retirement Income Security Act of 1974, using discount rates, asset returns and other assumptions appropriate for these plans. To the extent that the funded status of these plans in future years differs from our

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current projections, the actual contributions made in future years could materially differ from the amounts shown in the table above. Additionally, we have not included minimum funding requirements beyond 2017, because these projected contributions are not reasonably determinable.

We are not subject to any minimum funding requirement for cash contributions in 2012 in the UPS Retirement Plan or UPS Pension Plan. The amount of any minimum funding requirement, as applicable, for these plans could change significantly in future periods, depending on many factors, including future plan asset returns and discount rates. A sustained significant decline in the world equity markets, and the resulting impact on our pension assets and investment returns, could result in our domestic pension plans being subject to significantly higher minimum funding requirements. Such an outcome could have a material adverse impact on our financial position and cash flows in future periods.

As discussed in Note 6 to our consolidated financial statements, we are not currently subject to any minimum contributions or surcharges with respect to the multiemployer pension and health and welfare plans in which we participate. Contribution rates to these multiemployer pension and health and welfare plans are established through the collective bargaining process. As we are not subject to any minimum contribution levels, we have not included any amounts in the contractual commitments table with respect to these multiemployer plans.

The contractual payments due for other liabilities primarily include commitment payments related to our investment in certain partnerships. The table above does not include approximately \$252 million of liabilities for uncertain tax positions because we are uncertain if or when such amounts will ultimately be settled in cash. In addition, we also have recognized assets associated with uncertain tax positions in excess of the related liabilities such that we do not believe a net contractual obligation exists to the taxing authorities. Uncertain tax positions are further discussed in Note 13 to the consolidated financial statements.

As of December 31, 2011, we had outstanding letters of credit totaling approximately \$1.551 billion issued in connection with routine business requirements. We also issue surety bonds as an alternative to letters of credit in certain instances, and as of December 31, 2011, we had \$583 million of surety bonds written. As of December 31, 2011, we had unfunded loan commitments totaling \$248 million associated with our financial business.

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, for the foreseeable future.

### *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. 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,

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and plaintiffs appealed. 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, which was affirmed in January 2012. The trial court also granted our motion for summary judgment against the members of the certified class, which was reversed in January 2012. 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 and affirmed on appeal in December 2011. 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 final 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 that 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) we believe that we have a number of meritorious defenses; (2) AFMS has not articulated any measure of damages; and (3) the DOJ investigation is ongoing. 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.

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### *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 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. In February 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 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. In July 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

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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 Internal Revenue Service ( 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, 2011, we had approximately 245,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the Teamsters. These agreements run through July 31, 2013. We have approximately 2,700 pilots who are employed under a collective bargaining agreement with the IPA, which became 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, approximately 3,200 of our ground mechanics who are not employed under agreements with the Teamsters are employed under collective bargaining agreements with the IAM. Our agreement with the IAM runs through July 31, 2014.

We participate in a number of trustee-managed multiemployer 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.

### *Rate Adjustments*

In November 2011, we announced an increase in base rates and changes in our fuel surcharge for package shipments that took effect January 2, 2012. UPS Ground service rates increased a net 4.9% through a combination of a 5.9% increase in rates and a 1% reduction in the index used to determine the ground fuel surcharge. UPS Next Day Air, UPS 2<sup>nd</sup> Day Air, UPS 3 Day Select, and international air shipments originating in the United States (including Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard Service) increased a net 4.9%, through a combination of a 6.9% increase in base rates and

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a 2% reduction in the index used to determine the air fuel surcharge. These rate changes are customary and occur on an annual basis. Rate changes for shipments originating outside the U.S. are made throughout the year and vary by geographic market.

### **New Accounting Pronouncements**

#### ***Recently Adopted Accounting Standards***

In September 2011, the Financial Accounting Standards Board ( FASB ) issued an accounting standards update regarding disclosure of an employer's participation in multiemployer pension and health and welfare 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 are 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 impacted our disclosures only, and did not have any impact on our financial condition, results of operations or liquidity. The disclosures required by this accounting standards update are presented in Note 6 to the consolidated financial statements.

In September 2011, the FASB issued an accounting standards update that amends the accounting guidance on goodwill impairment testing. This accounting standards 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 standards 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 adopted this accounting standards update and applied its provisions to certain of our reporting units for our annual goodwill impairment testing as of October 1, 2011.

Other accounting pronouncements adopted during the periods covered by the consolidated financial statements had an immaterial impact on our consolidated financial position and results of operations.

#### ***Accounting Standards Issued But Not Yet Effective***

Accounting pronouncements issued, but not effective until after December 31, 2011, are not expected to have a significant impact on our consolidated financial position or results of operations.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America. As indicated in Note 1 to our consolidated financial statements, the amounts of assets, liabilities, revenue, and expenses reported in our financial statements are affected by estimates and judgments that are necessary to comply with generally accepted accounting principles. We base our estimates on prior experience and other assumptions that we consider reasonable to our circumstances. Actual results could differ from our estimates, which would affect the related amounts reported in our consolidated financial statements. While estimates and judgments are applied in arriving at many reported amounts, we believe that the following matters may involve a higher degree of judgment and complexity.

#### ***Contingencies***

As discussed in Note 9 to our consolidated financial statements, we are involved in various legal proceedings and contingencies. We record a liability based on our estimate of the probable cost of the resolution of a contingency. The actual resolution of these contingencies may differ from our estimates. If a contingency is settled for an amount greater than our estimate, a future charge to income would result. Likewise, if a contingency is settled for an amount that is less than our estimate, a future credit to income would result.

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The events that may impact our contingent liabilities are often unique and generally are not predictable. At the time a contingency is identified, we consider all relevant facts as part of our evaluation. We record a liability for a loss when the loss is probable of occurring and reasonably estimable. Events may arise that were not anticipated and the outcome of a contingency may result in a loss to us that differs from our previously estimated liability. These factors could result in a material difference between estimated and actual operating results. Contingent losses that are probable and estimable, excluding those related to income taxes and self-insurance which are discussed further below, were not material to our financial position as of December 31, 2011. In addition, we have certain contingent liabilities that have not been recognized as of December 31, 2011, because a loss is not reasonably estimable.

***Goodwill and Intangible Impairment***

We perform impairment testing of goodwill for each of our reporting units on an annual basis. Our reporting units are comprised of the Europe, Asia, and Americas reporting units in the International Package reporting segment, and the Forwarding, Logistics, UPS Freight, MBE / The UPS Store and UPS Capital reporting units in the Supply Chain & Freight reporting segment. Our annual goodwill impairment testing date is October 1<sup>st</sup> for each reporting unit. In assessing goodwill for impairment, we initially evaluate qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the qualitative assessment is not conclusive and it is necessary to calculate the fair value of a reporting unit, then we utilize a two-step process to test goodwill for impairment. First, a comparison of the fair value of the applicable reporting unit with the aggregate carrying value, including goodwill, is performed. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, we perform the second step of the goodwill impairment test to determine the amount of impairment loss. The second step includes comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill.

We primarily determine the fair value of our reporting units using a discounted cash flow model (DCF model), and supplement this with observable valuation multiples for comparable companies, as applicable. The completion of the DCF model requires that we make a number of significant assumptions to produce an estimate of future cash flows. These assumptions include projections of future revenue, costs and working capital changes. In addition, we make assumptions about the estimated cost of capital and other relevant variables, as required, in estimating the fair value of our reporting units. The projections that we use in our DCF model are updated annually and will change over time based on the historical performance and changing business conditions for each of our reporting units. The determination of whether goodwill is impaired involves a significant level of judgment in these assumptions, and changes in our business strategy, government regulations or economic or market conditions could significantly impact these judgments. We will continue to monitor market conditions and other factors to determine if interim impairment tests are necessary in future periods. If impairment indicators are present in future periods, the resulting impairment charges could have a material impact on our results of operations.

None of the reporting units incurred any goodwill impairment charges in 2011, 2010 or 2009. Changes in our forecasts could cause carrying values of our reporting units to exceed their fair values in future periods, potentially resulting in a goodwill impairment charge. As of our October 1, 2011 goodwill impairment testing date, our UPS Freight reporting unit's fair value exceeded its carrying value by approximately 10%. The fair value of this reporting unit was negatively impacted in 2011 by the difficult market environment for the LTL industry, resulting in reduced equity valuations for market comparable companies. Several factors, including lower than expected revenues and/or operating margins, an increased cost of capital and higher than anticipated capital expenditure requirements, could result in the reporting unit's fair value declining below its carrying value in a future period. Additionally, a sustained decline in the valuations of publicly-traded comparable companies in the LTL industry would also reduce the calculated fair value of this reporting unit. Our UPS Freight reporting unit has a total goodwill balance of \$441 million as of December 31, 2011. A 10% decrease in the estimated fair value of our other reporting units as of our most recent goodwill testing date (October 1, 2011) would not result in a goodwill impairment charge.

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Licenses with a carrying value of \$5 million as of December 31, 2011 are deemed to be indefinite-lived intangibles, and therefore are not amortized. Impairment tests for indefinite-lived intangibles are performed on an annual basis. All of our remaining recorded intangible assets are deemed to be finite-lived intangibles, and are thus amortized over their estimated useful lives. Impairment tests for these intangible assets are only performed when a triggering event occurs that indicates that the carrying value of the intangible may not be recoverable based on the undiscounted future cash flows of the intangible. If the carrying amount of the intangible is determined not to be recoverable, a write-down to fair value is recorded. Fair values are determined based on a DCF model. No impairments of indefinite-lived or finite-lived intangible assets were recognized in 2011, 2010 or 2009.

### ***Self-Insurance Accruals***

We self-insure costs associated with workers' compensation claims, automotive liability, health and welfare and general business liabilities, up to certain limits. 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 yet reported. Recorded balances are based on reserve levels, which incorporate historical loss experience and judgments about the present and expected levels of cost per claim. Trends in actual experience are a significant factor in the determination of such reserves. We believe our estimated reserves for such claims are adequate, but actual experience in claim frequency and/or severity could materially differ from our estimates and affect our results of operations.

Workers' compensation, automobile liability and general liability insurance claims may take several years to completely settle. Consequently, actuarial estimates are required to project the ultimate cost that will be incurred to fully resolve the claims. A number of factors can affect the actual cost of a claim, including the length of time the claim remains open, trends in health care costs and the results of related litigation. Furthermore, claims may emerge in future years for events that occurred in a prior year at a rate that differs from previous actuarial projections. Changes in state legislation with respect to workers compensation can affect the adequacy of our self-insurance accruals. All of these factors can result in revisions to prior actuarial projections and produce a material difference between estimated and actual operating results.

We sponsor a number of health and welfare insurance plans for our employees. These liabilities and related expenses are based on estimates of the number of employees and eligible dependents covered under the plans, anticipated medical usage by participants and overall trends in medical costs and inflation. Actual results may differ from these estimates and, therefore, produce a material difference between estimated and actual operating results.

### ***Fair Value Measurements***

In the normal course of business, we hold and issue financial instruments that contain elements of market risk, including derivatives, marketable securities, finance receivables, other investments and debt. Certain of these financial instruments are required to be recorded at fair value, principally derivatives, marketable securities, pension assets and certain other investments. Fair values are based on listed market prices, when such prices are available. To the extent that listed market prices are not available, fair value is determined based on other relevant factors, including dealer price quotations. Certain financial instruments, including over-the-counter derivative instruments, are valued using pricing models that consider, among other factors, contractual and market prices, correlations, time value, credit spreads and yield curve volatility factors. Changes in the fixed income, equity, foreign exchange and commodity markets will impact our estimates of fair value in the future, potentially affecting our results of operations. A quantitative sensitivity analysis of our exposure to changes in commodity prices, foreign currency exchange rates, interest rates and equity prices is presented in the Market Risk section of this report.

**Table of Contents*****Pension and Postretirement Medical Benefits***

Our pension and other postretirement benefit costs are calculated using various actuarial assumptions and methodologies. These assumptions include discount rates, health care cost trend rates, inflation, compensation increase rates, expected returns on plan assets, mortality rates and other factors. The assumptions utilized in recording the obligations under our plans represent our best estimates, and we believe that they are reasonable, based on information as to historical experience and performance as well as other factors that might cause future expectations to differ from past trends.

Differences in actual experience or changes in assumptions may affect our pension and other postretirement obligations and future expense. The primary factors contributing to actuarial gains and losses each year are (1) changes in the discount rate used to value pension and postretirement benefit obligations as of the measurement date and (2) differences between the expected and the actual return on plan assets.

In the fourth quarter of 2011, we elected to change our accounting methodologies for recognizing expense for our company-sponsored U.S. and International pension and other postretirement benefit plans. Previously, net actuarial gains or losses in excess of 10% of the greater of the market-related value of plan assets or the plans' projected benefit obligations (the "corridor") were recognized over the average remaining service life of employees in each respective plan. Further, for our largest pension plan (the UPS Retirement Plan), we used a calculated value of plan assets reflecting changes in the fair value of plan assets over a five-year period.

Under our new accounting methods, we will recognize changes in the fair value of plan assets and net actuarial gains or losses in excess of the corridor annually in the fourth quarter each year. These new accounting methods result in changes in the fair value of plan assets and net actuarial gains and losses being recognized in expense faster than our previous amortization method. The remaining components of pension expense, primarily service and interest costs and the expected return on plan assets, will be recorded on a quarterly basis as ongoing pension expense (herein referred to as "ongoing expense" or "ongoing net periodic benefit cost").

The following sensitivity analysis shows the impact of a 25 basis point change in the assumed discount rate, expected return on assets, and health care cost trend rate for our pension and postretirement benefit plans, and the resulting increase (decrease) on our obligations and ongoing expense as of, and for the year ended, December 31, 2011 (in millions).

|   | <b>25 Basis Point<br/>Increase</b> | <b>25 Basis Point<br/>Decrease</b> |
|---|------------------------------------|------------------------------------|
| <b>Pension Plans</b>                                    |                                    |                                    |
| <i>Discount Rate:</i>                                   |                                    |                                    |
| Effect on ongoing net periodic benefit cost             | \$ (43)                            | \$ 45                              |
| Effect on projected benefit obligation                  | (976)                              | 1,017                              |
| <i>Return on Assets:</i>                                |                                    |                                    |
| Effect on ongoing net periodic benefit cost             | (54)                               | 54                                 |
| <b>Postretirement Medical Plans</b>                     |                                    |                                    |
| <i>Discount Rate:</i>                                   |                                    |                                    |
| Effect on ongoing net periodic benefit cost             |                                    |                                    |
| Effect on accumulated postretirement benefit obligation | (102)                              | 105                                |
| <i>Health Care Cost Trend Rate:</i>                     |                                    |                                    |
| Effect on ongoing net periodic benefit cost             | 1                                  | (1)                                |
| Effect on accumulated postretirement benefit obligation | 15                                 | (16)                               |

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Ongoing expense will increase in 2012 compared with 2011, due primarily to the decline in the U.S. discount rate used to determine expense from 5.95% for 2011 to 5.61% for 2012. This is partially offset by the contributions to the plans in 2011 that increased the expected return on assets used for expense calculation purposes.

### ***Depreciation, Residual Value and Impairment of Fixed Assets***

As of December 31, 2011, we had \$17.621 billion of net fixed assets, the most significant category of which is aircraft. In accounting for fixed assets, we make estimates about the expected useful lives and the expected residual values of the assets, and the potential for impairment based on the fair values of the assets and the cash flows generated by these assets.

In estimating the lives and expected residual values of aircraft, we have relied upon actual experience with the same or similar aircraft types. Subsequent revisions to these estimates could be caused by changes to our maintenance program, changes in the utilization of the aircraft, governmental regulations on aging aircraft and changing market prices of new and used aircraft of the same or similar types. We periodically evaluate these estimates and assumptions, and adjust the estimates and assumptions as necessary. Adjustments to the expected lives and residual values are accounted for on a prospective basis through depreciation expense.

We review long-lived assets for impairment when circumstances indicate the carrying amount of an asset may not be recoverable based on the undiscounted future cash flows of the asset. If the carrying amount of the asset is determined not to be recoverable, a write-down to fair value is recorded. Fair values are determined based on quoted market values, discounted cash flows or external appraisals, as applicable. We review long-lived assets for impairment at the individual asset or the asset group level for which the lowest level of independent cash flows can be identified. The circumstances that would indicate potential impairment may include, but are not limited to, a significant change in the extent to which an asset is utilized, a significant decrease in the market value of an asset and operating or cash flow losses associated with the use of the asset. In estimating cash flows, we project future volume levels for our different air express products in all geographic regions in which we do business. Adverse changes in these volume forecasts, or a shortfall of our actual volume compared with our projections, could result in our current aircraft capacity exceeding current or projected demand. This situation would lead to an excess of a particular aircraft type, resulting in an aircraft impairment charge or a reduction of the expected life of an aircraft type (thus resulting in increased depreciation expense).

In 2011 and 2010, there were no indicators of impairment in our aircraft fleet, and no impairment charges were recorded in either period. In 2009, we recorded a \$181 million impairment charge, as described in the following paragraphs.

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

Based on the factors noted above, as well as FAA aging aircraft directives that would require significant future maintenance expenditures, we determined that a triggering event had occurred that required an impairment assessment of our McDonnell-Douglas DC-8-71 and DC-8-73 aircraft fleets. We conducted an impairment analysis as of March 31, 2009, and determined that the carrying amount of these fleets was not recoverable due to the accelerated expected retirement dates of the aircraft. Based on anticipated residual values for the airframes, engines, and parts, we recognized an impairment charge of \$181 million in the first quarter of 2009. The DC-8 fleets were subsequently retired from service.

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### ***Income Taxes***

We make certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of income by legal entity and jurisdiction, tax credits, benefits, and deductions, and in the calculation of certain tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes, as well as the interest and penalties related to these uncertain tax positions. Significant changes to these estimates may result in an increase or decrease to our tax provision in a subsequent period.

We assess the likelihood that we will be able to recover our deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a valuation allowance against the deferred tax assets that we estimate will not ultimately be recoverable. We believe that we will ultimately recover a substantial majority of the deferred tax assets recorded on our consolidated balance sheets. However, should there be a change in our ability to recover our deferred tax assets, our tax provision would increase in the period in which we determined that the recovery was not likely.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. Once it is determined that the position meets the recognition threshold, the second step requires us to estimate and measure the tax benefit as the largest amount that is more likely than not to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as we have to determine the probability of various possible outcomes. We reevaluate these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement could result in the recognition of a tax benefit or an additional charge to the tax provision.

### ***Allowance for Doubtful Accounts***

Losses on accounts receivable are recognized when they are incurred, which requires us to make our best estimate of the probable losses inherent in our customer receivables at each balance sheet date. These estimates require consideration of historical loss experience adjusted for current conditions, trends in customer payment frequency, and judgments about the probable effects of relevant observable data, including present economic conditions and the financial health of specific customers and market sectors. Our risk management process includes standards and policies for reviewing major account exposures and concentrations of risk. Deterioration in macroeconomic variables could result in our ultimate loss exposures on our accounts receivable being significantly higher than what we have currently estimated and reserved for in our allowance for doubtful accounts. Our total allowance for doubtful accounts as of December 31, 2011 and 2010 was \$117 and \$127 million, respectively. Our total provision for doubtful accounts charged to expense during the years ended December 31, 2011, 2010 and 2009 was \$147, \$199 and \$254 million, respectively.

### **Item 7A. *Quantitative and Qualitative Disclosures about Market Risk***

We are exposed to market risk from changes in certain commodity prices, foreign currency exchange rates, interest rates and equity prices. All of these market risks arise 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 commodity, foreign exchange and interest rate forward contracts, options and swaps. A discussion of our accounting policies for derivative instruments and further disclosures are provided in Note 15 to the consolidated financial statements.

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### *Commodity Price Risk*

We are exposed to changes in the prices of refined fuels, principally jet-A, diesel and unleaded gasoline. 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. Additionally, we periodically use a combination of option contracts to provide partial protection from changing fuel and energy prices. As of December 31, 2011 and 2010, however, we had no commodity option contracts outstanding.

### *Foreign Currency Exchange Risk*

We have foreign currency risks related to our revenue, operating expenses and financing transactions in currencies other than the local currencies in which we operate. We are exposed to currency risk from the potential changes in functional currency values of our foreign currency-denominated assets, liabilities and cash flows. Our most significant foreign currency exposures relate to the Euro, the British Pound Sterling and the Canadian Dollar. We use a combination of purchased and written options and forward contracts to hedge forecasted cash flow currency exposures. These derivative instruments generally cover forecasted foreign currency exposures for periods of 12 to 24 months. Additionally, we utilize cross-currency interest rate swaps to hedge the currency risk inherent in the interest and principal payments associated with foreign currency denominated debt obligations. The terms of these swap agreements are commensurate with the underlying debt obligations.

### *Interest Rate Risk*

We have issued debt instruments, including debt associated with capital leases, that accrue expense at fixed and floating rates of interest. We use a combination of interest rate swaps as part of our program to manage the fixed and floating interest rate mix of our total debt portfolio and related overall cost of borrowing. The notional amount, interest payment and maturity dates of the swaps match the terms of the associated debt. We also utilize forward starting swaps and similar instruments to lock in all or a portion of the borrowing cost of anticipated debt issuances. Our floating rate debt and interest rate swaps subject us to risk resulting from changes in short-term (primarily LIBOR) interest rates.

We also are subject to interest rate risk with respect to our pension and postretirement benefit obligations, as changes in interest rates will effectively increase or decrease our liabilities associated with these benefit plans, which also results in changes to the amount of pension and postretirement benefit expense recognized in future periods.

We have investments in debt securities, as well as cash-equivalent instruments, some of which accrue income at variable rates of interest. Additionally, we hold a portfolio of finance receivables that accrue income at fixed and floating rates of interest.

### *Equity Price Risk*

We hold investments in various common equity securities that are subject to price risk. These securities are primarily in the form of equity index funds.

### *Sensitivity Analysis*

The following analysis provides quantitative information regarding our exposure to commodity price risk, foreign currency exchange risk, interest rate risk and equity price risk embedded in our existing financial instruments. We utilize valuation models to evaluate the sensitivity of the fair value of financial instruments with exposure to market risk that assume instantaneous, parallel shifts in exchange rates, interest rate yield curves and

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commodity and equity prices. For options and instruments with non-linear returns, models appropriate to the instrument are utilized to determine the impact of market shifts.

There are certain limitations inherent in the sensitivity analyses presented, primarily due to the assumption that exchange rates change in a parallel fashion and that interest rates change instantaneously. In addition, the analyses are unable to reflect the complex market reactions that normally would arise from the market shifts modeled. While this is our best estimate of the impact of the specified interest rate scenarios, these estimates should not be viewed as forecasts. We adjust the fixed and floating interest rate mix of our interest rate sensitive assets and liabilities in response to changes in market conditions. Additionally, changes in the fair value of foreign currency derivatives and commodity derivatives are offset by changes in the cash flows of the underlying hedged foreign currency and commodity transactions.

| (in millions)                    | Shock-Test Result  |         |
|----------------------------------|--------------------|---------|
|                                  | As of December 31, |         |
|                                  | 2011               | 2010    |
| <b>Change in Fair Value:</b>     |                    |         |
| Currency Derivatives(1)          | \$ (64)            | \$ (89) |
| <b>Change in Annual Expense:</b> |                    |         |
| Variable Rate Debt(2)            | \$ 7               | \$ 10   |
| Interest Rate Derivatives(2)     | \$ 71              | \$ 58   |

- (1) The potential change in fair value from a hypothetical 10% weakening of the U.S. Dollar against local currency exchange rates across all maturities.
- (2) The potential change in annual interest expense resulting from a hypothetical 100 basis point increase in short-term interest rates, applied to our variable rate debt and swap instruments (excluding hedges of anticipated debt issuances).

The sensitivity of our pension and postretirement benefit obligations to changes in interest rates is quantified in Critical Accounting Policies and Estimates. The sensitivity in the fair value and interest income of our marketable securities due to changes in equity prices and interest rates, respectively, was not material as of December 31, 2011 or 2010. The sensitivity in the fair value and interest income of our finance receivables due to changes in interest rates was also not material as of December 31, 2011 or 2010.

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**Item 8. *Financial Statements and Supplementary Data***

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**Report of Independent Registered Public Accounting Firm**

Board of Directors and Shareowners

United Parcel Service, Inc.

Atlanta, Georgia

We have audited the internal control over financial reporting of United Parcel Service, Inc. and subsidiaries (the Company) as of December 31, 2011, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of United Parcel Service, Inc. and its subsidiaries as of December 31, 2011, and the related statements of consolidated income, comprehensive income, and cash flows for the year ended December 31, 2011 and our report dated February 27, 2012 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding changes in certain of the Company's methods of accounting for defined benefit pension and other postretirement benefit costs.

/s/ Deloitte & Touche LLP

Atlanta, Georgia

February 27, 2012



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**Report of Independent Registered Public Accounting Firm**

Board of Directors and Shareowners

United Parcel Service, Inc.

Atlanta, Georgia

We have audited the accompanying consolidated balance sheets of United Parcel Service, Inc. and subsidiaries (the Company) as of December 31, 2011 and 2010, and the related statements of consolidated income, comprehensive income, and cash flows for each of the three years in the period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of United Parcel Service, Inc. and subsidiaries at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company has elected to change its methods of accounting for defined benefit pension and other post-retirement benefit plan costs in 2011. Such changes are reflected in the accompanying consolidated balance sheets as of December 31, 2011 and 2010, and the related statements of consolidated income, comprehensive income, and cash flows for each of the three years in the period ended December 31, 2011.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2012 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

Atlanta, Georgia

February 27, 2012

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(In millions)**

|   | <b>December 31,</b> |             |
|---|---------------------|-------------|
|   | <b>2011</b>         | <b>2010</b> |
| <b>ASSETS</b>   |                     |             |
| Current Assets:   |                     |             |
| Cash and cash equivalents   | \$ 3,034            | \$ 3,370    |
| Marketable securities   | 1,241               | 711         |
| Accounts receivable, net  | 6,246               | 5,627       |
| Deferred income tax assets  | 611                 | 659         |
| Other current assets  | 1,152               | 1,202       |
| Total Current Assets  | 12,284              | 11,569      |
| Property, Plant and Equipment, Net                                | 17,621              | 17,387      |
| Goodwill  | 2,101               | 2,081       |
| Intangible Assets, Net  | 585                 | 599         |
| Non-Current Investments and Restricted Cash                       | 303                 | 458         |
| Other Non-Current Assets  | 1,807               | 1,503       |
| Total Assets  | \$ 34,701           | \$ 33,597   |
| <b>LIABILITIES AND SHAREOWNERS EQUITY</b>                         |                     |             |
| Current Liabilities:  |                     |             |
| Current maturities of long-term debt and commercial paper         | \$ 33               | \$ 355      |
| Accounts payable  | 2,300               | 1,974       |
| Accrued wages and withholdings                                    | 1,843               | 1,505       |
| Self-insurance reserves   | 781                 | 725         |
| Other current liabilities   | 1,557               | 1,343       |
| Total Current Liabilities   | 6,514               | 5,902       |
| Long-Term Debt  | 11,095              | 10,491      |
| Pension and Postretirement Benefit Obligations                    | 5,505               | 4,663       |
| Deferred Income Tax Liabilities                                   | 1,900               | 1,870       |
| Self-Insurance Reserves   | 1,806               | 1,809       |
| Other Non-Current Liabilities                                     | 773                 | 815         |
| Shareowners Equity:   |                     |             |
| Class A common stock (240 and 258 shares issued in 2011 and 2010) | 3                   | 3           |
| Class B common stock (725 and 735 shares issued in 2011 and 2010) | 7                   | 7           |
| Additional paid-in capital  |                     |             |
| Retained earnings   | 10,128              | 10,604      |
| Accumulated other comprehensive loss                              | (3,103)             | (2,635)     |
| Deferred compensation obligations                                 | 88                  | 103         |
| Less: Treasury stock (2 shares in 2011 and 2010)                  | (88)                | (103)       |
| Total Equity for Controlling Interests                            | 7,035               | 7,979       |
| Noncontrolling Interests  | 73                  | 68          |
| Total Shareowners Equity  | 7,108               | 8,047       |
| Total Liabilities and Shareowners Equity                          | \$ 34,701           | \$ 33,597   |

See notes to consolidated financial statements.

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

|                                  | Years Ended December 31, |           |           |
|----------------------------------|--------------------------|-----------|-----------|
|                                  | 2011                     | 2010      | 2009      |
| Revenue                          | \$ 53,105                | \$ 49,545 | \$ 45,297 |
| Operating Expenses:              |                          |           |           |
| Compensation and benefits        | 27,575                   | 26,557    | 25,933    |
| Repairs and maintenance          | 1,286                    | 1,131     | 1,075     |
| Depreciation and amortization    | 1,782                    | 1,792     | 1,747     |
| Purchased transportation         | 7,232                    | 6,640     | 5,379     |
| Fuel                             | 4,046                    | 2,972     | 2,365     |
| Other occupancy                  | 943                      | 939       | 985       |
| Other expenses                   | 4,161                    | 3,873     | 4,305     |
| Total Operating Expenses         | 47,025                   | 43,904    | 41,789    |
| Operating Profit                 | 6,080                    | 5,641     | 3,508     |
| Other Income and (Expense):      |                          |           |           |
| Investment income                | 44                       | 3         | 10        |
| Interest expense                 | (348)                    | (354)     | (445)     |
| Total Other Income and (Expense) | (304)                    | (351)     | (435)     |
| Income Before Income Taxes       | 5,776                    | 5,290     | 3,073     |
| Income Tax Expense               | 1,972                    | 1,952     | 1,105     |
| Net Income                       | \$ 3,804                 | \$ 3,338  | \$ 1,968  |
| Basic Earnings Per Share         | \$ 3.88                  | \$ 3.36   | \$ 1.97   |
| Diluted Earnings Per Share       | \$ 3.84                  | \$ 3.33   | \$ 1.96   |

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

|   | Years Ended December 31, |          |          |
|---|--------------------------|----------|----------|
|   | 2011                     | 2010     | 2009     |
| Net income  | \$ 3,804                 | \$ 3,338 | \$ 1,968 |
| Change in foreign currency translation adjustment, net of tax               | (92)                     | (105)    | 75       |
| Change in unrealized gain (loss) on marketable securities, net of tax       | (6)                      | 39       | 33       |
| Change in unrealized gain (loss) on cash flow hedges, net of tax            | 35                       | (39)     | (93)     |
| Change in unrecognized pension and postretirement benefit costs, net of tax | (405)                    | (813)    | 684      |
| Comprehensive income  | \$ 3,336                 | \$ 2,420 | \$ 2,667 |

See notes to consolidated financial statements.

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

|  | <b>Years Ended December 31,</b> |                |                |
|--|---------------------------------|----------------|----------------|
|  | <b>2011</b>                     | <b>2010</b>    | <b>2009</b>    |
| <b>Cash Flows From Operating Activities:</b>                               |                                 |                |                |
| Net income   | \$ 3,804                        | \$ 3,338       | \$ 1,968       |
| Adjustments to reconcile net income to net cash from operating activities: |                                 |                |                |
| Depreciation and amortization  | 1,782                           | 1,792          | 1,747          |
| Pension and postretirement benefit expense                                 | 1,660                           | 1,136          | 1,165          |
| Pension and postretirement benefit contributions                           | (1,436)                         | (3,240)        | (924)          |
| Self-insurance reserves  | 53                              | 45             | 47             |
| Deferred taxes, credits and other  | 241                             | 919            | 362            |
| Stock compensation expense   | 524                             | 519            | 430            |
| Asset impairment charges   |                                 |                | 181            |
| Other (gains) losses   | 245                             | (13)           | 115            |
| Changes in assets and liabilities, net of effect of acquisitions:          |                                 |                |                |
| Accounts receivable  | (657)                           | (532)          | (30)           |
| Income taxes receivable  | 169                             | (146)          | 27             |
| Other current assets   | (62)                            | (60)           | 136            |
| Accounts payable   | 249                             | 265            | (107)          |
| Accrued wages and withholdings   | 339                             | 98             | (102)          |
| Other current liabilities  | 186                             | (284)          | 184            |
| Other operating activities   | (24)                            | (2)            | 86             |
| <b>Net cash from operating activities</b>                                  | <b>7,073</b>                    | <b>3,835</b>   | <b>5,285</b>   |
| <b>Cash Flows From Investing Activities:</b>                               |                                 |                |                |
| Capital expenditures   | (2,005)                         | (1,389)        | (1,602)        |
| Proceeds from disposals of property, plant and equipment                   | 27                              | 304            | 60             |
| Purchases of marketable securities   | (4,903)                         | (2,490)        | (2,251)        |
| Sales and maturities of marketable securities                              | 4,490                           | 2,520          | 2,240          |
| Net decrease in finance receivables  | 184                             | 108            | 261            |
| Cash received (paid) for business acquisitions and dispositions            | (73)                            | 63             | (9)            |
| Other investing activities   | (257)                           | 230            | 53             |
| <b>Net cash used in investing activities</b>                               | <b>(2,537)</b>                  | <b>(654)</b>   | <b>(1,248)</b> |
| <b>Cash Flows From Financing Activities:</b>                               |                                 |                |                |
| Net change in short-term debt  | (183)                           | (481)          | (1,738)        |
| Proceeds from long-term borrowings   | 279                             | 2,195          | 3,160          |
| Repayments of long-term borrowings   | (191)                           | (468)          | (1,944)        |
| Purchases of common stock  | (2,665)                         | (817)          | (561)          |
| Issuances of common stock  | 290                             | 218            | 149            |
| Dividends  | (1,997)                         | (1,818)        | (1,751)        |
| Other financing activities   | (395)                           | (175)          | (360)          |
| <b>Net cash used in financing activities</b>                               | <b>(4,862)</b>                  | <b>(1,346)</b> | <b>(3,045)</b> |
| <b>Effect Of Exchange Rate Changes On Cash And Cash Equivalents</b>        | <b>(10)</b>                     | <b>(7)</b>     | <b>43</b>      |

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|   |          |          |          |
|---|----------|----------|----------|
| <b>Net Increase (Decrease) In Cash And Cash Equivalents</b> | (336)    | 1,828    | 1,035    |
| <b>Cash And Cash Equivalents:</b>                           |          |          |          |
| Beginning of period   | 3,370    | 1,542    | 507      |
| End of period   | \$ 3,034 | \$ 3,370 | \$ 1,542 |
| <b>Cash Paid During The Period For:</b>                     |          |          |          |
| Interest (net of amount capitalized)                        | \$ 248   | \$ 340   | \$ 390   |
| Income taxes  | \$ 1,527 | \$ 1,312 | \$ 443   |

See notes to consolidated financial statements.

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. SUMMARY OF ACCOUNTING POLICIES**

*Basis of Financial Statements and Business Activities*

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ( GAAP ), and include the accounts of United Parcel Service, Inc., and all of its consolidated subsidiaries (collectively UPS or the Company ). All intercompany balances and transactions have been eliminated.

UPS concentrates its operations in the field of transportation services, primarily domestic and international letter and package delivery. Through our Supply Chain & Freight subsidiaries, we are also a global provider of specialized transportation, logistics, and financial services.

*Use of Estimates*

The preparation of our consolidated financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the reported amounts of revenues and expenses and the disclosure of contingencies. Estimates have been prepared on the basis of the most current and best information, and actual results could differ materially from those estimates.

*Revenue Recognition*

*U.S. Domestic and International Package Operations* Revenue is recognized upon delivery of a letter or package.

*Forwarding and Logistics* Freight forwarding revenue and the expense related to the transportation of freight are recognized at the time the services are performed. Material management and distribution revenue is recognized upon performance of the service provided. Customs brokerage revenue is recognized upon completing documents necessary for customs entry purposes.

*Freight* Revenue is recognized upon delivery of a less-than-truckload ( LTL ) or truckload ( TL ) shipment.

We utilize independent contractors and third party carriers in the performance of some transportation services. In situations where we act as principal party to the transaction, we recognize revenue on a gross basis; in circumstances where we act as an agent, we recognize revenue net of the cost of the purchased transportation.

*Financial Services* Income on loans and direct finance leases is recognized on the effective interest method. Accrual of interest income is suspended at the earlier of the time at which collection of an account becomes doubtful or the account becomes 90 days delinquent. Income on operating leases is recognized on the straight-line method over the terms of the underlying leases.

*Cash and Cash Equivalents*

Cash and cash equivalents consist of highly liquid investments that are readily convertible into cash. We consider securities with maturities of three months or less, when purchased, to be cash equivalents. The carrying amount of these securities approximates fair value because of the short-term maturity of these instruments.

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Investments*

Marketable securities are classified as available-for-sale and are carried at fair value, with related unrealized gains and losses reported, net of tax, as accumulated other comprehensive income ( AOCI ), a separate component of shareowners' equity. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion is included in investment income, along with interest and dividends. The cost of securities sold is based on the specific identification method; realized gains and losses resulting from such sales are included in investment income.

We periodically review our investments for indications of other than temporary impairment considering many factors, including the extent and duration to which a security's fair value has been less than its cost, overall economic and market conditions and the financial condition and specific prospects for the issuer. Impairment of investment securities results in a charge to income when a market decline below cost is other than temporary.

*Accounts Receivable*

Losses on accounts receivable are recognized when they are incurred, which requires us to make our best estimate of the probable losses inherent in our customer receivables at each balance sheet date. These estimates require consideration of historical loss experience, adjusted for current conditions, trends in customer payment frequency, and judgments about the probable effects of relevant observable data, including present economic conditions and the financial health of specific customers and market sectors. Our risk management process includes standards and policies for reviewing major account exposures and concentrations of risk.

Our total allowance for doubtful accounts as of December 31, 2011 and 2010 was \$117 and \$127 million, respectively. Our total provision for doubtful accounts charged to expense during the years ended December 31, 2011, 2010 and 2009 was \$147, \$199 and \$254 million, respectively.

*Inventories*

Jet fuel, diesel, and unleaded gasoline inventories are valued at the lower of average cost or market. Fuel and other materials and supplies inventories are recognized as inventory when purchased, and then charged to expense when used in our operations. Total inventories were \$345 and \$319 million as of December 31, 2011 and 2010, respectively, and are included in other current assets on the consolidated balance sheet.

*Property, Plant and Equipment*

Property, plant and equipment are carried at cost. Depreciation and amortization are provided by the straight-line method over the estimated useful lives of the assets, which are as follows: Vehicles 6 to 15 years; Aircraft 12 to 30 years; Buildings 20 to 40 years; Leasehold Improvements terms of leases; Plant Equipment 6 to 8 years; Technology Equipment 3 to 5 years. The costs of major airframe and engine overhauls, as well as routine maintenance and repairs, are charged to expense as incurred.

Interest incurred during the construction period of certain property, plant and equipment is capitalized until the underlying assets are placed in service, at which time amortization of the capitalized interest begins, straight-line, over the estimated useful lives of the related assets. Capitalized interest was \$17, \$18 and \$37 million for 2011, 2010, and 2009, respectively.

We review long-lived assets for impairment when circumstances indicate the carrying amount of an asset may not be recoverable based on the undiscounted future cash flows of the asset. If the carrying amount of the

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

asset is determined not to be recoverable, a write-down to fair value is recorded. Fair values are determined based on quoted market values, discounted cash flows, or external appraisals, as applicable. We review long-lived assets for impairment at the individual asset or the asset group level for which the lowest level of independent cash flows can be identified.

*Goodwill and Intangible Assets*

Costs of purchased businesses in excess of net identifiable assets acquired (goodwill), and indefinite-lived intangible assets are tested for impairment at least annually, unless changes in circumstances indicate an impairment may have occurred sooner. We are required to test goodwill on a reporting unit basis. A reporting unit is the operating segment unless, for businesses within that operating segment, discrete financial information is prepared and regularly reviewed by management, in which case such a component business is the reporting unit.

In assessing goodwill for impairment, we initially evaluate qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. We consider several factors, including macroeconomic conditions, industry and market conditions, overall financial performance of the reporting unit, changes in management, strategy or customers, and relevant reporting unit specific events such as a change in the carrying amount of net assets, a more-likely-than-not expectation of selling or disposing all, or a portion, of a reporting unit, and the testing for recoverability of a significant asset group within a reporting unit. If this qualitative assessment results in a conclusion that it is more likely than not that the fair value of a reporting unit exceeds the carrying value, then no further testing is performed for that reporting unit.

If the qualitative assessment is not conclusive and it is necessary to calculate the fair value of a reporting unit, then we utilize a two-step process to test goodwill for impairment. First, a comparison of the fair value of the applicable reporting unit with the aggregate carrying value, including goodwill, is performed. If the carrying amount of a reporting unit exceeds its calculated fair value, then the second step is performed, and an impairment charge is recognized for the amount, if any, by which the carrying amount of goodwill exceeds its implied fair value. We primarily determine the fair value of our reporting units using a discounted cash flow model, and supplement this with observable valuation multiples for comparable companies, as applicable.

Finite-lived intangible assets, including trademarks, licenses, patents, customer lists, non-compete agreements and franchise rights are amortized on a straight-line basis over the estimated useful lives of the assets, which range from 2 to 20 years. Capitalized software is amortized over periods ranging from 3 to 5 years.

*Self-Insurance Accruals*

We self-insure costs associated with workers' compensation claims, automotive liability, health and welfare, and general business liabilities, up to certain limits. 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 yet reported. Recorded balances are based on reserve levels, which incorporate historical loss experience and judgments about the present and expected levels of cost per claim.

*Pension and Postretirement Benefits*

We incur certain employment-related expenses associated with pension and postretirement medical benefits. These pension and postretirement medical benefit costs for company-sponsored benefit plans are calculated using various actuarial assumptions and methodologies, including discount rates, expected returns on plan assets, health care cost trend rates, inflation, compensation increase rates, mortality rates, and other factors. Actuarial assumptions are reviewed on an annual basis, unless circumstances require an interim remeasurement date for any of our plans.

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

We participate in a number of trustee-managed multiemployer pension and health and welfare plans for employees covered under collective bargaining agreements. Our contributions to these plans are determined in accordance with the respective collective bargaining agreements. We recognize expense for the contractually required contribution for each period, and we recognize a liability for any contributions due and unpaid (included in other current liabilities ).

In the fourth quarter of 2011, we elected to change our accounting methodologies for recognizing expense for our company-sponsored U.S. and international pension and other postretirement benefit plans. Previously, net actuarial gains or losses in excess of 10% of the greater of the market-related value of plan assets or the plans projected benefit obligations (the corridor ) were recognized over the average remaining service life of employees in each respective plan. Further, for our largest pension plan (the UPS Retirement Plan), we used a calculated value of plan assets reflecting changes in the fair value of plan assets over a five-year period.

Under our new accounting methods, we will recognize changes in the fair value of plan assets and net actuarial gains or losses in excess of the corridor annually in the fourth quarter each year. These new accounting methods result in changes in the fair value of plan assets and net actuarial gains and losses being recognized in expense faster than our previous amortization method. The remaining components of pension expense, primarily service and interest costs and the expected return on plan assets, will be recorded on a quarterly basis as ongoing pension expense. While the historical policy of recognizing pension and other postretirement benefit expense was considered acceptable, we believe that these new policies are preferable as they accelerate the recognition in our operating results of changes in the fair value of plan assets and actuarial gains and losses outside the corridor.

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These changes have been reported through retrospective application of the new policies to all periods presented. We recorded a cumulative reduction of retained earnings as of January 1, 2009 of \$3.226 billion related to these changes in accounting methodology. The impact of all adjustments made to the financial statements presented is summarized below (amounts in millions, except per share data):

|   | 2011                                   |                                | 2010                   |                 | 2009                   |                 |
|---|--|--------------------------------|------------------------|-----------------|------------------------|-----------------|
|   | Recognized Under<br>Previous<br>Method | Recognized Under<br>New Method | Previously<br>Reported | Adjusted        | Previously<br>Reported | Adjusted        |
| <b>Statements of Consolidated Income:</b>                                   |  |                                |                        |                 |                        |                 |
| Operating Expenses:   |  |                                |                        |                 |                        |                 |
| Compensation and benefits   | \$ 26,935                              | \$ 27,575                      | \$ 26,324              | \$ 26,557       | \$ 25,640              | \$ 25,933       |
| Operating Profit  | 6,720                                  | 6,080                          | 5,874                  | 5,641           | 3,801                  | 3,508           |
| Income Before Income Taxes  | 6,416                                  | 5,776                          | 5,523                  | 5,290           | 3,366                  | 3,073           |
| Income Tax Expense  | 2,203                                  | 1,972                          | 2,035                  | 1,952           | 1,214                  | 1,105           |
| <b>Net Income</b>   | <b>\$ 4,213</b>                        | <b>\$ 3,804</b>                | <b>\$ 3,488</b>        | <b>\$ 3,338</b> | <b>\$ 2,152</b>        | <b>\$ 1,968</b> |
| Per Share Amounts:  |  |                                |                        |                 |                        |                 |
| Basic Earnings Per Share  | \$ 4.29                                | \$ 3.88                        | \$ 3.51                | \$ 3.36         | \$ 2.16                | \$ 1.97         |
| Diluted Earnings Per Share  | \$ 4.25                                | \$ 3.84                        | \$ 3.48                | \$ 3.33         | \$ 2.14                | \$ 1.96         |
| <b>Statements of Consolidated Comprehensive Income:</b>                     |  |                                |                        |                 |                        |                 |
| Net Income  | \$ 4,213                               | \$ 3,804                       | \$ 3,488               | \$ 3,338        | \$ 2,152               | \$ 1,968        |
| Change in Unrecognized Pension and Postretirement Benefit Costs, Net of Tax | (814)                                  | (405)                          | (963)                  | (813)           | 500                    | 684             |
| <b>Consolidated Balance Sheet:</b>  |  |                                |                        |                 |                        |                 |
| Accumulated Other Comprehensive Income (Loss)                               | \$ (7,072)                             | \$ (3,103)                     | \$ (6,195)             | \$ (2,635)      | \$ (5,127)             | \$ (1,717)      |
| Retained Earnings   | 14,097                                 | 10,128                         | 14,164                 | 10,604          | 12,745                 | 9,335           |
| <b>Statement of Consolidated Cash Flows:</b>                                |  |                                |                        |                 |                        |                 |
| Cash Flows From Operating Activities:                                       |  |                                |                        |                 |                        |                 |
| Net Income  | \$ 4,213                               | \$ 3,804                       | \$ 3,488               | \$ 3,338        | \$ 2,152               | \$ 1,968        |
| Pension and Postretirement Benefit Expense                                  | 1,020                                  | 1,660                          | 903                    | 1,136           | 872                    | 1,165           |
| Deferred Taxes, Credits and Other   | 472                                    | 241                            | 1,002                  | 919             | 471                    | 362             |
| <i>Income Taxes</i>   |  |                                |                        |                 |                        |                 |

Income taxes are accounted for on an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. In estimating future tax consequences, we generally consider all expected future events other than proposed changes in the tax law or rates. Valuation allowances are provided if it is more likely than not that a deferred tax asset will not be realized.

We recognize liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. Once it is determined that the position meets the recognition threshold, the second step requires

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

us to estimate and measure the tax benefit as the largest amount that is more likely than not to be realized upon ultimate settlement. It is inherently difficult and subjective to estimate such amounts, as we have to determine the probability of various possible outcomes. We reevaluate these uncertain tax positions on a quarterly basis. This evaluation is based on factors including, but not limited to, changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement could result in the recognition of a tax benefit or an additional charge to the tax provision.

*Foreign Currency Translation*

We translate the results of operations of our foreign subsidiaries using average exchange rates during each period, whereas balance sheet accounts are translated using exchange rates at the end of each period. Balance sheet currency translation adjustments are recorded in AOCI. Net currency transaction gains and losses included in other operating expenses were pre-tax gains (losses) of \$(1), \$7 and \$(45) million in 2011, 2010 and 2009, respectively.

*Stock-Based Compensation*

All share-based awards to employees are measured based on their fair values and expensed over the period during which an employee is required to provide service in exchange for the award (the vesting period). We issue employee share-based awards under the UPS Incentive Compensation Plan that are subject to specific vesting conditions; generally, the awards cliff vest or vest ratably over a five year period, the nominal vesting period, or at the date the employee retires (as defined by the plan), if earlier. Compensation cost is recognized immediately for awards granted to retirement-eligible employees, or over the period from the grant date to the date retirement eligibility is achieved, if that is expected to occur during the nominal vesting period.

*Fair Value Measurements*

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

Certain non-financial assets and liabilities are measured at fair value on a nonrecurring basis, including property, plant, and equipment, goodwill and intangible assets. These assets are not measured at fair value on a recurring basis; however, they are subject to fair value adjustments in certain circumstances, such as when there is evidence of an impairment. A general description of the valuation methodologies used for assets and liabilities measured at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy, is included in each footnote with fair value measurements present.

*Derivative Instruments*

All financial derivative instruments are recorded on our consolidated balance sheets at fair value. Derivatives not designated as hedges must be adjusted to fair value through income. If a derivative is designated as a hedge, depending on the nature of the hedge, changes in its fair value that are considered to be effective, as defined, either offset the change in fair value of the hedged assets, liabilities or firm commitments through income, or are recorded in AOCI until the hedged item is recorded in income. Any portion of a change in a derivative's fair value that is considered to be ineffective, or is excluded from the measurement of effectiveness, is recorded immediately in income.

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Recently Adopted Accounting Standards*

In September 2011, the Financial Accounting Standards Board ( FASB ) issued an accounting standards update regarding disclosure of an employer's participation in multiemployer pension and health and welfare 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 are 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 impacted our disclosures only, and did not have any impact on our financial condition, results of operations or liquidity. The disclosures required by this accounting standards update are presented in Note 6.

In September 2011, the FASB issued an accounting standards update that amends the accounting guidance on goodwill impairment testing. This accounting standards 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 standards 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 adopted this accounting standards update and applied its provisions to certain of our reporting units for our annual goodwill impairment testing as of October 1, 2011.

Other accounting pronouncements adopted during the periods covered by the consolidated financial statements had an immaterial impact on our consolidated financial position and results of operations.

*Accounting Standards Issued But Not Yet Effective*

Accounting pronouncements issued, but not effective until after December 31, 2011, are not expected to have a significant impact on our consolidated financial position or results of operations.

*Changes in Presentation*

Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications had no impact on our financial position or results of operations.

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 2. CASH AND INVESTMENTS**

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

|  | Cost     | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|--|----------|---------------------|----------------------|-------------------------|
| <b>2011</b>                                    |          |                     |                      |                         |
| Current marketable securities:                 |          |                     |                      |                         |
| U.S. government and agency debt securities     | \$ 184   | \$ 3                | \$                   | \$ 187                  |
| Mortgage and asset-backed debt securities      | 188      | 4                   | (1)                  | 191                     |
| Corporate debt securities                      | 835      | 4                   | (2)                  | 837                     |
| U.S. state and local municipal debt securities | 15       |                     |                      | 15                      |
| Other debt and equity securities               | 10       | 1                   |                      | 11                      |
| Total marketable securities                    | \$ 1,232 | \$ 12               | \$ (3)               | \$ 1,241                |
| <b>2010</b>                                    |          |                     |                      |                         |
| 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                  |

The gross realized gains on sales of marketable securities totaled \$49, \$24 and \$16 million in 2011, 2010, and 2009, respectively. The gross realized losses totaled \$20, \$18 and \$12 million in 2011, 2010 and 2009, respectively. There were no impairment losses recognized on marketable securities during 2011, while impairment losses totaled \$21 and \$17 million during 2010 and 2009 (discussed further below), respectively.

*Auction Rate Securities*

During 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*

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

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

the losses compared with the investments' cost, the probability that we will be unable to collect all amounts due according to the contractual terms of the security, the credit rating of the security and our ability and intent to hold these investments until the anticipated recovery in market value occurs.

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 as a loss in investment income on the statement of consolidated income.

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

*Unrealized Losses*

The following table presents the age of gross unrealized losses and fair value by investment category for all securities in a loss position as of December 31, 2011 (in millions):

|  | Less Than 12 Months |                   | 12 Months or More |                   | Total      |                   |
|--|---------------------|-------------------|-------------------|-------------------|------------|-------------------|
|  | Fair Value          | Unrealized Losses | Fair Value        | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. government and agency debt securities     | \$ 34               | \$                | \$                | \$                | \$ 34      | \$                |
| Mortgage and asset-backed debt securities      | 10                  |                   | 11                | (1)               | 21         | (1)               |
| Corporate debt securities                      | 621                 | (2)               | 7                 |                   | 628        | (2)               |
| U.S. state and local municipal debt securities |                     |                   |                   |                   |            |                   |
| Other debt securities                          | 2                   |                   | 1                 |                   | 3          |                   |
| Total debt securities                          | 667                 | (2)               | 19                | (1)               | 686        | (3)               |
| Common equity securities                       |                     |                   |                   |                   |            |                   |
|  | \$ 667              | \$ (2)            | \$ 19             | \$ (1)            | \$ 686     | \$ (3)            |

The unrealized losses for the U.S. government and agency debt securities, mortgage and asset-backed debt securities, corporate debt securities and other debt securities primarily relate to holdings of various fixed income securities, and are primarily due to changes in market interest rates. We have both the intent and ability to hold the securities contained in the previous table for a time necessary to recover the cost basis.

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Maturity Information*

The amortized cost and estimated fair value of marketable securities at December 31, 2011, by contractual maturity, are shown below (in millions). Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

|  | <b>Cost</b> | <b>Estimated<br/>Fair Value</b> |
|--|-------------|---------------------------------|
| Due in one year or less                  | \$ 669      | \$ 668                          |
| Due after one year through three years   | 207         | 207                             |
| Due after three years through five years | 51          | 51                              |
| Due after five years                     | 303         | 313                             |
|  | 1,230       | 1,239                           |
| Equity securities                        | 2           | 2                               |
|  | \$ 1,232    | \$ 1,241                        |

*Non-Current Investments and Restricted Cash*

Restricted cash and cash equivalents relate to our self-insurance requirements. We entered into an escrow agreement with an insurance carrier to guarantee our self-insurance obligations. This agreement requires us to provide cash collateral to the insurance carrier, which is reported in *Non-Current Investments and Restricted Cash* on our consolidated balance sheets. Additional cash collateral provided is reflected in other investing activities in the statements of consolidated cash flows. This restricted cash is invested in money market funds and similar cash equivalent type assets. As of December 31, 2011 and 2010, we had \$286 million in restricted cash.

At December 31, 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 investment income on 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 previous holdings of auction rate securities as utilizing Level 3 inputs, as their valuation required substantial judgment and estimation of factors that were not observable in the market due to the lack of trading in the securities. These securities were valued as of December 31, 2010 considering several factors, including the credit quality of the securities, the rate of interest received since the failed auctions began, the yields of securities similar to the underlying auction rate securities and the input of broker-dealers in these securities.

We maintain holdings in certain investment partnerships that are measured at fair value utilizing Level 3 inputs (classified as *Other Investments* in the tables below, and as *Other Non-Current Assets* in the consolidated balance sheets). These partnership holdings do not have quoted prices, nor can they be valued using inputs based on observable market data. These investments are valued internally using a discounted cash flow model based on each partnership's financial statements and cash flow projections.



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

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

|  | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Balance as of<br>December 31, 2011 |
|--|--|---|--|------------------------------------|
| <b>2011</b>                                    |  |   |  |                                    |
| Marketable Securities:                         |  |   |  |                                    |
| U.S. Government and Agency Debt Securities     | \$ 187   | \$  | \$   | \$ 187                             |
| Mortgage and Asset-Backed Debt Securities      |  | 191   |  | 191                                |
| Corporate Debt Securities                      |  | 837   |  | 837                                |
| U.S. State and Local Municipal Debt Securities |  | 15  |  | 15                                 |
| Other Debt and Equity Securities               |  | 11  |  | 11                                 |
| Total Marketable Securities                    | 187  | 1,054   |  | 1,241                              |
| Other investments                              | 17   |   | 217  | 234                                |
| Total  | \$ 204   | \$ 1,054  | \$ 217   | \$ 1,475                           |

|  | Quoted<br>Prices in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Balance as of<br>December 31,<br>2010 |
|--|--|---|--|---------------------------------------|
| <b>2010</b>                                    |  |   |  |                                       |
| Marketable Securities:                         |  |   |  |                                       |
| U.S. Government and Agency Debt Securities     | \$ 206   | \$  | \$   | \$ 206                                |
| Mortgage and Asset-Backed Debt Securities      |  | 222   | 79   | 301                                   |
| Corporate Debt Securities                      |  | 183   |  | 183                                   |
| U.S. State and Local Municipal Debt Securities |  | 33  | 45   | 78                                    |
| Other Debt and Equity Securities               | 41   | 60  | 14   | 115                                   |
| Total Marketable Securities                    | 247  | 498   | 138  | 883                                   |
| Other investments                              |  |   | 267  | 267                                   |
| Total  | \$ 247   | \$ 498  | \$ 405   | \$ 1,150                              |

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

The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the years ended December 31, 2011 and 2010 (in millions).

|  | Marketable<br>Securities | Other<br>Investments | Total  |
|--|--------------------------|----------------------|--------|
| Balance on January 1, 2010                                   | \$ 216                   | \$ 301               | \$ 517 |
| Transfers into (out of) Level 3                              |                          |                      |        |
| Net realized and unrealized gains (losses):                  |                          |                      |        |
| Included in earnings (in investment income)                  | (27)                     | (34)                 | (61)   |
| Included in accumulated other comprehensive income (pre-tax) | 59                       |                      | 59     |
| Purchases  |                          |                      |        |
| Settlements  | (110)                    |                      | (110)  |
| Balance on December 31, 2010                                 | \$ 138                   | \$ 267               | \$ 405 |
| Transfers into (out of) Level 3                              |                          |                      |        |
| Net realized and unrealized gains (losses):                  |                          |                      |        |
| Included in earnings (in investment income)                  |                          | (50)                 | (50)   |
| Included in accumulated other comprehensive income (pre-tax) |                          |                      |        |
| Purchases  |                          |                      |        |
| Settlements  | (138)                    |                      | (138)  |
| Balance on December 31, 2011                                 | \$                       | \$ 217               | \$ 217 |

**NOTE 3. FINANCE RECEIVABLES**

The following is a summary of finance receivables at December 31, 2011 and 2010 (in millions):

|                                   | 2011   | 2010   |
|-----------------------------------|--------|--------|
| Commercial term loans             | \$ 197 | \$ 266 |
| Other financing receivables       | 154    | 245    |
| Gross finance receivables         | 351    | 511    |
| Less: Allowance for credit losses | (16)   | (20)   |
| Balance at December 31            | \$ 335 | \$ 491 |

Our finance receivables portfolio consists of two product groups: commercial term loans and other financing receivables. Other financing receivables consist of investments in finance leases, asset-based lending, cargo finance and receivable factoring. The current portion of finance receivables is included in Other current assets and the non-current portion of finance receivables is included in Other non-current assets on our consolidated balance sheets. Outstanding receivable balances at December 31, 2011 and 2010 are net of unearned income of \$12 and \$15 million, respectively.

When we factor (i.e., purchase) a customer invoice from a client, we record the customer receivable as an asset and also establish a liability for the funds due to the client, which is recorded in accounts payable on the consolidated balance sheets. As of December 31, 2011 and 2010, the

amounts due to clients under our factoring programs were \$79 and \$71 million, respectively.

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

The following is a rollforward of the allowance for credit losses on finance receivables (in millions):

|                                  | 2011  | 2010  |
|----------------------------------|-------|-------|
| Balance at January 1             | \$ 20 | \$ 31 |
| Provisions charged to operations | 4     | 10    |
| Charge-offs, net of recoveries   | (8)   | (21)  |
| Balance at December 31           | \$ 16 | \$ 20 |

We use a multiple tier risk assessment matrix to grade and monitor asset quality. The primary assessments are made to determine the degree of risk that an obligor may default in principal or interest payments and the potential range of loss in the event of default. The risk assessment categories are:

*U.S. Government Guaranteed* Payments are guaranteed by the Small Business Administration or U.S. Department of Agriculture, and no loss is likely.

*Acceptable Risk* Payments are current, and no loss is likely.

*Sub-Standard Risk* In default or high probability of default, but loss is unlikely.

*Classified* In default, loss is probable, specific allowance for loss is assigned.

The following is an allocation of the finance receivables portfolio by risk rating category as of December 31, 2011 (in millions):

|                            | Commercial<br>Lending | Other<br>Financing<br>Receivables | Total  |
|----------------------------|-----------------------|-----------------------------------|--------|
| U.S. Government guaranteed | \$ 62                 | \$                                | \$ 62  |
| Acceptable risk            | 119                   | 151                               | 270    |
| Sub-standard risk          | 7                     | 3                                 | 10     |
| Classified                 | 9                     |                                   | 9      |
|                            | \$ 197                | \$ 154                            | \$ 351 |

The following is an aging analysis of our finance receivables as of December 31, 2011 (in millions):

**Current**

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|                                  | 30-59 Days<br>Past<br>Due | 60-90 Days<br>Past<br>Due | Greater<br>than 90<br>Days Past<br>Due |               | Total<br>Finance<br>Receivables |
|----------------------------------|---------------------------|---------------------------|--|---------------|---------------------------------|
| Commercial term loans:           |                           |                           |  |               |                                 |
| U.S. Government guaranteed       | \$ 1                      | \$                        | \$ 30                                  | \$ 31         | \$ 62                           |
| Other unguaranteed               |                           | 5                         | 15                                     | 115           | 135                             |
| Other financing receivables      |                           |                           | 1                                      | 153           | 154                             |
| <b>Total finance receivables</b> | <b>\$ 1</b>               | <b>\$ 5</b>               | <b>\$ 46</b>                           | <b>\$ 299</b> | <b>\$ 351</b>                   |

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

The following is an analysis of impaired finance receivables as of December 31, 2011 (in millions):

|   | <b>Recorded<br/>Investment</b> | <b>Unpaid<br/>Principal<br/>Balance</b> | <b>Related<br/>Allowance</b> | <b>Average<br/>Recorded<br/>Investment</b> | <b>Interest<br/>Income<br/>Recognized</b> |
|---|--------------------------------|---|------------------------------|--|---|
| Impaired loans with related allowance         | \$ 9                           | \$ 36                                   | \$ 7                         | \$ 14                                      | \$  |
| Impaired loans with no related allowance      | 7                              | 80                                      |                              | 12   |   |
| Impaired loans with U.S. government guarantee | 35                             | 35                                      |                              | 51   |   |
| <b>Total impaired loans</b>                   | <b>\$ 51</b>                   | <b>\$ 151</b>                           | <b>\$ 7</b>                  | <b>\$ 77</b>                               | <b>\$</b>                                 |

The carrying value of finance receivables at December 31, 2011, by contractual maturity, is shown below (in millions). Actual maturities may differ from contractual maturities because some borrowers have the right to prepay these receivables without prepayment penalties.

|  | <b>Carrying<br/>Value</b> |
|--|---------------------------|
| Due in one year or less                  | \$ 130                    |
| Due after one year through three years   | 33                        |
| Due after three years through five years | 28                        |
| Due after five years                     | 160                       |
|  | <b>\$ 351</b>             |

Based on interest rates for financial instruments with similar terms and maturities, the estimated fair value of finance receivables is approximately \$335 and \$491 million as of December 31, 2011 and 2010, respectively. At December 31, 2011, we had unfunded loan commitments totaling \$248 million, consisting of standby letters of credit of \$29 million and other unfunded lending commitments of \$219 million.

During 2009, impaired finance receivables with a carrying amount of \$13 million were written down to a net fair value of \$8 million, based on the fair value for the related collateral which was determined using unobservable inputs (Level 3).

**NOTE 4. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment, including both owned assets as well as assets subject to capital leases, consists of the following as of December 31 (in millions):

|                                     | <b>2011</b> | <b>2010</b> |
|-------------------------------------|-------------|-------------|
| Vehicles                            | \$ 5,981    | \$ 5,519    |
| Aircraft                            | 14,616      | 14,063      |
| Land                                | 1,114       | 1,081       |
| Buildings                           | 3,095       | 3,102       |
| Building and leasehold improvements | 2,943       | 2,860       |
| Plant equipment                     | 6,803       | 6,656       |

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|   |           |           |
|---|-----------|-----------|
| Technology equipment                            | 1,593     | 1,552     |
| Equipment under operating leases                | 93        | 122       |
| Construction-in-progress                        | 303       | 265       |
|   | 36,541    | 35,220    |
| Less: Accumulated depreciation and amortization | (18,920)  | (17,833)  |
|   | \$ 17,621 | \$ 17,387 |

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

We continually monitor our aircraft fleet utilization in light of current and projected volume levels, aircraft fuel prices and other factors. In 2011 and 2010, there were no indicators of impairment in our aircraft fleet, and no impairment charges were recorded in either period. In 2009, we recorded a \$181 million impairment charge, as described in the following paragraphs.

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

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

The impaired airframes, engines and parts had a net carrying value of \$192 million, and were written down to an aggregate fair value of \$11 million. The fair values for the impaired airframes, engines, and parts were determined using unobservable inputs (Level 3).

**NOTE 5. COMPANY-SPONSORED EMPLOYEE BENEFIT PLANS**

We sponsor various retirement and pension plans, including defined benefit and defined contribution plans which cover our employees worldwide.

***U.S. Pension Benefits***

In the U.S. we maintain the following single-employer defined benefit pension plans: UPS Retirement Plan, UPS Pension Plan, UPS IBT Pension Plan and the UPS Excess Coordinating Benefit Plan, a non-qualified plan.

The UPS Retirement Plan is noncontributory and includes substantially all eligible employees of participating domestic subsidiaries who are not members of a collective bargaining unit, as well as certain employees covered by a collective bargaining agreement. This plan generally provides for retirement benefits based on average compensation levels earned by employees prior to retirement. Benefits payable under this plan are subject to maximum compensation limits and the annual benefit limits for a tax qualified defined benefit plan as prescribed by the Internal Revenue Service ( IRS ).

The UPS Excess Coordinating Benefit Plan is a non-qualified plan that provides benefits to certain participants in the UPS Retirement Plan for amounts that exceed the benefit limits described above.

The UPS Pension Plan is noncontributory and includes certain eligible employees of participating domestic subsidiaries and members of collective bargaining units that elect to participate in the plan. This plan generally provides for retirement benefits based on service credits earned by employees prior to retirement.

The UPS IBT Pension Plan is noncontributory and includes employees that were previously members of the Central States, Southeast and Southwest Areas Pension Fund ( Central States Pension Fund ), a multiemployer pension plan, in addition to other eligible employees who are covered under certain collective bargaining agreements.



**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****U.S. Postretirement Medical Benefits***

We also sponsor postretirement medical plans in the U.S. that provide health care benefits to our retirees who meet certain eligibility requirements and who are not otherwise covered by multiemployer plans. Generally, this includes employees with at least 10 years of service who have reached age 55 and employees who are eligible for postretirement medical benefits from a Company-sponsored plan pursuant to collective bargaining agreements. We have the right to modify or terminate certain of these plans. These benefits have been provided to certain retirees on a noncontributory basis; however, in many cases, retirees are required to contribute all or a portion of the total cost of the coverage.

***International Pension Benefits***

We also sponsor various defined benefit plans covering certain of our international employees. The majority of our international obligations are for defined benefit plans in Canada and the United Kingdom. In addition, many of our international employees are covered by government-sponsored retirement and pension plans. We are not directly responsible for providing benefits to participants of government-sponsored plans.

***Defined Contribution Plans***

We also sponsor several defined contribution plans for all employees not covered under collective bargaining agreements, and for certain employees covered under collective bargaining agreements. The Company matches, in shares of UPS common stock or cash, a portion of the participating employees' contributions. In early 2009, we suspended the company matching contributions to the primary employee defined contribution plan. A revised program of company matching contributions was reinstated effective January 1, 2011. Matching contributions charged to expense were \$80, \$4 and \$21 million for 2011, 2010 and 2009, respectively.

Contributions are also made to defined contribution money purchase plans under certain collective bargaining agreements. Amounts charged to expense were \$76, \$78 and \$80 million for 2011, 2010, and 2009, respectively.

***Net Periodic Benefit Cost***

Information about net periodic benefit cost for the company-sponsored pension and postretirement benefit plans is as follows (in millions):

|                           | U.S. Pension Benefits |         |         | U.S. Postretirement Medical Benefits |        |        | International Pension Benefits |       |       |
|---------------------------|-----------------------|---------|---------|--------------------------------------|--------|--------|--------------------------------|-------|-------|
|                           | 2011                  | 2010    | 2009    | 2011                                 | 2010   | 2009   | 2011                           | 2010  | 2009  |
| <b>Net Periodic Cost:</b> |                       |         |         |                                      |        |        |                                |       |       |
| Service cost              | \$ 870                | \$ 723  | \$ 689  | \$ 89                                | \$ 86  | \$ 85  | \$ 34                          | \$ 24 | \$ 17 |
| Interest cost             | 1,309                 | 1,199   | 1,130   | 207                                  | 214    | 211    | 39                             | 34    | 28    |
| Expected return on assets | (1,835)               | (1,381) | (1,151) | (16)                                 | (22)   | (27)   | (43)                           | (36)  | (26)  |
| Amortization of:          |                       |         |         |                                      |        |        |                                |       |       |
| Transition obligation     |                       |         | 4       |                                      |        |        |                                |       |       |
| Prior service cost        | 171                   | 172     | 178     | 7                                    | 4      | 6      | 1                              | 1     | 1     |
| Actuarial (gain) loss     | 736                   | 70      |         |                                      |        |        | 91                             | 42    | 16    |
| Other                     |                       |         | 3       |                                      |        |        |                                | 6     | 1     |
| Net periodic benefit cost | \$ 1,251              | \$ 783  | \$ 853  | \$ 287                               | \$ 282 | \$ 275 | \$ 122                         | \$ 71 | \$ 37 |



**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Actuarial Assumptions*

The table below provides the weighted-average actuarial assumptions used to determine the net periodic benefit cost.

|                               | U.S. Pension Benefits |       |       | U.S. Postretirement Medical Benefits |       |       | International Pension Benefits |       |       |
|-------------------------------|-----------------------|-------|-------|--------------------------------------|-------|-------|--------------------------------|-------|-------|
|                               | 2011                  | 2010  | 2009  | 2011                                 | 2010  | 2009  | 2011                           | 2010  | 2009  |
| Discount rate                 | 5.98%                 | 6.58% | 6.75% | 5.77%                                | 6.43% | 6.66% | 5.36%                          | 5.84% | 6.17% |
| Rate of compensation increase | 4.50%                 | 4.50% | 4.50% | N/A                                  | N/A   | N/A   | 3.57%                          | 3.62% | 3.65% |
| Expected return on assets     | 8.75%                 | 8.75% | 8.96% | 8.75%                                | 8.75% | 9.00% | 7.31%                          | 7.25% | 7.09% |

The table below provides the weighted-average actuarial assumptions used to determine the benefit obligations of our plans.

|                               | U.S. Pension Benefits |       | U.S. Postretirement Medical Benefits |       | International Pension Benefits |       |
|-------------------------------|-----------------------|-------|--------------------------------------|-------|--------------------------------|-------|
|                               | 2011                  | 2010  | 2011                                 | 2010  | 2011                           | 2010  |
| Discount rate                 | 5.64%                 | 5.98% | 5.47%                                | 5.77% | 4.63%                          | 5.36% |
| Rate of compensation increase | 4.50%                 | 4.50% | N/A                                  | N/A   | 3.58%                          | 3.57% |

A discount rate is used to determine the present value of our future benefit obligations. To determine our discount rate for our U.S. pension and other postretirement benefit plans, we use a bond matching approach to select specific bonds that would satisfy our projected benefit payments. We believe the bond matching approach reflects the process we would employ to settle our pension and postretirement benefit obligations. For our international plans, the discount rate is determined by matching the expected cash flows of a sample plan of similar duration to a yield curve based on long-term, high quality fixed income debt instruments available as of the measurement date. For 2011, each basis point increase in the discount rate decreases the projected benefit obligation by approximately \$39 million and \$4 million for pension and postretirement medical benefits, respectively. These assumptions are updated each measurement date, which is typically annually.

An assumption for expected return on plan assets is used to determine a component of net periodic benefit cost for the fiscal year. This assumption for our U.S. plans was developed using a long-term projection of returns for each asset class, and taking into consideration our target asset allocation. The expected return for each asset class is a function of passive, long-term capital market assumptions and excess returns generated from active management. The capital market assumptions used are provided by independent investment advisors, while excess return assumptions are supported by historical performance, fund mandates and investment expectations. In addition, we compare the expected return on asset assumption with the average historical rate of return these plans have been able to generate.

For plans outside the U.S., consideration is given to local market expectations of long-term returns. Strategic asset allocations are determined by country, based on the nature of liabilities and considering the demographic composition of the plan participants.

Health care cost trends are used to project future postretirement benefits payable from our plans. For year-end 2011 U.S. plan obligations, future postretirement medical benefit costs were forecasted assuming an initial annual increase of 8.0%, decreasing to 5.0% by the year 2018 and with consistent annual increases at those ultimate levels thereafter.

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

Assumed health care cost trends can have a significant effect on the amounts reported for the U.S. postretirement medical plans. A one-percent change in assumed health care cost trend rates would have had the following effects on 2011 results (in millions):

|   | 1% Increase | 1% Decrease |
|---|-------------|-------------|
| Effect on total of service cost and interest cost | \$ 6        | \$ (6)      |
| Effect on postretirement benefit obligation       | \$ 61       | \$ (65)     |

**Benefit Obligations and Fair Value of Plan Assets**

The following table provides a reconciliation of the changes in the plans' benefit obligations and fair value of plan assets as of the respective measurement dates in each year (in millions).

|   | U.S. Pension Benefits |           | U.S. Postretirement Medical Benefits |          | International Pension Benefits |        |
|---|-----------------------|-----------|--------------------------------------|----------|--------------------------------|--------|
|   | 2011                  | 2010      | 2011                                 | 2010     | 2011                           | 2010   |
| <b>Benefit Obligations:</b>                       |                       |           |                                      |          |                                |        |
| Projected benefit obligation at beginning of year | \$ 21,342             | \$ 17,763 | \$ 3,597                             | \$ 3,336 | \$ 680                         | \$ 575 |
| Service cost                                      | 870                   | 723       | 89                                   | 86       | 34                             | 24     |
| Interest cost                                     | 1,309                 | 1,199     | 207                                  | 214      | 39                             | 34     |
| Gross benefits paid                               | (657)                 | (574)     | (219)                                | (207)    | (15)                           | (13)   |
| Plan participants' contributions                  |                       |           | 16                                   | 17       | 1                              | 1      |
| Plan amendments                                   | 3                     | (7)       | (24)                                 | 8        | 7                              |        |
| Actuarial (gain)/loss                             | 1,519                 | 2,238     | 170                                  | 142      | 99                             | 58     |
| Foreign currency exchange rate changes            |                       |           |                                      |          | (4)                            | (4)    |
| Curtailments and settlements                      |                       |           |                                      |          |                                | (1)    |
| Other   |                       |           |                                      | 1        |                                | 6      |
| Projected benefit obligation at end of year       | \$ 24,386             | \$ 21,342 | \$ 3,836                             | \$ 3,597 | \$ 841                         | \$ 680 |

|  | U.S. Pension Benefits |           | U.S. Postretirement Medical Benefits |        | International Pension Benefits |        |
|--|-----------------------|-----------|--------------------------------------|--------|--------------------------------|--------|
|  | 2011                  | 2010      | 2011                                 | 2010   | 2011                           | 2010   |
| <b>Fair Value of Plan Assets:</b>              |                       |           |                                      |        |                                |        |
| Fair value of plan assets at beginning of year | \$ 20,092             | \$ 15,351 | \$ 233                               | \$ 298 | \$ 561                         | \$ 481 |
| Actual return on plan assets                   | 1,956                 | 2,215     | 9                                    | 30     | 10                             | 48     |
| Employer contributions                         | 1,272                 | 3,100     | 108                                  | 95     | 56                             | 45     |
| Plan participants' contributions               |                       |           | 16                                   | 17     | 1                              | 1      |
| Gross benefits paid                            | (657)                 | (574)     | (219)                                | (207)  | (15)                           | (13)   |
| Foreign currency exchange rate changes         |                       |           |                                      |        |                                |        |
| Curtailments and settlements                   |                       |           |                                      |        |                                | (1)    |
| Other  |                       |           | 27                                   |        |                                |        |
| Fair value of plan assets at end of year       | \$ 22,663             | \$ 20,092 | \$ 174                               | \$ 233 | \$ 613                         | \$ 561 |



**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Funded Status**

The following table discloses the funded status of our plans and the amounts recognized in our balance sheet as of December 31 (in millions):

|   | U.S. Pension Benefits |            | U.S. Postretirement Medical Benefits |            | International Pension Benefits |          |
|---|-----------------------|------------|--------------------------------------|------------|--------------------------------|----------|
|   | 2011                  | 2010       | 2011                                 | 2010       | 2011                           | 2010     |
| <b>Funded Status:</b>   |                       |            |                                      |            |                                |          |
| Fair value of plan assets                                     | \$ 22,663             | \$ 20,092  | \$ 174                               | \$ 233     | \$ 613                         | \$ 561   |
| Benefit obligation  | (24,386)              | (21,342)   | (3,836)                              | (3,597)    | (841)                          | (680)    |
| Funded status recognized at December 31                       | \$ (1,723)            | \$ (1,250) | \$ (3,662)                           | \$ (3,364) | \$ (228)                       | \$ (119) |
| <b>Funded Status Amounts Recognized in our Balance Sheet:</b> |                       |            |                                      |            |                                |          |
| Other non-current assets                                      | \$                    | \$ 42      | \$                                   | \$         | \$ 1                           | \$ 1     |
| Other current liabilities                                     | (13)                  | (11)       | (93)                                 | (99)       | (3)                            | (3)      |
| Pension and postretirement benefit obligations                | (1,710)               | (1,281)    | (3,569)                              | (3,265)    | (226)                          | (117)    |
| Net liability at December 31                                  | \$ (1,723)            | \$ (1,250) | \$ (3,662)                           | \$ (3,364) | \$ (228)                       | \$ (119) |
| <b>Amounts Recognized in AOCI:</b>                            |                       |            |                                      |            |                                |          |
| Unrecognized net prior service cost                           | \$ (1,492)            | \$ (1,660) | \$ (82)                              | \$ (113)   | \$ (14)                        | \$ (8)   |
| Unrecognized net actuarial loss                               | (2,439)               | (1,777)    | (307)                                | (157)      | (52)                           | (22)     |
| Gross unrecognized cost at December 31                        | (3,931)               | (3,437)    | (389)                                | (270)      | (66)                           | (30)     |
| Deferred tax asset at December 31                             | 1,479                 | 1,292      | 146                                  | 102        | 16                             | 3        |
| Net unrecognized cost at December 31                          | \$ (2,452)            | \$ (2,145) | \$ (243)                             | \$ (168)   | \$ (50)                        | \$ (27)  |

The accumulated benefit obligation for our pension plans as of the measurement dates in 2011 and 2010 was \$23.307 and \$20.241 billion, respectively.

Benefit payments under the pension plans include \$14 million paid from employer assets in both 2011 and 2010. Benefit payments (net of participant contributions) under the postretirement medical benefit plans include \$108 and \$94 million paid from employer assets in 2011 and 2010, respectively. Such benefit payments from employer assets are also categorized as employer contributions.

At December 31, 2011 and 2010, the projected benefit obligation, the accumulated benefit obligation, and the fair value of plan assets for pension plans with benefit obligations in excess of plan assets were as follows (in millions):

|                              | Projected Benefit Obligation Exceeds the Fair Value of Plan Assets |      | Accumulated Benefit Obligation Exceeds the Fair Value of Plan Assets |      |
|------------------------------|--|------|--|------|
|                              | 2011   | 2010 | 2011   | 2010 |
| <b>U.S. Pension Benefits</b> |  |      |  |      |

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|                                       |           |          |          |          |
|---------------------------------------|-----------|----------|----------|----------|
| Projected benefit obligation          | \$ 24,386 | \$ 3,227 | \$ 7,499 | \$ 3,227 |
| Accumulated benefit obligation        | 22,574    | 3,195    | 7,395    | 3,195    |
| Fair value of plan assets             | 22,663    | 1,934    | 6,646    | 1,934    |
| <b>International Pension Benefits</b> |           |          |          |          |
| Projected benefit obligation          | \$ 814    | \$ 662   | \$ 499   | \$ 362   |
| Accumulated benefit obligation        | 714       | 323      | 448      | 323      |
| Fair value of plan assets             | 594       | 543      | 296      | 257      |

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

The increase in U.S. pension benefits amounts where the projected benefit obligation exceeds the fair value of plan assets is due to the funded status for both the UPS Retirement Plan and UPS Pension Plan changing from overfunded at December 31, 2010 to underfunded at December 31, 2011.

The accumulated postretirement benefit obligation exceeds plan assets for all of our U.S. postretirement medical benefit plans.

***Accumulated Other Comprehensive Income***

The estimated amounts of prior service cost in AOCI expected to be amortized and recognized as a component of net periodic benefit cost in 2012 are as follows (in millions):

|  | U.S. Pension Benefits | U.S. Postretirement<br>Medical<br>Benefits | International Pension<br>Benefits |
|--|-----------------------|--|-----------------------------------|
| Prior service cost / (benefit)                       | \$ 173                | \$ 5                                       | \$ 2                              |
| <b><i>Pension and Postretirement Plan Assets</i></b> |                       |  |                                   |

The applicable benefit plan committees establish investment guidelines and strategies, and regularly monitor the performance of the funds and portfolio managers. Our investment guidelines address the following items: governance, general investment beliefs and principles, investment objectives, specific investment goals, process for determining/maintaining the asset allocation policy, long-term asset allocation, rebalancing, investment restrictions/prohibited transactions, portfolio manager structure and diversification (which addresses limits on the amount of investments held by any one manager to minimize risk), portfolio manager selection criteria, plan evaluation, portfolio manager performance review and evaluation and risk management (including various measures used to evaluate risk tolerance).

Our investment strategy with respect to pension assets is to invest the assets in accordance with applicable laws and regulations. The long-term primary objectives for our pension assets are to: (1) provide for a reasonable amount of long-term growth of capital, with prudent exposure to risk; and protect the assets from erosion of purchasing power; (2) provide investment results that meet or exceed the plans' expected long-term rate of return; and (3) match the duration of the liabilities and assets of the plans to reduce the potential risk of large employer contributions being necessary in the future. The plans strive to meet these objectives by employing portfolio managers to actively manage assets within the guidelines and strategies set forth by the benefit plan committees. These managers are evaluated by comparing their performance to applicable benchmarks.

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

The fair values of U.S. pension and postretirement benefit plan assets by asset category as of December 31, 2011 are presented below (in millions), as well as the percentage that each category comprises of our total plan assets and the respective target allocations.

|                                      | Level 1         | Level 2         | Level 3         | Total Assets     | Percentage of Plan Assets - 2011 | Target Allocation 2011 |
|--------------------------------------|-----------------|-----------------|-----------------|------------------|----------------------------------|------------------------|
| <b>Asset Category:</b>               |                 |                 |                 |                  |                                  |                        |
| Cash and cash equivalents            | \$ 74           | \$ 1            | \$              | \$ 75            | 0.3%                             | 0-5%                   |
| <b>Equity Securities:</b>            |                 |                 |                 |                  |                                  |                        |
| U.S. Large Cap                       | 2,264           | 2,460           |                 | 4,724            |                                  |                        |
| U.S. Small Cap                       | 706             | 27              |                 | 733              |                                  |                        |
| Global Equity                        | 1,115           | 12              |                 | 1,127            |                                  |                        |
| International Core                   | 592             | 926             |                 | 1,518            |                                  |                        |
| Emerging Markets                     | 389             | 264             |                 | 653              |                                  |                        |
| International Small Cap              | 362             | 165             |                 | 527              |                                  |                        |
| <b>Total Equity Securities</b>       | <b>5,428</b>    | <b>3,854</b>    |                 | <b>9,282</b>     | <b>40.7</b>                      | <b>40-60</b>           |
| <b>Fixed Income Securities:</b>      |                 |                 |                 |                  |                                  |                        |
| U.S. Government Securities           | 3,412           | 1,217           |                 | 4,629            |                                  |                        |
| Corporate Bonds                      | 9               | 3,462           | 80              | 3,551            |                                  |                        |
| Municipal Bonds                      |                 | 104             |                 | 104              |                                  |                        |
| <b>Total Fixed Income Securities</b> | <b>3,421</b>    | <b>4,783</b>    | <b>80</b>       | <b>8,284</b>     | <b>36.3</b>                      | <b>20-40</b>           |
| <b>Other Investments:</b>            |                 |                 |                 |                  |                                  |                        |
| Hedge Funds                          |                 |                 | 2,743           | 2,743            | 12.0                             | 5-15                   |
| Real Estate                          | 151             |                 | 948             | 1,099            | 4.8                              | 1-10                   |
| Private Equity                       |                 |                 | 1,354           | 1,354            | 5.9                              | 1-10                   |
| <b>Total U.S. Plan Assets</b>        | <b>\$ 9,074</b> | <b>\$ 8,638</b> | <b>\$ 5,125</b> | <b>\$ 22,837</b> | <b>100.0%</b>                    |                        |

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

The fair values of U.S. pension and postretirement benefit plan assets by asset category as of December 31, 2010 are presented below (in millions), as well as the percentage that each category comprises of our total plan assets and the respective target allocations.

|                                      | Level 1          | Level 2         | Level 3         | Total Assets     | Percentage of Plan Assets - 2010 | Target Allocation 2010 |
|--------------------------------------|------------------|-----------------|-----------------|------------------|----------------------------------|------------------------|
| <b>Asset Category:</b>               |                  |                 |                 |                  |                                  |                        |
| Cash and cash equivalents            | \$               | \$ 579          | \$              | \$ 579           | 2.9%                             | 0-5%                   |
| <b>Equity Securities:</b>            |                  |                 |                 |                  |                                  |                        |
| U.S. Large Cap                       | 4,897            |                 |                 | 4,897            |                                  |                        |
| U.S. Small Cap                       | 874              |                 |                 | 874              |                                  |                        |
| International Core                   | 1,219            | 920             |                 | 2,139            |                                  |                        |
| Emerging Markets                     | 528              | 281             |                 | 809              |                                  |                        |
| International Small Cap              | 117              | 196             |                 | 313              |                                  |                        |
| <b>Total Equity Securities</b>       | <b>7,635</b>     | <b>1,397</b>    |                 | <b>9,032</b>     | <b>44.4</b>                      | <b>40-60</b>           |
| <b>Fixed Income Securities:</b>      |                  |                 |                 |                  |                                  |                        |
| U.S. Government Securities           | 3,502            | 313             |                 | 3,815            |                                  |                        |
| Corporate Bonds                      | 608              | 1,694           | 193             | 2,495            |                                  |                        |
| Mortgage-Backed Securities           |                  | 50              |                 | 50               |                                  |                        |
| <b>Total Fixed Income Securities</b> | <b>4,110</b>     | <b>2,057</b>    | <b>193</b>      | <b>6,360</b>     | <b>31.3</b>                      | <b>20-40</b>           |
| <b>Other Investments:</b>            |                  |                 |                 |                  |                                  |                        |
| Hedge Funds                          |                  |                 | 2,023           | 2,023            | 10.0                             | 5-15                   |
| Real Estate                          | 98               | 135             | 789             | 1,022            | 5.0                              | 1-10                   |
| Private Equity                       |                  |                 | 1,309           | 1,309            | 6.4                              | 1-10                   |
| <b>Total U.S. Plan Assets</b>        | <b>\$ 11,843</b> | <b>\$ 4,168</b> | <b>\$ 4,314</b> | <b>\$ 20,325</b> | <b>100.0%</b>                    |                        |

There were no UPS class A or B shares of common stock directly held in plan assets as of December 31, 2011. Equity securities include UPS class A shares of common stock in the amount of \$346 million (1.7% of total plan assets) as of December 31, 2010.

Pension assets utilizing Level 1 inputs include fair values of equity investments, corporate debt instruments, and U.S. government securities that were determined by closing prices for those securities traded on national stock exchanges, while securities traded in the over-the-counter market and listed securities for which no sale was reported on the valuation date are valued at the mean between the last reported bid and asked prices.

Level 2 assets include certain bonds that are valued based on yields currently available on comparable securities of other issues with similar credit ratings, mortgage-backed securities that are valued based on cash flow and yield models using acceptable modeling and pricing conventions, and certain investments that are pooled with other investments held by the trustee in a commingled employee benefit trust fund. The investments in the commingled funds are valued by taking the percentage owned by the respective plan in the underlying net asset value of the trust fund, which was determined in accordance with the paragraph above.

Certain investments' estimated fair value is based on unobservable inputs that are not corroborated by observable market data and are thus classified as Level 3. These investments include commingled funds comprised of corporate and government bonds, hedge funds, real estate investments and private equity funds. The commingled funds are valued using net asset values, adjusted, as appropriate, for investment fund specific inputs determined to be significant to the valuation. Investments in hedge funds are valued using reported net



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

asset values as of December 31. These assets are primarily invested in a portfolio of diversified, direct investments and funds of hedge funds. Real estate investments and private equity funds are valued using fair values per the most recent partnership audited financial reports, adjusted as appropriate for any lag between the date of the financial reports and December 31. The real estate investments consist of U.S. and non-U.S. real estate investments and are broadly diversified. The fair values may, due to the inherent uncertainty of valuation for those alternative investments, differ significantly from the values that would have been used had a ready market for the alternative investments existed, and the differences could be material.

At December 31, 2011 and 2010, \$3.895 and \$3.766 billion of plan assets are held in commingled stock funds that hold U.S. and international public market securities. The plans held the right to liquidate positions in these commingled stock funds at any time, subject only to a brief notification period. No unfunded commitments existed with respect to these commingled stock funds at December 31, 2011.

The plans hold \$2.302 and \$2.098 billion of investments in limited partnership interests in various private equity and real estate funds. Limited provision exists for the redemption of these interests by the general partners that invest in these funds until the end of the term of the partnerships, typically ranging between 12 and 18 years from the date of inception. An active secondary market exists for similar partnership interests, although no particular value (discount or premium) can be guaranteed. At December 31, 2011, unfunded commitments to such limited partnerships totaling approximately \$701 million are expected to be contributed over the remaining investment period, typically ranging between three and six years.

At December 31, 2011 and 2010, \$2.743 and \$2.023 billion of plan investments are held in hedge funds that pursue multiple strategies to diversify risk and reduce volatility. Most of these funds allow redemptions either quarterly or semi-annually after a two to three month notice period, while other funds allow for redemption after only a brief notification period with no restriction on redemption frequency. No unfunded commitments existed with respect to these hedge funds as of December 31, 2011.

The following tables presents the changes in the Level 3 instruments measured on a recurring basis for the years ended December 31, 2011 and 2010 (in millions):

|                                 | <b>Corporate<br/>Bonds</b> | <b>Hedge<br/>Funds</b> | <b>Real<br/>Estate</b> | <b>Private<br/>Equity</b> | <b>Total</b> |
|---------------------------------|----------------------------|------------------------|------------------------|---------------------------|--------------|
| Balance on January 1, 2010      | \$ 201                     | \$ 1,284               | \$ 550                 | \$ 1,145                  | \$ 3,180     |
| Actual Return on Assets:        |                            |                        |                        |                           |              |
| Assets Held at End of Year      | (5)                        | 129                    | 100                    | 177                       | 401          |
| Assets Sold During the Year     | 13                         | 10                     |                        | 1                         | 24           |
| Purchases                       | 41                         | 711                    | 152                    | 149                       | 1,053        |
| Sales                           | (57)                       | (111)                  | (13)                   | (163)                     | (344)        |
| Settlements                     |                            |                        |                        |                           |              |
| Transfers Into (Out of) Level 3 |                            |                        |                        |                           |              |
| Balance on December 31, 2010    | \$ 193                     | \$ 2,023               | \$ 789                 | \$ 1,309                  | \$ 4,314     |
| Actual Return on Assets:        |                            |                        |                        |                           |              |
| Assets Held at End of Year      | (14)                       | 122                    | 144                    | 145                       | 397          |
| Assets Sold During the Year     | 3                          | 22                     | 5                      |                           | 30           |
| Purchases                       | 57                         | 757                    | 150                    | 164                       | 1,128        |
| Sales                           | (159)                      | (181)                  | (140)                  | (264)                     | (744)        |
| Settlements                     |                            |                        |                        |                           |              |
| Transfers Into (Out of) Level 3 |                            |                        |                        |                           |              |
| Balance on December 31, 2011    | \$ 80                      | \$ 2,743               | \$ 948                 | \$ 1,354                  | \$ 5,125     |



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

The fair value disclosures above have not been provided for our international pension benefit plans since asset allocations are determined and managed at the individual country level. In general, the asset allocations for these plans are approximately 55% in equity securities, 35% in debt securities and 10% in other securities. The amount of assets having significant unobservable inputs (Level 3), if any, in these plans would be immaterial to our financial statements.

**Expected Cash Flows**

Information about expected cash flows for the pension and postretirement benefit plans is as follows (in millions):

|                                      | U.S.<br>Pension Benefits | U.S. Postretirement<br>Medical Benefits | International Pension<br>Benefits |
|--------------------------------------|--------------------------|---|-----------------------------------|
| <b>Employer Contributions:</b>       |                          |   |                                   |
| 2012 (expected) to plan trusts       | \$ 355                   | \$ 371                                  | \$ 53                             |
| 2012 (expected) to plan participants | 13                       | 101                                     | 3                                 |
| <b>Expected Benefit Payments:</b>    |                          |   |                                   |
| 2012                                 | \$ 708                   | \$ 233                                  | \$ 18                             |
| 2013                                 | 789                      | 253                                     | 17                                |
| 2014                                 | 873                      | 230                                     | 19                                |
| 2015                                 | 966                      | 246                                     | 21                                |
| 2016                                 | 1,065                    | 260                                     | 23                                |
| 2017 - 2021                          | 7,112                    | 1,466                                   | 153                               |

Our funding policy for U.S. plans is to contribute amounts annually that are at least equal to the amounts required by applicable laws and regulations, or to directly fund payments to plan participants, as applicable. International plans will be funded in accordance with local regulations. Additional discretionary contributions may be made when deemed appropriate to meet the long-term obligations of the plans. Expected benefit payments for pensions will be primarily paid from plan trusts. Expected benefit payments for postretirement medical benefits will be paid from plan trusts and corporate assets.

**NOTE 6. MULTIEMPLOYER EMPLOYEE BENEFIT PLANS**

We contribute to a number of multiemployer defined benefit plans under the terms of collective bargaining agreements that cover our union-represented employees. These plans generally provide for retirement, death and/or termination benefits for eligible employees within the applicable collective bargaining units, based on specific eligibility/participation requirements, vesting periods and benefit formulas. The risks of participating in these multiemployer plans are different from single-employer plans in the following aspects:

Assets contributed to the multiemployer plan by one employer may be used to provide benefits to employees of other participating employers.

If a participating employer stops contributing to the multiemployer plan, the unfunded obligations of the plan may be borne by the remaining participating employers.

If we choose to stop participating in some of our multiemployer plans, we may be required to pay those plans an amount based on the underfunded status of the plan, referred to as a withdrawal liability. However, cessation of participation in a multiemployer plan

and subsequent payment of any withdrawal liability is subject to the collective bargaining process.

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The discussion that follows sets forth the financial impact on our results of operations and cash flows for the years ended December 31, 2011, 2010 and 2009 from our participation in multiemployer benefit plans. Several factors could cause us to make significantly higher future contributions to these plans, including unfavorable investment performance, changes in demographics and increased benefits to participants. However, all surcharges are subject to the collective bargaining process. At this time, we are unable to determine the amount of additional future contributions, if any, or whether any material adverse effect on our financial condition, results of operations or liquidity would result from our participation in these plans.

The number of employees covered by our multiemployer plans has remained consistent over the past three years, and there have been no significant changes that affect the comparability of 2011, 2010 and 2009 contributions. We recognize expense for the contractually-required contribution for each period, and we recognize a liability for any contributions due and unpaid at the end of a reporting period.

***Multiemployer Pension Plans***

The following table outlines our participation in multiemployer pension plans for the periods ended December 31, 2011, 2010 and 2009, and sets forth our calendar year contributions into each plan. The EIN/Pension Plan Number column provides the Employer Identification Number (EIN) and the three-digit plan number. The most recent Pension Protection Act zone status available in 2011 and 2010 relates to the plans' two most recent fiscal year-ends. The zone status is based on information that we received from the plans' administrators and is certified by each plan's actuary. Among other factors, plans certified in the red zone are generally less than 65% funded, plans certified in the orange zone are both less than 80% funded and have an accumulated funding deficiency or are expected to have a deficiency in any of the next six plan years, plans certified in the yellow zone are less than 80% funded, and plans certified in the green zone are at least 80% funded. The FIP/RP Status Pending/Implemented column indicates whether a financial improvement plan (FIP) for yellow/orange zone plans, or a rehabilitation plan (RP) for red zone plans, is either pending or has been implemented. As of December 31, 2011, all plans that have either a FIP or RP requirement have had the respective FIP or RP implemented.

Our collectively-bargained contributions satisfy the requirements of all implemented FIPs and RPs and do not currently require the payment of any surcharges. In addition, minimum contributions outside of the agreed upon contractual rate are not required. For the plans detailed in the following table, the expiration date of the associated collective bargaining agreements is July 31, 2013, with the exception of the Automotive Industries Pension Plan and the IAM National Pension Fund / National Pension Plan which both have a July 31, 2014 expiration date. For all plans detailed in the following table, we provided more than 5 percent of the total plan contributions from all employers for 2011, 2010 and 2009 (as disclosed in the Form 5500 for each respective plan).

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Certain plans have been aggregated in the All Other Multiemployer Pension Plans line in the following table, as the contributions to each of these individual plans are not material.

| Pension Fund  | EIN / Pension Plan Number | Pension Protection Act Zone Status |        | FIP/RP Status Pending/ Implemented | (in millions) UPS Contributions |          |          | Surcharge Imposed |
|---|---------------------------|------------------------------------|--------|------------------------------------|---------------------------------|----------|----------|-------------------|
|   |                           | 2011                               | 2010   |                                    | 2011                            | 2010     | 2009     |                   |
| Alaska Teamster-Employer Pension Plan                                       | 92-6003463-024            | Red                                | Red    | Yes/Implemented                    | \$ 4                            | \$ 3     | \$ 3     | No                |
| Automotive Industries Pension Plan  | 94-1133245-001            | Red                                | Red    | Yes/Implemented                    | 4                               | 4        | 4        | No                |
| Central Pennsylvania Teamsters Defined Benefit Plan                         | 23-6262789-001            | Green                              | Yellow | No                                 | 27                              | 26       | 25       | No                |
| Employer-Teamsters Local Nos. 175 & 505 Pension Trust Fund                  | 55-6021850-001            | Green                              | Green  | No                                 | 8                               | 8        | 8        | No                |
| Hagerstown Motor Carriers and Teamsters Pension Fund                        | 52-6045424-001            | Red                                | Red    | Yes/Implemented                    | 5                               | 4        | 4        | No                |
| I.A.M. National Pension Fund / National Pension Plan                        | 51-6031295-002            | Green                              | Green  | No                                 | 25                              | 24       | 22       | No                |
| International Brotherhood of Teamsters Union Local No. 710 Pension Fund     | 36-2377656-001            | Yellow                             | Yellow | Yes/Implemented                    | 74                              | 70       | 66       | No                |
| Local 705, International Brotherhood of Teamsters Pension Plan              | 36-6492502-001            | Yellow                             | Yellow | Yes/Implemented                    | 58                              | 56       | 52       | No                |
| Local 804 I.B.T. & Local 447 I.A.M. UPS Multiemployer Retirement Plan       | 51-6117726-001            | Red                                | Red    | Yes/Implemented                    | 84                              | 84       | 83       | No                |
| Milwaukee Drivers Pension Trust Fund  | 39-6045229-001            | Green                              | Yellow | No                                 | 26                              | 24       | 22       | No                |
| New England Teamsters & Trucking Industry Pension Fund                      | 04-6372430-001            | Red                                | Red    | Yes/Implemented                    | 124                             | 112      | 104      | No                |
| New York State Teamsters Conference Pension and Retirement Fund             | 16-6063585-074            | Red                                | Red    | Yes/Implemented                    | 57                              | 52       | 50       | No                |
| Teamster Pension Fund of Philadelphia and Vicinity                          | 23-1511735-001            | Yellow                             | Orange | Yes/Implemented                    | 41                              | 39       | 37       | No                |
| Teamsters Joint Council No. 83 of Virginia Pension Fund                     | 54-6097996-001            | Yellow                             | Red    | Yes/Implemented                    | 41                              | 38       | 35       | No                |
| Teamsters Local 639 Employers Pension Trust                                 | 53-0237142-001            | Green                              | Yellow | Yes/Implemented                    | 33                              | 31       | 30       | No                |
| Teamsters Negotiated Pension Plan   | 43-6196083-001            | Red                                | Red    | Yes/Implemented                    | 22                              | 20       | 19       | No                |
| Truck Drivers and Helpers Local Union No. 355 Retirement Pension Plan       | 52-6043608-001            | Yellow                             | Red    | Yes/Implemented                    | 12                              | 12       | 12       | No                |
| United Parcel Service, Inc. Local 177, I.B.T. Multiemployer Retirement Plan | 13-1426500-419            | Red                                | Red    | Yes/Implemented                    | 57                              | 59       | 61       | No                |
| Western Conference of Teamsters Pension Plan                                | 91-6145047-001            | Green                              | Green  | No                                 | 476                             | 449      | 427      | No                |
| Western Pennsylvania Teamsters and Employers Pension Fund                   | 25-6029946-001            | Red                                | Red    | Yes/Implemented                    | 21                              | 20       | 19       | No                |
| All Other Multiemployer Pension Plans                                       |                           |                                    |        |                                    | 44                              | 51       | 42       |                   |
| Total Contributions   |                           |                                    |        |                                    | \$ 1,243                        | \$ 1,186 | \$ 1,125 |                   |

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Multiemployer Health and Welfare Plans***

We also contribute to several multiemployer health and welfare plans that cover both active and retired employees. Health care benefits are provided to participants who meet certain eligibility requirements as covered under the applicable collective bargaining unit. The following table sets forth our calendar year plan contributions. Certain plans have been aggregated in the All Other Multiemployer Health and Welfare Plans line in the table, as the contributions to each of these individual plans are not material.

| <b>Health and Welfare Fund</b>   | (in millions)            |                 |                 |
|--|--------------------------|-----------------|-----------------|
|  | <b>UPS Contributions</b> |                 |                 |
|  | <b>2011</b>              | <b>2010</b>     | <b>2009</b>     |
| Bay Area Delivery Drivers  | \$ 27                    | \$ 26           | \$ 22           |
| Central Pennsylvania Teamsters Health & Pension Fund                                 | 18                       | 17              | 16              |
| Central States, South East & South West Areas Health and Welfare Fund                | 452                      | 441             | 428             |
| Delta Health Systems East Bay Drayage Drivers  | 17                       | 15              | 16              |
| Employer Teamster Local Nos. 175 & 505   | 8                        | 7               | 6               |
| Joint Council #83 Health & Welfare Fund  | 25                       | 25              | 25              |
| Local 191 Teamsters Health Fund  | 9                        | 9               | 8               |
| Local 401 Teamsters Health & Welfare Fund  | 6                        | 5               | 5               |
| Local 804 Welfare Trust Fund   | 58                       | 54              | 51              |
| Milwaukee Drivers Pension Trust Fund Milwaukee Drivers Health and Welfare Trust Fund | 28                       | 27              | 27              |
| Montana Teamster Employers Trust   | 6                        | 6               | 6               |
| Northern California General Teamsters (DELTA)  | 73                       | 70              | 69              |
| New York State Teamsters Health & Hospital Fund                                      | 41                       | 40              | 37              |
| North Coast Benefit Trust  | 7                        | 7               | 6               |
| Northern New England Benefit Trust   | 32                       | 31              | 30              |
| Oregon / Teamster Employers Trust  | 27                       | 25              | 23              |
| Teamsters 170 Health & Welfare Fund  | 12                       | 12              | 12              |
| Teamsters Benefit Trust  | 29                       | 27              | 26              |
| Teamsters Local 251 Health & Insurance Plan  | 10                       | 10              | 10              |
| Teamsters Local 404 Health & Insurance Plan  | 6                        | 6               | 5               |
| Teamsters Local 638 Health Fund  | 28                       | 27              | 27              |
| Teamsters Local 639 Employers Health & Pension Trust Funds                           | 22                       | 21              | 20              |
| Teamsters Local 671 Health Services & Insurance Plan                                 | 13                       | 12              | 12              |
| Teamsters Union 25 Health Services & Insurance Plan                                  | 34                       | 33              | 31              |
| Teamsters Union Local 677 Health Services & Insurance Plan                           | 8                        | 7               | 7               |
| Truck Drivers and Helpers Local 355 Baltimore Area Health & Welfare Fund             | 12                       | 12              | 12              |
| Utah-Idaho Teamsters Security Fund   | 15                       | 15              | 14              |
| Washington Teamsters Welfare Trust   | 30                       | 27              | 26              |
| All Other Multiemployer Health and Welfare Plans                                     | 50                       | 52              | 54              |
| <b>Total Contributions</b>   | <b>\$ 1,103</b>          | <b>\$ 1,066</b> | <b>\$ 1,031</b> |

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 7. BUSINESS ACQUISITIONS, GOODWILL AND INTANGIBLE ASSETS**

The following table indicates the allocation of goodwill by reportable segment (in millions):

|                                 | U.S. Domestic<br>Package | International<br>Package | Supply Chain &<br>Freight | Consolidated |
|---------------------------------|--------------------------|--------------------------|---------------------------|--------------|
| December 31, 2009 balance       | \$                       | \$ 374                   | \$ 1,715                  | \$ 2,089     |
| Acquired                        |                          |                          |                           |              |
| Purchase Accounting Adjustments |                          | 5                        | (2)                       | 3            |
| Currency / Other                |                          | (2)                      | (9)                       | (11)         |
| December 31, 2010 balance       | \$                       | \$ 377                   | \$ 1,704                  | \$ 2,081     |
| Acquired                        |                          |                          | 46                        | 46           |
| Currency / Other                |                          | (16)                     | (10)                      | (26)         |
| December 31, 2011 balance       | \$                       | \$ 361                   | \$ 1,740                  | \$ 2,101     |

**Business Acquisitions**

The increase in goodwill within the Supply Chain & Freight segment in 2011 was due to the December acquisition of the Pieffe Group ( Pieffe ), an Italian pharmaceutical logistics company. Pieffe offers storage, distribution and other logistics services to some of the world's leading pharmaceutical companies. The purchase price allocation was not complete as of December 31, 2011, and therefore adjustments to the recorded amount of goodwill may occur in 2012 prior to the one year anniversary of the acquisition. This increase in goodwill was partially offset by the impact of the strengthening of the U.S. Dollar on the translation of non-U.S. Dollar goodwill balances.

The increase to goodwill in the International Package segment during 2010 was due to adjustments to the purchase price allocation for Unsped Paket Servisi San ve Ticaret A.S. ( Unsped ), which was acquired in August 2009. This increase in goodwill was partially offset by the impact of the strengthening of the U.S. Dollar on the translation of non-U.S. Dollar goodwill balances.

Pro forma results of operations have not been presented for these acquisitions, because the effects of these transactions were not material. The results of operations of these acquired companies have been included in our statements of consolidated income from the date of acquisition.

**Goodwill Impairment**

We test our goodwill for impairment annually, as of October 1<sup>st</sup>, on a reporting unit basis. Our reporting units are comprised of the Europe, Asia, and Americas reporting units in the International Package reporting segment, and the Forwarding, Logistics, UPS Freight, MBE / The UPS Store, and UPS Capital reporting units in the Supply Chain & Freight reporting segment.

In assessing our goodwill for impairment, we initially evaluate qualitative factors to determine if it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the qualitative assessment is not conclusive and it is necessary to calculate the fair value of a reporting unit, then we utilize a two-step process to test goodwill for impairment. First, a comparison of the fair value of the applicable reporting unit with the aggregate carrying value, including goodwill, is performed. We primarily determine the fair value of our reporting units using a discounted cash flow model, and supplement this with observable valuation multiples for comparable companies, as applicable. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, we perform the second step of the goodwill impairment test to determine the amount of impairment loss. The second step includes comparing the implied fair value of the affected reporting unit's goodwill with the carrying value of that goodwill.



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We did not have any goodwill impairment charges in 2011, 2010 or 2009. Cumulatively, our Supply Chain & Freight reporting segment has recorded goodwill impairment charges of \$622 million, while our International and U.S. Domestic Package segments have not recorded any impairment charges.

**Intangible Assets**

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

|  | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value | Weighted-Average Amortization Period (in years) |
|--|-----------------------|--------------------------|--------------------|---|
| <b>December 31, 2011:</b>                |                       |                          |                    |   |
| Trademarks, licenses, patents, and other | \$ 146                | \$ (54)                  | \$ 92              | 4.3   |
| Customer lists                           | 120                   | (66)                     | 54                 | 11.5  |
| Franchise rights                         | 109                   | (58)                     | 51                 | 20.0  |
| Capitalized software                     | 2,014                 | (1,626)                  | 388                | 3.1   |
| <b>Total Intangible Assets, Net</b>      | <b>\$ 2,389</b>       | <b>\$ (1,804)</b>        | <b>\$ 585</b>      | <b>4.4</b>                                      |
| <b>December 31, 2010:</b>                |                       |                          |                    |   |
| 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                |   |
| <b>Total Intangible Assets, Net</b>      | <b>\$ 2,322</b>       | <b>\$ (1,723)</b>        | <b>\$ 599</b>      |   |

Licenses with a carrying value of \$5 million as of December 31, 2011 are deemed to be indefinite-lived intangibles, and therefore are not amortized. Impairment tests for indefinite-lived intangibles are performed on an annual basis. All of our other recorded intangible assets are deemed to be finite-lived intangibles, and are thus amortized over their estimated useful lives. Impairment tests for these intangible assets are only performed when a triggering event occurs that indicates that the carrying value of the intangible may not be recoverable. There were no impairments of any finite-lived or indefinite-lived intangible assets in 2011, 2010 or 2009.

Amortization of intangible assets was \$228, \$224 and \$185 million during 2011, 2010 and 2009, respectively. Expected amortization of finite-lived intangible assets recorded as of December 31, 2011 for the next five years is as follows (in millions): 2012 \$244; 2013 \$169; 2014 \$90; 2015 \$23; 2016 \$9. Amortization expense in future periods will be affected by business acquisitions, software development, licensing agreements, sponsorships and other factors.

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 8. DEBT AND FINANCING ARRANGEMENTS**

The carrying value of our debt obligations, as of December 31, consists of the following (in millions):

|                            | Maturity    | 2011      | 2010      |
|----------------------------|-------------|-----------|-----------|
| Commercial paper           | 2012        | \$        | \$ 341    |
| 4.50% senior notes         | 2013        | 1,778     | 1,815     |
| 3.875% senior notes        | 2014        | 1,050     | 1,061     |
| 5.50% senior notes         | 2018        | 841       | 795       |
| 5.125% senior notes        | 2019        | 1,119     | 1,032     |
| 8.375% debentures          | 2020        | 504       | 453       |
| 3.125% senior notes        | 2021        | 1,641     | 1,464     |
| 8.375% debentures          | 2030        | 284       | 284       |
| 6.20% senior notes         | 2038        | 1,480     | 1,480     |
| 4.875% senior notes        | 2040        | 489       | 488       |
| Floating rate senior notes | 2049 2053   | 376       | 386       |
| Capital lease obligations  | 2012 3004   | 469       | 160       |
| Facility notes and bonds   | 2015 2036   | 320       | 320       |
| Pound Sterling notes       | 2031 / 2050 | 777       | 764       |
| Other debt                 | 2012        |           | 3         |
| Total debt                 |             | 11,128    | 10,846    |
| Less current maturities    |             | (33)      | (355)     |
| Long-term debt             |             | \$ 11,095 | \$ 10,491 |

**Commercial Paper**

As of December 31, 2011, we had no commercial paper outstanding. The amount of commercial paper outstanding in 2012 is expected to fluctuate. We are authorized to borrow up to \$10.0 billion under the U.S. commercial paper program we maintain as of December 31, 2011. We also maintain a European commercial paper program under which we are authorized to borrow up to 1.0 billion in a variety of currencies, however no amounts were outstanding under this program as of December 31, 2011.

**Fixed Rate Senior Notes**

In January 2008, we completed an offering of \$1.750 billion of 4.50% senior notes due January 2013, \$750 million of 5.50% senior notes due January 2018, and \$1.500 billion of 6.20% senior notes due January 2038. All of the notes pay interest semiannually, and allow for redemption of the notes by UPS at any time by paying the greater of the principal amount or a make-whole amount, plus accrued interest. After pricing and underwriting discounts, we received a total of \$3.961 billion in cash proceeds from the offering. The proceeds from the offering were used to reduce our outstanding commercial paper balance. We subsequently entered into interest rate swaps on the 2013 and 2018 notes, which effectively converted the fixed interest rates on the notes to variable LIBOR-based interest rates. The average interest rate payable on the notes, including the impact of the interest rate swaps, for 2011 and 2010, respectively, was 2.39% and 2.42% for the 2013 notes, and 2.53% and 2.22% for the 2018 notes.

In March 2009, we completed an offering of \$1.0 billion of 3.875% senior notes due April 2014 and \$1.0 billion of 5.125% senior notes due April 2019. These notes pay interest semiannually, and we may redeem the notes at any time by paying the greater of the principal amount or a make-whole amount, plus accrued interest.



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

After pricing and underwriting discounts, we received a total of \$1.989 billion in cash proceeds from the offering. The proceeds from the offering were used for general corporate purposes, including the reduction of our outstanding commercial paper balance. We subsequently entered into interest rate swaps on the 2014 and the 2019 notes, which effectively converted the fixed interest rates on the notes to variable LIBOR-based interest rates. The average interest rate payable on the notes, including the impact of the interest rate swaps, for 2011 and 2010, respectively, was 0.99% and 1.02% for the 2014 notes, and 2.04% and 1.69% for the 2019 notes.

In November 2010, we completed an offering of \$1.5 billion of 3.125% senior notes due January 2021 and \$500 million of 4.875% senior notes due November 2040. These notes pay interest semiannually, and we may redeem the notes at any time by paying the greater of the principal amount or a make-whole amount, plus accrued interest. After pricing and underwriting discounts, we received a total of \$1.972 billion in cash proceeds from the offering. The proceeds from the offering were used to make contributions to our primary domestic pension plans. We subsequently entered into interest rate swaps on the 2021 notes, which effectively converted the fixed interest rates on the notes to variable LIBOR-based interest rates. The average interest rate payable on the 2021 notes, including the impact of the interest rate swaps, for 2011 and 2010, respectively, was 0.52% and 1.76%.

***8.375% Debentures***

On January 22, 1998, we exchanged \$276 million of an original \$700 million in debentures for new debentures of equal principal with a maturity of April 1, 2030. The new debentures have the same interest rate as the 8.375% debentures due 2020 until April 1, 2020, and, thereafter, the interest rate will be 7.62% for the final 10 years. The 2030 debentures are redeemable in whole or in part at our option at any time. The redemption price is equal to the greater of 100% of the principal amount and accrued interest or the sum of the present values of the remaining scheduled payout of principal and interest thereon discounted to the date of redemption at a benchmark treasury yield plus five basis points plus accrued interest. The remaining \$424 million of 2020 debentures are not subject to redemption prior to maturity. Interest is payable semiannually on the first of April and October for both debentures and neither debenture is subject to sinking fund requirements. We subsequently entered into interest rate swaps on the 2020 notes, which effectively converted the fixed interest rates on the notes to variable LIBOR-based interest rates. The average interest rate payable on the 2020 notes, including the impact of the interest rate swaps, for 2011 was 5.97%.

***Floating Rate Senior Notes***

The floating rate senior notes bear interest at one-month LIBOR less 45 basis points. The average interest rate for 2011 and 2010 was 0.00% for both years. These notes are callable at various times after 30 years at a stated percentage of par value, and puttable by the note holders at various times after 10 years at a stated percentage of par value. The notes have maturities ranging from 2049 through 2053. In 2011 and 2010, we redeemed notes with a principal value of \$10 and \$23 million, respectively, after put options were exercised by the note holders.

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Capital Lease Obligations***

We have certain property, plant and equipment subject to capital leases. Some of the obligations associated with these capital leases have been legally defeased. The recorded value of our property, plant and equipment subject to capital leases is as follows as of December 31 (in millions):

|                          | 2011     | 2010     |
|--------------------------|----------|----------|
| Vehicles                 | \$ 35    | \$       |
| Aircraft                 | 2,282    | 2,466    |
| Buildings                | 24       |          |
| Plant Equipment          | 2        |          |
| Technology Equipment     | 1        |          |
| Accumulated amortization | (457)    | (628)    |
|                          | \$ 1,887 | \$ 1,838 |

These capital lease obligations have principal payments due at various dates from 2012 through 3004.

***Facility Notes and Bonds***

We have entered into agreements with certain municipalities to finance the construction of, or improvements to, facilities that support our U.S. Domestic Package and Supply Chain & Freight operations in the United States. These facilities are located around airport properties in Louisville, Kentucky; Dallas, Texas; and Philadelphia, Pennsylvania. Under these arrangements, we enter into a lease or loan agreement that covers the debt service obligations on the bonds issued by the municipalities, as follows:

Bonds with a principal balance of \$149 million issued by the Louisville Regional Airport Authority associated with our Worldport facility in Louisville, Kentucky. The bonds, which are due in January 2029, bear interest at a variable rate, and the average interest rates for 2011 and 2010 were 0.11% and 0.22%, respectively.

Bonds with a principal balance of \$43 million issued by the Louisville Regional Airport Authority associated with our air freight facility in Louisville, Kentucky. The bonds were issued in November 2006 and are due in November 2036. The bonds bear interest at a variable rate, and the average interest rates for 2011 and 2010 were 0.11% and 0.24%, respectively.

Bonds with a principal balance of \$29 million issued by the Dallas / Fort Worth International Airport Facility Improvement Corporation associated with our Dallas, Texas airport facilities. The bonds are due in May 2032 and bear interest at a variable rate, however the variable cash flows on the obligation have been swapped to a fixed 5.11%.

Bonds with a principal balance of \$100 million issued by the Delaware County, Pennsylvania Industrial Development Authority associated with our Philadelphia, Pennsylvania airport facilities. The bonds, which are due in December 2015, bear interest at a variable rate, and the average interest rates for 2011 and 2010 were 0.11% and 0.20%, respectively.

In October 2009, \$62 million in facility notes and bonds matured, and an additional \$46 million that were originally scheduled to mature in 2018 were called for early redemption. The bonds were issued by the city of Dayton, Ohio and were associated with a Dayton airport facility.

*Pound Sterling Notes*

The Pound Sterling notes were issued in 2001 with a principal balance of £500 million, accrue interest at a 5.50% fixed rate, and are due on February 12, 2031. In May 2007, we completed an exchange offer for the

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existing notes. Holders of £434 million of the notes accepted the exchange offer, and as a result, these notes were exchanged for new notes with a principal amount of £455 million, bearing interest at 5.13% and due in February 2050. The new notes are callable at our option at a redemption price equal to the greater of 100% of the principal amount and accrued interest, or the sum of the present values of the remaining scheduled payout of principal and interest thereon discounted to the date of redemption at a benchmark U.K. government bond yield plus 15 basis points and accrued interest. The £66 million of existing notes that were not exchanged continue to bear interest at 5.50% and are due in 2031. We maintain cross-currency interest rate swaps to hedge the foreign currency risk associated with the bond cash flows. The average fixed interest rate payable on the swaps is 5.72%.

**Contractual Commitments**

We lease certain aircraft, facilities, land, equipment and vehicles under operating leases, which expire at various dates through 2038. Certain of the leases contain escalation clauses and renewal or purchase options. Rent expense related to our operating leases was \$629, \$615 and \$622 million for 2011, 2010, and 2009, respectively.

The following table sets forth the aggregate minimum lease payments under capital and operating leases, the aggregate annual principal payments due under our long-term debt, and the aggregate amounts expected to be spent for purchase commitments (in millions).

| Year  | Capital<br>Leases | Operating<br>Leases | Debt<br>Principal | Purchase<br>Commitments |
|---|-------------------|---------------------|-------------------|-------------------------|
| 2012  | \$ 59             | \$ 329              | \$                | \$ 517                  |
| 2013  | 56                | 257                 | 1,750             | 453                     |
| 2014  | 51                | 192                 | 1,000             | 32                      |
| 2015  | 50                | 140                 | 100               | 16                      |
| 2016  | 48                | 97                  |                   | 34                      |
| After 2016  | 474               | 393                 | 7,366             |                         |
| <b>Total</b>  | <b>738</b>        | <b>\$ 1,408</b>     | <b>\$ 10,216</b>  | <b>\$ 1,052</b>         |
| Less: imputed interest                              | (269)             |                     |                   |                         |
| Present value of minimum capitalized lease payments | 469               |                     |                   |                         |
| Less: current portion                               | (33)              |                     |                   |                         |
| <b>Long-term capitalized lease obligations</b>      | <b>\$ 436</b>     |                     |                   |                         |

As of December 31, 2011, we had outstanding letters of credit totaling approximately \$1.551 billion issued in connection with our self-insurance reserves and other routine business requirements. We also issue surety bonds as an alternative to letters of credit in certain instances, and as of December 31, 2011, we had \$583 million of surety bonds written.

**Available Credit**

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



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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 December 31, 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 December 31, 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 December 31, 2011 and for all prior periods presented, 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 December 31, 2011, 10% of net tangible assets is equivalent to \$2.550 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 December 31, 2011, our net worth, as defined, was equivalent to \$10.138 billion. We do not expect these covenants to have a material impact on our financial condition or liquidity.

*Fair Value of Debt*

Based on the borrowing rates currently available to the Company for long-term debt with similar terms and maturities, the fair value of long-term debt, including current maturities, is approximately \$12.035 and \$11.355 billion as of December 31, 2011 and 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.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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. 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, and plaintiffs appealed. 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, which was affirmed in January 2012. The trial court also granted our motion for summary judgment against the members of the certified class, which was reversed in January 2012. 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 and affirmed on appeal in December 2011. 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 final 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 that 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) we believe that we have a number of meritorious defenses; (2) AFMS has not articulated any measure of damages; and (3) the DOJ investigation is ongoing. 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

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 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. In February 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.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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. In July 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.

**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 by their respective voting rights. Class A shares of UPS 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, as well as trusts and descendants of the Company's founders, and these shares are fully convertible into class B shares at any time. Class B shares are publicly traded on the New York Stock Exchange ( NYSE ) under the symbol UPS. Class A and B shares both have a \$0.01 par value, and as of December 31, 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 authorized to be issued, with a par value of \$0.01 per share; as of December 31, 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 (in millions, except per share amounts):

|  | 2011       |                  | 2010       |                  | 2009       |                 |
|--|------------|------------------|------------|------------------|------------|-----------------|
|  | Shares     | Dollars          | Shares     | Dollars          | Shares     | Dollars         |
| <b>Class A Common Stock</b>                      |            |                  |            |                  |            |                 |
| Balance at beginning of year                     | 258        | \$ 3             | 285        | \$ 3             | 314        | \$ 3            |
| Common stock purchases                           | (7)        |                  | (6)        |                  | (10)       |                 |
| Stock award plans                                | 7          |                  | 6          |                  | 5          |                 |
| Common stock issuances                           | 3          |                  | 3          |                  | 4          |                 |
| Conversions of class A to class B common stock   | (21)       |                  | (30)       |                  | (28)       |                 |
| <b>Class A shares issued at end of year</b>      | <b>240</b> | <b>\$ 3</b>      | <b>258</b> | <b>\$ 3</b>      | <b>285</b> | <b>\$ 3</b>     |
| <b>Class B Common Stock</b>                      |            |                  |            |                  |            |                 |
| Balance at beginning of year                     | 735        | \$ 7             | 711        | \$ 7             | 684        | \$ 7            |
| Common stock purchases                           | (31)       |                  | (6)        |                  | (1)        |                 |
| Conversions of class A to class B common stock   | 21         |                  | 30         |                  | 28         |                 |
| <b>Class B shares issued at end of year</b>      | <b>725</b> | <b>\$ 7</b>      | <b>735</b> | <b>\$ 7</b>      | <b>711</b> | <b>\$ 7</b>     |
| <b>Additional Paid-In Capital</b>                |            |                  |            |                  |            |                 |
| Balance at beginning of year                     |            | \$               |            | \$ 2             |            | \$              |
| Stock award plans                                |            | 388              |            | 398              |            | 381             |
| Common stock purchases                           |            | (475)            |            | (649)            |            | (569)           |
| Common stock issuances                           |            | 287              |            | 249              |            | 190             |
| Option Premiums Paid                             |            | (200)            |            |                  |            |                 |
| <b>Balance at end of year</b>                    |            | <b>\$</b>        |            | <b>\$</b>        |            | <b>\$ 2</b>     |
| <b>Retained Earnings</b>                         |            |                  |            |                  |            |                 |
| Balance at beginning of year                     |            | \$ 10,604        |            | \$ 9,335         |            | \$ 9,186        |
| Net income attributable to controlling interests |            | 3,804            |            | 3,338            |            | 1,968           |
| Dividends (\$2.08, \$1.88 and \$1.80 per share)  |            | (2,086)          |            | (1,909)          |            | (1,819)         |
| Common stock purchases                           |            | (2,194)          |            | (160)            |            |                 |
| <b>Balance at end of year</b>                    |            | <b>\$ 10,128</b> |            | <b>\$ 10,604</b> |            | <b>\$ 9,335</b> |

For the years ended December 31, 2011, 2010 and 2009, we repurchased a total of 38.7, 12.4 and 10.9 million shares of class A and class B common stock for \$2.669 billion, \$809 million and \$569 million, respectively. In January 2008, our Board of Directors authorized an increase in our share repurchase authority to \$10.0 billion. 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. As of December 31, 2011, we had \$2.525 billion of our share repurchase authorization remaining.

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 receive either a pre-determined amount of cash or stock. Upon expiration of each agreement, if the

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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

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December 31, 2011, we had paid premiums of \$200 million on options for the purchase of 3.3 million shares that will settle in the first half of 2012. During 2011, we settled options that resulted in the repurchase of 0.8 million shares at \$65.11 per share, as well as the receipt of \$6 million in premiums (in excess of our initial investment).

*Accumulated Other Comprehensive Income (Loss)*

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

|  | 2011       | 2010       | 2009       |
|--|------------|------------|------------|
| <b>Foreign currency translation gain (loss):</b>   |            |            |            |
| Balance at beginning of year   | \$ (68)    | \$ 37      | \$ (38)    |
| Aggregate adjustment for the year (net of tax effect of \$11, \$(34), and \$(27))  | (92)       | (105)      | 75         |
| Balance at end of year   | (160)      | (68)       | 37         |
| <b>Unrealized gain (loss) on marketable securities, net of tax:</b>  |            |            |            |
| Balance at beginning of year   | 12         | (27)       | (60)       |
| Current period changes in fair value (net of tax effect of \$11, \$17, and \$3)  | 18         | 30         | 25         |
| Reclassification to earnings (net of tax effect of \$(14), \$6, and \$5)   | (24)       | 9          | 8          |
| Balance at end of year   | 6          | 12         | (27)       |
| <b>Unrealized gain (loss) on cash flow hedges, net of tax:</b>   |            |            |            |
| Balance at beginning of year   | (239)      | (200)      | (107)      |
| Current period changes in fair value (net of tax effect of \$(16), \$(4), and \$4)   | (26)       | (7)        | 6          |
| Reclassification to earnings (net of tax effect of \$37, \$(19) and \$(60))  | 61         | (32)       | (99)       |
| Balance at end of year   | (204)      | (239)      | (200)      |
| <b>Unrecognized pension and postretirement benefit costs, net of tax:</b>  |            |            |            |
| Balance at beginning of year   | (2,340)    | (1,527)    | (2,211)    |
| Reclassification to earnings (net of tax effect of \$378, \$150 and \$197)   | 628        | 245        | 329        |
| Net actuarial gain (loss) and prior service cost resulting from remeasurements of plan assets and liabilities (net of tax effect of \$(622), \$(633), and \$219) | (1,033)    | (1,058)    | 355        |
| Balance at end of year   | (2,745)    | (2,340)    | (1,527)    |
| Accumulated other comprehensive income (loss) at end of year   | \$ (3,103) | \$ (2,635) | \$ (1,717) |

*Deferred Compensation Obligations and Treasury Stock*

We maintain a deferred compensation plan whereby certain employees were previously able to elect to defer the gains on stock option exercises by deferring the shares received upon exercise into a rabbi trust. The shares held in this trust are classified as treasury stock, and the liability to participating employees is classified as deferred compensation obligations in the shareowners equity section of the consolidated balance sheets. The number of shares needed to settle the liability for deferred compensation obligations is included in the denominator in both the basic and

diluted earnings per share calculations. Employees are generally no longer

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

able to defer the gains from stock options exercised subsequent to December 31, 2004. Activity in the deferred compensation program for the years ended December 31, 2011, 2010, and 2009 is as follows (in millions):

|  | 2011   |          | 2010   |          | 2009   |          |
|--|--------|----------|--------|----------|--------|----------|
|  | Shares | Dollars  | Shares | Dollars  | Shares | Dollars  |
| <b>Deferred Compensation Obligations</b> |        |          |        |          |        |          |
| Balance at beginning of year             |        | \$ 103   |        | \$ 108   |        | \$ 121   |
| Reinvested dividends                     |        | 4        |        | 4        |        | 3        |
| Options exercise deferrals               |        |          |        | 1        |        |          |
| Benefit payments                         |        | (19)     |        | (10)     |        | (16)     |
| Balance at end of year                   |        | \$ 88    |        | \$ 103   |        | \$ 108   |
| <b>Treasury Stock</b>                    |        |          |        |          |        |          |
| Balance at beginning of year             | (2)    | \$ (103) | (2)    | \$ (108) | (2)    | \$ (121) |
| Reinvested dividends                     |        | (4)      |        | (4)      |        | (3)      |
| Options exercise deferrals               |        |          |        | (1)      |        |          |
| Benefit payments                         |        | 19       |        | 10       |        | 16       |
| Balance at end of year                   | (2)    | \$ (88)  | (2)    | \$ (103) | (2)    | \$ (108) |

*Noncontrolling Interests*

We have noncontrolling interests in certain consolidated subsidiaries in our International Package and Supply Chain & Freight segments, the largest of which relates to a joint venture that operates in the Middle East, Turkey, and portions of the Central Asia region. The activity related to our noncontrolling interests is presented below (in millions):

|   | 2011  | 2010  |
|---|-------|-------|
| <b>Noncontrolling Interests</b>                     |       |       |
| Balance at beginning of period                      | \$ 68 | \$ 66 |
| Acquired noncontrolling interests                   | 5     | 2     |
| Dividends attributable to noncontrolling interests  |       |       |
| Net income attributable to noncontrolling interests |       |       |
| Balance at end of period                            | \$ 73 | \$ 68 |

**NOTE 11. STOCK-BASED COMPENSATION***Incentive Compensation Plan*

The UPS Incentive Compensation Plan permits the grant of nonqualified and incentive stock options, stock appreciation rights, restricted stock and stock units, and restricted performance shares and units, to eligible employees. The number of shares reserved for issuance under the Incentive Compensation Plan is 80 million. Each share issued pursuant to an option and each share issued subject to the exercised portion of a stock appreciation right will reduce the share reserve by one share. Each share issued pursuant to restricted stock and stock units, and restricted performance shares and units, will reduce the share reserve by 2.76 shares. As of December 31, 2011, stock options, restricted performance units

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and restricted stock units had been granted under the Incentive Compensation Plan. We had 39 million shares available to be issued under the Incentive Compensation Plan as of December 31, 2011.

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Compensation Program Changes*

Effective January 1, 2011, we modified certain components of our management compensation programs for future award grants, as follows:

We eliminated our Long-Term Incentive program, and incorporated the value of the award into our Management Incentive Award program. The combined award is referred to as the Management Incentive Award program.

The performance period for the Management Incentive Award program changed from an October 1<sup>st</sup> – September 30<sup>th</sup> fiscal year to a calendar year, to be consistent with our business planning cycle.

Previously, the restricted stock units granted under the Management Incentive Award program were granted in the fourth quarter of each year, while the restricted performance units granted under the Long-Term Incentive Program were granted in the second quarter of each year (restricted stock units and restricted performance units are referred to as Restricted Units). Prospectively, Restricted Units granted under the modified Management Incentive Award will generally be granted in the first quarter of each year.

These changes did not impact any existing awards that had been previously granted.

*Management Incentive Award*

Subsequent to January 1, 2011, non-executive management earning the right to receive Management Incentive Awards are determined annually by the Salary Committee, which is comprised of executive officers of the Company. Awards granted to executive officers are determined annually by the Compensation Committee of the UPS Board of Directors. Our Management Incentive Awards program provides, with certain exceptions, that one-half to two-thirds of the annual Management Incentive Award will be made in Restricted Units (depending upon the level of management involved), which generally vest over a five-year period. The other one-third to one-half of the award is in the form of cash or unrestricted shares of class A common stock, and is fully vested at the time of grant.

Upon vesting, Restricted Units result in the issuance of the equivalent number of UPS class A common shares after required tax withholdings. Except in the case of death, disability, or retirement, Restricted Units granted for our Management Incentive Awards and previous Long-Term Incentive Program generally vest over a five year period with approximately 20% of the award vesting at each anniversary date of the grant. The entire grant is expensed on a straight-line basis over the requisite service period. All Restricted Units granted are subject to earlier cancellation or vesting under certain conditions. Dividends earned on Restricted Units are reinvested in additional Restricted Units at each dividend payable date.

*Long-Term Incentive Performance Award*

We also award Restricted Units in conjunction with our Long-Term Incentive Performance Awards program to certain eligible employees. The Restricted Units ultimately granted under the Long-Term Incentive Performance Awards program will be based upon the achievement of certain performance measures, including growth in consolidated revenue and operating return on invested capital, each year during the performance award cycle, and other measures, including growth in consolidated earnings per share, over the entire three year performance award cycle. The Restricted Units granted under this program vest at the end of the three year performance award cycle.

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

As of December 31, 2011, we had the following Restricted Units outstanding, including reinvested dividends:

|                                   | Shares<br>(in thousands) | Weighted<br>Average<br>Grant Date<br>Fair<br>Value | Weighted Average Remaining<br>Contractual Term<br>(in years) | Aggregate Intrinsic<br>Value (in<br>millions) |
|-----------------------------------|--------------------------|--|--|---|
| Nonvested at January 1, 2011      | 20,029                   | \$ 62.46   |  |   |
| Vested                            | (8,329)                  | 64.68  |  |   |
| Granted                           | 3,895                    | 69.53  |  |   |
| Reinvested Dividends              | 631                      | N/A  |  |   |
| Forfeited / Expired               | (387)                    | 62.20  |  |   |
| Nonvested at December 31, 2011    | 15,839                   | \$ 62.98   | 1.62   | \$ 1,159                                      |
| Restricted Units Expected to Vest | 15,226                   | \$ 62.90   | 1.60   | \$ 1,114                                      |

The fair value of each Restricted Unit is the NYSE closing price of class B common stock on the date of grant. The weighted-average grant date fair value of Restricted Units granted during 2011, 2010, and 2009 was \$69.53, \$66.36 and \$56.33, respectively. The total fair value of Restricted Units vested was \$557, \$523 and \$318 million in 2011, 2010, and 2009, respectively. As of December 31, 2011, there was \$577 million of total unrecognized compensation cost related to nonvested Restricted Units. That cost is expected to be recognized over a weighted average period of 2 years and 6 months.

*Nonqualified Stock Options*

We maintain fixed stock option plans, under which options are granted to purchase shares of UPS class A common stock. Stock options granted in connection with the Incentive Compensation Plan must have an exercise price at least equal to the NYSE closing price of UPS class B common stock on the date the option is granted.

Executive officers and certain senior managers annually receive non-qualified stock options of which the value is determined as a percentage of salary. Options granted generally vest over a five year period with approximately 20% of the award vesting at each anniversary date of the grant. All options granted are subject to earlier cancellation or vesting under certain conditions. Option holders may exercise their options via the tender of cash or class A common stock, and new class A shares are issued upon exercise. Options granted to eligible employees will be granted annually during the first quarter of each year.

The following is an analysis of options to purchase shares of class A common stock issued and outstanding:

|                                | Shares<br>(in thousands) | Weighted<br>Average<br>Exercise<br>Price | Weighted Average Remaining<br>Contractual Term<br>(in years) | Aggregate Intrinsic<br>Value (in<br>millions) |
|--------------------------------|--------------------------|--|--|---|
| Outstanding at January 1, 2011 | 15,302                   | \$ 68.62                                 |  |   |
| Exercised                      | (2,208)                  | 59.81                                    |  |   |
| Granted                        | 189                      | 74.25                                    |  |   |
| Forfeited / Expired            | (84)                     | 66.67                                    |  |   |

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|                                     |        |          |      |       |
|-------------------------------------|--------|----------|------|-------|
| Outstanding at December 31, 2011    | 13,199 | \$ 70.18 | 3.42 | \$ 57 |
| Options Vested and Expected to Vest | 13,117 | \$ 70.18 | 3.40 | \$ 57 |
| Exercisable at December 31, 2011    | 10,773 | \$ 70.19 | 2.84 | \$ 49 |

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

The fair value of each option grant is estimated using the Black-Scholes option pricing model. The weighted average assumptions used, by year, and the calculated weighted average fair values of options, are as follows:

|  | 2011     | 2010     | 2009     |
|--|----------|----------|----------|
| Expected dividend yield                        | 2.77%    | 2.70%    | 3.25%    |
| Risk-free interest rate                        | 2.90%    | 3.30%    | 3.22%    |
| Expected life in years                         | 7.5      | 7.5      | 7.5      |
| Expected volatility                            | 24.26%   | 23.59%   | 23.16%   |
| Weighted average fair value of options granted | \$ 15.92 | \$ 14.83 | \$ 10.86 |

Expected volatilities are based on the historical returns on our stock and the implied volatility of our publicly-traded options. The expected dividend yield is based on the recent historical dividend yields for our stock, taking into account changes in dividend policy. The risk-free interest rate is based on the term structure of interest rates at the time of the option grant. The expected life represents an estimate of the period of time options are expected to remain outstanding, and we have relied upon a combination of the observed exercise behavior of our prior grants with similar characteristics, the vesting schedule of the grants, and an index of peer companies with similar grant characteristics in estimating this variable.

We received cash of \$92, \$60 and \$27 million during 2011, 2010, and 2009, respectively, from option holders resulting from the exercise of stock options. We received a tax benefit of \$6, \$4 and \$1 million during 2011, 2010, and 2009, respectively, from the exercise of stock options, which is reported as cash from financing activities in the cash flow statement.

The total intrinsic value of options exercised during 2011, 2010, and 2009 was \$31, \$18 and \$5 million, respectively. As of December 31, 2011, there was \$4 million of total unrecognized compensation cost related to nonvested options. That cost is expected to be recognized over a weighted average period of 1 year and 11 months.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2011:

| Exercise Price Range | Options Outstanding      |                            |                              | Options Exercisable      |                              |
|----------------------|--------------------------|----------------------------|------------------------------|--------------------------|------------------------------|
|                      | Shares<br>(in thousands) | Average Life<br>(in years) | Average<br>Exercise<br>Price | Shares<br>(in thousands) | Average<br>Exercise<br>Price |
| \$50.01 - \$60.00    | 244                      | 7.35                       | \$ 55.83                     | 109                      | \$ 55.83                     |
| \$60.01 - \$70.00    | 3,377                    | 1.31                       | 61.78                        | 3,246                    | 61.57                        |
| \$70.01 - \$80.00    | 7,378                    | 3.98                       | 71.30                        | 5,218                    | 71.34                        |
| \$80.01 - \$90.00    | 2,200                    | 4.33                       | 80.92                        | 2,200                    | 80.92                        |
|                      | 13,199                   | 3.42                       | \$ 70.18                     | 10,773                   | \$ 70.19                     |

*Discounted Employee Stock Purchase Plan*

We maintain an employee stock purchase plan for all eligible employees, which was modified in 2009. Under the modified plan, shares of UPS class A common stock may be purchased at quarterly intervals at 95% of the NYSE closing price of UPS class B common stock on the last day of each quarterly period. Prior to the modification in the second quarter of 2009, shares could be purchased at quarterly intervals at 90% of the lower of the NYSE closing price of the UPS class B common stock on the first or the last day of each quarterly period.



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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Employees purchased 1.3, 1.5 and 0.6 million shares at average prices of \$66.86, \$57.98 and \$44.30 per share during 2011, 2010, and 2009, respectively. Subsequent to the modification, the plan is no longer considered to be compensatory, and therefore no compensation cost is measured for the modified employees' purchase rights. Prior to the modification, compensation cost was measured for the fair value of employees' purchase rights under our discounted employee stock purchase plan using the Black-Scholes option pricing model, and we determined the weighted average fair value of the employee purchase rights to be \$7.52 per share for 2009.

**NOTE 12. SEGMENT AND GEOGRAPHIC INFORMATION**

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

*U.S. Domestic Package*

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

*International Package*

International Package operations include delivery to more than 220 countries and territories worldwide, including shipments wholly outside the United States, as well as shipments with either origin or destination outside the United States. Our International Package reporting segment includes the operations of our Europe, Asia and Americas operating segments.

*Supply Chain & Freight*

Supply Chain & Freight includes our forwarding and logistics operations, UPS Freight and other aggregated business units. Our forwarding and logistics business provides services in more than 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 LTL and TL services to customers in North America. Other aggregated business units within this segment include Mail Boxes Etc. (the franchisor of Mail Boxes Etc. and The UPS Store) and UPS Capital.

In evaluating financial performance, we focus on operating profit as a segment's measure of profit or loss. Operating profit is before investment income, interest expense and income taxes. The accounting policies of the reportable segments are the same as those described in the summary of accounting policies (see Note 1), with certain expenses allocated between the segments using activity-based costing methods. Unallocated assets are comprised primarily of cash, marketable securities, and certain investment partnerships.

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

Segment information as of, and for the years ended, December 31 is as follows (in millions):

|   | 2011             | 2010             | 2009             |
|---|------------------|------------------|------------------|
| <b>Revenue:</b>                               |                  |                  |                  |
| U.S. Domestic Package                         | \$ 31,717        | \$ 29,742        | \$ 28,158        |
| International Package                         | 12,249           | 11,133           | 9,699            |
| Supply Chain & Freight                        | 9,139            | 8,670            | 7,440            |
| <b>Consolidated</b>                           | <b>\$ 53,105</b> | <b>\$ 49,545</b> | <b>\$ 45,297</b> |
| <b>Operating Profit:</b>                      |                  |                  |                  |
| U.S. Domestic Package                         | \$ 3,764         | \$ 3,238         | \$ 1,919         |
| International Package                         | 1,709            | 1,831            | 1,279            |
| Supply Chain & Freight                        | 607              | 572              | 310              |
| <b>Consolidated</b>                           | <b>\$ 6,080</b>  | <b>\$ 5,641</b>  | <b>\$ 3,508</b>  |
| <b>Assets:</b>                                |                  |                  |                  |
| U.S. Domestic Package                         | \$ 19,300        | \$ 18,425        | \$ 18,572        |
| International Package                         | 6,729            | 6,228            | 5,882            |
| Supply Chain & Freight                        | 6,588            | 6,283            | 6,620            |
| Unallocated                                   | 2,084            | 2,661            | 809              |
| <b>Consolidated</b>                           | <b>\$ 34,701</b> | <b>\$ 33,597</b> | <b>\$ 31,883</b> |
| <b>Depreciation and Amortization Expense:</b> |                  |                  |                  |
| U.S. Domestic Package                         | \$ 1,154         | \$ 1,174         | \$ 1,064         |
| International Package                         | 474              | 443              | 500              |
| Supply Chain & Freight                        | 154              | 175              | 183              |
| <b>Consolidated</b>                           | <b>\$ 1,782</b>  | <b>\$ 1,792</b>  | <b>\$ 1,747</b>  |

Revenue by product type for the years ended December 31 is as follows (in millions):

|                                    | 2011          | 2010          | 2009          |
|------------------------------------|---------------|---------------|---------------|
| <b>U.S. Domestic Package:</b>      |               |               |               |
| Next Day Air                       | \$ 6,229      | \$ 5,835      | \$ 5,456      |
| Deferred                           | 3,299         | 2,975         | 2,859         |
| Ground                             | 22,189        | 20,932        | 19,843        |
| <b>Total U.S. Domestic Package</b> | <b>31,717</b> | <b>29,742</b> | <b>28,158</b> |
| <b>International Package:</b>      |               |               |               |
| Domestic                           | 2,628         | 2,365         | 2,111         |
| Export                             | 9,056         | 8,234         | 7,176         |
| Cargo                              | 565           | 534           | 412           |

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|                              |           |           |           |
|------------------------------|-----------|-----------|-----------|
| Total International Package  | 12,249    | 11,133    | 9,699     |
| Supply Chain & Freight:      |           |           |           |
| Forwarding and Logistics     | 6,103     | 6,022     | 5,080     |
| Freight                      | 2,563     | 2,208     | 1,943     |
| Other                        | 473       | 440       | 417       |
| Total Supply Chain & Freight | 9,139     | 8,670     | 7,440     |
| Consolidated                 | \$ 53,105 | \$ 49,545 | \$ 45,297 |

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

Geographic information as of, and for the years ended, December 31 is as follows (in millions):

|                   | 2011      | 2010      | 2009      |
|-------------------|-----------|-----------|-----------|
| United States:    |           |           |           |
| Revenue           | \$ 39,347 | \$ 36,795 | \$ 34,375 |
| Long-lived assets | \$ 16,085 | \$ 16,693 | \$ 17,336 |
| International:    |           |           |           |
| Revenue           | \$ 13,758 | \$ 12,750 | \$ 10,922 |
| Long-lived assets | \$ 5,220  | \$ 5,047  | \$ 4,935  |
| Consolidated:     |           |           |           |
| Revenue           | \$ 53,105 | \$ 49,545 | \$ 45,297 |
| Long-lived assets | \$ 21,305 | \$ 21,740 | \$ 22,271 |

Long-lived assets include property, plant and equipment, pension and postretirement benefit assets, long-term investments, goodwill, and intangible assets.

No countries outside of the United States, nor any individual customers, provided 10% or more of consolidated revenue in 2011, 2010 or 2009.

**NOTE 13. INCOME TAXES**

The income tax expense (benefit) for the years ended December 31 consists of the following (in millions):

|                      | 2011     | 2010     | 2009     |
|----------------------|----------|----------|----------|
| Current:             |          |          |          |
| U.S. Federal         | \$ 1,371 | \$ 776   | \$ 715   |
| U.S. State and Local | 121      | 119      | 30       |
| Non-U.S.             | 166      | 161      | 147      |
| Total Current        | 1,658    | 1,056    | 892      |
| Deferred:            |          |          |          |
| U.S. Federal         | 262      | 828      | 137      |
| U.S. State and Local | 44       | 98       | 21       |
| Non-U.S.             | 8        | (30)     | 55       |
| Total Deferred       | 314      | 896      | 213      |
| Total                | \$ 1,972 | \$ 1,952 | \$ 1,105 |

Income before income taxes includes the following components (in millions):

|               | 2011     | 2010     | 2009     |
|---------------|----------|----------|----------|
| United States | \$ 5,309 | \$ 4,586 | \$ 2,750 |
| Non-U.S.      | 467      | 704      | 323      |

\$ 5,776 \$ 5,290 \$ 3,073

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

A reconciliation of the statutory federal income tax rate to the effective income tax rate for the years ended December 31 consists of the following:

|  | 2011         | 2010         | 2009         |
|--|--------------|--------------|--------------|
| Statutory U.S. federal income tax rate                     | 35.0%        | 35.0%        | 35.0%        |
| U.S. state and local income taxes (net of federal benefit) | 2.0          | 2.4          | 1.2          |
| Non-U.S. tax rate differential                             | (0.4)        | (0.7)        | (1.6)        |
| Nondeductible/nontaxable items                             | (0.1)        | 0.3          | 1.0          |
| U.S. federal tax credits                                   | (1.7)        | (1.9)        | (3.5)        |
| Other  | (0.7)        | 1.8          | 3.9          |
| <b>Effective income tax rate</b>                           | <b>34.1%</b> | <b>36.9%</b> | <b>36.0%</b> |

Our effective tax rate declined to 34.1% in 2011 compared with 36.9% in 2010 as a result of several factors, including the change in the tax status of a subsidiary, changes in deferred tax asset valuation allowances, and the relative proportion of taxable income in certain non-U.S. jurisdictions, among other factors.

In 2011, we had a higher proportion of our total taxable income in certain non-U.S. jurisdictions, where corporate tax rates are generally lower, compared with 2010. Additionally in 2011, we recognized 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 third quarter of 2010, we recognized a \$40 million tax benefit associated with the release of a valuation allowance against deferred tax assets in our international package operations, partially offset by tax provided for interest earned on refunds.

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 remeasurement 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.

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

Deferred tax liabilities and assets are comprised of the following at December 31 (in millions):

|  | <b>2011</b>  | <b>2010</b>  |
|--|--------------|--------------|
| Property, plant and equipment  | \$ 3,607     | \$ 3,335     |
| Goodwill and intangible assets   | 951          | 853          |
| Other  | 554          | 562          |
| <br>Gross deferred tax liabilities                                       | <br>5,112    | <br>4,750    |
| Pension and postretirement benefits                                      | 2,106        | 1,864        |
| Loss and credit carryforwards (non-U.S. and state)                       | 259          | 295          |
| Insurance reserves   | 696          | 655          |
| Vacation pay accrual   | 208          | 191          |
| Stock compensation   | 211          | 242          |
| Other  | 635          | 568          |
| <br>Gross deferred tax assets  | <br>4,115    | <br>3,815    |
| Deferred tax assets valuation allowance                                  | (205)        | (207)        |
| <br>Net deferred tax asset   | <br>3,910    | <br>3,608    |
| <br>Net deferred tax liability   | <br>\$ 1,202 | <br>\$ 1,142 |
| <b>Amounts recognized in the consolidated balance sheets:</b>            |              |              |
| Current deferred tax assets  | \$ 611       | \$ 659       |
| Current deferred tax liabilities (included in other current liabilities) | \$ 31        | \$ 28        |
| Non-current deferred tax assets (included in other non-current assets)   | \$ 118       | \$ 97        |
| Non-current deferred tax liabilities                                     | \$ 1,900     | \$ 1,870     |

The valuation allowance changed by \$2, \$30, and \$(120) million during the years ended December 31, 2011, 2010 and 2009, respectively.

We have U.S. state and local operating loss and credit carryforwards as follows (in millions):

|   | <b>2011</b> | <b>2010</b> |
|---|-------------|-------------|
| U.S. state and local operating loss carryforwards | \$ 859      | \$ 1,088    |
| U.S. state and local credit carryforwards         | \$ 77       | \$ 74       |

The operating loss carryforwards expire at varying dates through 2031. The state credits can be carried forward for periods ranging from three years to indefinitely.

We also have non-U.S. loss carryforwards of approximately \$788 million as of December 31, 2011, the majority of which may be carried forward indefinitely. As indicated in the table above, we have established a valuation allowance for certain non-U.S. and state loss

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carryforwards, due to the uncertainty resulting from a lack of previous taxable income within the applicable tax jurisdictions.

Undistributed earnings of foreign subsidiaries amounted to approximately \$3.161 billion at December 31, 2011. Those earnings are considered to be indefinitely reinvested and, accordingly, no deferred income taxes have been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, we would be subject to income taxes and withholding taxes payable in various jurisdictions, which could potentially be offset by foreign tax credits. Determination of the amount of unrecognized deferred income tax liability is not practicable because of the complexities associated with its hypothetical calculation.

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

The following table summarizes the activity related to our unrecognized tax benefits (in millions):

|  | <b>Tax</b> | <b>Interest</b> | <b>Penalties</b> |
|--|------------|-----------------|------------------|
| Balance at January 1, 2009                       | \$ 388     | \$ 97           | \$ 10            |
| Additions for tax positions of the current year  | 41         |                 |                  |
| Additions for tax positions of prior years       | 76         | 27              | 2                |
| Reductions for tax positions of prior years for: |            |                 |                  |
| Changes based on facts and circumstances         | (214)      | (34)            | (3)              |
| Settlements during the period                    | (23)       | (4)             |                  |
| Lapses of applicable statute of limitations      | (2)        |                 | (1)              |
| Balance at December 31, 2009                     | 266        | 86              | 8                |
| Additions for tax positions of the current year  | 16         |                 |                  |
| Additions for tax positions of prior years       | 45         | 25              | 2                |
| Reductions for tax positions of prior years for: |            |                 |                  |
| Changes based on facts and circumstances         | (27)       | (10)            | (3)              |
| Settlements during the period                    | (6)        | (3)             |                  |
| Lapses of applicable statute of limitations      | (10)       | (3)             |                  |
| Balance at December 31, 2010                     | 284        | 95              | 7                |
| Additions for tax positions of the current year  | 13         |                 |                  |
| Additions for tax positions of prior years       | 17         | 6               |                  |
| Reductions for tax positions of prior years for: |            |                 |                  |
| Changes based on facts and circumstances         | (50)       | (9)             | (2)              |
| Settlements during the period                    | (11)       | (19)            | (1)              |
| Lapses of applicable statute of limitations      | (1)        |                 | (1)              |
| Balance at December 31, 2011                     | \$ 252     | \$ 73           | \$ 3             |

The total amount of gross unrecognized tax benefits as of December 31, 2011, 2010 and 2009 that, if recognized, would affect the effective tax rate was \$247, \$283 and \$243 million, respectively. We also had gross recognized tax benefits of \$291, \$326 and \$329 million recorded as of December 31, 2011, 2010 and 2009, respectively, associated with outstanding refund claims for prior tax years. Therefore, we had a net receivable recorded with respect to prior years' income tax matters in the accompanying consolidated balance sheets. Additionally, we have recognized a receivable for interest of \$27, \$32 and \$56 million for the recognized tax benefits associated with outstanding refund claims as of December 31, 2011, 2010 and 2009, respectively. Our continuing practice is to recognize interest and penalties associated with income tax matters as a component of income tax expense.

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 2005. 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.

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



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

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.

**NOTE 14. EARNINGS PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share (in millions, except per share amounts):

|   | 2011           | 2010           | 2009           |
|---|----------------|----------------|----------------|
| <b>Numerator:</b>                                 |                |                |                |
| Net income attributable to common shareowners     | \$ 3,804       | \$ 3,338       | \$ 1,968       |
| <b>Denominator:</b>                               |                |                |                |
| Weighted average shares                           | 977            | 991            | 995            |
| Deferred compensation obligations                 | 2              | 2              | 2              |
| Vested portion of restricted shares               | 2              | 1              | 1              |
| <b>Denominator for basic earnings per share</b>   | <b>981</b>     | <b>994</b>     | <b>998</b>     |
| <b>Effect of dilutive securities:</b>             |                |                |                |
| Restricted performance units                      | 3              | 3              | 2              |
| Restricted stock units                            | 6              | 6              | 4              |
| Stock options                                     | 1              |                |                |
| <b>Denominator for diluted earnings per share</b> | <b>991</b>     | <b>1,003</b>   | <b>1,004</b>   |
| <b>Basic earnings per share</b>                   | <b>\$ 3.88</b> | <b>\$ 3.36</b> | <b>\$ 1.97</b> |
| <b>Diluted earnings per share</b>                 | <b>\$ 3.84</b> | <b>\$ 3.33</b> | <b>\$ 1.96</b> |

Diluted earnings per share for the years ended December 31, 2011, 2010, and 2009 exclude the effect of 7.4, 11.1 and 17.4 million shares, respectively, of common stock that may be issued upon the exercise of employee stock options because such effect would be antidilutive.



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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 15. 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*

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.

We have agreements with substantially all of our active counterparties containing early termination rights and/or bilateral collateral provisions whereby cash is required whenever the net fair value of derivatives associated with those counterparties exceed specific thresholds. Events, such as a credit rating downgrade (depending on the ultimate rating level) would typically require an increase in the amount of collateral required of the counterparty and/or allow us to take additional protective measures such as early termination of trades. At December 31, 2011, we held cash collateral of \$55 million under these agreements.

In connection with the agreements described above, we could also be required to provide additional collateral or terminate transactions with certain counterparties in the event of a downgrade of our debt rating. The amount of additional collateral is a fixed incremental amount. At December 31, 2011 the aggregate fair value of the instruments covered by these contractual features that were in a net liability position was \$10 million. The Company has never been required to post any collateral as a result of these contractual features.

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,

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 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.

*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

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

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 and maturity dates of the swaps match the terms of the associated debt being hedged. Interest rate swaps allow us to maintain a target range of floating rate debt within our capital structure.

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

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

*Outstanding Positions*

The notional amounts of our outstanding derivative positions were as follows:

|                                       | December 31, 2011<br>Notional Value | December 31, 2010<br>Notional Value |
|---------------------------------------|-------------------------------------|-------------------------------------|
| <b>Currency Hedges:</b>               |                                     |                                     |
| Euro                                  | 1,685                               | 1,732                               |
| British Pound Sterling                | £ 870                               | £ 871                               |
| Canadian Dollar                       | C\$ 318                             | C\$ 289                             |
| <b>Interest Rate Hedges:</b>          |                                     |                                     |
| Fixed to Floating Interest Rate Swaps | \$ 6,424                            | \$ 6,000                            |
| Floating to Fixed Interest Rate Swaps | \$ 791                              | \$ 53                               |

As of December 31, 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.

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Balance Sheet Recognition*

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

| <b>Asset Derivatives</b>                     | <b>Balance Sheet Location</b> | <b>Fair Value Hierarchy Level</b> | <b>December 31, 2011 Fair Value</b> | <b>December 31, 2010 Fair Value</b> |
|--|-------------------------------|-----------------------------------|-------------------------------------|-------------------------------------|
| <b>Derivatives designated as hedges:</b>     |                               |                                   |                                     |                                     |
| Foreign exchange contracts                   | Other current assets          | Level 2                           | \$ 164                              | \$ 36                               |
| Interest rate contracts                      | Other non-current assets      | Level 2                           | 401                                 | 182                                 |
| <b>Derivatives not designated as hedges:</b> |                               |                                   |                                     |                                     |
| Foreign exchange contracts                   | Other current assets          | Level 2                           | 2                                   |                                     |
| Interest rate contracts                      | Other non-current assets      | Level 2                           | 82                                  |                                     |
| <b>Total Asset Derivatives</b>               |                               |                                   | <b>\$ 649</b>                       | <b>\$ 218</b>                       |

| <b>Liability Derivatives</b>                 | <b>Balance Sheet Location</b> | <b>Fair Value Hierarchy Level</b> | <b>December 31, 2011 Fair Value</b> | <b>December 31, 2010 Fair Value</b> |
|--|-------------------------------|-----------------------------------|-------------------------------------|-------------------------------------|
| <b>Derivatives designated as hedges:</b>     |                               |                                   |                                     |                                     |
| Foreign exchange contracts                   | Other current liabilities     | Level 2                           | \$                                  | \$ 9                                |
| Foreign exchange contracts                   | Other non-current liabilities | Level 2                           | 185                                 | 99                                  |
| Interest rate contracts                      | Other non-current liabilities | Level 2                           | 13                                  | 29                                  |
| <b>Derivatives not designated as hedges:</b> |                               |                                   |                                     |                                     |
| Foreign exchange contracts                   | Other current liabilities     | Level 2                           |                                     | 3                                   |
| Interest rate contracts                      | Other non-current liabilities | Level 2                           | 10                                  | 1                                   |
| <b>Total Liability Derivatives</b>           |                               |                                   | <b>\$ 208</b>                       | <b>\$ 141</b>                       |

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Income Statement Recognition*

The following table indicates the amount and location in the statements of consolidated income 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 for the years ended December 31, 2011 and 2010 (in millions):

|  | 2011 Amount of<br>Gain<br>(Loss)<br>Recognized<br>in<br>OCI on<br>Derivative<br>(Effective<br>Portion) | 2010 Amount of<br>Gain<br>(Loss)<br>Recognized<br>in<br>OCI on<br>Derivative<br>(Effective<br>Portion) | Location of Gain<br>(Loss) Reclassified<br>from Accumulated<br>OCI into Income<br>(Effective Portion) | 2011 Amount of<br>Gain (Loss)<br>Reclassified from<br>Accumulated<br>OCI into<br>Income<br>(Effective<br>Portion) | 2010 Amount of<br>Gain<br>(Loss)<br>Reclassified from<br>Accumulated<br>OCI into<br>Income<br>(Effective<br>Portion) |
|--|--|--|---|---|--|
| <b>Derivative Instruments in Cash<br/>Flow Hedging Relationships</b> |  |  |   |   |  |
| Interest rate contracts  | \$ (6)   | \$ 7   | Interest Expense  | \$ (19)   | \$ (18)  |
| Foreign exchange contracts   | (85)   | (48)   | Interest Expense  | 13  | (27)   |
| Foreign exchange contracts   | 5  |  | Other Operating Expense   |   |  |
| Foreign exchange contracts   | 35   | 30   | Revenue   | (101)   | 96   |
| Commodity contracts  | 9  |  | Fuel Expense  | 9   |  |
| Total  | \$ (42)  | \$ (11)  |   | \$ (98)   | \$ 51  |

As of December 31, 2011, \$83 million of pre-tax gains related to cash flow hedges that are currently deferred in AOCI are expected to be reclassified to income over the 12 month period ended December 31, 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.

The amount of ineffectiveness recognized in income on derivative instruments designated in cash flow hedging relationships was immaterial for the years ended December 31, 2011, 2010 and 2009.

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 years ended December 31, 2011 and 2010 (in millions):

|   | Location of Gain (Loss)<br>Recognized in<br>Income | 2011<br>Amount<br>of<br>Gain<br>(Loss)<br>Recognized<br>in<br>Income | 2010<br>Amount<br>of<br>Gain<br>(Loss)<br>Recognized<br>in<br>Income | Hedged Items in<br>Fair Value Hedging<br>Relationships | Location of Gain<br>(Loss)<br>Recognized in<br>Income | 2011<br>Amount<br>of<br>Gain<br>(Loss)<br>Recognized<br>in<br>Income | 2010<br>Amount<br>of<br>Gain<br>(Loss)<br>Recognized<br>in<br>Income |
|---|--|--|--|--|---|--|--|
| <b>Derivative Instruments in<br/>Fair Value Hedging<br/>Relationships</b> |  |  |  |  |   |  |  |
| Interest rate contracts   | Interest Expense                                   | \$ 320   | \$ 134   | Fixed-Rate Debt<br>and Capital Leases                  | Interest Expense                                      | \$ (320)   | \$ (134)   |

Additionally, we maintain some foreign exchange forward and interest rate swap contracts that are not designated as hedges. 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. These interest rate swap contracts are intended to provide an economic hedge of a portfolio of interest

bearing receivables. The income statement impact of these hedges was not material for any period presented.

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.

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

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 and interest rate swap contracts not designated as hedges for the years ended December 31, 2011 and 2010 (in millions):

| <b>Derivative Instruments Not Designated in Hedging Relationships</b> | <b>Location of Gain (Loss) Recognized in Income</b> | <b>2011 Amount of Gain (Loss) Recognized in Income</b> | <b>2010 Amount of Gain (Loss) Recognized in Income</b> |
|---|---|--|--|
| Foreign Exchange Contracts  | Other Operating Expenses                            | \$ 2   | \$ 13  |
| Interest Rate Swap Contracts  | Interest Expense                                    | (8)  |  |
| <i>Fair Value Measurements</i>  |   |  |  |

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. The fair values of our derivative assets and liabilities as of December 31, 2011 and 2010 by hedge type are as follows (in millions):

|                            | <b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b> | <b>Significant Other Observable Inputs (Level 2)</b> | <b>Significant Unobservable Inputs (Level 3)</b> | <b>Balance as of December 31, 2011</b> |
|----------------------------|---|--|--|--|
| <b>2011:</b>               |   |  |  |  |
| <b>Assets</b>              |   |  |  |  |
| Foreign Exchange Contracts | \$  | \$ 166   | \$   | \$ 166                                 |
| Interest Rate Contracts    |   | 483  |  | 483                                    |
| <b>Total</b>               | <b>\$</b>   | <b>\$ 649</b>  | <b>\$</b>  | <b>\$ 649</b>                          |
| <b>Liabilities</b>         |   |  |  |  |
| Foreign Exchange Contracts | \$  | \$ 185   | \$   | \$ 185                                 |
| Interest Rate Contracts    |   | 23   |  | 23                                     |
| <b>Total</b>               | <b>\$</b>   | <b>\$ 208</b>  | <b>\$</b>  | <b>\$ 208</b>                          |

|               | <b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b> | <b>Significant Other Observable Inputs (Level 2)</b> | <b>Significant Unobservable Inputs (Level 3)</b> | <b>Balance as of December 31, 2010</b> |
|---------------|---|--|--|--|
| <b>2010:</b>  |   |  |  |  |
| <b>Assets</b> |   |  |  |  |

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|                            |           |               |           |               |
|----------------------------|-----------|---------------|-----------|---------------|
| Foreign Exchange Contracts | \$        | \$ 36         | \$        | \$ 36         |
| Interest Rate Contracts    |           | 182           |           | 182           |
| <b>Total</b>               | <b>\$</b> | <b>\$ 218</b> | <b>\$</b> | <b>\$ 218</b> |
| <b>Liabilities</b>         |           |               |           |               |
| Foreign Exchange Contracts | \$        | \$ 111        | \$        | \$ 111        |
| Interest Rate Contracts    |           | 30            |           | 30            |
| <b>Total</b>               | <b>\$</b> | <b>\$ 141</b> | <b>\$</b> | <b>\$ 141</b> |

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 16. RESTRUCTURING COSTS AND BUSINESS DISPOSITIONS**

We have 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 integration of acquired companies, as well as restructuring activities associated with cost containment and operational efficiency programs. Additionally, we have sold or shut-down certain non-core business units in 2010, and recorded gains or losses upon the sale, as well as costs associated with each transaction.

*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 provided a guarantee for a period of two years from the date of sale for certain employee benefit payments being assumed by the buyer. We recorded a pre-tax loss of \$51 million (\$47 million after-tax) for this transaction in 2010, which included the costs associated with the sale transaction and the fair value of the guarantee. This loss is recorded in the caption *other expenses* in the statements of consolidated income.

*Supply Chain & Freight United States*

In December 2010, we completed the sale of our UPS Logistics Technologies, Inc. business unit, which produced transportation routing and fleet management systems. We recognized a \$71 million pre-tax gain on the sale (\$44 million after tax), which is included in the caption *other expenses* in the consolidated income statement, and is included in the results of our Supply Chain & Freight segment. The operating results of the UPS Logistics Technologies, Inc business unit were not material to our consolidated or segment operating results in any of the periods presented.

*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 based on length of service, and access to support programs. 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 reflects the value of voluntary retirement benefits, severance benefits and unvested stock compensation. During the remainder of 2010, we incurred additional costs related to the relocation of employees and other restructuring activities, however those costs were offset by savings from the staffing reductions.

**NOTE 17. SUBSEQUENT EVENTS**

In February 2012, we acquired Kiala S.A. ( *Kiala* ), a Belgium-based developer of a platform that enables e-commerce retailers to offer their shoppers the option of having goods delivered to a convenient retail location. Kiala currently operates in Belgium, France, Luxembourg, the Netherlands and Spain. The acquisition will broaden our service portfolio for business-to-consumer deliveries. Kiala is not material to our consolidated financial position or results of operations.

**Table of Contents****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****NOTE 18. QUARTERLY INFORMATION (unaudited)**

Our revenue, segment operating profit, net income, basic and diluted earnings per share on a quarterly basis are presented below (in millions, except per share amounts):

|                               | First Quarter |               | Second Quarter  |               | Third Quarter   |               | Fourth Quarter |                 |
|-------------------------------|---------------|---------------|-----------------|---------------|-----------------|---------------|----------------|-----------------|
|                               | 2011          | 2010          | 2011            | 2010          | 2011            | 2010          | 2011           | 2010            |
| <b>Revenue:</b>               |               |               |                 |               |                 |               |                |                 |
| U.S. Domestic Package         | \$ 7,543      | \$ 7,102      | \$ 7,737        | \$ 7,269      | \$ 7,767        | \$ 7,291      | \$ 8,670       | \$ 8,080        |
| International Package         | 2,900         | 2,639         | 3,139           | 2,771         | 3,057           | 2,676         | 3,153          | 3,047           |
| Supply Chain & Freight        | 2,139         | 1,987         | 2,315           | 2,164         | 2,342           | 2,225         | 2,343          | 2,294           |
| <b>Total revenue</b>          | <b>12,582</b> | <b>11,728</b> | <b>13,191</b>   | <b>12,204</b> | <b>13,166</b>   | <b>12,192</b> | <b>14,166</b>  | <b>13,421</b>   |
| <b>Operating profit:</b>      |               |               |                 |               |                 |               |                |                 |
| U.S. Domestic Package         | 880           | 536           | 997             | 722           | 1,046           | 994           | 841            | 986             |
| International Package         | 453           | 420           | 505             | 513           | 417             | 411           | 334            | 487             |
| Supply Chain & Freight        | 139           | 56            | 243             | 136           | 203             | 181           | 22             | 199             |
| <b>Total operating profit</b> | <b>1,472</b>  | <b>1,012</b>  | <b>1,745</b>    | <b>1,371</b>  | <b>1,666</b>    | <b>1,586</b>  | <b>1,197</b>   | <b>1,672</b>    |
| <b>Net income</b>             | <b>\$ 915</b> | <b>\$ 515</b> | <b>\$ 1,092</b> | <b>\$ 826</b> | <b>\$ 1,072</b> | <b>\$ 972</b> | <b>\$ 725</b>  | <b>\$ 1,025</b> |
| <b>Earnings per share:</b>    |               |               |                 |               |                 |               |                |                 |
| Basic                         | \$ 0.92       | \$ 0.52       | \$ 1.11         | \$ 0.83       | \$ 1.10         | \$ 0.98       | \$ 0.75        | \$ 1.03         |
| Diluted                       | \$ 0.91       | \$ 0.51       | \$ 1.09         | \$ 0.82       | \$ 1.09         | \$ 0.97       | \$ 0.74        | \$ 1.02         |

Second quarter 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. The combined impact of these transactions increased net income by \$20 million, and basic and diluted earnings per share by \$0.02.

Fourth quarter 2011 operating profit was impacted by a mark-to-market loss on our pension and postretirement benefit plans related to the remeasurement of plan assets and liabilities recognized outside of a 10% corridor of \$827 million (allocated as follows: U.S. Domestic Package \$479 million, International Package \$171 million, Supply Chain & Freight \$177 million). This loss reduced net income by \$527 million, and basic and diluted earnings per share by \$0.54.

First quarter 2010 U.S. Domestic Package operating profit includes a \$98 million restructuring charge related to the reorganization of our domestic management structure, as discussed in Note 16. First quarter 2010 Supply Chain & Freight operating profit includes a \$38 million loss on the sale of a specialized transportation business in Germany, also discussed in Note 16. Additionally, first quarter 2010 net income includes a \$76 million charge to income tax expense, resulting from a change in the tax filing status of a German subsidiary, as discussed in Note 13. The combined impact of these items reduced net income by \$175 million, basic earnings per share by \$0.17, and diluted earnings per share by \$0.18.

Third quarter 2010 U.S. Domestic Package operating profit includes a \$109 million gain on the sale of real estate. This gain increased net income by \$61 million, and basic and diluted earnings per share by \$0.06.

Fourth quarter 2010 Supply Chain & Freight operating profit includes a \$71 million gain on the sale of UPS Logistics Technologies and a \$13 million loss related to a financial guarantee associated with the specialized transportation business sold in the first quarter of 2010, which are discussed in Note 16. Additionally, fourth quarter 2010 operating profit was impacted by a mark-to-market loss on our pension and postretirement benefit plans related to the remeasurement of plan assets and liabilities recognized outside of a 10% corridor of \$112 million (allocated as follows: U.S. Domestic Package \$31 million, International Package \$42 million, Supply Chain & Freight \$39 million). The combined impact of these items decreased net income by \$43 million, and basic and diluted earnings per share by \$0.04.



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As discussed in Note 1, our operating profit, net income and earnings per share have all been revised for the retrospective application of our changes in accounting policies for recognizing the expense associated with our pension and postretirement benefit plans. The impact of these accounting policy changes revised our previously reported information by the following (in millions, except per share amounts):

| Increase (Reduction) to Previously-Reported Information | First Quarter |                | Second Quarter |                | Third Quarter |                | Fourth Quarter  |                |
|---|---------------|----------------|----------------|----------------|---------------|----------------|-----------------|----------------|
|   | 2011          | 2010           | 2011           | 2010           | 2011          | 2010           | 2011            | 2010           |
| <b>Operating profit:</b>                                |               |                |                |                |               |                |                 |                |
| U.S. Domestic Package                                   | \$ 31         | \$ (26)        | \$ 31          | \$ (26)        | \$ 31         | \$ (26)        | \$ (448)        | \$ (57)        |
| International Package                                   | 7             | (7)            | 8              | (8)            | 8             | (8)            | (163)           | (50)           |
| Supply Chain & Freight                                  | 8             | 3              | 8              | 3              | 8             | 4              | (169)           | (35)           |
| <b>Total operating profit</b>                           | <b>46</b>     | <b>(30)</b>    | <b>47</b>      | <b>(31)</b>    | <b>47</b>     | <b>(30)</b>    | <b>(780)</b>    | <b>(142)</b>   |
| <b>Net income</b>                                       | <b>\$ 30</b>  | <b>\$ (18)</b> | <b>\$ 29</b>   | <b>\$ (19)</b> | <b>\$ 30</b>  | <b>\$ (19)</b> | <b>\$ (498)</b> | <b>\$ (94)</b> |
| <b>Earnings per share:</b>                              |               |                |                |                |               |                |                 |                |
| Basic   | \$ 0.03       | \$ (0.02)      | \$ 0.03        | \$ (0.02)      | \$ 0.03       | \$ (0.02)      | \$ (0.51)       | \$ (0.10)      |
| Diluted   | \$ 0.03       | \$ (0.02)      | \$ 0.02        | \$ (0.02)      | \$ 0.03       | \$ (0.02)      | \$ (0.51)       | \$ (0.09)      |

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. 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 and internal controls over financial reporting. Based upon, and as of the date of, the evaluation, our chief executive officer and chief financial officer concluded that the disclosure controls and procedures and internal controls over financial reporting were effective to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is recorded, processed, summarized and reported as and when required and is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow 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 December 31, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

*Management's Report on Internal Control Over Financial Reporting:*

UPS management is responsible for establishing and maintaining adequate internal controls over financial reporting for United Parcel Service, Inc. and its subsidiaries (the Company). Based on the criteria for effective internal control over financial reporting established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, management has assessed the Company's internal control over financial reporting as effective as of December 31, 2011. The independent registered public accounting firm of Deloitte & Touche LLP, as auditors of the consolidated balance sheets of United Parcel Service, Inc. and its subsidiaries as of December 31, 2011 and the related consolidated statements of income, comprehensive income and cash flows for the year ended December 31, 2011, has issued an attestation report on the Company's internal control over financial reporting, which is included herein.

United Parcel Service, Inc.

February 27, 2012

**Item 9B. *Other Information***

None.

**Table of Contents****PART III****Item 10. Directors, Executive Officers and Corporate Governance  
Executive Officers of the Registrant**

| <b>Name and Office</b>  | <b>Age</b> | <b>Principal Occupation<br/>and Employment For<br/>the Last Five Years</b>  |
|---|------------|---|
| David P. Abney<br>Senior Vice President and Chief Operating Officer               | 56         | Senior Vice President and Chief Operating Officer (2007 present), President, UPS Airlines (2007–2008), Senior Vice President and President, UPS International (2003–2007).  |
| David A. Barnes<br>Senior Vice President and Chief Information Officer            | 56         | Senior Vice President and Chief Information Officer (2005 present).   |
| Daniel J. Brutto<br>Senior Vice President and President, UPS International        | 55         | Senior Vice President and President, UPS International (2008 present), President, Global Freight Forwarding (2006–2007), Corporate Controller (2004–2006).  |
| D. Scott Davis<br>Chairman and Chief Executive Officer                            | 60         | Chairman and Chief Executive Officer (2008–present), Vice Chairman (2006–2007), Senior Vice President, Chief Financial Officer and Treasurer (2001–2007), Director (2006–present).  |
| Alan Gershenhorn<br>Senior Vice President   | 53         | Senior Vice President, Worldwide Sales, Marketing and Strategy (2011–present), Senior Vice President, Worldwide Sales and Marketing (2008–2010), Senior Vice President and President, UPS International (2007), President, UPS Supply Chain Solutions—Asia and Europe (2006). |
| Myron Gray<br>Senior Vice President   | 54         | Senior Vice President, U.S. Operations (2009–present), Vice President, Americas Region (2008–2009), Vice President, North Central Region (2004–2008).   |
| Allen E. Hill *<br>Senior Vice President  | 56         | Senior Vice President, Human Resources (2007–present), Senior Vice President, Human Resources and Public Affairs (2006), Senior Vice President, General Counsel and Corporate Secretary (2004–2006).  |
| Kurt P. Kuehn<br>Senior Vice President and Chief Financial Officer                | 57         | Senior Vice President and Chief Financial Officer (2008 present), Treasurer (2008–2010), Senior Vice President, Worldwide Sales and Marketing (2004–2007).  |
| Teri P. McClure<br>Senior Vice President, General Counsel and Corporate Secretary | 48         | Senior Vice President of Legal, Compliance and Public Affairs, General Counsel and Corporate Secretary (2006–present), Corporate Legal Department Manager (2005–2006).  |

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| <b>Name and Office</b>                      | <b>Age</b> | <b>Principal Occupation<br/>and Employment For<br/>the Last Five Years</b>  |
|---|------------|---|
| John J. McDevitt<br>Senior Vice President   | 53         | Senior Vice President, Human Resources and Labor Relations (2012 - Present), Senior Vice President, Global Transportation Services and Labor Relations (2005 - 2011). |
| Christine M. Owens<br>Senior Vice President | 56         | Senior Vice President, Communications and Brand Management (2005 - present).  |

\* Allen Hill announced his retirement from UPS, effective March 2012.

Information about our directors is presented under the caption "Election of Directors" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 3, 2012 and is incorporated herein by reference.

Information about our Audit Committee is presented under the caption "Election of Directors - Committees of the Board of Directors - Audit Committee" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 3, 2012 and is incorporated herein by reference.

Information about our Code of Business Conduct is presented under the caption "Where You Can Find More Information" in Part I, Item 1 of this report.

Information about our compliance with Section 16 of the Exchange Act of 1934, as amended, is presented under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 3, 2012 and is incorporated herein by reference.

**Item 11. *Executive Compensation***

Information about executive compensation is presented under the captions "Compensation Discussion and Analysis," "Compensation of Executive Officers," "Compensation of Directors," "Report of the Compensation Committee" and "Compensation Committee Interlocks and Insider Participation" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 3, 2012 and is incorporated herein by reference.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information about security ownership is presented under the caption "Beneficial Ownership of Common Stock" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 3, 2012 and is incorporated herein by reference.

Information about our equity compensation plans is presented under the caption "Equity Compensation Plans" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 3, 2012 and is incorporated herein by reference.

**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

Information about transactions with related persons is presented under the caption "Related Person Transactions" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 3, 2012 and is incorporated herein by reference.

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Information about director independence is presented under the caption "Election of Directors - Director Independence" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 3, 2012 and is incorporated herein by reference.

**Item 14. *Principal Accounting Fees and Services***

Information about aggregate fees billed to us by our principal accountant is presented under the caption "Principal Accounting Firm Fees" in our definitive Proxy Statement for the Annual Meetings of Shareowners to be held on May 3, 2012 and is incorporated herein by reference.

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**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

(a) 1. *Financial Statements.*

See Item 8 for the financial statements filed with this report.

2. *Financial Statement Schedules.*

None.

3. *List of Exhibits.*

See the Exhibit Index for a list of the exhibits incorporated by reference into or filed with this report.

(b) *Exhibits required by Item 601 of Regulation S-K.*

See the Exhibit Index for a list of the exhibits incorporated by reference into or filed with this report.

(c) *Financial Statement Schedules.*

None.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, United Parcel Service, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UNITED PARCEL SERVICE, INC.  
(REGISTRANT)

By: */s/ D. SCOTT DAVIS*  
**D. Scott Davis**  
*Chairman and*  
*Chief Executive Officer*

Date: February 27, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| <b>Signature</b>   | <b>Title</b>  | <b>Date</b>       |
|--|---|-------------------|
| <i>/s/ F. DUANE ACKERMAN</i><br><b>F. Duane Ackerman</b>     | Director  | February 22, 2012 |
| <i>/s/ MICHAEL J. BURNS</i><br><b>Michael J. Burns</b>       | Director  | February 21, 2012 |
| <i>/s/ D. SCOTT DAVIS</i><br><b>D. Scott Davis</b>           | Chairman, Chief Executive Officer and Director<br>(Principal Executive Officer) | February 27, 2012 |
| <i>/s/ STUART E. EIZENSTAT</i><br><b>Stuart E. Eizenstat</b> | Director  | February 23, 2012 |
| <i>/s/ MICHAEL L. ESKEW</i><br><b>Michael L. Eskew</b>       | Director  | February 22, 2012 |
| <i>/s/ WILLIAM R. JOHNSON</i><br><b>William R. Johnson</b>   | Director  | February 16, 2012 |
| <i>/s/ CANDACE B. KENDLE</i><br><b>Candace B. Kendle</b>     | Director  | February 17, 2012 |
| <i>/s/ KURT P. KUEHN</i><br><b>Kurt P. Kuehn</b>             | Chief Financial Officer (Principal Financial and<br>Accounting Officer)         | February 27, 2012 |

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|                            |          |                   |
|----------------------------|----------|-------------------|
| /s/ ANN M. LIVERMORE       | Director | February 17, 2012 |
| <b>Ann M. Livermore</b>    |          |                   |
| /s/ RUDY MARKHAM           | Director | February 23, 2012 |
| <b>Rudy Markham</b>        |          |                   |
| /s/ CLARK T. RANDT, JR.    | Director | February 23, 2012 |
| <b>Clark T. Randt, Jr.</b> |          |                   |

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| <b>Signature</b>                                    | <b>Title</b> | <b>Date</b>       |
|---|--------------|-------------------|
| /s/ JOHN W. THOMPSON<br><br><b>John W. Thompson</b> | Director     | February 16, 2012 |
| /s/ CAROL B. TOMÉ<br><br><b>Carol B. Tomé</b>       | Director     | February 16, 2012 |

**Table of Contents****EXHIBIT INDEX****Exhibit**

| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 2.1        | Agreement and Plan of Merger, dated as of September 22, 1999, among United Parcel Service of America, Inc., United Parcel Service, Inc. and UPS Merger Subsidiary, Inc. (incorporated by reference to Form S-4 (No. 333-83349), filed on July 21, 1999, as amended).             |
| 2.2        | Agreement and Plan of Merger, dated as of May 15, 2005, among United Parcel Service, Inc., Overnite Corporation, and Olympic Merger Sub, Inc. (incorporated by reference to Form 8-K, filed on May 18, 2005).  |
| 3.1        | Form of Restated Certificate of Incorporation of United Parcel Service, Inc. (incorporated by reference to Exhibit 3.2 to Form 8-K filed on May 12, 2010).   |
| 3.2        | Amended and Restated Bylaws of United Parcel Service, Inc. as of May 6, 2010 (incorporated by reference to Exhibit 3.1 to Form 8-K, filed on May 12, 2010).  |
| 4.1        | Form of Class A Common Stock Certificate (incorporated by reference to Exhibit 4.1 to Form S-4 (No. 333-83349), filed on July 21, 1999, as amended).   |
| 4.2        | Form of Class B Common Stock Certificate (incorporated by reference to Exhibit 4.2 to Form S-4 (No. 333-83349), filed on July 21, 1999).   |
| 4.3        | Specimen Certificate of 8 <sup>3</sup> / <sub>8</sub> % Debentures due April 1, 2020 (incorporated by reference to Exhibit 4(c) to Registration Statement No. 33-32481, filed December 7, 1989).   |
| 4.4        | Indenture relating to 8 <sup>3</sup> / <sub>8</sub> % Debentures due April 1, 2020 (incorporated by reference to Exhibit 4(c) to Registration Statement No. 33-32481, filed December 7, 1989).   |
| 4.5        | Specimen Certificate of 8 <sup>3</sup> / <sub>8</sub> % Debentures due April 1, 2030 (incorporated by reference to Exhibit T-3C to Form T-3 filed December 18, 1997).  |
| 4.6        | Indenture relating to Exchange Offer Notes Due 2030 (incorporated by reference to Exhibit T-3C to Form T-3 filed December 18, 1997).   |
| 4.7        | Indenture relating to \$2,000,000,000 of debt securities (incorporated by reference to Exhibit 4.1 to Pre-Effective Amendment No. 1 to Form S-3 (No. 333-08369), filed on January 26, 1999).   |
| 4.8        | Form of Supplemental Indenture relating to \$2,000,000,000 of debt securities (incorporated by reference to Exhibit 4.2 to Post-Effective Amendment No. 1 to Form S-3 (No. 333-08369-01), filed on March 15, 2000).  |
| 4.9        | Form of Second Supplemental Indenture relating to \$2,000,000,000 of debt securities (incorporated by reference to Exhibit 4 to Form 10-Q for the Quarter Ended September 30, 2001).   |
| 4.10       | Form of Indenture relating to \$2,000,000,000 of debt securities (incorporated by reference to Exhibit 4.1 to Form S-3 (No. 333-108272), filed on August 27, 2003).  |
| 4.11       | Form of Underwriting Agreement relating to \$2,000,000,000 of debt securities (incorporated by reference to Exhibit 1.1 to Form S-3 (No. 333-108272), filed on August 27, 2003).   |
| 4.12       | Distribution Agreement relating to UPS Notes with maturities of 9 months or more from date of issue (incorporated by reference to Exhibit 10.1 to Form 8-K filed on May 30, 2008) and Form of Note (incorporated by reference to Exhibit 4.1 to Form 8-K filed on May 30, 2008). |
| 4.13       | Underwriting agreement relating to 4.50% Senior Notes due January 15, 2013, 5.50% Senior Notes due January 15, 2018 and 6.20% Senior Notes due January 15, 2038 (incorporated by reference to Exhibit 1.1 to Form 8-K filed on January 15, 2008).                                |
| 4.14       | Form of Note for 4.50% Senior Notes due January 15, 2013 (incorporated by reference to Exhibit 4.1 to Form 8-K filed on January 15, 2008).   |

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**Exhibit**

| <b>No.</b> | <b>Description</b>  |
|------------|---|
| 4.15       | Form of Note for 5.50% Senior Notes due January 15, 2018 (incorporated by reference to Exhibit 4.2 to Form 8-K filed on January 15, 2008).  |
| 4.16       | Form of Note for 6.20% Senior Notes due January 15, 2038 (incorporated by reference to Exhibit 4.3 to Form 8-K filed on January 15, 2008).  |
| 4.17       | Underwriting agreement relating to 3.875% Senior Notes due April 1, 2014 and 5.125% Senior Notes due April 1, 2019 (incorporated by reference to Exhibit 1.1 to Form 8-K filed on March 24, 2009).  |
| 4.18       | Form of Note for 3.875% Senior Notes due April 1, 2014 (incorporated by reference to Exhibit 4.1 to Form 8-K filed on March 24, 2009).  |
| 4.19       | Form of Note for 5.125% Senior Notes due April 1, 2019 (incorporated by reference to Exhibit 4.2 to Form 8-K filed on March 24, 2009).  |
| 4.20       | Underwriting Agreement relating to \$1,500,000,000 aggregate principal amount of 3.125% Senior Notes due January 15, 2021, and \$500,000,000 aggregate principal amount of 4.875% Senior Notes due November 15, 2040 (incorporated by reference to Exhibit 1.1 to Form 8-K filed on November 12, 2010).   |
| 4.21       | Form of Note for 3.125% Senior Notes due January 15, 2021 (incorporated by reference to Exhibit 4.1 to Form 8-K filed on November 12, 2010).  |
| 4.22       | Form of Note for 4.875% Senior Notes due November 15, 2040 (incorporated by reference to Exhibit 4.2 to Form 8-K filed on November 12, 2010).   |
| 10.1       | UPS Retirement Plan, as Amended and Restated, effective January 1, 2010 (incorporated by reference to Exhibit 10.2 to the 2009 Annual Report on Form 10-K).<br><br>(1) Amendment No. 1 to the UPS Retirement Plan (incorporated by reference to Exhibit 10.2(1) to the 2010 Annual Report on Form 10-K).<br><br>(2) Amendment No. 2 to the UPS Retirement Plan.<br><br>(3) Amendment No. 3 to the UPS Retirement Plan.  |
| 10.2       | UPS Savings Plan, as Amended and Restated (incorporated by reference to Exhibit 10.3 to 2008 Annual Report on Form 10-K).<br><br>(1) Amendment No. 1 to the UPS Savings Plan (incorporated by reference to Exhibit 10.3(1) to the 2009 Annual Report on Form 10-K).<br><br>(2) Amendment No. 2 to the UPS Savings Plan (incorporated by reference to Exhibit 10.3(2) to the 2009 Annual Report on Form 10-K).<br><br>(3) Amendment No. 3 to the UPS Savings Plan (incorporated by reference to Exhibit 10.3(3) to the 2010 Annual Report on Form 10-K).<br><br>(4) Amendment No. 4 to the UPS Savings Plan.<br><br>(5) Amendment No. 5 to the UPS Savings Plan. |
| 10.3       | Credit Agreement (364-Day Facility) dated April 14, 2011 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Securities LLC as joint arrangers and book runners, Barclays Capital and BNP Paribas Securities Corp. as co-lead arrangers, Barclays Capital and BNP Paribas as co-documentation agents, Citibank, N.A. as administrative agent, and J.P. Morgan Securities LLC as syndication agent (incorporated by reference to Exhibit 10.1 to Form 10-Q for the Quarter Ended March 31, 2011).  |

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**Exhibit**

| <b>No.</b> | <b>Description</b>   |
|------------|--|
| 10.4       | Credit Agreement (4-Year Facility) dated April 14, 2011 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Securities LLC as joint arrangers and book runners, Barclays Capital and BNP Paribas Securities Corp. as co-lead arrangers, Barclays Bank PLC and BNP Paribas as co-documentation agents, Citibank, N.A. as administrative agent, and J.P. Morgan Securities LLC as syndication agent (incorporated by reference to Exhibit 10.2 to Form 10-Q for the Quarter Ended March 31, 2011).   |
| 10.5       | UPS Excess Coordinating Benefit Plan, as amended and restated.   |
| 10.6       | Form of United Parcel Service, Inc. Incentive Compensation Plan (incorporated by reference to the registration statement on Form S-4 (No. 333-83349), filed on July 21, 1999, as amended). <ul style="list-style-type: none"> <li>(1) Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.7 to Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2005).</li> <li>(2) Form of Nonqualified Stock Option Award Agreement (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K, filed on May 5, 2006).</li> <li>(3) Form of Restricted Performance Unit Award Agreement (incorporated by reference to Exhibit 10.2 to the Current Report on Form 8-K filed on May 5, 2006).</li> <li>(4) Form of First Amendment to Restricted Stock Award Agreement for Non-Management Directors under the Incentive Compensation Plan (incorporated by reference to Exhibit 10.4 to Quarterly Report on Form 10-Q for the Quarter Ended September 30, 2007).</li> </ul> |
| 10.7       | United Parcel Service, Inc. 2009 Omnibus Incentive Compensation Plan (incorporated by reference to Annex II to the Definitive Proxy Statement, filed on March 13, 2009). <ul style="list-style-type: none"> <li>(1) Form of Long-Term Incentive Performance Award Agreement (incorporated by reference to Exhibit 10.3 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2011).</li> <li>(2) Form of Non-Management Director Restricted Stock Unit Award (incorporated by reference to Exhibit 10.2 to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2010).</li> <li>(3) UPS Management Incentive Program Terms and Conditions effective as of January 1, 2011 (incorporated by reference to Exhibit 10.10(3) to the 2010 Annual Report on Form 10-K).</li> <li>(4) UPS Stock Option Program Terms and Conditions effective as of January 1, 2012.</li> <li>(5) UPS Long-Term Incentive Performance Program Terms and Conditions effective as of January 1, 2012.</li> </ul>      |
| 10.8       | Form of UPS Deferred Compensation Plan (incorporated by reference to Exhibit 10.11 to the 2010 Annual Report on Form 10-K).  |
| 10.9       | United Parcel Service, Inc. Nonqualified Employee Stock Purchase Plan (incorporated by reference to Exhibit 99.1 to the registration statement on Form S-8 (No. 333-34054), filed on April 5, 2000).   |
| 10.10      | Discounted Employee Stock Purchase Plan, as amended and restated, effective October 1, 2002. <ul style="list-style-type: none"> <li>(1) Amendment No. 1 to the Discounted Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.12(1) to the 2005 Annual Report on Form 10-K).</li> <li>(2) Amendment No. 2 to the Discounted Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.13(2) to the 2009 Annual Report on Form 10-K).</li> </ul>  |
| 11         | Statement regarding Computation of per Share Earnings (incorporated by reference to Note 14 to Part I, Item 8 Financial Statements and Supplementary Data of this Annual Report on Form 10-K).   |

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**Exhibit**

| <b>No.</b> | <b>Description</b>  |
|------------|---|
| 12         | Ratio of Earnings to Fixed Charges.   |
| 18         | Letter on Change in Accounting Principles.  |
| 21         | Subsidiaries of the Registrant.   |
| 23         | Consent of Deloitte & Touche LLP.   |
| 31.1       | Certificate of Chief Executive Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2       | Certificate of 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 Annual Report on Form 10-K for the year ended December 31, 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.