

UNITED PARCEL SERVICE INC

Form 10-K

February 28, 2013

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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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, 2012

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

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United Parcel Service, Inc.

(Exact Name of Registrant as Specified in Its Charter)

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Delaware

(State or Other Jurisdiction of

Incorporation or Organization)

55 Glenlake Parkway, N.E. Atlanta, Georgia

(Address of Principal Executive Offices)

(404) 828-6000

(Registrant's telephone number, including area code)

58-2480149

(I.R.S. Employer

Identification No.)

30328

(Zip Code)

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

Title of Each Class

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

Name of Each Exchange on Which Registered

New York Stock Exchange

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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:

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 \$57,146,565,574 as of June 30, 2012. 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 January 31, 2013, there were 223,092,434 outstanding shares of class A common stock and 730,357,508 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 2, 2013 are incorporated by reference into Part III of this report.

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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,” “target,” “plan,” 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 2012, we delivered an average of 16.3 million pieces per day worldwide, or a total of 4.1 billion packages. Total revenue in 2012 was \$54.1 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 expenditures 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 enables our customers to bridge time zones, cultures, distances and languages to keep the entire supply chain moving smoothly. 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

11 of our consolidated financial statements.

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### Business Strategy

Customers leverage our broad array of services; balanced global presence in North America, Europe, Asia and Latin America; reliability; industry-leading technology; and solutions expertise for competitive advantage in markets where they choose to compete. We prudently invest to expand our integrated global network and our service portfolio.

Technology investments create user-friendly shipping, e-commerce, logistics management and visibility tools for our customers, while supporting UPS's 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, 2012, we had a balance of cash and marketable securities of approximately \$7.924 billion and shareowners' equity of \$4.733 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 A+, respectively. We have a negative outlook from Standard & Poor's and a stable outlook from Moody's. 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

Transcontinental and trade across borders is predicted to grow at rates that are in excess of 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 occurs. Our balanced global presence and productivity enhancing technologies allow customers to easily 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 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 the introduction of import and export services, 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. Linkage between Asia and Europe is provided via flights between Hong Kong and our recently expanded 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's growth.

#### Increasing need for segment 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, and consumer 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. Over the past 18 months, we opened 12 new dedicated health care facilities on four continents. We also expanded our health care network in China, India, Australia and Brazil and are in the process of expanding five existing North American facilities. In total, we currently operate nearly 6 million square feet of dedicated health care distribution space across an integrated network of 37 facilities. 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.

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We also continue to invest in health care focused transportation solutions, such as UPS Temperature True. UPS Temperature True is an air freight solution specifically designed to safeguard temperature-sensitive shipments using a portfolio of specialized containers with passive, semi-active, or active refrigeration. This service provides door-to-door transportation of sensitive products in accordance with precise, measurable operating procedures. In 2012, UPS added 400 new UPS Temperature True international trade lanes. We also launched UPS Temperature True Small Package to provide optimized packaging solutions to ensure product integrity for customers with smaller format shipments of environmentally-sensitive products.

We will continue to expand our sector 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 benefiting from these sector 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, transportation, 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, such as our 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.

• 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.



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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's 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.

### Global Small Package

UPS's global small package operations provide time-definite delivery services for express letters, documents, small packages and palletized freight 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 as well as palletized shipments weighing greater than 150 pounds. 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 154,000 domestic and international entry points including: 39,100 drop boxes; 2,100 customer centers; 4,700 independently owned and operated locations of The UPS Store worldwide; 6,700 Kiala locations; 12,400 authorized shipping outlets and commercial counters; 5,900 alliance locations; and 83,900 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. With 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 one of the largest airlines in the world, with global operations 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. Our European air hub is located in Cologne, Germany, and we maintain Asia-Pacific air hubs in Shanghai, China; Shenzhen, China; Taipei, Taiwan; Incheon, South Korea; 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.

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In the U.S., Worldport is supported by our regional 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 facilities while enabling us to use fewer, larger and more fuel-efficient aircraft. Our U.S. ground fleet serves all business and residential zip codes in the contiguous U.S.

### 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. 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.

In 2013, we introduced UPS Worldwide Express Freight for palletized shipments over 150 pounds from 37 points of origin to 41 points of destination. This service meets the needs of international customers who have palletized freight shipments that require the same speed and reliability as our international express package service. UPS Worldwide Express Freight leverages our unique combination of package and freight networks to provide industry leading transit times with a money-back guarantee.

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-Asia trade and the dynamic Chinese economy. We are bringing faster time-in-transit to customers focused on intra-Asia 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.



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Additional International highlights include the following:

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

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.

## 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 one of the largest U.S. domestic air freight carriers and among the top 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. With this service, 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 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.

We worked with the non-profit organization Business for Social Responsibility (“BSR”) to evaluate significant sustainability issues (Economic, Environmental and Social), and ranked each issue by importance based on multiple stakeholder feedback. We then worked with BSR to develop a materiality matrix by mapping the issues on a grid with two axes: “Importance to Stakeholder” and “Influence on Business Success”. The materiality matrix is now being used to aid in prioritizing our sustainability strategy. More information is available in the UPS Corporate Sustainability Report.

Sustainability highlights in 2012 include:

• Rated 1<sup>st</sup> in Fortune Magazine’s 2012 “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 8th 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 2012.

• Recognized as a constituent of the Dow Jones Sustainability Index for the 11th consecutive year.

• 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 tied one other company for the highest in the U.S.

• Recognized by ClimateCounts.org as best company in the consumer shipping sector for the 4th consecutive year and was the second highest score overall globally.

More information is available on the UPS Sustainability website.

### 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 2012 include:

• Local non-profits around the world received more than 1.8 million hours of volunteer service from UPS employees participating in our Neighbor-to-Neighbor program.

The UPS Foundation, our charitable organization, oversaw \$98 million in donations of cash and in-kind services to global causes primarily in four focus areas—community safety, environmental sustainability, diversity and volunteerism.

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UPS employees, both active and retired, contributed \$48 million to United Way last year which was matched by a corporate contribution of \$7 million. During the 2012 campaign, employees (both active and retired) pledged an additional \$51 million 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 drought-stricken Sahel region of Africa and areas impacted by Hurricanes Isaac and Sandy.

- 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 105-year history of safe driving.

### Reputation

Great brands require connecting with customers. In working to develop these connections, we have once again received high accolades from independent brand evaluations. In 2012, we were pleased that UPS earned the top rating in our industry on Interbrand's Best Global Brands and Millward Brown's BrandZ Most Valuable Global Brands. UPS also was 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 399,000 employees (excluding temporary seasonal employees) as of December 31, 2012, of which 323,000 are in the U.S. and 76,000 are located internationally. Our global workforce includes approximately 71,000 management employees (36% of whom are part-time) and 328,000 hourly employees (46% of whom are part-time).

As of December 31, 2012, we had approximately 249,000 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 2,600 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 3,100 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.

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

Health and Safety is a value at UPS and an enduring belief that the wellbeing of our people, business partners, and the public is of utmost importance. We train our people to avoid injury to themselves and others in all aspects of their work. We do not tolerate unsafe work practices.

We use an all-encompassing Comprehensive Health and Safety Process ("CHSP") to prevent occupational illnesses, injuries, and auto crashes, as well as promote wellness through the development of workplace programs. The foundation of this process is our co-chaired employee and management health and safety committees. Together they conduct facility and equipment audits, perform work practice and behavior analysis, conduct training, and recommend work process and equipment changes.

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The components of CHSP are:

• **Personal Value** - Which is the foundation and forms the base of our safety and wellness culture.

• **Management Commitment and Employee Involvement** - Where employees take an active role in their own safety as well as their fellow workers and are supported by management.

• **Work Site Analysis** - Which includes injury and auto crash data analysis, behavior observations, and facility and equipment audits to identify gaps and develop solutions. Our operations managers are responsible for their employees' safety results. We investigate every injury and auto crash and develop prevention activities.

• **Hazard Prevention and Control** - Where solutions are developed and documented to ensure identified risks have been mitigated.

• **Safety Education and Training** - Employees who are healthy and well-trained in proper methods are more safe and efficient in performing their jobs. Our approach starts with training the trainer. All trainers are certified to ensure that they have the skills and motivation to effectively train new employees. All new employees receive safety training during orientation and in the work area. In addition, each new driver receives extensive classroom and online training as well as on-road training, followed by three safety training rides integrated into his or her training cycle.

Other components to ensure the safety of our fleet include:

• **Recognition** - We have a well-defined safe driving honor plan to recognize our drivers when they achieve accident-free milestones. We have more than 6,400 drivers enshrined in our coveted Circle of Honor for drivers who have driven 25 years or more without an avoidable auto crash.

• **Preventive Maintenance** - We have a comprehensive Preventive Maintenance Program to ensure the safety of our fleet. Our fleet is managed and monitored electronically to ensure that each vehicle is serviced at a specific time to prevent malfunction or breakdown.

### 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.

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 online 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.



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**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 professional courtesy 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 facilities; 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 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, and personnel. 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 2012 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.

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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.

### 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. However, information on these websites is not incorporated by reference into this report or any other report filed with or furnished to the SEC.



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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.

### 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.

Changes in our relationships with our significant customers, including the loss or reduction in business from one or more of them, could have an adverse impact on us.

Our top 20 customers account for less than 10% of our consolidated revenue. We do not believe the loss of any single customer would materially impair our overall financial condition or results of operations; however, collectively, some of these large customers might account for a relatively significant portion of the growth in revenue in a particular quarter or year. These customers can drive the growth in revenue for particular services based on factors such as: new customer product launches; the seasonality associated with the fourth quarter Holiday season; business mergers and acquisitions; and the overall fast growth of a customer's underlying business. These customers could choose to divert all or a portion of their business with us to one of our competitors, demand pricing concessions for our services, require us to provide enhanced services that increase our costs, or develop their own shipping and distribution capabilities. If these factors drove some of our large customers to cancel all or a portion of their business relationships

with us, it could materially impact the growth in our business and the ability to meet our current and long-term financial forecasts.

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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 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.

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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 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, Canadian Dollar, Chinese Renminbi and Hong Kong 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 derivative instruments to mitigate the impact of changes in these rates on our financial position and results of operations; however, 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.

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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 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 a weak 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, fixed 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 399,000 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 and the decreasing trend of discount rates in which we use to value our pension liabilities. 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.

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.

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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 745,000 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 29 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 more than 800 facilities that support our international package operations and an additional 574 facilities that support our freight forwarding and logistics operations. Our freight forwarding and logistics operations maintain facilities with approximately 28.6 million square feet of floor space. We own and operate a logistics campus consisting of approximately 3.7 million square feet in Louisville, Kentucky.

UPS Freight operates 210 service centers with a total of 6 million square feet of floor space. UPS Freight owns 149 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 217,000 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.

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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; Incheon, South Korea; 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-the-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 112,000 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 Bao'an 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 443,600 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.

## Fleet

## Aircraft

The following table shows information about our aircraft fleet as of December 31, 2012:

| 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 757-200F   | 75                             | —  | —           | —               |
| Boeing 767-300ERF | 51                             | —  | 8           | —               |
| Boeing MD-11F     | 38                             | —  | —           | —               |
| Airbus A300-600F  | 53                             | —  | —           | —               |
| Other             | —                              | 332  | —           | —               |
| Total             | 230                            | 332  | 8           | —               |

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 2012, we took delivery of seven Boeing 767-300ERF aircraft. We have firm commitments to purchase eight Boeing 767-300ERF freighters to be delivered in 2013.

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Vehicles

We operate a global ground fleet of approximately 101,000 package cars, vans, tractors and motorcycles. Our ground support fleet consists of 32,000 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 31,000 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.

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## 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 2012 and 2011. Our class B common stock is listed on the New York Stock Exchange under the symbol "UPS".

|                | High    | Low     | Close   | Dividends Declared |
|----------------|---------|---------|---------|--------------------|
| 2012:          |         |         |         |                    |
| First Quarter  | \$81.79 | \$72.15 | \$80.72 | \$0.57             |
| Second Quarter | \$80.97 | \$72.19 | \$78.76 | \$0.57             |
| Third Quarter  | \$80.52 | \$71.18 | \$71.57 | \$0.57             |
| Fourth Quarter | \$76.20 | \$69.56 | \$73.73 | \$0.57             |
| 2011:          |         |         |         |                    |
| 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             |

As of February 6, 2013, there were 156,741 and 18,108 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 14, 2013, our Board declared a dividend of \$0.62 per share, which is payable on March 12, 2013 to shareowners of record on February 25, 2013. This represents an 8.8% increase from the previous \$0.57 quarterly dividend in 2012.

On May 3, 2012, the Board of Directors approved a share repurchase authorization of \$5.0 billion, which replaced an authorization previously announced in 2008. A summary of repurchases of our class A and class B common stock during the fourth quarter of 2012 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        | 0.6                                 | \$73.64                         | 0.6  | \$4,169  |
| November 1—November 30      | 1.2                                 | 73.26                           | 1.2  | 4,087  |
| December 1—December 31      | 1.7                                 | 73.40                           | 1.6  | 3,970  |
| Total October 1—December 31 | 3.5                                 | \$73.40                         | 3.4  |  |

(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.

On February 14, 2013, the Board of Directors approved a new share repurchase authorization of \$10.0 billion, which replaced the 2012 authorization. The new share repurchase authorization has no expiration date. We anticipate repurchasing approximately \$4.0 billion of shares in 2013.



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## 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, 2007 in the Standard & Poor’s 500 Index, the Dow Jones Transportation Average, and our class B common stock.

|                                  | 12/31/2007 | 12/31/2008 | 12/31/2009 | 12/31/2010 | 12/31/2011 | 12/31/2012 |
|----------------------------------|------------|------------|------------|------------|------------|------------|
| United Parcel Service, Inc.      | \$ 100.00  | \$ 80.20   | \$ 86.42   | \$ 112.60  | \$ 116.97  | \$ 121.46  |
| Standard & Poor’s 500 Index      | \$ 100.00  | \$ 63.00   | \$ 79.67   | \$ 91.68   | \$ 93.61   | \$ 108.59  |
| Dow Jones Transportation Average | \$ 100.00  | \$ 78.58   | \$ 93.19   | \$ 118.14  | \$ 118.15  | \$ 127.07  |

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## Item 6. Selected Financial Data

The following table sets forth selected financial data for each of the five years in the period ended December 31, 2012 (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, |          |          |          |          |
|--------------------------------------|--------------------------|----------|----------|----------|----------|
|                                      | 2012                     | 2011     | 2010     | 2009     | 2008     |
| Selected Income Statement Data       |                          |          |          |          |          |
| Revenue:                             |                          |          |          |          |          |
| U.S. Domestic Package                | \$32,856                 | \$31,717 | \$29,742 | \$28,158 | \$31,278 |
| International Package                | 12,124                   | 12,249   | 11,133   | 9,699    | 11,293   |
| Supply Chain & Freight               | 9,147                    | 9,139    | 8,670    | 7,440    | 8,915    |
| Total revenue                        | 54,127                   | 53,105   | 49,545   | 45,297   | 51,486   |
| Operating expenses:                  |                          |          |          |          |          |
| Compensation and benefits            | 33,102                   | 27,575   | 26,557   | 25,933   | 29,826   |
| Other                                | 19,682                   | 19,450   | 17,347   | 15,856   | 20,041   |
| Total operating expenses             | 52,784                   | 47,025   | 43,904   | 41,789   | 49,867   |
| Operating profit (loss):             |                          |          |          |          |          |
| U.S. Domestic Package                | 459                      | 3,764    | 3,238    | 1,919    | 823      |
| International Package                | 869                      | 1,709    | 1,831    | 1,279    | 1,246    |
| Supply Chain and Freight             | 15                       | 607      | 572      | 310      | (450)    |
| Total operating profit               | 1,343                    | 6,080    | 5,641    | 3,508    | 1,619    |
| Other income (expense):              |                          |          |          |          |          |
| Investment income                    | 24                       | 44       | 3        | 10       | 75       |
| Interest expense                     | (393)                    | (348)    | (354)    | (445)    | (442)    |
| Income before income taxes           | 974                      | 5,776    | 5,290    | 3,073    | 1,252    |
| Income tax expense                   | 167                      | 1,972    | 1,952    | 1,105    | 597      |
| Net income                           | \$807                    | \$3,804  | \$3,338  | \$1,968  | \$655    |
| Per share amounts:                   |                          |          |          |          |          |
| Basic earnings per share             | \$0.84                   | \$3.88   | \$3.36   | \$1.97   | \$0.64   |
| Diluted earnings per share           | \$0.83                   | \$3.84   | \$3.33   | \$1.96   | \$0.64   |
| Dividends declared per share         | \$2.28                   | \$2.08   | \$1.88   | \$1.80   | \$1.80   |
| Weighted average shares outstanding: |                          |          |          |          |          |
| Basic                                | 960                      | 981      | 994      | 998      | 1,016    |
| Diluted                              | 969                      | 991      | 1,003    | 1,004    | 1,022    |
|                                      | As of December 31,       |          |          |          |          |
|                                      | 2012                     | 2011     | 2010     | 2009     | 2008     |
| Selected Balance Sheet Data          |                          |          |          |          |          |
| Cash and marketable securities       | \$7,924                  | \$4,275  | \$4,081  | \$2,100  | \$1,049  |
| Total assets                         | 38,863                   | 34,701   | 33,597   | 31,883   | 31,879   |
| Long-term debt                       | 11,089                   | 11,095   | 10,491   | 8,668    | 7,797    |
| Shareowners' equity                  | 4,733                    | 7,108    | 8,047    | 7,696    | 6,780    |



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## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

## Overview

The U.S. economic expansion has continued at a slow-to-moderate pace through the end of 2012. Continued growth in retail sales, particularly among e-commerce retailers, has provided for expansion in the overall U.S. small package delivery market; however, recent weakness in manufacturing activity, combined with the uneven nature of the overall economic recovery, has negatively impacted the small package delivery market. Given these trends, our products most aligned with business-to-consumer shipments have experienced the strongest growth, while our business-to-business volume continues to lag overall GDP growth.

Outside of the U.S., economic growth has slowed considerably due to volatility in world markets and fiscal austerity measures, particularly in Europe. This slower global economic growth has created an environment in which customers are more likely to trade-down from premium express products to standard delivery products. Additionally, the uneven nature of economic growth worldwide has led to shifting trade patterns whereby transcontinental trade is being pressured, but intra-regional trade is continuing to grow. These circumstances have led us to adjust our air capacity and cost structure in our transportation network to the prevailing volume mix levels. Our broad portfolio of product offerings and the flexibilities inherent in our transportation network have helped us adapt to these changing trends. While the worldwide economic environment has been challenging in 2012, we have continued to undertake initiatives to improve yield management, increase operational efficiency and contain costs across all segments. Continued deployment of technology improvements should lead to further gains in our operational efficiency, flexibility and reliability, thus restraining cost increases and improving margins. In our International Package segment, we have adjusted our air network and utilized newly constructed or expanded operating facilities to improve time-in-transit for shipments in each 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. Additionally, in the first quarter of 2012, we acquired Kiala S.A., which will expand our service offerings for business-to-consumer deliveries in Europe.

Our consolidated results are presented in the table below:

|   | Year Ended December 31, |          |          | % Change    |             |   |
|---|-------------------------|----------|----------|-------------|-------------|---|
|   | 2012                    | 2011     | 2010     | 2012 / 2011 | 2011 / 2010 |   |
| Revenue (in millions)                       | \$54,127                | \$53,105 | \$49,545 | 1.9         | % 7.2       | % |
| Operating Expenses (in millions)            | 52,784                  | 47,025   | 43,904   | 12.2        | % 7.1       | % |
| Operating Profit (in millions)              | \$1,343                 | \$6,080  | \$5,641  | (77.9)      | )% 7.8      | % |
| Operating Margin                            | 2.5                     | % 11.4   | % 11.4   | %           |             |   |
| Average Daily Package Volume (in thousands) | 16,295                  | 15,797   | 15,574   | 3.2         | % 1.4       | % |
| Average Revenue Per Piece                   | \$10.82                 | \$10.82  | \$10.24  | —           | % 5.7       | % |
| Net Income (in millions)                    | \$807                   | \$3,804  | \$3,338  | (78.8)      | )% 14.0     | % |
| Basic Earnings Per Share                    | \$0.84                  | \$3.88   | \$3.36   | (78.4)      | )% 15.5     | % |
| Diluted Earnings Per Share                  | \$0.83                  | \$3.84   | \$3.33   | (78.4)      | )% 15.3     | % |

## Items Affecting Comparability

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

|   | Year Ended December 31, |        |        |
|---|-------------------------|--------|--------|
|   | 2012                    | 2011   | 2010   |
| Operating Expenses:                               |                         |        |        |
| Defined Benefit Plans Mark-to-Market Charge       | \$4,831                 | \$827  | \$112  |
| Multiemployer Pension Plan Withdrawal Charge      | 896                     | —      | —      |
| Restructuring Charge                              | —                       | —      | 98     |
| Gains on Sales of Businesses                      | —                       | —      | (20 )  |
| Gains on Real Estate Transactions                 | —                       | (33 )  | (109 ) |
| Income Tax Expense (Benefit) from the Items Above | (2,145 )                | (287 ) | —      |

|  |   |   |    |
|--|---|---|----|
| Charge for Change in Tax Filing Status for German Subsidiary | — | — | 76 |
|--|---|---|----|

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These items have been excluded from comparisons of "adjusted" operating expenses, operating profit and operating margin in the discussion that follows.

**Defined Benefit Plans Mark-to-Market Charge**

In 2012, 2011 and 2010, we incurred pre-tax mark-to-market losses of \$4.831 billion, \$827 million and \$112 million, respectively, on a consolidated basis (\$3.023 billion, \$527 million and \$75 million after-tax, respectively) on our pension and postretirement defined benefit plans related to the remeasurement of plan assets and liabilities recognized outside of a 10% corridor. These mark-to-market losses for 2012, 2011 and 2010 primarily resulted from decreases in the discount rates used to value our projected benefit obligations in each year, which more than offset the impact of the actual rate of return on plan assets exceeding the expected rate of return. These losses, which were recorded in compensation and benefits expense in our statements of consolidated income, impacted each of our three reporting segments for 2012, 2011 and 2010.

**Multiemployer Pension Plan Withdrawal Charge**

In 2012, we recognized an \$896 million pre-tax charge (\$559 million after-tax) for the establishment of a withdrawal liability related to our withdrawal from the New England Teamsters and Trucking Industry Pension Fund ("New England Pension Fund"), a multiemployer pension plan. This charge was recorded in compensation and benefits expense in our statements of consolidated income, and impacted our U.S. Domestic Package segment.

**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 was recorded in compensation and benefits expense in our statements of consolidated income. The charge reflects the value of voluntary retirement benefits and severance benefits, as well as the accelerated recognition of 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 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. The gains and losses associated with these transactions are recorded in other operating expenses in our statements of consolidated income.

**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. The gains and losses associated with these transactions are recorded in other operating expenses in our statements of consolidated income.

**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.

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## 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.

## U.S. Domestic Package Operations

|  | Year Ended December 31, |          |          | % Change    |             |   |  |
|--|-------------------------|----------|----------|-------------|-------------|---|--|
|  | 2012                    | 2011     | 2010     | 2012 / 2011 | 2011 / 2010 |   |  |
| Average Daily Package Volume (in thousands):         |                         |          |          |             |             |   |  |
| Next Day Air   | 1,277                   | 1,206    | 1,205    | 5.9         | % 0.1       | % |  |
| Deferred   | 1,031                   | 975      | 941      | 5.7         | % 3.6       | % |  |
| Ground   | 11,588                  | 11,230   | 11,140   | 3.2         | % 0.8       | % |  |
| Total Avg. Daily Package Volume                      | 13,896                  | 13,411   | 13,286   | 3.6         | % 0.9       | % |  |
| Average Revenue Per Piece:                           |                         |          |          |             |             |   |  |
| Next Day Air   | \$19.93                 | \$20.33  | \$19.14  | (2.0)       | )% 6.2      | % |  |
| Deferred   | 13.06                   | 13.32    | 12.50    | (2.0)       | )% 6.6      | % |  |
| Ground   | 7.89                    | 7.78     | 7.43     | 1.4         | % 4.7       | % |  |
| Total Avg. Revenue Per Piece                         | \$9.38                  | \$9.31   | \$8.85   | 0.8         | % 5.2       | % |  |
| Operating Days in Period                             |                         |          |          |             |             |   |  |
|  | 252                     | 254      | 253      |             |             |   |  |
| Revenue (in millions):                               |                         |          |          |             |             |   |  |
| Next Day Air   | \$6,412                 | \$6,229  | \$5,835  | 2.9         | % 6.8       | % |  |
| Deferred   | 3,392                   | 3,299    | 2,975    | 2.8         | % 10.9      | % |  |
| Ground   | 23,052                  | 22,189   | 20,932   | 3.9         | % 6.0       | % |  |
| Total Revenue  | \$32,856                | \$31,717 | \$29,742 | 3.6         | % 6.6       | % |  |
| Operating Expenses (in millions):                    |                         |          |          |             |             |   |  |
| Operating Expenses                                   | \$32,397                | \$27,953 | \$26,504 | 15.9        | % 5.5       | % |  |
| Defined Benefit Plans Mark-to-Market Charge          | (3,177 )                | (479 )   | (31 )    |             |             |   |  |
| Restructuring Charge                                 | —                       | —        | (98 )    |             |             |   |  |
| Gains (Losses) on Real Estate Transactions           | —                       | (15 )    | 109      |             |             |   |  |
| Multiemployer Pension Plan Withdrawal Charge         | (896 )                  | —        | —        |             |             |   |  |
| Adjusted Operating Expenses                          | \$28,324                | \$27,459 | \$26,484 | 3.2         | % 3.7       | % |  |
| Operating Profit (in millions) and Operating Margin: |                         |          |          |             |             |   |  |
| Operating Profit                                     | \$459                   | \$3,764  | \$3,238  | (87.8)      | )% 16.2     | % |  |
| Adjusted Operating Profit                            | \$4,532                 | \$4,258  | \$3,258  | 6.4         | % 30.7      | % |  |
| Operating Margin                                     | 1.4                     | % 11.9   | % 10.9   | %           |             |   |  |
| Adjusted Operating Margin                            | 13.8                    | % 13.4   | % 11.0   | %           |             |   |  |



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## Revenue

The change in overall revenue was impacted by the following factors for the years ended December 31, 2012 and 2011, compared with the corresponding prior year periods:

|                         | Volume | Rates /<br>Product Mix | Fuel<br>Surcharge | Total<br>Revenue<br>Change |   |
|-------------------------|--------|------------------------|-------------------|----------------------------|---|
| Revenue Change Drivers: |        |                        |                   |                            |   |
| 2012 / 2011             | 2.8    | % 0.6                  | % 0.2             | % 3.6                      | % |
| 2011 / 2010             | 1.3    | % 2.3                  | % 3.0             | % 6.6                      | % |

## Volume

## 2012 compared to 2011

Our overall volume increased in 2012 compared with 2011, largely due to continued solid growth in retail e-commerce and strong customer demand for our lightweight products. Business-to-consumer shipments, which represent slightly over 40% of total U.S. Domestic Package volume, grew rapidly and drove growth in both air and ground shipments; however, business-to-business volume remained relatively flat in 2012 compared with 2011. This can be attributed to multiple trends that have prevailed over the past few years, including the migration of traditional retail to online retail, the lack of growth in small and medium-size enterprises and reduced business investments attributed to policy uncertainty.

Among our air products, Next Day Air letter and package volume both experienced solid increases in 2012, with particular growth in our Next Day Air Saver products. The higher volume for our deferred air products, which increased 5.7% for the year, was primarily due to healthy demand for our residential package services. The overall growth in our air products was driven primarily by business-to-consumer shipments from e-commerce retailers, while our business-to-business air volume declined slightly.

The increase in ground volume in 2012 was driven by our lightweight service offerings, including SurePost, which target low-cost, non-urgent residential deliveries. Volume for these lightweight products grew significantly, and accounted for approximately 40% of the total increase in ground shipments. Outside of these lightweight service offerings, volume for our traditional ground residential services also experienced an increase in 2012. Overall ground volume growth continues to be driven by business-to-consumer shipping activity from e-commerce retailers, while our business-to-business ground volume was flat in 2012 compared with 2011.

## 2011 compared to 2010

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 represented approximately 40% of total U.S. Domestic Package volume, experienced stronger growth than business-to-business 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 lightweight products experienced robust 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 activity during the holiday season.

## Rates and Product Mix

## 2012 compared to 2011

Overall revenue per piece increased 0.8% in 2012 compared with 2011, and was impacted by changes in base rates, product mix and fuel surcharge rates, as discussed below.



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Revenue per piece for our Next Day Air and deferred products decreased in 2012 compared with 2011, as declines in fuel surcharge rates and product mix changes more than offset the impact of a base rate increase that took effect in early 2012. Changes in product mix negatively impacted revenue per piece for our air products, as our lightweight service offerings accounted for a larger portion of our overall air volume in 2012 compared with 2011, and our Next Day Air Saver volume continued to grow at a faster rate than our premium Next Day Air services.

Ground revenue per piece increased in 2012 compared with 2011, primarily due to a base rate increase that took effect in early 2012; however, this was partially offset by product mix changes, as strong volume growth in our lightweight service offerings resulted in these relatively lower-yielding products accounting for a greater portion of our overall volume in 2012, compared with 2011.

Revenue per piece for our ground and air products was positively impacted by an increase in base rates that took effect on January 2, 2012. 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 indices (discussed further below). Other pricing changes included an increase in the residential surcharge, and an increase in the delivery area surcharge on certain residential and commercial services. These rate changes are customary and occur on an annual basis.

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 indices (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.

**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 rates for domestic air and ground products were as follows:

|                         | Year Ended December 31, |        |       | % Point Change |             |
|-------------------------|-------------------------|--------|-------|----------------|-------------|
|                         | 2012                    | 2011   | 2010  | 2012 / 2011    | 2011 / 2010 |
| Next Day Air / Deferred | 13.0                    | % 13.3 | % 8.0 | % (0.3)        | % 5.3       |
| Ground                  | 8.0                     | % 8.0  | % 5.6 | % —            | % 2.4       |

In connection with our base rate increases on January 2, 2012 and 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, each year. In 2012, these index reductions offset the increase in jet and diesel fuel prices, resulting in a small decrease in the average air fuel surcharge rate and no change in the average ground surcharge rate. The 2011 increases in the air and ground fuel surcharge rates were due to the significant increases in jet and diesel fuel prices, but partially offset by the reductions in the index on both the air and ground surcharges. Total domestic fuel surcharge revenue increased \$54 and \$884 million in 2012 and 2011, respectively, primarily due to volume growth in 2012 and the higher fuel surcharge rates in 2011.





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Operating Expenses

2012 compared to 2011

Overall adjusted operating expenses for the segment increased \$865 million in 2012 compared with 2011. This increase was primarily due to pick-up and delivery costs, which grew \$682 million, as well as the cost of operating our domestic integrated air and ground network, which increased \$238 million for the year. The growth in pick-up and delivery and network costs was largely due to increased volume and higher employee compensation costs, which were impacted by a union contractual wage increase (package driver wage rates rose 2.0%), an increase in driver hours (up 1.1%) and increased employee health care costs. These increases were partially offset by reductions in indirect operating costs of \$79 million in 2012, largely due to a decrease in the expense for management incentive awards. Cost increases have been moderated as we adjust our air and ground networks to better match higher volume levels, and utilize technology to increase package sorting efficiency. Improved delivery densities, particularly for our residential products, have also contained increases in cost. These network improvements allowed us to process the 3.6% volume growth more efficiently. Some of the primary drivers of expense increased at a slower rate than the growth in volume, including average daily direct labor hours (up 1.1%), aircraft block hours (up 0.5%) and miles driven (up 1.3%), resulting in the total cost per piece increasing only 0.3%.

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 related to the cost of operating our domestic integrated air and ground network, which increased \$579 million in 2011 largely due 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 were mitigated due to network efficiencies that we achieved, as we adjusted 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, also contained increases in cost.

Operating Profit and Margin

2012 compared to 2011

The increase in adjusted operating profit in 2012 compared with 2011 was largely due to the revenue growth and the achievement of significant operating leverage, but partially offset by the impact of having two less operating days during 2012. Overall volume growth allowed us to better leverage our transportation network, resulting in productivity improvements and better pick-up and delivery density, which favorably impacted our operating margins; however, these trends were somewhat offset by changes in customer and product mix, which combined to adversely affect our revenue per piece. Additionally, Hurricane Sandy negatively impacted operating profit by approximately \$75 million in 2012.

These factors drove a 40 basis point increase in our adjusted operating margin in 2012, compared with 2011, resulting in the 6.4% increase in adjusted operating profit.

2011 compared to 2010

Higher adjusted operating profit during 2011 compared with 2010 was driven by the increased network efficiencies, combined with large 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. Significant volume growth in the business-to-consumer sector, along with cost control efforts and network efficiencies, were the primary factors for the fourth quarter 2011 performance.



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## International Package Operations

|   | Year Ended December 31, |          |          | % Change    |             |          |          |
|---|-------------------------|----------|----------|-------------|-------------|----------|----------|
|   | 2012                    | 2011     | 2010     | 2012 / 2011 | 2011 / 2010 |          |          |
| Average Daily Package Volume (in thousands):          |                         |          |          |             |             |          |          |
| Domestic  | 1,427                   | 1,444    | 1,403    | (1.2        | )%          | 2.9      | %        |
| Export  | 972                     | 942      | 885      | 3.2         | %           | 6.4      | %        |
| Total Avg. Daily Package Volume                       | 2,399                   | 2,386    | 2,288    | 0.5         | %           | 4.3      | %        |
| Average Revenue Per Piece:                            |                         |          |          |             |             |          |          |
| Domestic  | \$7.04                  | \$7.17   | \$6.66   | (1.8        | )%          | 7.7      | %        |
| Export  | 36.88                   | 37.85    | 36.77    | (2.6        | )%          | 2.9      | %        |
| Total Avg. Revenue Per Piece                          | \$19.13                 | \$19.28  | \$18.31  | (0.8        | )%          | 5.3      | %        |
| Operating Days in Period                              |                         |          |          |             |             |          |          |
|   | 252                     | 254      | 253      |             |             |          |          |
| Revenue (in millions):                                |                         |          |          |             |             |          |          |
| Domestic  | \$2,531                 | \$2,628  | \$2,365  | (3.7        | )%          | 11.1     | %        |
| Export  | 9,033                   | 9,056    | 8,234    | (0.3        | )%          | 10.0     | %        |
| Cargo   | 560                     | 565      | 534      | (0.9        | )%          | 5.8      | %        |
| Total Revenue   | \$12,124                | \$12,249 | \$11,133 | (1.0        | )%          | 10.0     | %        |
| Operating Expenses (in millions):                     |                         |          |          |             |             |          |          |
| Operating Expenses                                    | \$11,255                | \$10,540 | \$9,302  | 6.8         | %           | 13.3     | %        |
| Defined Benefit Plan Mark-to-Market Charge            | (941 )                  | (171 )   | (42 )    |             |             |          |          |
| Adjusted Operating Expenses                           | \$10,314                | \$10,369 | \$9,260  | (0.5        | )%          | 12.0     | %        |
| Operating Profit (in millions) and Operating Margin:  |                         |          |          |             |             |          |          |
| Operating Profit                                      | \$869                   | \$1,709  | \$1,831  | (49.2       | )%          | (6.7     | )%       |
| Adjusted Operating Profit                             | \$1,810                 | \$1,880  | \$1,873  | (3.7        | )%          | 0.4      | %        |
| Operating Margin                                      | 7.2                     | % 14.0   | % 16.4   | %           |             |          |          |
| Adjusted Operating Margin                             | 14.9                    | % 15.3   | % 16.8   | %           |             |          |          |
| Currency Translation Benefit / (Cost)—(in millions)*: |                         |          |          |             |             |          |          |
| Revenue   |                         |          |          |             |             | \$(231 ) | \$75     |
| Operating Expenses                                    |                         |          |          |             |             | 265      | (198 )   |
| Operating Profit                                      |                         |          |          |             |             | \$34     | \$(123 ) |

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

## Revenue

The change in overall revenue was impacted by the following factors for the years ended December 31, 2012 and 2011, compared with the corresponding prior year periods:

|                         | Volume | Rates /<br>Product Mix | Fuel<br>Surcharge | Currency | Total<br>Revenue<br>Change |    |      |    |
|-------------------------|--------|------------------------|-------------------|----------|----------------------------|----|------|----|
| Revenue Change Drivers: |        |                        |                   |          |                            |    |      |    |
| 2012 / 2011             | (0.2   | )%                     | 1.0               | % 0.1    | % (1.9                     | )% | (1.0 | )% |
| 2011 / 2010             | 4.7    | % 0.6                  | % 4.0             | % 0.7    | % 10.0                     | %  |      |    |

## Volume

## 2012 compared to 2011

Our overall average daily volume increased slightly in 2012 compared with 2011, as the worldwide economic slowdown and the associated impact on global trade restrained the growth of the international small package market.



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Export volume increased in 2012 compared with 2011, as growth was achieved in several key trade lanes. Asia to U.S. export volume increased, and was favorably impacted by new technology sector product launches from several customers. Intra-regional export volume increased in Europe and Asia, as more regional sourcing by customers led to growth in our Transborder products. U.S. export volume declined, particularly exports from the U.S. to Europe, as economic weakness within the European Union negatively impacted volume. Additionally, overall export volume continued to shift towards our less premium products, such as Transborder Standard and Worldwide Expedited, as compared with our premium express products, such as Worldwide Express, primarily due to the impact of the weaker economic conditions on our customers internationally.

Domestic volume decreased during 2012 compared with 2011, and was negatively impacted by economic weakness across Europe; however, this was partially offset by domestic volume growth in the U.K. and Canada.

2011 compared to 2010

Export volume increased in 2011 compared to 2010, primarily due to growth in key markets in Europe and the Americas. Our Transborder products experienced significant volume 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.

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

Rates and Product Mix

2012 compared to 2011

Total average revenue per piece increased 1.5% in 2012 on a currency-adjusted basis, and was impacted by base rate increases, as well as changes in product mix and fuel surcharge rates, which are discussed below.

Currency-adjusted export revenue per piece decreased 1.3% for the year, as the shift in product mix from our premium express products to our standard products more than offset the increase in base rates. Additionally, currency-adjusted export revenue per piece was adversely impacted by a shortening of average trade lanes, as we experienced greater volume growth among our lower-yielding Transborder and Trade Direct products relative to our higher-yielding transcontinental volume.

Currency-adjusted domestic revenue per piece increased 3.8% for the year, largely due to base rate increases.

On January 2, 2012, 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 the fuel surcharge indices. Rate changes for shipments originating outside the U.S. are made throughout the year and vary by geographic market.

2011 compared to 2010

Total average revenue per piece increased 4.6% for 2011 on a currency-adjusted basis, and was impacted by base rate increases, as well as changes in product mix and fuel surcharge rates, which are discussed below.

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 robust growth among our Transborder products. Revenue per piece was also negatively impacted 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 the fuel surcharge indices. Rate changes for shipments originating outside the U.S. are made throughout the year and vary by geographic market.

Fuel Surcharges

In connection with our base rate increases on January 2, 2012 and January 3, 2011, 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 air products originating outside the United States are indexed to the DOE's Gulf Coast spot price for a gallon of kerosene-type jet fuel, while the fuel surcharges for ground products originating outside the United States are indexed to fuel prices in the international region or country where the shipment takes place. Total international fuel surcharge revenue increased by \$11 and \$449 million in 2012 and 2011, respectively, due to higher fuel surcharge rates caused by increased fuel prices as well as an increase in international air volume.

Operating Expenses

2012 compared to 2011

Overall adjusted operating expenses for the segment decreased \$55 million in 2012 compared with 2011. The largest component of this decrease related to the cost of operating our international integrated air and ground network, which decreased \$117 million. This decrease primarily resulted from cost control initiatives, including a 1.8% reduction in average daily aircraft block hours resulting from ongoing modifications to our air network. The cost of pick-up and delivery decreased \$53 million, largely due to the impact of currency exchange rate movements and in-country cost control initiatives.

Partially offsetting these cost reductions was an increase in indirect operating costs, which increased \$143 million in 2012 compared with 2011. This increase was impacted by our investment in enhanced security screening for our international locations and expenses associated with business acquisition activities, including our proposed acquisition of TNT Express N.V. (see note 16 to the consolidated financial statements) as well as the February 2012 acquisition of Kiala S.A.

Excluding the impact of currency exchange rate changes, the total cost per piece for the segment increased 2.3% in 2012 compared with 2011.

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.

Operating Profit and Margin

2012 compared to 2011

Adjusted operating margin declined 40 basis points in 2012 compared with 2011, as the product mix shift from our premium express products to our standard products in 2012 reduced margins in this segment. Additionally, the volume declines in certain key transcontinental trade lanes during portions of 2012 also adversely impacted margins, since these routes have a larger cost infrastructure (relative to the remainder of the International Package segment) to support the air express volume in each region. These factors were mitigated, however, from benefits derived from air network adjustments, cost containment programs and the positive impact from foreign currency exchange rate fluctuations. As a result, we experienced a 3.7% decline in adjusted operating profit in 2012 compared with 2011.





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## 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 negatively affected 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 negatively affected 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.

## Supply Chain &amp; Freight Operations

|   | Year Ended December 31, |         |         | % Change    |             |   |
|---|-------------------------|---------|---------|-------------|-------------|---|
|   | 2012                    | 2011    | 2010    | 2012 / 2011 | 2011 / 2010 |   |
| Freight LTL Statistics:                               |                         |         |         |             |             |   |
| Revenue (in millions)                                 | \$2,377                 | \$2,299 | \$2,002 | 3.4         | % 14.8      | % |
| Revenue Per Hundredweight                             | \$21.73                 | \$21.17 | \$19.18 | 2.6         | % 10.4      | % |
| Shipments (in thousands)                              | 10,136                  | 10,247  | 9,952   | (1.1)       | )% 3.0      | % |
| Shipments Per Day (in thousands)                      | 40.1                    | 40.5    | 39.5    | (1.1)       | )% 2.5      | % |
| Gross Weight Hauled (in millions of lbs)              | 10,939                  | 10,858  | 10,440  | 0.7         | % 4.0       | % |
| Weight Per Shipment (in lbs)                          | 1,079                   | 1,060   | 1,049   | 1.8         | % 1.0       | % |
| Operating Days in Period                              | 253                     | 253     | 252     |             |             |   |
| Revenue (in millions):                                |                         |         |         |             |             |   |
| Forwarding and Logistics                              | \$5,977                 | \$6,103 | \$6,022 | (2.1)       | )% 1.3      | % |
| Freight   | 2,640                   | 2,563   | 2,208   | 3.0         | % 16.1      | % |
| Other   | 530                     | 473     | 440     | 12.1        | % 7.5       | % |
| Total Revenue   | \$9,147                 | \$9,139 | \$8,670 | 0.1         | % 5.4       | % |
| Operating Expenses (in millions):                     |                         |         |         |             |             |   |
| Operating Expenses                                    | \$9,132                 | \$8,532 | \$8,098 | 7.0         | % 5.4       | % |
| Defined Benefit Plans Mark-to-Market Charge           | (713 )                  | (177 )  | (39 )   |             |             |   |
| Gains on Real Estate Transactions                     | —                       | 48      | —       |             |             |   |
| Gains on Sales of Businesses                          | —                       | —       | 20      |             |             |   |
| Adjusted Operating Expenses                           | \$8,419                 | \$8,403 | \$8,079 | 0.2         | % 4.0       | % |
| Operating Profit (in millions) and Operating Margins: |                         |         |         |             |             |   |
| Operating Profit                                      | \$15                    | \$607   | \$572   | (97.5)      | )% 6.1      | % |
| Adjusted Operating Profit                             | \$728                   | \$736   | \$591   | (1.1)       | )% 24.5     | % |
| Operating Margin                                      | 0.2                     | % 6.6   | % 6.6   | %           |             |   |
| Adjusted Operating Margin                             | 8.0                     | % 8.1   | % 6.8   | %           |             |   |
| Currency Translation Benefit / (Cost)—(in millions)*: |                         |         |         |             |             |   |
| Revenue   |                         |         |         | \$ (100 )   | \$ 139      |   |
| Operating Expenses                                    |                         |         |         | 97          | (132 )      |   |
| Operating Profit                                      |                         |         |         | \$(3 )      | \$7         |   |

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



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Revenue

2012 compared to 2011

Forwarding and logistics revenue decreased \$126 million in 2012 compared with 2011. Forwarding revenue decreased in 2012, primarily due to lower rates in our air forwarding business and the adverse impact of foreign currency exchange rates; however, this was partially offset by improved tonnage in both our air and ocean forwarding businesses. The reduction in rates in the air forwarding business was largely due to industry overcapacity in key trade lanes, particularly the Asia-outbound market. In our logistics products, revenue increased in 2012 as we experienced robust growth in our mail services and health care solutions. The improved revenue in our health care solutions business was driven by organic growth as well as the December 2011 acquisition of Pieffe Group.

Freight revenue increased \$77 million for the year, driven by an increase in LTL revenue per hundredweight and in gross weight hauled; however, these factors were somewhat offset by a decline in average daily LTL shipments. The increase in LTL revenue per hundredweight was largely due to our focus on yield management and profitable revenue growth, as well as a general rate increase averaging 5.9% that took effect on July 16, 2012, covering non-contractual shipments in the United States, Canada and Mexico. The decline in average daily LTL shipments in 2012 was impacted by increased competitiveness in the LTL market and the slowdown in the U.S. economy. Fuel surcharge revenue increased by \$16 million for 2012 compared with the prior year, due to changes in diesel fuel prices and overall LTL shipment volume.

The other businesses within Supply Chain & Freight increased revenue by \$57 million in 2012 compared with 2011, primarily due to growth at The UPS Store, UPS Customer Solutions and our contract to provide domestic air transportation services for the U.S. Postal Service.

2011 compared to 2010

Forwarding and logistics revenue increased \$81 million 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 \$355 million in 2011 compared with 2010, 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 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 a \$33 million increase in revenue, primarily due to growth at UPS Capital, the UPS Store, UPS Customer Solutions and our contract to provide domestic air transportation services for the U.S. Postal Service.

Operating Expenses

2012 compared to 2011

Forwarding and logistics adjusted operating expenses decreased \$97 million in 2012 compared with 2011, due to several factors. Purchased transportation expense fell by \$65 million in 2012, primarily due to lower rates charged to us by third-party transportation carriers (though this briefly reversed in the fourth quarter). Compensation and benefits expense declined by \$28 million in 2012, largely due to reduced payroll and lower management incentive compensation costs. These factors were partially offset by a \$10 million increase in depreciation and amortization, due

to the amortization of intangible assets associated with our acquisition of Pieffe Group and the continued investment in technology and facilities in our health care logistics business.

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Freight adjusted operating expenses increased \$57 million in 2012, while the total cost per LTL shipment increased 3.8% for the year. The largest component of this increase related to the cost of operating our linehaul network, which grew by \$40 million for the year, primarily as a result of an increase in tonnage, coupled with wage and purchased transportation increases. Pick-up and delivery costs increased \$12 million for the year, largely due to the increase in tonnage as well as contractual driver wage increases of 3.5%. Rising diesel fuel prices increased the fuel expense for our fleet, as well as increased the fuel surcharge rates passed to us from third-party transportation carriers. These factors were, however, partially offset by productivity improvements.

Adjusted operating expenses for the other businesses within Supply Chain & Freight increased \$56 million in 2012 compared with 2011.

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 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.

Operating Profit and Margin

2012 compared to 2011

Adjusted operating profit for the forwarding and logistics unit decreased by \$29 million in 2012 compared with 2011. This decrease was primarily due to reduced profitability in our international air forwarding business, as European economic uncertainty, slower growth in China and a sluggish U.S. economy all contributed to a reduction in overall air freight market demand. This lower demand pressured the rates we charge to our customers, which more than offset the reduced rates we incur from third-party transportation carriers, and thereby led to a decline in our operating margin. Operating profit for our logistics business declined in 2012 compared with 2011, largely due to increased depreciation expense resulting from the continued investment in technology and facilities for our global health care business.

Adjusted operating profit for our freight unit increased \$20 million in 2012 compared with 2011, as gains in productivity (including pick-up and delivery stops per hour, dock bills per hour and linehaul network utilization) as well as improved yields, more than offset the overall decline in volume.

The combined adjusted operating profit for all of our other businesses in this segment increased \$1 million in 2012 compared with 2011, largely due to growth from our contract to provide domestic air transportation services for the U.S. Postal Service.

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## 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.

## Operating Expenses

|  | Year Ended December 31, |          |          | % Change    |             |       |
|--|-------------------------|----------|----------|-------------|-------------|-------|
|  | 2012                    | 2011     | 2010     | 2012 / 2011 | 2011 / 2010 |       |
| Operating Expenses (in millions):            |                         |          |          |             |             |       |
| Compensation and Benefits                    | \$33,102                | \$27,575 | \$26,557 | 20.0        | % 3.8       | %     |
| Defined Benefit Plans Mark-to-Market Charge  | (4,831 )                | (827 )   | (112 )   |             |             |       |
| Multiemployer Pension Plan Withdrawal Charge | (896 )                  | —        | —        |             |             |       |
| Restructuring Charge                         | —                       | —        | (98 )    |             |             |       |
| Adjusted Compensation and Benefits           | 27,375                  | 26,748   | 26,347   | 2.3         | % 1.5       | %     |
| Repairs and Maintenance                      | 1,228                   | 1,286    | 1,131    | (4.5        | )% 13.7     | %     |
| Depreciation and Amortization                | 1,858                   | 1,782    | 1,792    | 4.3         | % (0.6      | )%    |
| Purchased Transportation                     | 7,354                   | 7,232    | 6,640    | 1.7         | % 8.9       | %     |
| Fuel   | 4,090                   | 4,046    | 2,972    | 1.1         | % 36.1      | %     |
| Other Occupancy                              | 902                     | 943      | 939      | (4.3        | )% 0.4      | %     |
| Other Expenses                               | 4,250                   | 4,161    | 3,873    | 2.1         | % 7.4       | %     |
| Gains on Real Estate Transactions            | —                       | 33       | 109      |             |             |       |
| Gains on Sales of Businesses                 | —                       | —        | 20       |             |             |       |
| Adjusted Other Expenses                      | 4,250                   | 4,194    | 4,002    | 1.3         | % 4.8       | %     |
| Total Operating Expenses                     | \$52,784                | \$47,025 | \$43,904 | 12.2        | % 7.1       | %     |
| Adjusted Total Operating Expenses            | \$47,057                | \$46,231 | \$43,823 | 1.8         | % 5.5       | %     |
| Currency Translation Cost / (Benefit)*       |                         |          |          |             | \$(362 )    | \$330 |

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

## Compensation and Benefits

## 2012 compared to 2011

Employee payroll costs increased \$183 million in 2012 compared with 2011, largely due to contractual union wage rate increases that took effect under our collective bargaining agreement with the Teamsters, as well as an increase in total union labor hours; however, this was partially offset by a decline in management payroll costs due to a reduction in incentive compensation expense.

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Adjusted benefits expense increased \$444 million in 2012 compared with 2011, primarily due to higher pension expense, increased health and welfare costs and changes in the expense associated with our self-insurance for workers' compensation claims, as follows:

Adjusted pension expense increased \$200 million in 2012 compared with 2011, due to higher union contribution rates for multiemployer pension plans combined with increased service and interest costs for company-sponsored plans. The increase in service and interest costs for company-sponsored plans was largely due to continued service accruals and lower discount rates.

Health and welfare costs increased \$157 million in 2012 compared with 2011, largely due to higher medical claims and the impact of several provisions of the Patient Protection and Affordable Care Act of 2010.

The expense associated with our self-insurance programs for workers' compensation claims increased \$60 million in 2012 compared with 2011. Insurance reserves are established for estimates of the loss that we will ultimately incur on reported workers' compensation 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. The increase in expense in 2012 was largely impacted by increased payroll estimates, changes in state workers' compensation laws, and medical inflation.

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 workers' compensation claims, but partially offset by a decline in pension expense. These factors are discussed further as follows:

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.

The expense associated with our self-insurance programs for workers' compensation claims increased by \$48 million in 2011. 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.

Repairs and Maintenance

2012 compared to 2011

The decrease in repairs and maintenance expense was largely due to lower aircraft maintenance costs, which decreased \$77 million in 2012 compared with 2011. This decrease resulted primarily from a 0.8% reduction in average daily aircraft block hours, and the conversion of an engine maintenance agreement with an outside vendor from a cost reimbursement approach to a fixed rate per flight hour. Additionally, aircraft maintenance expense declined due to a reduction in the number of scheduled maintenance checks for our Airbus A300-600F, Boeing 757-200F and Boeing MD-11F aircraft.

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.

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Depreciation and Amortization

2012 compared to 2011

The increase in depreciation and amortization expense was primarily due to higher depreciation expense on vehicles of \$57 million in 2012 compared with 2011, resulting from the replacement of older, fully-depreciated vehicles, technology upgrades on new vehicles and an overall increase in the size of our vehicle fleet in our U.S. Domestic package operations.

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.

Purchased Transportation

2012 compared to 2011

The increase in purchased transportation expense charged to us by third-party air, ocean and truck carriers in 2012 compared with 2011 was impacted by several factors. We incurred a \$187 million increase in purchased transportation expense for 2012 in our U.S. Domestic Package segment, primarily due to higher fees paid to the U.S. Postal Service associated with the strong volume growth in our SurePost product, and higher rates passed to us from rail carriers. This was partially offset by a \$65 million decrease in expense in our freight forwarding business, largely as a result of lower rates charged to us by third-party air carriers.

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.

Fuel

2012 compared to 2011

The fuel expense increase in 2012 compared with 2011 was largely due to higher fuel prices, which increased expense by \$116 million; however, this was partially offset by lower usage of fuel products, which decreased expense by \$72 million. The lower fuel usage was largely due to the decrease in total aircraft block hours and vehicle miles driven.

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.

Other Occupancy

2012 compared to 2011

Other occupancy expense decreased in 2012 compared with 2011, primarily due to reductions in personal property and real estate taxes combined with a decrease in utilities expense. The relatively warm winter in the United States, combined with lower natural gas prices, helped to reduce heating and snow removal costs in our facilities during the early months of 2012.

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.



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## Other Expenses

## 2012 compared to 2011

Adjusted other expenses increased in 2012 compared with 2011, primarily due to an increase in transportation equipment rentals, bad debt expense and auto liability insurance, as well as expenses incurred in 2012 related to the proposed TNT Express N.V. acquisition. These increases were partially offset by a reduction in employee relocation expenses and a decline in package claims expense. Additionally, 2012 adjusted other expenses were reduced by a \$9 million gain on the sale of a distribution facility in our Supply Chain & Freight segment.

## 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.

## Investment Income and Interest Expense

The following table sets forth investment income and interest expense for the years ended December 31, 2012, 2011 and 2010 (in millions):

|                   | Year Ended December 31, |          |          | % Change    |             |
|-------------------|-------------------------|----------|----------|-------------|-------------|
|                   | 2012                    | 2011     | 2010     | 2012 / 2011 | 2011 / 2010 |
| Investment Income | \$24                    | \$44     | \$3      | (45.5 )%    | N/A         |
| Interest Expense  | \$(393 )                | \$(348 ) | \$(354 ) | 12.9 %      | (1.7 )%     |

## Investment Income

## 2012 compared to 2011

The decrease in investment income in 2012 compared with 2011 was primarily caused by an \$8 million decline in fair value adjustments and an \$25 million decline in realized gains on sales of investments. These declines were partially offset by an increase in interest income, largely due to having a higher average balance of interest-earning cash and investments in our portfolio in 2012 compared with 2011.

## 2011 compared to 2010

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.

## Interest Expense

## 2012 compared to 2011

Interest expense increased in 2012 compared with 2011, largely due to a higher average balance of debt outstanding, as well as a higher effective interest rate incurred on our debt. The higher effective interest rate largely resulted from two factors: (1) having a greater proportion of fixed-rate debt outstanding relative to lower-yielding variable rate debt and (2) an increase in the interest rate indices underlying our variable-rate debt and swaps in 2012. Additionally, interest expense increased in 2012 compared with 2011 due to unfavorable fair value adjustments on interest rate swaps that have not been designated as hedges, as well as the imputation of interest expense on the multiemployer pension withdrawal liability related to the New England Pension Fund.



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## 2011 compared to 2010

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.

## Income Tax Expense

The following table sets forth income tax expense and our effective tax rate for the years ended December 31, 2012, 2011 and 2010 (in millions):

|   | Year Ended December 31, |         |         | % Change    |             |   |
|---|-------------------------|---------|---------|-------------|-------------|---|
|   | 2012                    | 2011    | 2010    | 2012 / 2011 | 2011 / 2010 |   |
| Income Tax Expense                                | \$167                   | \$1,972 | \$1,952 | (91.5 )%    | 1.0         | % |
| Income Tax Impact of:                             |                         |         |         |             |             |   |
| Defined Benefit Plans Mark-to-Market Charge       | 1,808                   | 300     | 37      |             |             |   |
| Multiemployer Pension Plan Withdrawal Charge      | 337                     | —       | —       |             |             |   |
| Restructuring Charge                              | —                       | —       | 34      |             |             |   |
| Gain on Sales of Businesses                       | —                       | —       | (23 )   |             |             |   |
| Gain on Real Estate Transactions                  | —                       | (13 )   | (48 )   |             |             |   |
| Change in Tax Filing Status for German Subsidiary | —                       | —       | (76 )   |             |             |   |
| Adjusted Income Tax Expense                       | \$2,312                 | \$2,259 | \$1,876 | 2.3         | % 20.4      | % |
| Effective Tax Rate                                | 17.1                    | % 34.1  | % 36.9  | %           |             |   |
| Adjusted Effective Tax Rate                       | 34.5                    | % 34.4  | % 34.9  | %           |             |   |

## 2012 compared to 2011

Our adjusted effective tax rate increased in 2012 compared with 2011 primarily due to the expiration of certain U.S. tax credit provisions at the end of 2011, and a decrease in the relative benefit of other deductions and tax credits that do not increase in proportion to increases in pre-tax income. Adjusted income tax expense increased in 2012 compared with 2011 primarily due to higher pre-tax income and the factors described above.

## 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.

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## Liquidity and Capital Resources

## Operating Activities

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

|  | 2012    | 2011     | 2010     |
|--|---------|----------|----------|
| Net income   | \$807   | \$3,804  | \$3,338  |
| Non-cash operating activities(a)                                       | 7,301   | 4,505    | 4,398    |
| Pension and postretirement plan contributions (UPS-sponsored plans)    | (917 )  | (1,436 ) | (3,240 ) |
| Income tax receivables and payables                                    | 280     | 236      | (319 )   |
| Changes in working capital and other noncurrent assets and liabilities | (148 )  | (12 )    | (340 )   |
| Other operating activities   | (107 )  | (24 )    | (2 )     |
| Net cash from operating activities                                     | \$7,216 | \$7,073  | \$3,835  |

Represents depreciation and amortization, gains and losses on derivative and foreign exchange transactions, (a)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 2010 to 2012 time period. Operating cash flow was favorably impacted in 2012, compared with 2011, by lower contributions into our defined benefit pension and postretirement benefit plans; however, this was partially offset by changes in our working capital position, which was impacted by overall growth in the business. 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 2012, we made a \$355 million required contribution to the UPS IBT Pension Plan.

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, we made \$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.

The remaining contributions in the 2010 through 2012 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.

As of December 31, 2012, the total of our worldwide holdings of cash and cash equivalents was \$7.327 billion.

Approximately \$4.211 billion of this amount was held in European subsidiaries with the intended purpose of completing the acquisition of TNT Express N.V. (see note 16 to the consolidated financial statements). Excluding this portion of cash held outside the U.S. for acquisition-related purposes, approximately 50%-60% of the remaining cash and cash equivalents are held by foreign subsidiaries throughout the year. The amount of cash held by our U.S. and foreign subsidiaries fluctuates throughout the year due to a variety of factors, including the timing of cash receipts and disbursements in the normal course of business. Cash provided by operating activities in the United States continues to be our primary source of funds to finance domestic operating needs, capital expenditures, share repurchases and dividend payments to shareowners. To the extent that such amounts represent previously untaxed earnings, the cash held by foreign subsidiaries would be subject to tax if such amounts were repatriated in the form of dividends; however, not all international cash balances would have to be repatriated in the form of a dividend if returned to the U.S. When amounts earned by foreign subsidiaries are expected to be indefinitely reinvested, no accrual for taxes is provided.





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## Investing Activities

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

|   | 2012       | 2011       | 2010       |   |
|---|------------|------------|------------|---|
| Net cash used in investing activities                           | \$(1,335 ) | \$(2,537 ) | \$(654 )   | ) |
| Capital Expenditures:   |            |            |            |   |
| Buildings and facilities  | \$(506 )   | \$(373 )   | \$(352 )   | ) |
| Aircraft and parts  | (568 )     | (598 )     | (416 )     | ) |
| Vehicles  | (672 )     | (659 )     | (339 )     | ) |
| Information technology  | (407 )     | (375 )     | (282 )     | ) |
|   | \$(2,153 ) | \$(2,005 ) | \$(1,389 ) | ) |
| Capital Expenditures as a % of Revenue                          | 4.0        | % 3.8      | % 2.8      | % |
| Other Investing Activities:                                     |            |            |            |   |
| Proceeds from disposals of property, plant and equipment        | \$95       | \$27       | \$304      |   |
| Net decrease in finance receivables                             | \$101      | \$184      | \$108      |   |
| Net (purchases) sales of marketable securities                  | \$628      | \$(413 )   | \$30       |   |
| Cash received (paid) for business acquisitions and dispositions | \$(100 )   | \$(73 )    | \$63       |   |
| Other investing activities                                      | \$94       | \$(257 )   | \$230      |   |

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. 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 2013 will be approximately \$2.4 billion, or approximately 4% of revenue.

Capital spending on aircraft over the 2010 to 2012 period was largely due to scheduled deliveries of previous orders for the Boeing 767-300ERF and 747-400F aircraft. Capital spending on vehicles increased during the 2010 to 2012 period 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 increased 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 that began in 2011 and will be completed in 2013. The proceeds from the disposal of property, plant and equipment were largely due to real estate and aircraft sales during the 2010 through 2012 period, as well as the proceeds from insurance recoveries in 2010. The net decline in finance receivables in the 2010 through 2012 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 2012 and 2011 was largely due to the acquisitions of Kiala S.A. in Belgium and Pieffe Group in Italy, respectively. The cash received from business dispositions in 2010 was largely due to the sale of UPS Logistics Technologies, Inc.

Other investing activities are impacted by the cash settlement of derivative contracts used in our currency hedging programs, and the timing of aircraft purchase contract deposits on our Boeing 767-300ERF and 747-400F aircraft orders. We received (paid) cash related to purchases and settlements of energy and currency derivative contracts used in our hedging programs of \$41, \$(78) and \$111 million during 2012, 2011 and 2010, respectively.

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## Financing Activities

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

|   | 2012       | 2011       | 2010       |
|---|------------|------------|------------|
| Net cash used in financing activities         | \$(1,817 ) | \$(4,862 ) | \$(1,346 ) |
| Share Repurchases:                            |            |            |            |
| Cash expended for shares repurchased          | \$(1,621 ) | \$(2,665 ) | \$(817 )   |
| Number of shares repurchased                  | (21.8 )    | (38.7 )    | (12.4 )    |
| Shares outstanding at year-end                | 953        | 963        | 991        |
| Percent reduction in shares outstanding       | (1.0 )%    | (2.8 )%    | (0.3 )%    |
| Dividends:                                    |            |            |            |
| Dividends declared per share                  | \$2.28     | \$2.08     | \$1.88     |
| Cash expended for dividend payments           | \$(2,130 ) | \$(1,997 ) | \$(1,818 ) |
| Borrowings:                                   |            |            |            |
| Net borrowings (repayments) of debt principal | \$1,729    | \$(95 )    | \$1,246    |
| Other Financing Activities:                   |            |            |            |
| Cash received for common stock issuances      | \$301      | \$290      | \$218      |
| Other financing activities                    | \$(96 )    | \$(395 )   | \$(175 )   |
| Capitalization:                               |            |            |            |
| Total debt outstanding at year-end            | \$12,870   | \$11,128   | \$10,846   |
| Total shareowners' equity at year-end         | 4,733      | 7,108      | 8,047      |
| Total capitalization                          | \$17,603   | \$18,236   | \$18,893   |
| Debt to Total Capitalization %                | 73.1 %     | 61.0 %     | 57.4 %     |

On May 3, 2012, the Board of Directors approved a share repurchase authorization of \$5.0 billion, which replaced an authorization previously announced in 2008. As of December 31, 2012, we had \$3.970 billion of this share repurchase authorization remaining. On February 14, 2013, the Board of Directors approved a new share repurchase authorization of \$10.0 billion, which replaced the 2012 authorization. This new share repurchase authorization has no expiration date. We anticipate repurchasing approximately \$4.0 billion of shares in 2013.

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 2013, we increased our quarterly dividend payment from \$0.57 to \$0.62 per share, an 8.8% increase.

Issuances of debt in 2012 consisted primarily of senior fixed rate note offerings totaling \$1.75 billion, the proceeds of which were used to repay the principal balance of our \$1.75 billion notes that matured on January 15, 2013. In 2011, issuances of debt consisted primarily of commercial paper and five new aircraft leases. In 2010, issuances of debt consisted of senior fixed rate note offerings totaling \$2.0 billion, the proceeds of which were used to make discretionary contributions to UPS-sponsored pension plans and other general corporate purposes.

Repayments of debt in 2012, 2011 and 2010 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, 2012 and 2011. The amount of commercial paper outstanding fluctuates throughout each year based on daily liquidity needs. The average commercial paper balance was \$962 million and the average interest rate paid was 0.07% in 2012 (\$849 million and 0.08% in 2011, respectively).



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Cash received from common stock issuances to employees increased primarily due to additional stock option exercises in 2012 and 2011. 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 2012 and 2010, we settled several interest rate derivatives that were designated as hedges of these debt offerings, which resulted in cash inflows (outflows) of \$(70) and \$7 million, respectively. During 2012, the expiration and settlement of several capped call options for the purchase of UPS class B shares resulted in a cash inflow of \$206 million in premiums, while the initial premium payments for these options in 2011 resulted in a cash outflow of \$200 million during that year.

Sources of Credit

We are authorized to borrow up to \$10.0 billion under our U.S. commercial paper program. 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. 0 amounts were outstanding under these programs as of December 31, 2012. The amount of commercial paper outstanding under these programs in 2013 is expected to fluctuate.

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 11, 2013. 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 0.10% 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, 2012.

The second agreement provides revolving credit facilities of \$1.0 billion, and expires on April 12, 2017. 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 0.100% to 0.375%, and the maximum applicable margin rates range from 0.750% to 1.250%. 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, 2012.

Our existing debt instruments and credit facilities subject us to certain financial covenants. As of December 31, 2012 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, 2012, 10% of net tangible assets is equivalent to \$2.770 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, 2012, our net worth, as defined, was equivalent to \$8.007 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.

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## 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, 2012 (in millions):

| Commitment Type      | 2013    | 2014    | 2015    | 2016    | 2017    | After<br>2017 | Total    |
|----------------------|---------|---------|---------|---------|---------|---------------|----------|
| Capital Leases       | \$55    | \$52    | \$50    | \$49    | \$48    | \$426         | \$680    |
| Operating Leases     | 342     | 271     | 203     | 145     | 118     | 358           | 1,437    |
| Debt Principal       | 1,750   | 1,000   | 101     | 1       | 375     | 8,765         | 11,992   |
| Debt Interest        | 322     | 294     | 287     | 285     | 285     | 4,759         | 6,232    |
| Purchase Commitments | 629     | 103     | 22      | 14      | 7       | —             | 775      |
| Pension Fundings     | —       | —       | 563     | 1,020   | 1,058   | 986           | 3,627    |
| Other Liabilities    | 64      | 58      | 43      | 23      | 10      | 5             | 203      |
| Total                | \$3,162 | \$1,778 | \$1,269 | \$1,537 | \$1,901 | \$15,299      | \$24,946 |

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 7 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, 2012. 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, 2012, we have firm commitments to purchase eight Boeing 767-300ERF aircraft to be delivered in 2013.

Pension fundings represent the anticipated required cash contributions that will be made to our qualified U.S. pension plans (these plans are discussed further in note 4 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. In July 2012, federal legislation was signed into law that allows pension plan sponsors to use higher interest rate assumptions (based on a 25-year rate history) in valuing plan liabilities and determining funding obligations. As a result of this legislation, we are not subject to required contributions in 2013 and 2014 for our domestic pension plans. 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. To the extent that the funded status of these plans in future years differs from our current projections, the actual contributions made in future years could materially differ from the amounts shown in the table above.

As discussed in note 5 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 \$232 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 12 to the consolidated financial statements.

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As of December 31, 2012, we had outstanding letters of credit totaling approximately \$1.369 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, 2012, we had \$584 million of surety bonds written. As of December 31, 2012, we had unfunded loan commitments totaling \$157 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 (except as otherwise noted herein) 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 a lawsuit in California Superior Court about the rebranding of The UPS Store franchises. In the Morgate case, the plaintiffs are 125 individual franchisees who did not rebrand to The UPS Store and a certified class of all franchisees who did rebrand. The trial court entered judgment against a bellwether individual plaintiff, which was affirmed in January 2012. The trial court granted our motion for summary judgment against the certified class, which was reversed in January 2012.

There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from whatever remaining aspects of this case proceeds, including: (1) we are vigorously defending ourselves and believe we have a number of meritorious legal defenses; and (2) it remains uncertain what evidence of damages, if any, plaintiffs will be able to present. 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.

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 by individually imposing policies that prevent shippers from using such negotiators. The case is scheduled to go to trial in August 2013. The Antitrust Division of the U.S. Department of Justice ("DOJ") has an ongoing 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) discovery is ongoing; 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.

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In Canada, four purported class-action cases were filed against us in British Columbia (2006); Ontario (2007) and Québec (2006 and 2013). 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 motion to authorize the 2006 Québec litigation as a class action was dismissed by the motions judge in October 2012; there was no appeal, which ended that case in our favor. The 2013 Québec litigation is in the earliest stages. We deny 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 online pharmacies that may have operated illegally. We have been cooperating with this investigation and are exploring the possibility of resolving this matter, which could include our undertaking further enhancements to our compliance program and a payment. Such a payment may exceed the amounts previously accrued with respect to this matter, but we do not expect that the amount of such additional loss 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 January 2013, we received a letter from the DOJ confirming that it is not pursuing a case against UPS with respect to the investigation.

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. In November 2012, we also received a request for information related to similar matters from authorities in Singapore.

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.

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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. The plaintiffs filed a Second Amended Complaint in October 2010, which we moved to dismiss. In August 2012, the Court granted our motion to dismiss all claims relevant to UPS in the Second Amended Complaint, with leave to amend. The plaintiffs filed a Third Amended Complaint in November 2012. We intend to file another motion to dismiss, and to otherwise 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 court has dismissed the complaint once but has not considered the adequacy of the amended complaint; (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.

**Tax Matters**

In June 2011, we received an IRS Revenue Agent Report (RAR) covering excise taxes for tax years 2003 through 2007, in addition to the income tax matters described in note 12 to the consolidated financial statements. The excise tax RAR proposed two alternate theories for asserting additional excise tax on transportation of property by air. We disagreed with these proposed excise tax theories and related adjustments. We filed protests and, in the third quarter of 2011, the IRS responded to our protests and forwarded the case to IRS Appeals.

In the third quarter of 2012, following the Appeals Opening Conference in July 2012, we had settlement discussions which we expect will lead to a complete resolution of all excise tax matters and correlative income tax refund claims for the 2003 through 2007 tax years within the next twelve months. We do not believe the ultimate resolution of these matters will have a material effect on our financial condition, results of operations or liquidity.

**Collective Bargaining Agreements**

As of December 31, 2012, we had approximately 249,000 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 2,600 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 3,100 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.

**Multiemployer Benefit Plans**

We contribute to a number of multiemployer defined benefit and health and welfare plans under terms of collective bargaining agreements that cover our union represented employees. 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.

In the third quarter of 2012, we reached an agreement with the New England Pension Fund, a multiemployer pension plan in which UPS is a participant, to restructure the pension liabilities for approximately 10,200 UPS employees

represented by the Teamsters. The agreement reflects a decision by the New England Pension Fund's trustees to restructure the fund through plan amendments to utilize a "two pool approach", which effectively subdivides the plan assets and liabilities between two groups of beneficiaries. As part of this agreement, UPS agreed to withdraw from the original pool of the New England Pension Fund of which it had historically been a participant, and reenter the New England Pension Fund's newly-established pool as a new employer.

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Upon ratification of the agreement by the Teamsters in September 2012, we withdrew from the original pool of the New England Pension Fund and incurred an undiscounted withdrawal liability of \$2.162 billion to be paid in equal monthly installments over 50 years. The undiscounted withdrawal liability was calculated by independent actuaries employed by the New England Pension Fund, in accordance with the governing plan documents and the applicable requirements of the Employee Retirement Income Security Act of 1974. In the third quarter of 2012, we recorded a charge to expense to establish an \$896 million withdrawal liability on our balance sheet, which represents the present value of the \$2.162 billion future payment obligation discounted at a 4.25% interest rate. This discount rate represents the estimated credit-adjusted market rate of interest at which we could obtain financing of a similar maturity and seniority.

As part of this agreement, we believe that UPS, the New England Pension Fund and our affected employees have obtained several benefits, including:

The old pool of the New England Pension Fund has historically had, and would likely continue to have, funding challenges; this represented a risk to UPS of having to face higher future contribution requirements, as well as a risk to the security of the pension benefits of those UPS employees who participate in the New England Pension Fund. The 50 year fixed payment obligation should improve the funded status of the New England Pension Fund over time, while reducing the risk to UPS of significantly higher future contribution requirements.

The newly-established pool provides better protections for new participating employers. This pool uses a direct-attribution methodology for calculating any potential future withdrawal liabilities, which reduces our exposure to the liabilities of other participating employers. Additionally, this pool contains provisions designed to maintain a fully-funded status, including automatic benefit reductions and/or increased employee contributions in the event of an underfunded situation occurring.

As part of the agreement, we were able to freeze our hourly pension contribution rate to the newly-established pool of the New England Pension Fund for a period of 10 years, which provides cash flow visibility for both UPS and the New England Pension Fund.

The \$896 million charge to expense recorded in the third quarter of 2012 is included in "compensation and benefits expense" in the consolidated statement of income, while the corresponding withdrawal liability is included in "other non-current liabilities" on the consolidated balance sheet. We will impute interest on the withdrawal liability using the 4.25% discount rate, while the monthly payments made to the New England Pension Fund will reduce the remaining balance of the withdrawal liability.

Our status in the newly-established pool of the New England Pension Fund is accounted for as the participation in a new multiemployer pension plan, and therefore we will recognize expense based on the contractually-required contribution for each period, and we will recognize a liability for any contributions due and unpaid at the end of a reporting period.

**Rate Adjustments**

In June 2012, our UPS Freight unit announced a general rate increase averaging 5.9%, covering non-contractual shipments in the United States, Canada and Mexico. The rate adjustment took effect on July 16, 2012, and applies to minimum charge, LTL rates and accessorial charges.

In November 2012, we announced an increase in base rates and changes in our fuel surcharge for package shipments that took effect December 31, 2012, including the following:

• UPS Ground service rates increased an average 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 an average net 4.5%, through a combination of a 6.5% increase in base rates and a 2% reduction in the index used to determine the air fuel surcharge.



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UPS Next Day Air Freight, UPS 2<sup>nd</sup> Day Air Freight, and UPS 3 Day Freight rates for shipments within and between the U.S., Canada, and Puerto Rico increased 4.9%. UPS Express Freight rates for shipments originating in the U.S. also increased 4.9%.

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 May 2011, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update to disclosure requirements for fair value measurement. These amendments, which became effective for us in the first quarter of 2012, result in a common definition of fair value and common measurement and disclosure requirements between U.S. GAAP and IFRS. Consequently, the amendments change some fair value measurement principles and disclosure requirements. The implementation of this amended accounting guidance had an immaterial impact on our consolidated financial position and results of operations.

In June 2011, the FASB issued an Accounting Standards Update that increases the prominence of items reported in other comprehensive income in the financial statements. This update requires companies to present comprehensive income in a single statement below net income or in a separate statement of comprehensive income immediately following the income statement. This requirement became effective for us beginning with the first quarter of 2012, and we have included the required presentation in all applicable filings since that date.

In July 2012, the FASB issued an Accounting Standards Update that added an optional qualitative assessment for determining whether an indefinite-lived intangible asset is impaired. The objective of this update is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by allowing an entity the option to make a qualitative evaluation about the likelihood of an intangible impairment to determine whether it should calculate the fair value of the asset. 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 the intangible asset is less than its carrying amount. We adopted this accounting standard update and applied its provisions to certain of our intangible assets for our annual impairment testing as of October 1, 2012.

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

In February 2013, the FASB issued an accounting standards update that adds new disclosure requirements for items reclassified out of accumulated other comprehensive income. This update requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source (e.g., the release due to cash flow hedges from interest rate contracts) and the income statement line items affected by the reclassification (e.g., interest income or interest expense). If a component is not required to be reclassified to net income in its entirety (e.g., the net periodic pension cost), companies would instead cross reference to the related footnote for additional information (e.g., the pension footnote). This update is effective for us beginning in the first quarter of 2013.

Other accounting pronouncements issued, but not effective until after December 31, 2012, are not expected to have a significant impact on our consolidated financial position or results of operations.

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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 8 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.

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 or results of operations as of, and for the year ended, December 31, 2012. In addition, we have certain contingent liabilities that have not been recognized as of December 31, 2012, 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.

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None of the reporting units incurred any goodwill impairment charges in 2012, 2011 or 2010. 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. A 10% decrease in the estimated fair value of our reporting units as of our most recent goodwill testing date (October 1, 2012) would not result in a goodwill impairment charge.

Licenses with a carrying value of \$5 million as of December 31, 2012 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 2012, 2011 or 2010.

**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.



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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND  
RESULTS OF OPERATIONS

## 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.

We recognize changes in the fair value of plan assets and net actuarial gains or losses in excess of a corridor (defined as 10% of the greater of the fair value of plan assets or the plans' projected benefit obligations) in pension expense annually at December 31st each year. The remaining components of pension expense, primarily service and interest costs and the expected return on plan assets, are recorded on a quarterly basis.

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 expense (excluding the impact of actuarial gains and losses recognized outside of the corridor) as of, and for the year ended, December 31, 2012 (in millions).

|   | 25 Basis Point<br>Increase | 25 Basis Point<br>Decrease |
|---|----------------------------|----------------------------|
| Pension Plans   |                            |                            |
| Discount Rate:  |                            |                            |
| Effect on ongoing net periodic benefit cost             | \$(50                      | ) \$50                     |
| Effect on projected benefit obligation                  | (1,427                     | ) 1,496                    |
| Return on Assets:                                       |                            |                            |
| Effect on ongoing net periodic benefit cost             | (58                        | ) 58                       |
| Postretirement Medical Plans                            |                            |                            |
| Discount Rate:  |                            |                            |
| Effect on ongoing net periodic benefit cost             | —                          | —                          |
| Effect on accumulated postretirement benefit obligation | (119                       | ) 124                      |
| Health Care Cost Trend Rate:                            |                            |                            |
| Effect on ongoing net periodic benefit cost             | 1                          | (1 )                       |
| Effect on accumulated postretirement benefit obligation | 14                         | (17 )                      |

Expense is expected to increase in 2013 compared with 2012, due primarily to the decline in the discount rate used to determine expense from 5.58% for 2012 to 4.38% for 2013. This is partially offset by the contributions to the plans in 2012, that increased the expected return on assets used for expense calculation purposes.

## Depreciation, Residual Value and Impairment of Fixed Assets

As of December 31, 2012, we had \$17.894 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.



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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 2012, 2011 and 2010, there were no indicators of impairment in our property, plant and equipment, and no impairment charges were recorded in any period.

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.



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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, 2012 and 2011 was \$127 and \$117 million, respectively. Our total provision for doubtful accounts charged to expense during the years ended December 31, 2012, 2011 and 2010 was \$155, \$147 and \$199 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 14 to the consolidated financial statements.

Commodity Price Risk

We are exposed to changes in the prices of refined fuels, principally jet-A, diesel and unleaded gasoline, as well as changes in the price of natural gas. 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, 2012 and 2011, 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, Canadian Dollar, Chinese Renminbi and Hong Kong 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.

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## 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 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, |         |
|  | 2012               | 2011    |
| Change in Fair Value:                    |                    |         |
| Currency Derivatives <sup>(1)</sup>      | \$(1 )             | \$(64 ) |
| Change in Annual Expense:                |                    |         |
| Variable Rate Debt <sup>(2)</sup>        | \$7                | \$7     |
| Interest Rate Derivatives <sup>(2)</sup> | \$106              | \$71    |

(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.

The potential change in annual interest expense resulting from a hypothetical 100 basis point increase in short-term (2) 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, 2012 and 2011. 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, 2012 and 2011.

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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, 2012 and 2011, and the related statements of consolidated income, consolidated comprehensive income, and consolidated cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these 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, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, in conformity with accounting principles generally accepted in the United States of America.

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, 2012, 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 28, 2013 expressed an unqualified opinion on the Company’s internal control over financial reporting.

/s/ Deloitte & Touche LLP

Atlanta, Georgia

February 28, 2013

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(In millions)

|   | December 31, |          |
|---|--------------|----------|
|   | 2012         | 2011     |
| <b>ASSETS</b>   |              |          |
| Current Assets:   |              |          |
| Cash and cash equivalents   | \$7,327      | \$3,034  |
| Marketable securities   | 597          | 1,241    |
| Accounts receivable, net  | 6,111        | 6,246    |
| Deferred income tax assets  | 583          | 611      |
| Other current assets  | 973          | 1,152    |
| Total Current Assets  | 15,591       | 12,284   |
| Property, Plant and Equipment, Net                                | 17,894       | 17,621   |
| Goodwill  | 2,173        | 2,101    |
| Intangible Assets, Net  | 603          | 585      |
| Investments and Restricted Cash                                   | 307          | 303      |
| Derivative Assets   | 535          | 483      |
| Deferred Income Tax Assets  | 684          | 118      |
| Other Non-Current Assets  | 1,076        | 1,206    |
| Total Assets  | \$38,863     | \$34,701 |
| <b>LIABILITIES AND SHAREOWNERS' EQUITY</b>                        |              |          |
| Current Liabilities:  |              |          |
| Current maturities of long-term debt and commercial paper         | \$1,781      | \$33     |
| Accounts payable  | 2,278        | 2,300    |
| Accrued wages and withholdings                                    | 1,927        | 1,843    |
| Self-insurance reserves   | 763          | 781      |
| Other current liabilities   | 1,641        | 1,557    |
| Total Current Liabilities   | 8,390        | 6,514    |
| Long-Term Debt  | 11,089       | 11,095   |
| Pension and Postretirement Benefit Obligations                    | 11,068       | 5,505    |
| Deferred Income Tax Liabilities                                   | 48           | 1,900    |
| Self-Insurance Reserves   | 1,980        | 1,806    |
| Other Non-Current Liabilities                                     | 1,555        | 773      |
| Shareowners' Equity:  |              |          |
| Class A common stock (225 and 240 shares issued in 2012 and 2011) | 3            | 3        |
| Class B common stock (729 and 725 shares issued in 2012 and 2011) | 7            | 7        |
| Additional paid-in capital  | —            | —        |
| Retained earnings   | 7,997        | 10,128   |
| Accumulated other comprehensive loss                              | (3,354)      | (3,103)  |
| Deferred compensation obligations                                 | 78           | 88       |
| Less: Treasury stock (1 and 2 shares in 2012 and 2011)            | (78)         | (88)     |
| Total Equity for Controlling Interests                            | 4,653        | 7,035    |
| Noncontrolling Interests  | 80           | 73       |
| Total Shareowners' Equity   | 4,733        | 7,108    |
| Total Liabilities and Shareowners' Equity                         | \$38,863     | \$34,701 |

See notes to consolidated financial statements.



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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## STATEMENTS OF CONSOLIDATED INCOME

(In millions, except per share amounts)

|                                  | Years Ended December 31, |          |          |
|----------------------------------|--------------------------|----------|----------|
|                                  | 2012                     | 2011     | 2010     |
| Revenue                          | \$54,127                 | \$53,105 | \$49,545 |
| Operating Expenses:              |                          |          |          |
| Compensation and benefits        | 33,102                   | 27,575   | 26,557   |
| Repairs and maintenance          | 1,228                    | 1,286    | 1,131    |
| Depreciation and amortization    | 1,858                    | 1,782    | 1,792    |
| Purchased transportation         | 7,354                    | 7,232    | 6,640    |
| Fuel                             | 4,090                    | 4,046    | 2,972    |
| Other occupancy                  | 902                      | 943      | 939      |
| Other expenses                   | 4,250                    | 4,161    | 3,873    |
| Total Operating Expenses         | 52,784                   | 47,025   | 43,904   |
| Operating Profit                 | 1,343                    | 6,080    | 5,641    |
| Other Income and (Expense):      |                          |          |          |
| Investment income                | 24                       | 44       | 3        |
| Interest expense                 | (393)                    | (348)    | (354)    |
| Total Other Income and (Expense) | (369)                    | (304)    | (351)    |
| Income Before Income Taxes       | 974                      | 5,776    | 5,290    |
| Income Tax Expense               | 167                      | 1,972    | 1,952    |
| Net Income                       | \$807                    | \$3,804  | \$3,338  |
| Basic Earnings Per Share         | \$0.84                   | \$3.88   | \$3.36   |
| Diluted Earnings Per Share       | \$0.83                   | \$3.84   | \$3.33   |

## STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME

(In millions)

|   | Years Ended December 31, |         |         |
|---|--------------------------|---------|---------|
|   | 2012                     | 2011    | 2010    |
| Net income  | \$807                    | \$3,804 | \$3,338 |
| Change in foreign currency translation adjustment, net of tax               | 294                      | (92)    | (105)   |
| Change in unrealized gain (loss) on marketable securities, net of tax       | —                        | (6)     | 39      |
| Change in unrealized gain (loss) on cash flow hedges, net of tax            | (82)                     | 35      | (39)    |
| Change in unrecognized pension and postretirement benefit costs, net of tax | (463)                    | (405)   | (813)   |
| Comprehensive income  | \$556                    | \$3,336 | \$2,420 |

See notes to consolidated financial statements.

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

|  | Years Ended December 31, |         |         |
|--|--------------------------|---------|---------|
|  | 2012                     | 2011    | 2010    |
| <b>Cash Flows From Operating Activities:</b>                               |                          |         |         |
| Net income   | \$807                    | \$3,804 | \$3,338 |
| Adjustments to reconcile net income to net cash from operating activities: |                          |         |         |
| Depreciation and amortization  | 1,858                    | 1,782   | 1,792   |
| Pension and postretirement benefit expense                                 | 5,753                    | 1,660   | 1,136   |
| Pension and postretirement benefit contributions                           | (917)                    | (1,436) | (3,240) |
| Self-insurance reserves  | 156                      | 53      | 45      |
| Deferred taxes, credits and other  | (1,199)                  | 241     | 919     |
| Stock compensation expense   | 547                      | 524     | 519     |
| Other (gains) losses   | 186                      | 245     | (13)    |
| Changes in assets and liabilities, net of effect of acquisitions:          |                          |         |         |
| Accounts receivable  | (124)                    | (657)   | (532)   |
| Other current assets   | 10                       | 107     | (206)   |
| Accounts payable   | (58)                     | 249     | 265     |
| Accrued wages and withholdings   | 98                       | 339     | 98      |
| Other current liabilities  | 206                      | 186     | (284)   |
| Other operating activities   | (107)                    | (24)    | (2)     |
| Net cash from operating activities   | 7,216                    | 7,073   | 3,835   |
| <b>Cash Flows From Investing Activities:</b>                               |                          |         |         |
| Capital expenditures   | (2,153)                  | (2,005) | (1,389) |
| Proceeds from disposals of property, plant and equipment                   | 95                       | 27      | 304     |
| Purchases of marketable securities   | (2,357)                  | (4,903) | (2,490) |
| Sales and maturities of marketable securities                              | 2,985                    | 4,490   | 2,520   |
| Net decrease in finance receivables  | 101                      | 184     | 108     |
| Cash received (paid) for business acquisitions and dispositions            | (100)                    | (73)    | 63      |
| Other investing activities   | 94                       | (257)   | 230     |
| Net cash used in investing activities                                      | (1,335)                  | (2,537) | (654)   |
| <b>Cash Flows From Financing Activities:</b>                               |                          |         |         |
| Net change in short-term debt  | —                        | (183)   | (481)   |
| Proceeds from long-term borrowings   | 1,745                    | 279     | 2,195   |
| Repayments of long-term borrowings   | (16)                     | (191)   | (468)   |
| Purchases of common stock  | (1,621)                  | (2,665) | (817)   |
| Issuances of common stock  | 301                      | 290     | 218     |
| Dividends  | (2,130)                  | (1,997) | (1,818) |
| Other financing activities   | (96)                     | (395)   | (175)   |
| Net cash used in financing activities                                      | (1,817)                  | (4,862) | (1,346) |
| Effect Of Exchange Rate Changes On Cash And Cash Equivalents               | 229                      | (10)    | (7)     |
| Net Increase (Decrease) In Cash And Cash Equivalents                       | 4,293                    | (336)   | 1,828   |
| <b>Cash And Cash Equivalents:</b>  |                          |         |         |
| Beginning of period  | 3,034                    | 3,370   | 1,542   |
| End of period  | \$7,327                  | \$3,034 | \$3,370 |
| <b>Cash Paid During The Period For:</b>                                    |                          |         |         |
| Interest (net of amount capitalized)                                       | \$381                    | \$248   | \$340   |



|              |         |         |         |
|--------------|---------|---------|---------|
| Income taxes | \$1,988 | \$1,527 | \$1,312 |
|--------------|---------|---------|---------|

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.

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 shareholders’ 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.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2012 and 2011 was \$127 and \$117 million, respectively. Our total provision for doubtful accounts charged to expense during the years ended December 31, 2012, 2011 and 2010 was \$155, \$147 and \$199 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 \$393 and \$345 million as of December 31, 2012 and 2011, 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 8.25 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 \$18, \$17 and \$18 million for 2012, 2011, and 2010, 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 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.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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.

We recognize changes in the fair value of plan assets and net actuarial gains or losses in excess of a corridor (defined as 10% of the greater of the fair value of plan assets or the plans' projected benefit obligations) in pension expense annually at December 31st each year. The remaining components of pension expense, primarily service and interest costs and the expected return on plan assets, are recorded on a quarterly basis.

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").

**Income Taxes**

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 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.



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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. Currency transaction gains and losses, net of hedging, included in other operating expenses were pre-tax gains (losses) of \$10, \$(1) and \$7 million in 2012, 2011 and 2010, 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 three or 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 hedge's fair value that is considered to be ineffective, or is excluded from the measurement of effectiveness, is recorded immediately in income.

Recently Adopted Accounting Standards

In May 2011, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update to disclosure requirements for fair value measurement. These amendments, which became effective for us in the first quarter of 2012, result in a common definition of fair value and common measurement and disclosure requirements between U.S. GAAP and IFRS. Consequently, the amendments change some fair value measurement principles and disclosure requirements. The implementation of this amended accounting guidance had an immaterial impact on our consolidated financial position and results of operations.

In June 2011, the FASB issued an Accounting Standards Update that increases the prominence of items reported in other comprehensive income in the financial statements. This update requires companies to present comprehensive income in a single statement below net income or in a separate statement of comprehensive income immediately following the income statement. This requirement became effective for us beginning with the first quarter of 2012, and we have included the required presentation in all applicable filings since that date.



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In July 2012, the FASB issued an Accounting Standards Update that added an optional qualitative assessment for determining whether an indefinite-lived intangible asset is impaired. The objective of this update is to reduce the cost and complexity of performing an impairment test for indefinite-lived intangible assets by allowing an entity the option to make a qualitative evaluation about the likelihood of an intangible impairment to determine whether it should calculate the fair value of the asset. 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 the intangible asset is less than its carrying amount. We adopted this accounting standard update and applied its provisions to certain of our intangible assets for our annual impairment testing as of October 1, 2012.

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

In February 2013, the FASB issued an accounting standards update that adds new disclosure requirements for items reclassified out of accumulated other comprehensive income. This update requires that companies present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source (e.g., the release due to cash flow hedges from interest rate contracts) and the income statement line items affected by the reclassification (e.g., interest income or interest expense). If a component is not required to be reclassified to net income in its entirety (e.g., the net periodic pension cost), companies would instead cross reference to the related footnote for additional information (e.g., the pension footnote). This update is effective for us beginning in the first quarter of 2013.

Other accounting pronouncements issued, but not effective until after December 31, 2012, 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.

**NOTE 2. CASH AND INVESTMENTS**

The following is a summary of marketable securities classified as available-for-sale at December 31, 2012 and 2011 (in millions):

|  | Cost  | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|--|-------|---------------------|----------------------|-------------------------|
| <b>2012</b>                                    |       |                     |                      |                         |
| Current marketable securities:                 |       |                     |                      |                         |
| U.S. government and agency debt securities     | \$236 | \$2                 | \$—                  | \$238                   |
| Mortgage and asset-backed debt securities      | 171   | 3                   | —                    | 174                     |
| Corporate debt securities                      | 158   | 5                   | —                    | 163                     |
| U.S. state and local municipal debt securities | 15    | —                   | —                    | 15                      |
| Other debt and equity securities               | 7     | —                   | —                    | 7                       |
| Total marketable securities                    | \$587 | \$10                | \$—                  | \$597                   |
| <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                   |



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|  |         |      |      |           |
|--|---------|------|------|-----------|
| 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 |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The gross realized gains on sales of marketable securities totaled \$15, \$49 and \$24 million in 2012, 2011, and 2010, respectively. The gross realized losses totaled \$6, \$20 and \$18 million in 2012, 2011, and 2010, respectively. There were no impairment losses recognized on marketable securities during 2012 or 2011, while impairment losses totaled \$21 million during 2010 (discussed further below).

**Investment Other-Than-Temporary Impairments**

We have concluded that no other-than-temporary impairment losses existed as of December 31, 2012. In making this determination, we considered the financial condition and prospects of the issuer, the magnitude of the losses compared with the investments' cost, the 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.

**Maturity Information**

The amortized cost and estimated fair value of marketable securities at December 31, 2012, by contractual maturity, are shown below (in millions). Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

|  | Cost  | Estimated<br>Fair Value |
|--|-------|-------------------------|
| Due in one year or less                  | \$37  | \$37                    |
| Due after one year through three years   | 251   | 252                     |
| Due after three years through five years | 49    | 49                      |
| Due after five years                     | 248   | 257                     |
|  | 585   | 595                     |
| Equity securities                        | 2     | 2                       |
|  | \$587 | \$597                   |

**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 "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, 2012 and 2011, we had \$288 and \$286 million in restricted cash, respectively.

We held a \$19 and \$17 million investment in a variable life insurance policy to fund benefits for the UPS Excess Coordinating Benefit Plan at December 31, 2012 and 2011, respectively. This investment is classified as "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.

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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 with two significant inputs: (1) the after-tax cash flow projections for each partnership, and (2) a risk-adjusted discount rate consistent with the duration of the expected cash flows for each partnership. The weighted-average discount rates used to value these investments were 7.75% and 7.91% as of December 31, 2012 and 2011, respectively. These inputs and the resulting fair values are updated on a quarterly basis.

The following table presents information about our investments measured at fair value on a recurring basis as of December 31, 2012 and 2011, 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) | Total |
|--|--|---|--|-------|
| 2012   |  |   |  |       |
| Marketable securities:                         |  |   |  |       |
| U.S. government and agency debt securities     | \$237  | \$1   | \$—  | \$238 |
| Mortgage and asset-backed debt securities      | —  | 174   | —  | 174   |
| Corporate debt securities                      | —  | 163   | —  | 163   |
| U.S. state and local municipal debt securities | —  | 15  | —  | 15    |
| Other debt and equity securities               | —  | 7   | —  | 7     |
| Total marketable securities                    | 237  | 360   | —  | 597   |
| Other investments                              | 19   | —   | 163  | 182   |
| Total  | \$256  | \$360   | \$163  | \$779 |

|  | 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) | Total |
|--|--|---|--|-------|
| 2011   |  |   |  |       |
| 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    |

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|                             |       |         |       |         |
|-----------------------------|-------|---------|-------|---------|
| Total marketable securities | 187   | 1,054   | —     | 1,241   |
| Other investments           | 17    | —       | 217   | 234     |
| Total                       | \$204 | \$1,054 | \$217 | \$1,475 |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the years ended December 31, 2012 and 2011 (in millions).

|  | Marketable<br>Securities | Other<br>Investments | Total  |
|--|--------------------------|----------------------|--------|
| Balance on January 1, 2011                                   | \$ 138                   | \$ 267               | \$ 405 |
| Transfers into (out of) Level 3                              | —                        | —                    | —      |
| Net realized and unrealized gains (losses):                  |                          |                      |        |
| Included in earnings (in investment income)                  | —                        | (50                  | ) (50  |
| Included in accumulated other comprehensive income (pre-tax) | —                        | —                    | —      |
| Purchases  | —                        | —                    | —      |
| Settlements  | (138                     | ) —                  | (138   |
| Balance on December 31, 2011                                 | \$—                      | \$ 217               | \$ 217 |
| Transfers into (out of) Level 3                              | —                        | —                    | —      |
| Net realized and unrealized gains (losses):                  |                          |                      |        |
| Included in earnings (in investment income)                  | —                        | (54                  | ) (54  |
| Included in accumulated other comprehensive income (pre-tax) | —                        | —                    | —      |
| Purchases  | —                        | —                    | —      |
| Settlements  | —                        | —                    | —      |
| Balance on December 31, 2012                                 | \$—                      | \$ 163               | \$ 163 |

## NOTE 3. 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):

|   | 2012      | 2011      |
|---|-----------|-----------|
| Vehicles  | \$6,344   | \$5,981   |
| Aircraft  | 15,164    | 14,616    |
| Land  | 1,122     | 1,114     |
| Buildings                                       | 3,138     | 3,095     |
| Building and leasehold improvements             | 3,049     | 2,943     |
| Plant equipment                                 | 7,010     | 6,803     |
| Technology equipment                            | 1,675     | 1,593     |
| Equipment under operating leases                | 69        | 93        |
| Construction-in-progress                        | 470       | 303       |
|   | 38,041    | 36,541    |
| Less: Accumulated depreciation and amortization | (20,147   | ) (18,920 |
|   | \$ 17,894 | \$ 17,621 |

We continually monitor our aircraft fleet utilization in light of current and projected volume levels, aircraft fuel prices and other factors. Additionally, we monitor our other property, plant and equipment categories for any indicators that the carrying value of the assets exceed the fair value. In 2012, 2011 and 2010, there were no indicators of impairment in our property, plant and equipment, and no impairment charges were recorded in any period.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. 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.

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 \$83, \$80 and \$4 million for 2012, 2011 and 2010, respectively.

Contributions are also made to defined contribution money purchase plans under certain collective bargaining agreements. Amounts charged to expense were \$80, \$76 and \$78 million for 2012, 2011 and 2010, respectively.

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## 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 |       |       |
|---------------------------|-----------------------|----------|----------|--------------------------------------|-------|-------|--------------------------------|-------|-------|
|                           | 2012                  | 2011     | 2010     | 2012                                 | 2011  | 2010  | 2012                           | 2011  | 2010  |
| Net Periodic Cost:        |                       |          |          |                                      |       |       |                                |       |       |
| Service cost              | \$998                 | \$870    | \$723    | \$89                                 | \$89  | \$86  | \$41                           | \$34  | \$24  |
| Interest cost             | 1,410                 | 1,309    | 1,199    | 208                                  | 207   | 214   | 41                             | 39    | 34    |
| Expected return on assets | (1,970 )              | (1,835 ) | (1,381 ) | (18 )                                | (16 ) | (22 ) | (47 )                          | (43 ) | (36 ) |
| Amortization of:          |                       |          |          |                                      |       |       |                                |       |       |
| Transition obligation     | —                     | —        | —        | —                                    | —     | —     | —                              | —     | —     |
| Prior service cost        | 173                   | 171      | 172      | 5                                    | 7     | 4     | 2                              | 1     | 1     |
| Actuarial (gain) loss     | 4,388                 | 736      | 70       | 374                                  | —     | —     | 69                             | 91    | 42    |
| Other                     | —                     | —        | —        | —                                    | —     | —     | (10 )                          | —     | 6     |
| Net periodic benefit cost | \$4,999               | \$1,251  | \$783    | \$658                                | \$287 | \$282 | \$96                           | \$122 | \$71  |

## 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 |        |        |
|-------------------------------|-----------------------|--------|--------|--------------------------------------|--------|--------|--------------------------------|--------|--------|
|                               | 2012                  | 2011   | 2010   | 2012                                 | 2011   | 2010   | 2012                           | 2011   | 2010   |
| Discount rate                 | 5.64 %                | 5.98 % | 6.58 % | 5.47 %                               | 5.77 % | 6.43 % | 4.63 %                         | 5.36 % | 5.84 % |
| Rate of compensation increase | 4.50 %                | 4.50 % | 4.50 % | N/A                                  | N/A    | N/A    | 3.58 %                         | 3.57 % | 3.62 % |
| Expected return on assets     | 8.75 %                | 8.75 % | 8.75 % | 8.75 %                               | 8.75 % | 8.75 % | 7.20 %                         | 7.31 % | 7.25 % |

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 |        |      |
|-------------------------------|-----------------------|--------|--------|--------------------------------------|--------|--------|--------------------------------|--------|------|
|                               | 2012                  | 2011   | 2010   | 2012                                 | 2011   | 2010   | 2012                           | 2011   | 2010 |
| Discount rate                 | 4.42 %                | 5.64 % | 4.21 % | 5.47 %                               | 4.00 % | 4.63 % | 3.03 %                         | 3.58 % |      |
| Rate of compensation increase | 4.16 %                | 4.50 % | N/A    | N/A                                  |        |        |                                |        |      |

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 2012, each basis point increase in the discount rate decreases the projected benefit obligation by approximately \$57 million and \$5 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.

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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 2012 U.S. plan obligations, future postretirement medical benefit costs were forecasted assuming an initial annual increase of 7.5%, decreasing to 5.0% by the year 2018 and with consistent annual increases at those ultimate levels thereafter.

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 2012 results (in millions):

|   | 1% Increase | 1% Decrease |
|---|-------------|-------------|
| Effect on total of service cost and interest cost | \$4         | \$(4)       |
| Effect on postretirement benefit obligation       | \$58        | \$(69)      |

## 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 |       |
|---|-----------------------|----------|--------------------------------------|---------|--------------------------------|-------|
|   | 2012                  | 2011     | 2012                                 | 2011    | 2012                           | 2011  |
| <b>Benefit Obligations:</b>                       |                       |          |                                      |         |                                |       |
| Projected benefit obligation at beginning of year | \$24,386              | \$21,342 | \$3,836                              | \$3,597 | \$841                          | \$680 |
| Service cost                                      | 998                   | 870      | 89                                   | 89      | 41                             | 34    |
| Interest cost                                     | 1,410                 | 1,309    | 208                                  | 207     | 41                             | 39    |
| Gross benefits paid                               | (774)                 | (657)    | (233)                                | (219)   | (20)                           | (15)  |
| Plan participants' contributions                  | —                     | —        | 16                                   | 16      | 4                              | 1     |
| Plan amendments                                   | (2)                   | 3        | 1                                    | (24)    | —                              | 7     |
| Actuarial (gain)/loss                             | 5,850                 | 1,519    | 495                                  | 170     | 112                            | 99    |
| Foreign currency exchange rate changes            | —                     | —        | —                                    | —       | 24                             | (4)   |
| Curtailments and settlements                      | —                     | —        | —                                    | —       | (5)                            | —     |
| Other   | —                     | —        | —                                    | —       | 51                             | —     |
| Projected benefit obligation at end of year       | \$31,868              | \$24,386 | \$4,412                              | \$3,836 | \$1,089                        | \$841 |
| <b>Fair Value of Plan Assets:</b>                 |                       |          |                                      |         |                                |       |
| Fair value of plan assets at beginning of year    | \$22,663              | \$20,092 | \$174                                | \$233   | \$613                          | \$561 |
| Actual return on plan assets                      | 2,684                 | 1,956    | 19                                   | 9       | 56                             | 10    |
| Employer contributions                            | 368                   | 1,272    | 475                                  | 108     | 74                             | 56    |
| Plan participants' contributions                  | —                     | —        | 16                                   | 16      | 1                              | 1     |
| Gross benefits paid                               | (774)                 | (657)    | (233)                                | (219)   | (20)                           | (15)  |
| Foreign currency exchange rate changes            | —                     | —        | —                                    | —       | 20                             | —     |
| Curtailments and settlements                      | —                     | —        | —                                    | —       | (4)                            | —     |
| Other   | —                     | —        | 9                                    | 27      | 61                             | —     |

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|  |          |          |       |       |       |       |
|--|----------|----------|-------|-------|-------|-------|
| Fair value of plan assets at end of year | \$24,941 | \$22,663 | \$460 | \$174 | \$801 | \$613 |
|--|----------|----------|-------|-------|-------|-------|

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## 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 |          |
|---|-----------------------|------------|--------------------------------------|------------|--------------------------------|----------|
|   | 2012                  | 2011       | 2012                                 | 2011       | 2012                           | 2011     |
| <b>Funded Status:</b>   |                       |            |                                      |            |                                |          |
| Fair value of plan assets                                     | \$24,941              | \$22,663   | \$460                                | \$174      | \$801                          | \$613    |
| Benefit obligation  | (31,868 )             | (24,386 )  | (4,412 )                             | (3,836 )   | (1,089 )                       | (841 )   |
| Funded status recognized at December 31                       | \$(6,927 )            | \$(1,723 ) | \$(3,952 )                           | \$(3,662 ) | \$(288 )                       | \$(228 ) |
| <b>Funded Status Amounts Recognized in our Balance Sheet:</b> |                       |            |                                      |            |                                |          |
| Other non-current assets                                      | \$—                   | \$—        | \$—                                  | \$—        | \$26                           | \$1      |
| Other current liabilities                                     | (14 )                 | (13 )      | (108 )                               | (93 )      | (3 )                           | (3 )     |
| Pension and postretirement benefit obligations                | (6,913 )              | (1,710 )   | (3,844 )                             | (3,569 )   | (311 )                         | (226 )   |
| Net liability at December 31                                  | \$(6,927 )            | \$(1,723 ) | \$(3,952 )                           | \$(3,662 ) | \$(288 )                       | \$(228 ) |
| <b>Amounts Recognized in AOCI:</b>                            |                       |            |                                      |            |                                |          |
| Unrecognized net prior service cost                           | \$(1,318 )            | \$(1,492 ) | \$(79 )                              | \$(82 )    | \$(13 )                        | \$(14 )  |
| Unrecognized net actuarial loss                               | (3,187 )              | (2,439 )   | (441 )                               | (307 )     | (86 )                          | (52 )    |
| Gross unrecognized cost at December 31                        | (4,505 )              | (3,931 )   | (520 )                               | (389 )     | (99 )                          | (66 )    |
| Deferred tax asset at December 31                             | 1,694                 | 1,479      | 196                                  | 146        | 26                             | 16       |
| Net unrecognized cost at December 31                          | \$(2,811 )            | \$(2,452 ) | \$(324 )                             | \$(243 )   | \$(73 )                        | \$(50 )  |

The accumulated benefit obligation for our pension plans as of the measurement dates in 2012 and 2011 was \$30.350 and \$23.307 billion, respectively.

Benefit payments under the pension plans include \$16 and \$14 million paid from employer assets in both 2012 and 2011. Benefit payments (net of participant contributions) under the postretirement medical benefit plans include \$110 and \$108 million paid from employer assets in 2012 and 2011, respectively. Such benefit payments from employer assets are also categorized as employer contributions.

At December 31, 2012 and 2011, 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 |         |
|---------------------------------------|--|----------|--|---------|
|                                       | 2012   | 2011     | 2012   | 2011    |
| <b>U.S. Pension Benefits</b>          |  |          |  |         |
| Projected benefit obligation          | \$31,868   | \$24,386 | \$31,868   | \$7,499 |
| Accumulated benefit obligation        | 29,382   | 22,574   | 29,382   | 7,395   |
| Fair value of plan assets             | 24,941   | 22,663   | 24,941   | 6,646   |
| <b>International Pension Benefits</b> |  |          |  |         |
| Projected benefit obligation          | \$1,028  | \$814    | \$678  | \$499   |
| Accumulated benefit obligation        | 917  | 714      | 606  | 448     |
| Fair value of plan assets             | 723  | 594      | 388  | 296     |

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



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## Pension and Postretirement Plan Assets

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.

The fair values of U.S. pension and postretirement benefit plan assets by asset category as of December 31, 2012 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 - 2012 | Target Allocation 2012 |
|------------------------------------|-----------|----------|----------|--------------|----------------------------------|------------------------|
| Asset Category:                    |           |          |          |              |                                  |                        |
| Cash and cash equivalents          | \$ 103    | \$ 139   | \$—      | \$ 242       | 0.9                              | % 0-5                  |
| Equity Securities:                 |           |          |          |              |                                  |                        |
| U.S. Large Cap                     | 2,548     | 2,162    | —        | 4,710        |                                  |                        |
| U.S. Small Cap                     | 450       | 31       | —        | 481          |                                  |                        |
| Emerging Markets                   | 1,160     | 123      | —        | 1,283        |                                  |                        |
| Global Equity                      | 2,242     | —        | —        | 2,242        |                                  |                        |
| International Equity               | 442       | 694      | —        | 1,136        |                                  |                        |
| Total Equity Securities            | 6,842     | 3,010    | —        | 9,852        | 38.8                             | 35-55                  |
| Fixed Income Securities:           |           |          |          |              |                                  |                        |
| U.S. Government Securities         | 4,008     | 443      | —        | 4,451        |                                  |                        |
| Corporate Bonds                    | 9         | 3,113    | 138      | 3,260        |                                  |                        |
| Global Bonds                       | —         | 457      | —        | 457          |                                  |                        |
| Municipal Bonds                    | —         | 83       | —        | 83           |                                  |                        |
| Total Fixed Income Securities      | 4,017     | 4,096    | 138      | 8,251        | 32.5                             | 25-35                  |
| Other Investments:                 |           |          |          |              |                                  |                        |
| Hedge Funds                        | —         | —        | 2,829    | 2,829        | 11.1                             | 5-15                   |
| Private Equity                     | —         | —        | 1,416    | 1,416        | 5.6                              | 1-10                   |
| Real Estate                        | 177       | 23       | 1,039    | 1,239        | 4.9                              | 1-10                   |
| Structured Products <sup>(1)</sup> | —         | 210      | —        | 210          | 0.8                              | 0-5                    |
| Other <sup>(2)</sup>               | —         | —        | 1,362    | 1,362        | 5.4                              | 1-10                   |
| Total U.S. Plan Assets             | \$ 11,139 | \$ 7,478 | \$ 6,784 | \$ 25,401    | 100.0                            | %                      |

(1) Represents mortgage and asset-backed securities.

(2) Represents global balanced-risk commingled funds, consisting primarily of equity, bonds, and some currencies and commodities.

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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 |
|-------------------------------|---------|---------|---------|--------------|----------------------------------|------------------------|
| Asset Category:               |         |         |         |              |                                  |                        |
| Cash and cash equivalents     | \$74    | \$1     | \$—     | \$75         | 0.3                              | % 0-5                  |
| Equity Securities:            |         |         |         |              |                                  |                        |
| U.S. Large Cap                | 2,264   | 2,460   | —       | 4,724        |                                  |                        |
| U.S. Small Cap                | 706     | 27      | —       | 733          |                                  |                        |
| Emerging Markets              | 533     | 264     | —       | 797          |                                  |                        |
| Global Equity                 | 1,115   | 12      | —       | 1,127        |                                  |                        |
| International Equity          | 810     | 1,091   | —       | 1,901        |                                  |                        |
| Total Equity Securities       | 5,428   | 3,854   | —       | 9,282        | 40.7                             | 35-55                  |
| Fixed Income Securities:      |         |         |         |              |                                  |                        |
| U.S. Government Securities    | 3,374   | 1,131   | —       | 4,505        |                                  |                        |
| Corporate Bonds               | 9       | 3,462   | 80      | 3,551        |                                  |                        |
| Global Bonds                  | 38      | 69      | —       | 107          |                                  |                        |
| Municipal Bonds               | —       | 121     | —       | 121          |                                  |                        |
| Total Fixed Income Securities | 3,421   | 4,783   | 80      | 8,284        | 36.3                             | 20-40                  |
| Other Investments:            |         |         |         |              |                                  |                        |
| Hedge Funds                   | —       | —       | 2,132   | 2,132        | 9.3                              | 5-15                   |
| Private Equity                | —       | —       | 1,354   | 1,354        | 5.9                              | 1-10                   |
| Real Estate                   | 151     | —       | 948     | 1,099        | 4.8                              | 1-10                   |
| Other <sup>(1)</sup>          | —       | —       | 611     | 611          | 2.7                              | 1-10                   |
| Total U.S. Plan Assets        | \$9,074 | \$8,638 | \$5,125 | \$22,837     | 100.0                            | %                      |

<sup>(1)</sup> Represents global balanced-risk commingled funds, consisting primarily of equity, bonds, and some currencies and commodities.

There were no UPS class A or B shares of common stock directly held in plan assets as of December 31, 2012 or December 31, 2011.

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.



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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 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.

As of December 31, 2012 and 2011, \$2.960 and \$3.895 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, 2012.

As of December 31, 2012 and 2011, the plans hold \$2.455 and \$2.302 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, 2012, unfunded commitments to such limited partnerships totaling approximately \$626 million are expected to be contributed over the remaining investment period, typically ranging between three and six years.

As of December 31, 2012 and 2011, \$4.191 and \$2.743 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, 2012.

The following tables presents the changes in the Level 3 instruments measured on a recurring basis for the years ended December 31, 2012 and 2011 (in millions):

|                                 | Corporate<br>Bonds | Hedge<br>Funds | Real<br>Estate | Private<br>Equity | Other | Total   |
|---------------------------------|--------------------|----------------|----------------|-------------------|-------|---------|
| Balance on January 1, 2011      | \$193              | \$1,765        | \$789          | \$1,309           | \$258 | \$4,314 |
| Actual Return on Assets:        |                    |                |                |                   |       |         |
| Assets Held at End of Year      | (14                | ) 69           | 144            | 145               | 53    | 397     |
| Assets Sold During the Year     | 3                  | 22             | 5              | —                 | —     | 30      |
| Purchases                       | 57                 | 457            | 150            | 164               | 300   | 1,128   |
| Sales                           | (159               | ) (181         | ) (140         | ) (264            | ) —   | (744    |
| Settlements                     | —                  | —              | —              | —                 | —     | —       |
| Transfers Into (Out of) Level 3 | —                  | —              | —              | —                 | —     | —       |
| Balance on December 31, 2011    | \$80               | \$2,132        | \$948          | \$1,354           | \$611 | \$5,125 |
| Actual Return on Assets:        |                    |                |                |                   |       |         |
| Assets Held at End of Year      | 1                  | 59             | 85             | 163               | 151   | 459     |
| Assets Sold During the Year     | (3                 | ) 5            | 4              | —                 | —     | 6       |
| Purchases                       | 71                 | 1,300          | 144            | 184               | 600   | 2,299   |
| Sales                           | (11                | ) (667         | ) (142         | ) (285            | ) —   | (1,105  |

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|                                 |       |         |         |         |         |         |
|---------------------------------|-------|---------|---------|---------|---------|---------|
| Settlements                     | —     | —       | —       | —       | —       | —       |
| Transfers Into (Out of) Level 3 | —     | —       | —       | —       | —       | —       |
| Balance on December 31, 2012    | \$138 | \$2,829 | \$1,039 | \$1,416 | \$1,362 | \$6,784 |

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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 were approximately 56% in equity securities, 34% in debt securities and 10% in other securities in 2012 (approximately 55%, 35%, and 10% in 2011, respectively). The amount of assets having significant unobservable inputs (Level 3), if any, in these plans would be immaterial to our financial statements.

**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 2013 are as follows (in millions):

|                                | U.S. Pension Benefits | U.S. Postretirement Medical Benefits | International Pension Benefits |
|--------------------------------|-----------------------|--------------------------------------|--------------------------------|
| Prior service cost / (benefit) | \$ 172                | \$4                                  | \$2                            |
| Expected Cash Flows            |                       |                                      |                                |

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

|                                      | U.S. Pension Benefits | U.S. Postretirement Medical Benefits | International Pension Benefits |
|--------------------------------------|-----------------------|--------------------------------------|--------------------------------|
| <b>Employer Contributions:</b>       |                       |                                      |                                |
| 2013 (expected) to plan trusts       | \$—                   | \$—                                  | \$ 76                          |
| 2013 (expected) to plan participants | 14                    | 111                                  | 3                              |
| <b>Expected Benefit Payments:</b>    |                       |                                      |                                |
| 2013                                 | \$ 798                | \$255                                | \$ 20                          |
| 2014                                 | 887                   | 237                                  | 22                             |
| 2015                                 | 978                   | 254                                  | 25                             |
| 2016                                 | 1,076                 | 271                                  | 27                             |
| 2017                                 | 1,182                 | 288                                  | 30                             |
| 2018 - 2022                          | 7,815                 | 1,575                                | 199                            |

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.

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## NOTE 5. 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.

The discussion that follows sets forth the financial impact on our results of operations and cash flows for the years ended December 31, 2012, 2011 and 2010 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 2012, 2011 and 2010 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, 2012, 2011 and 2010, 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 2012 and 2011 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, 2012, 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% of the total plan contributions from all employers for 2012, 2011 and 2010 (as disclosed in the Form 5500 for each respective plan).

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.



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|   | EIN / Pension Plan Number | Pension Protection Act Zone Status |        | FIP/RP Status Pending/ Implemented | (in millions) UPS Contributions |      |      | Surcharge Imposed |
|---|---------------------------|------------------------------------|--------|------------------------------------|---------------------------------|------|------|-------------------|
|   |                           | 2012                               | 2011   |                                    | 2012                            | 2011 | 2010 |                   |
| Alaska Teamster-Employer Pension Plan                                   | 92-6003463-024            | Red                                | Red    | Yes/Implemented                    | \$4                             | \$4  | \$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            | Yellow                             | Green  | Yes/Implemented                    | 29                              | 27   | 26   | No                |
| Employer-Teamsters Local Nos. 175 & 505 Pension Trust Fund              | 55-6021850-001            | Green                              | Green  | No                                 | 9                               | 8    | 8    | No                |
| Hagerstown Motor Carriers and Teamsters Pension Fund                    | 52-6045424-001            | Red                                | Red    | Yes/Implemented                    | 5                               | 5    | 4    | No                |
| I.A.M. National Pension Fund / National Pension Plan                    | 51-6031295-002            | Green                              | Green  | No                                 | 24                              | 25   | 24   | No                |
| International Brotherhood of Teamsters Union Local No. 710 Pension Fund | 36-2377656-001            | Green                              | Yellow | No                                 | 75                              | 74   | 70   | No                |
| Local 705, International Brotherhood of Teamsters Pension Plan          | 36-6492502-001            | Red                                | Yellow | Yes/Implemented                    | 46                              | 58   | 56   | No                |
| Local 804 I.B.T. & Local 447 I.A.M.—UPS Multiemployer Retirement Plan   | 51-6117726-001            | Red                                | Red    | Yes/Implemented                    | 87                              | 84   | 84   | No                |
| Milwaukee Drivers Pension Trust Fund                                    | 39-6045229-001            | Green                              | Green  | No                                 | 26                              | 26   | 24   | No                |
| New England Teamsters & Trucking Industry Pension Fund                  | 04-6372430-001            | Red                                | Red    | Yes/Implemented                    | 124                             | 124  | 112  | No                |
| New York State Teamsters Conference Pension and Retirement Fund         | 16-6063585-074            | Red                                | Red    | Yes/Implemented                    | 65                              | 57   | 52   | No                |
| Teamster Pension Fund of Philadelphia and Vicinity                      | 23-1511735-001            | Yellow                             | Yellow | Yes/Implemented                    | 44                              | 41   | 39   | No                |
| Teamsters Joint Council No. 83 of Virginia Pension Fund                 | 54-6097996-001            | Yellow                             | Yellow | Yes/Implemented                    | 44                              | 41   | 38   | No                |
|   | 53-0237142-001            | Green                              | Green  | Yes/Implemented                    | 36                              | 33   | 31   | No                |



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## 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.

|  | (in millions)     |         |         |
|--|-------------------|---------|---------|
|  | UPS Contributions |         |         |
|  | 2012              | 2011    | 2010    |
| Health and Welfare Fund  |                   |         |         |
| Bay Area Delivery Drivers  | \$28              | \$27    | \$26    |
| Central Pennsylvania Teamsters Health & Pension Fund                                 | 19                | 18      | 17      |
| Central States, South East & South West Areas Health and Welfare Fund                | 471               | 452     | 441     |
| Delta Health Systems—East Bay Drayage Drivers  | 24                | 17      | 15      |
| Employer—Teamster Local Nos. 175 & 505   | 8                 | 8       | 7       |
| Joint Council #83 Health & Welfare Fund  | 25                | 25      | 25      |
| Local 191 Teamsters Health Fund  | 9                 | 9       | 9       |
| Local 401 Teamsters Health & Welfare Fund  | 6                 | 6       | 5       |
| Local 804 Welfare Trust Fund   | 62                | 58      | 54      |
| Milwaukee Drivers Pension Trust Fund—Milwaukee Drivers Health and Welfare Trust Fund | 29                | 28      | 27      |
| Montana Teamster Employers Trust   | 6                 | 6       | 6       |
| New York State Teamsters Health & Hospital Fund                                      | 44                | 41      | 40      |
| North Coast Benefit Trust  | 7                 | 7       | 7       |
| Northern California General Teamsters (DELTA)  | 75                | 73      | 70      |
| Northern New England Benefit Trust   | 33                | 32      | 31      |
| Oregon / Teamster Employers Trust  | 27                | 27      | 25      |
| Teamsters 170 Health & Welfare Fund  | 12                | 12      | 12      |
| Teamsters Benefit Trust  | 32                | 29      | 27      |
| Teamsters Local 251 Health & Insurance Plan  | 10                | 10      | 10      |
| Teamsters Local 404 Health & Insurance Plan  | 6                 | 6       | 6       |
| Teamsters Local 638 Health Fund  | 29                | 28      | 27      |
| Teamsters Local 639—Employers Health & Pension Trust Funds                           | 22                | 22      | 21      |
| Teamsters Local 671 Health Services & Insurance Plan                                 | 12                | 13      | 12      |
| Teamsters Union 25 Health Services & Insurance Plan                                  | 36                | 34      | 33      |
| Teamsters Union Local 677 Health Services & Insurance Plan                           | 8                 | 8       | 7       |
| Truck Drivers and Helpers Local 355 Baltimore Area Health & Welfare Fund             | 13                | 12      | 12      |
| Utah-Idaho Teamsters Security Fund   | 16                | 15      | 15      |
| Washington Teamsters Welfare Trust   | 32                | 30      | 27      |
| All Other Multiemployer Health and Welfare Plans                                     | 55                | 50      | 52      |
| Total Contributions  | \$1,156           | \$1,103 | \$1,066 |



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## NOTE 6. 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 |
|------------------------------|--------------------------|--------------------------|---------------------------|--------------|
| Balance on January 1, 2011   | \$—                      | \$377                    | \$1,704                   | \$2,081      |
| Acquired                     | —                        | —                        | 46                        | 46           |
| Currency / Other             | —                        | (16                      | ) (10                     | ) (26        |
| Balance on December 31, 2011 | \$—                      | \$361                    | \$1,740                   | \$2,101      |
| Acquired                     | —                        | 67                       | —                         | 67           |
| Currency / Other             | —                        | 2                        | 3                         | 5            |
| Balance on December 31, 2012 | \$—                      | \$430                    | \$1,743                   | \$2,173      |

**Business Acquisitions**

The increase in goodwill within the International Package segment in 2012 was due to the February acquisition of 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 broadens our service portfolio for business-to-consumer deliveries.

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.

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.

The remaining change in goodwill for both the International Package and Supply Chain & Freight segments was due to the impact of changes in the value of the U.S. Dollar on the translation of non-U.S. Dollar goodwill balances.

**Goodwill Impairment**

We test our goodwill for impairment annually, as of October 1st, 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.

We did not have any goodwill impairment charges in 2012, 2011 or 2010. 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.

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## Intangible Assets

The following is a summary of intangible assets at December 31, 2012 and 2011 (in millions):

|  | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net Carrying<br>Value | Weighted-<br>Average<br>Amortization<br>Period<br>(in years) |
|--|--------------------------|-----------------------------|-----------------------|--|
| December 31, 2012                        |                          |                             |                       |  |
| Trademarks, licenses, patents, and other | \$163                    | \$(80)                      | ) \$83                | 5.5  |
| Customer lists                           | 131                      | (79)                        | ) 52                  | 11.5   |
| Franchise rights                         | 117                      | (64)                        | ) 53                  | 20.0   |
| Capitalized software                     | 2,197                    | (1,782)                     | ) 415                 | 3.1  |
| Total Intangible Assets, Net             | \$2,608                  | \$(2,005)                   | ) \$603               | 4.4  |
| December 31, 2011                        |                          |                             |                       |  |
| Trademarks, licenses, patents, and other | \$146                    | \$(54)                      | ) \$92                |  |
| Customer lists                           | 120                      | (66)                        | ) 54                  |  |
| Franchise rights                         | 109                      | (58)                        | ) 51                  |  |
| Capitalized software                     | 2,014                    | (1,626)                     | ) 388                 |  |
| Total Intangible Assets, Net             | \$2,389                  | \$(1,804)                   | ) \$585               |  |

Licenses with a carrying value of \$5 million as of December 31, 2012 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 2012, 2011 or 2010.

Amortization of intangible assets was \$244, \$228 and \$224 million during 2012, 2011 or 2010, respectively. Expected amortization of finite-lived intangible assets recorded as of December 31, 2012 for the next five years is as follows (in millions): 2013—\$252; 2014—\$168; 2015—\$94; 2016—\$14; 2017—\$13. Amortization expense in future periods will be affected by business acquisitions, software development, licensing agreements, sponsorships and other factors.

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## NOTE 7. DEBT AND FINANCING ARRANGEMENTS

The following table sets forth the principal amount, maturity or range of maturities, as well as the carrying value of our debt obligations, as of December 31, 2012 and 2011 (in millions). The carrying value of these debt obligations can differ from the principal amount due to the impact of unamortized discounts or premiums and valuation adjustments resulting from interest rate swap hedging relationships.

|                            | Principal<br>Amount | Maturity    | Carrying Value |          |
|----------------------------|---------------------|-------------|----------------|----------|
|                            |                     |             | 2012           | 2011     |
| Commercial paper           | \$—                 |             | \$—            | \$—      |
| Fixed-rate senior notes:   |                     |             |                |          |
| 4.50% senior notes         | 1,750               | 2013        | 1,751          | 1,778    |
| 3.875% senior notes        | 1,000               | 2014        | 1,033          | 1,050    |
| 1.125% senior notes        | 375                 | 2017        | 373            | —        |
| 5.50% senior notes         | 750                 | 2018        | 851            | 841      |
| 5.125% senior notes        | 1,000               | 2019        | 1,140          | 1,119    |
| 3.125% senior notes        | 1,500               | 2021        | 1,655          | 1,641    |
| 2.45% senior notes         | 1,000               | 2022        | 996            | —        |
| 6.20% senior notes         | 1,500               | 2038        | 1,480          | 1,480    |
| 4.875% senior notes        | 500                 | 2040        | 489            | 489      |
| 3.625% senior notes        | 375                 | 2042        | 367            | —        |
| 8.375% Debentures:         |                     |             |                |          |
| 8.375% debentures          | 424                 | 2020        | 512            | 504      |
| 8.375% debentures          | 276                 | 2030        | 284            | 284      |
| Pound Sterling Notes:      |                     |             |                |          |
| 5.50% notes                | 107                 | 2031        | 103            | 99       |
| 5.13% notes                | 734                 | 2050        | 699            | 678      |
| Floating rate senior notes | 378                 | 2049 – 2053 | 374            | 376      |
| Capital lease obligations  | 440                 | 2013 – 3004 | 440            | 469      |
| Facility notes and bonds   | 320                 | 2015 – 2036 | 320            | 320      |
| Other debt                 | 3                   | 2013 - 2022 | 3              | —        |
| Total debt                 | \$12,432            |             | 12,870         | 11,128   |
| Less: current maturities   |                     |             | (1,781 )       | (33 )    |
| Long-term debt             |                     |             | \$11,089       | \$11,095 |

## Commercial Paper

We are authorized to borrow up to \$10.0 billion under our U.S. commercial paper program. 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. No amounts were outstanding under these programs as of December 31, 2012. The amount of commercial paper outstanding under these programs in 2013 is expected to fluctuate.

## Fixed Rate Senior Notes

We have completed several offerings of fixed rate senior notes. 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. We subsequently entered into interest rate swaps on several of these notes, which effectively converted the fixed interest rates on the notes to variable LIBOR-based interest rates. The average interest rate payable on these notes, including the impact of the interest rate swaps, for 2012 and 2011, respectively, were as follows:



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|                     | Principal |          | Average Effective Interest Rate |        |   |
|---------------------|-----------|----------|---------------------------------|--------|---|
|                     | Value     | Maturity | 2012                            | 2011   |   |
| 4.50% senior notes  | 1,750     | 2013     | 2.51 %                          | 2.39 % | % |
| 3.875% senior notes | 1,000     | 2014     | 1.14 %                          | 0.99 % | % |
| 1.125% senior notes | 375       | 2017     | 0.57 %                          | —      | % |
| 5.50% senior notes  | 750       | 2018     | 2.71 %                          | 2.53 % | % |
| 5.125% senior notes | 1,000     | 2019     | 2.20 %                          | 2.04 % | % |
| 3.125% senior notes | 1,500     | 2021     | 1.28 %                          | 0.52 % | % |
| 2.45% senior notes  | 1,000     | 2022     | 0.86 %                          | —      | % |
| 8.375% Debentures   |           |          |                                 |        |   |

The 8.375% debentures consist of two separate tranches, as follows:

\$276 million of the debentures have a maturity of April 1, 2030. These debentures have an 8.375% interest rate until April 1, 2020, and, thereafter, the interest rate will be 7.62% for the final 10 years. These 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.

\$424 million of the debentures have a maturity of April 1, 2020. These 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 2012 and 2011 was 5.73% and 5.97%, respectively.

**Floating Rate Senior Notes**

The floating rate senior notes bear interest at one-month LIBOR less 45 basis points. The average interest rate for 2012 and 2011 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 2012 and 2011, we redeemed notes with a principal value of \$2 and \$10 million, respectively, after put options were exercised by the note holders.

**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):

|                          | 2012    | 2011    |
|--------------------------|---------|---------|
| Vehicles                 | \$63    | \$35    |
| Aircraft                 | 2,282   | 2,282   |
| Buildings                | 65      | 24      |
| Plant Equipment          | 2       | 2       |
| Technology Equipment     | 3       | 1       |
| Accumulated amortization | (611)   | (457)   |
|                          | \$1,804 | \$1,887 |

These capital lease obligations have principal payments due at various dates from 2013 through 3004.



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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 2012 and 2011 were 0.15% and 0.11%, respectively.

Bonds with a principal balance of \$42 million and due in November 2036 issued by the Louisville Regional Airport Authority associated with our air freight facility in Louisville, Kentucky. The bonds bear interest at a variable rate, and the average interest rates for 2012 and 2011 were 0.15% and 0.11%, 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 2012 and 2011 were 0.13% and 0.11%, respectively.

Pound Sterling Notes

The Pound Sterling notes consist of two separate tranches, as follows:

Notes with a principal amount of £66 million accrue interest at a 5.50% fixed rate, and are due in February 2031. These notes are not callable.

Notes with a principal amount of £455 million accrue interest at a 5.13% fixed rate, and are due in February 2050. These 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.

We maintain cross-currency interest rate swaps to hedge the foreign currency risk associated with the bond cash flows for both tranches of these bonds. 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 \$619, \$629 and \$615 million for 2012, 2011 and 2010, respectively.

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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 |
|---|-------------------|---------------------|-------------------|-------------------------|
| 2013  | \$55              | \$342               | \$1,750           | \$629                   |
| 2014  | 52                | 271                 | 1,000             | 103                     |
| 2015  | 50                | 203                 | 101               | 22                      |
| 2016  | 49                | 145                 | 1                 | 14                      |
| 2017  | 48                | 118                 | 375               | 7                       |
| After 2017  | 426               | 358                 | 8,765             | —                       |
| Total   | 680               | \$1,437             | \$11,992          | \$775                   |
| Less: imputed interest                              | (240              | )                   |                   |                         |
| Present value of minimum capitalized lease payments | 440               |                     |                   |                         |
| Less: current portion                               | (31               | )                   |                   |                         |
| Long-term capitalized lease obligations             | \$409             |                     |                   |                         |

As of December 31, 2012, we had outstanding letters of credit totaling approximately \$1.369 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, 2012, we had \$584 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 11, 2013. 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 0.10% 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, 2012.

The second agreement provides revolving credit facilities of \$1.0 billion, and expires on April 12, 2017. 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 0.100% to 0.375%, and the maximum applicable margin rates range from 0.750% to 1.250%. 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, 2012.





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Debt Covenants

Our existing debt instruments and credit facilities subject us to certain financial covenants. As of December 31, 2012 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, 2012, 10% of net tangible assets is equivalent to \$2.770 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, 2012, our net worth, as defined, was equivalent to \$8.007 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 \$14.658 and \$12.035 billion as of December 31, 2012 and 2011, respectively. We utilized Level 2 inputs in the fair value hierarchy of valuation techniques to determine the fair value of all of our debt instruments.

NOTE 8. 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 (except as otherwise noted herein) 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 a lawsuit in California Superior Court about the rebranding of The UPS Store franchises. In the Morgate case, the plaintiffs are 125 individual franchisees who did not rebrand to The UPS Store and a certified class of all franchisees who did rebrand. The trial court entered judgment against a bellwether individual plaintiff, which was affirmed in January 2012. The trial court granted our motion for summary judgment against the certified class, which was reversed in January 2012.

There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from whatever remaining aspects of this case proceeds, including: (1) we are vigorously defending ourselves and believe we have a number of meritorious legal defenses; and (2) it remains uncertain what evidence of damages, if any, plaintiffs will be able to present. 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.

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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 by individually imposing policies that prevent shippers from using such negotiators. The case is scheduled to go to trial in August 2013. The Antitrust Division of the U.S. Department of Justice (“DOJ”) has an ongoing 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) discovery is ongoing; 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, four purported class-action cases were filed against us in British Columbia (2006); Ontario (2007) and Québec (2006 and 2013). 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 motion to authorize the 2006 Québec litigation as a class action was dismissed by the motions judge in October 2012; there was no appeal, which ended that case in our favor. The 2013 Québec litigation is in the earliest stages. We deny 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 online pharmacies that may have operated illegally. We have been cooperating with this investigation and are exploring the possibility of resolving this matter, which could include our undertaking further enhancements to our compliance program and a payment. Such a payment may exceed the amounts previously accrued with respect to this matter, but we do not expect that the amount of such additional loss 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 January 2013, we received a letter from the DOJ confirming that it is not pursuing a case against UPS with respect to the investigation.

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. In November 2012, we also received a request for information related to similar matters from authorities in Singapore.

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.

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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. The plaintiffs filed a Second Amended Complaint in October 2010, which we moved to dismiss. In August 2012, the Court granted our motion to dismiss all claims relevant to UPS in the Second Amended Complaint, with leave to amend. The plaintiffs filed a Third Amended Complaint in November 2012. We intend to file another motion to dismiss, and to otherwise 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 court has dismissed the complaint once but has not considered the adequacy of the amended complaint; (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.

Tax Matters

In June 2011, we received an IRS Revenue Agent Report (RAR) covering excise taxes for tax years 2003 through 2007, in addition to the income tax matters described in note 12. The excise tax RAR proposed two alternate theories for asserting additional excise tax on transportation of property by air. We disagreed with these proposed excise tax theories and related adjustments. We filed protests and, in the third quarter of 2011, the IRS responded to our protests and forwarded the case to IRS Appeals.

In the third quarter of 2012, following the Appeals Opening Conference in July 2012, we had settlement discussions which we expect will lead to a complete resolution of all excise tax matters and correlative income tax refund claims for the 2003 through 2007 tax years within the next twelve months. We do not believe the ultimate resolution of these matters will have a material effect on our financial condition, results of operations or liquidity.

NOTE 9. 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, 2012, 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, 2012, 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):

|  | 2012   |          | 2011   |          | 2010   |          |   |
|--|--------|----------|--------|----------|--------|----------|---|
|  | Shares | Dollars  | Shares | Dollars  | Shares | Dollars  |   |
| <b>Class A Common Stock</b>                      |        |          |        |          |        |          |   |
| Balance at beginning of year                     | 240    | \$3      | 258    | \$3      | 285    | \$3      |   |
| Common stock purchases                           | (9     | ) —      | (7     | ) —      | (6     | ) —      |   |
| Stock award plans                                | 8      | —        | 7      | —        | 6      | —        |   |
| Common stock issuances                           | 3      | —        | 3      | —        | 3      | —        |   |
| Conversions of class A to class B common stock   | (17    | ) —      | (21    | ) —      | (30    | ) —      |   |
| Class A shares issued at end of year             | 225    | \$3      | 240    | \$3      | 258    | \$3      |   |
| <b>Class B Common Stock</b>                      |        |          |        |          |        |          |   |
| Balance at beginning of year                     | 725    | \$7      | 735    | \$7      | 711    | \$7      |   |
| Common stock purchases                           | (13    | ) —      | (31    | ) —      | (6     | ) —      |   |
| Conversions of class A to class B common stock   | 17     | —        | 21     | —        | 30     | —        |   |
| Class B shares issued at end of year             | 729    | \$7      | 725    | \$7      | 735    | \$7      |   |
| <b>Additional Paid-In Capital</b>                |        |          |        |          |        |          |   |
| Balance at beginning of year                     |        | \$—      |        | \$—      |        | \$2      |   |
| Stock award plans                                |        | 444      |        | 388      |        | 398      |   |
| Common stock purchases                           |        | (943     | )      | (475     | )      | (649     | ) |
| Common stock issuances                           |        | 293      |        | 287      |        | 249      |   |
| Option Premiums Received (Paid)                  |        | 206      |        | (200     | )      | —        |   |
| Balance at end of year                           |        | \$—      |        | \$—      |        | \$—      |   |
| <b>Retained Earnings</b>                         |        |          |        |          |        |          |   |
| Balance at beginning of year                     |        | \$10,128 |        | \$10,604 |        | \$9,335  |   |
| Net income attributable to controlling interests |        | 807      |        | 3,804    |        | 3,338    |   |
| Dividends (\$2.28, \$2.08 and \$1.88 per share)  |        | (2,243   | )      | (2,086   | )      | (1,909   | ) |
| Common stock purchases                           |        | (695     | )      | (2,194   | )      | (160     | ) |
| Balance at end of year                           |        | \$7,997  |        | \$10,128 |        | \$10,604 |   |

For the years ended December 31, 2012, 2011 and 2010, we repurchased a total of 21.8, 38.7 and 12.4 million shares of class A and class B common stock for \$1.638 billion, \$2.669 billion and \$809 million, respectively. On May 3, 2012, the Board of Directors approved a share repurchase authorization of \$5.0 billion, which replaced an authorization previously announced in 2008. As of December 31, 2012, we had \$3.970 billion of this share repurchase authorization remaining. On February 14, 2013, the Board of Directors approved a new share repurchase authorization of \$10.0 billion, which replaced the 2012 authorization. This new share repurchase authorization has no expiration date.

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 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. During 2012, we did not pay premiums on options for the purchase of shares; however, we received \$206 million in premiums for options that were entered into during 2011 that expired during 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):

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|   | 2012       | 2011       | 2010       |
|---|------------|------------|------------|
| Foreign currency translation gain (loss):   |            |            |            |
| Balance at beginning of year  | \$(160 )   | \$(68 )    | \$37 )     |
| Aggregate adjustment for the year (net of tax effect of \$(9), \$11 and \$(34))   | 294        | (92 )      | (105 )     |
| Balance at end of year  | 134        | (160 )     | (68 )      |
| Unrealized gain (loss) on marketable securities, net of tax:  |            |            |            |
| Balance at beginning of year  | 6          | 12         | (27 )      |
| Current period changes in fair value (net of tax effect of \$4, \$11 and \$17)  | 6          | 18         | 30         |
| Reclassification to earnings (net of tax effect of \$(3), \$(14) and \$6)   | (6 )       | (24 )      | 9 )        |
| Balance at end of year  | 6          | 6          | 12         |
| Unrealized gain (loss) on cash flow hedges, net of tax:   |            |            |            |
| Balance at beginning of year  | (204 )     | (239 )     | (200 )     |
| Current period changes in fair value (net of tax effect of \$(25), \$(16) and \$(4))  | (43 )      | (26 )      | (7 )       |
| Reclassification to earnings (net of tax effect of \$(24), \$37 and \$(19))   | (39 )      | 61 )       | (32 )      |
| Balance at end of year  | (286 )     | (204 )     | (239 )     |
| Unrecognized pension and postretirement benefit costs, net of tax:  |            |            |            |
| Balance at beginning of year  | (2,745 )   | (2,340 )   | (1,527 )   |
| Reclassification to earnings (net of tax effect of \$1,876, \$378 and \$150)  | 3,135      | 628        | 245        |
| Net actuarial gain (loss) and prior service cost resulting from remeasurements of plan assets and liabilities (net of tax effect of \$(2,151), \$(622) and \$(633)) | (3,598 )   | (1,033 )   | (1,058 )   |
| Balance at end of year  | (3,208 )   | (2,745 )   | (2,340 )   |
| Accumulated other comprehensive income (loss) at end of year  | \$(3,354 ) | \$(3,103 ) | \$(2,635 ) |

## 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 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, 2012, 2011 and 2010 is as follows (in millions):

|                                   | 2012   |         | 2011   |          | 2010   |          |
|-----------------------------------|--------|---------|--------|----------|--------|----------|
|                                   | Shares | Dollars | Shares | Dollars  | Shares | Dollars  |
| Deferred Compensation Obligations |        |         |        |          |        |          |
| Balance at beginning of year      |        | \$88    |        | \$103    |        | \$108    |
| Reinvested dividends              |        | 3       |        | 4        |        | 4        |
| Options exercise deferrals        |        | —       |        | —        |        | 1        |
| Benefit payments                  |        | (13 )   |        | (19 )    |        | (10 )    |
| Balance at end of year            |        | \$78    |        | \$88     |        | \$103    |
| Treasury Stock                    |        |         |        |          |        |          |
| Balance at beginning of year      | (2 )   | \$(88 ) | (2 )   | \$(103 ) | (2 )   | \$(108 ) |
| Reinvested dividends              | —      | (3 )    | —      | (4 )     | —      | (4 )     |
| Options exercise deferrals        | —      | —       | —      | —        | —      | (1 )     |
| Benefit payments                  | 1      | 13      | —      | 19       | —      | 10       |
| Balance at end of year            | (1 )   | \$(78 ) | (2 )   | \$(88 )  | (2 )   | \$(103 ) |





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## 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):

|   | 2012 | 2011 | 2010 |
|---|------|------|------|
| Noncontrolling Interests                            |      |      |      |
| Balance at beginning of period                      | \$73 | \$68 | \$66 |
| Acquired noncontrolling interests                   | 7    | 5    | 2    |
| Dividends attributable to noncontrolling interests  | —    | —    | —    |
| Net income attributable to noncontrolling interests | —    | —    | —    |
| Balance at end of period                            | \$80 | \$73 | \$68 |

## NOTE 10. 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 27 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 one share. As of December 31, 2012, stock options, restricted performance units and restricted stock units had been granted under the Incentive Compensation Plan. We had 27 million shares available to be issued under the Incentive Compensation Plan as of December 31, 2012.

## Management Incentive Award

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.

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As of December 31, 2012, we had the following Restricted Units outstanding, including reinvested dividends:

|                                   | Shares<br>(in thousands) | Weighted<br>Average<br>Grant Date<br>Fair Value | Weighted Average Remaining<br>Contractual Term<br>(in years) | Aggregate Intrinsic<br>Value (in<br>millions) |
|-----------------------------------|--------------------------|---|--|---|
| Nonvested at January 1, 2012      | 15,839                   | \$62.98   |  |   |
| Vested                            | (8,914 )                 | 63.99   |  |   |
| Granted                           | 7,423                    | 77.21   |  |   |
| Reinvested Dividends              | 568                      | N/A   |  |   |
| Forfeited / Expired               | (272 )                   | 67.51   |  |   |
| Nonvested at December 31, 2012    | 14,644                   | \$68.71   | 1.57   | \$ 1,080                                      |
| Restricted Units Expected to Vest | 14,172                   | \$68.61   | 1.55   | \$ 1,045                                      |

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 2012, 2011 and 2010 was \$77.21, \$69.53 and \$66.36, respectively. The total fair value of Restricted Units vested was \$627, \$557 and \$523 million in 2012, 2011 and 2010, respectively. As of December 31, 2012, there was \$571 million of total unrecognized compensation cost related to nonvested Restricted Units. That cost is expected to be recognized over a weighted average period of 3 years and 1 month.

**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, 2012      | 13,199                   | \$70.18                                  |  |   |
| Exercised                           | (2,778 )                 | 63.50                                    |  |   |
| Granted                             | 187                      | 76.94                                    |  |   |
| Forfeited / Expired                 | (13 )                    | 82.74                                    |  |   |
| Outstanding at December 31, 2012    | 10,595                   | \$72.04                                  | 3.03   | \$ 34   |
| Options Vested and Expected to Vest | 10,595                   | \$72.04                                  | 3.03   | \$ 34   |
| Exercisable at December 31, 2012    | 10,115                   | \$72.09                                  | 2.79   | \$ 32   |

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:

|                         | 2012 | 2011   | 2010   |   |
|-------------------------|------|--------|--------|---|
| Expected dividend yield | 2.77 | % 2.77 | % 2.70 | % |

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|  |         |   |         |   |         |   |
|--|---------|---|---------|---|---------|---|
| Risk-free interest rate                        | 1.63    | % | 2.90    | % | 3.30    | % |
| Expected life in years                         | 7.5     |   | 7.5     |   | 7.5     |   |
| Expected volatility                            | 25.06   | % | 24.26   | % | 23.59   | % |
| Weighted average fair value of options granted | \$14.88 |   | \$15.92 |   | \$14.83 |   |

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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 \$122, \$92 and \$60 million during 2012, 2011 and 2010, respectively, from option holders resulting from the exercise of stock options. We received a tax benefit of \$3, \$6 and \$4 million during 2012, 2011 and 2010, 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 2012, 2011 and 2010 was \$39, \$31 and \$18 million, respectively. As of December 31, 2012, there was \$2 million of total unrecognized compensation cost related to nonvested options. That cost is expected to be recognized over a weighted average period of 3 years and 4 months.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2012:

| 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    | 211                      | 6.35                       | \$55.83                      | 133                      | \$55.83                      |
| \$60.01 - \$70.00    | 1,337                    | 1.20                       | 62.98                        | 1,257                    | 62.72                        |
| \$70.01 - \$80.00    | 6,858                    | 3.19                       | 71.47                        | 6,536                    | 71.27                        |
| \$80.01 - \$90.00    | 2,189                    | 3.33                       | 80.92                        | 2,189                    | 80.92                        |
|                      | 10,595                   | 3.03                       | \$72.04                      | 10,115                   | \$72.09                      |

**Discounted Employee Stock Purchase Plan**

We maintain an employee stock purchase plan for all eligible employees. Under this 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. Employees purchased 1.2, 1.3 and 1.5 million shares at average prices of \$72.17, \$66.86 and \$57.98 per share during 2012, 2011, and 2010, respectively. This plan is not considered to be compensatory, and therefore no compensation cost is measured for the employees' purchase rights.

**NOTE 11. 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.

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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.

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

|  | 2012     | 2011     | 2010     |
|--|----------|----------|----------|
| Revenue:   |          |          |          |
| U.S. Domestic Package  | \$32,856 | \$31,717 | \$29,742 |
| International Package  | 12,124   | 12,249   | 11,133   |
| Supply Chain & Freight   | 9,147    | 9,139    | 8,670    |
| Consolidated   | \$54,127 | \$53,105 | \$49,545 |
| Operating Profit:  |          |          |          |
| U.S. Domestic Package  | \$459    | \$3,764  | \$3,238  |
| International Package  | 869      | 1,709    | 1,831    |
| Supply Chain & Freight   | 15       | 607      | 572      |
| Consolidated   | \$1,343  | \$6,080  | \$5,641  |
| Assets:  |          |          |          |
| U.S. Domestic Package  | \$19,934 | \$19,300 | \$18,425 |
| International Package  | 11,248   | 6,729    | 6,228    |
| Supply Chain & Freight   | 6,610    | 6,588    | 6,283    |
| Unallocated  | 1,071    | 2,084    | 2,661    |
| Consolidated   | \$38,863 | \$34,701 | \$33,597 |
| Depreciation and Amortization Expense:   |          |          |          |
| U.S. Domestic Package  | \$1,220  | \$1,154  | \$1,174  |
| International Package  | 475      | 474      | 443      |
| Supply Chain & Freight   | 163      | 154      | 175      |
| Consolidated   | \$1,858  | \$1,782  | \$1,792  |
| Revenue by product type for the years ended December 31 is as follows (in millions): |          |          |          |
|  | 2012     | 2011     | 2010     |
| U.S. Domestic Package:   |          |          |          |
| Next Day Air   | \$6,412  | \$6,229  | \$5,835  |
| Deferred   | 3,392    | 3,299    | 2,975    |
| Ground   | 23,052   | 22,189   | 20,932   |
| Total U.S. Domestic Package  | 32,856   | 31,717   | 29,742   |
| International Package:   |          |          |          |
| Domestic   | 2,531    | 2,628    | 2,365    |
| Export   | 9,033    | 9,056    | 8,234    |
| Cargo  | 560      | 565      | 534      |
| Total International Package  | 12,124   | 12,249   | 11,133   |
| Supply Chain & Freight:  |          |          |          |
| Forwarding and Logistics   | 5,977    | 6,103    | 6,022    |
| Freight  | 2,640    | 2,563    | 2,208    |
| Other  | 530      | 473      | 440      |
| Total Supply Chain & Freight   | 9,147    | 9,139    | 8,670    |
| Consolidated   | \$54,127 | \$53,105 | \$49,545 |





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

|                   | 2012     | 2011     | 2010     |
|-------------------|----------|----------|----------|
| United States:    |          |          |          |
| Revenue           | \$40,428 | \$39,347 | \$36,795 |
| Long-lived assets | \$16,262 | \$16,085 | \$16,693 |
| International:    |          |          |          |
| Revenue           | \$13,699 | \$13,758 | \$12,750 |
| Long-lived assets | \$5,312  | \$5,220  | \$5,047  |
| Consolidated:     |          |          |          |
| Revenue           | \$54,127 | \$53,105 | \$49,545 |
| Long-lived assets | \$21,574 | \$21,305 | \$21,740 |

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 for the years ended December 31, 2012, 2011 or 2010.

## NOTE 12. INCOME TAXES

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

|                      | 2012    | 2011    | 2010    |   |
|----------------------|---------|---------|---------|---|
| Current:             |         |         |         |   |
| U.S. Federal         | \$1,901 | \$1,371 | \$776   |   |
| U.S. State and Local | 182     | 121     | 119     |   |
| Non-U.S.             | 167     | 166     | 161     |   |
| Total Current        | 2,250   | 1,658   | 1,056   |   |
| Deferred:            |         |         |         |   |
| U.S. Federal         | (1,871  | ) 262   | 828     |   |
| U.S. State and Local | (201    | ) 44    | 98      |   |
| Non-U.S.             | (11     | ) 8     | (30     | ) |
| Total Deferred       | (2,083  | ) 314   | 896     |   |
| Total                | \$167   | \$1,972 | \$1,952 |   |

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

|               | 2012  | 2011    | 2010    |
|---------------|-------|---------|---------|
| United States | \$384 | \$5,309 | \$4,586 |
| Non-U.S.      | 590   | 467     | 704     |
|               | \$974 | \$5,776 | \$5,290 |

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:

|  | 2012 | 2011   | 2010   |   |
|--|------|--------|--------|---|
| 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    |   |
| Non-U.S. tax rate differential                             | (6.1 | ) (0.4 | ) (0.7 | ) |
| Nondeductible/nontaxable items                             | (0.4 | ) (0.1 | ) 0.3  |   |
| U.S. federal tax credits                                   | (7.4 | ) (1.7 | ) (1.9 | ) |
| Other  | (4.0 | ) (0.7 | ) 1.8  |   |
| Effective income tax rate                                  | 17.1 | % 34.1 | % 36.9 |   |



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Our effective tax rate declined to 17.1% in 2012 compared with 34.1% in 2011 largely due to the significance of U.S. Federal tax credits and the proportion of taxable income in certain non-U.S. jurisdictions relative to total pre-tax income.

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.

Beginning in 2012, we were granted a tax incentive for certain of our non-U.S. operations, which is effective through December 31, 2017 and may be extended through December 31, 2022 if additional requirements are satisfied. The tax incentive is conditional upon our meeting specific employment and investment thresholds. The impact of this tax incentive decreased non-U.S. tax expense by \$22 million, or \$0.02 per share, for 2012.

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

|  | 2012       | 2011       |
|--|------------|------------|
| Property, plant and equipment                      | \$(3,624 ) | \$(3,607 ) |
| Goodwill and intangible assets                     | (1,035 )   | (951 )     |
| Other  | (617 )     | (554 )     |
| Deferred tax liabilities                           | (5,276 )   | (5,112 )   |
| Pension and postretirement benefits                | 4,608      | 2,106      |
| Loss and credit carryforwards (non-U.S. and state) | 258        | 259        |
| Insurance reserves                                 | 737        | 696        |
| Vacation pay accrual                               | 209        | 208        |
| Stock compensation                                 | 159        | 211        |
| Other  | 708        | 635        |
| Deferred tax assets                                | 6,679      | 4,115      |
| Deferred tax assets valuation allowance            | (220 )     | (205 )     |
| Deferred tax asset (net of valuation allowance)    | 6,459      | 3,910      |
| Net deferred tax asset (liability)                 | \$1,183    | \$(1,202 ) |

Amounts recognized in the consolidated balance sheets:

|  |         |            |
|--|---------|------------|
| Current deferred tax assets  | \$583   | \$611      |
| Current deferred tax liabilities (included in other current liabilities) | (36 )   | (31 )      |
| Non-current deferred tax assets  | 684     | 118        |
| Non-current deferred tax liabilities                                     | (48 )   | (1,900 )   |
| Net deferred tax asset (liability)                                       | \$1,183 | \$(1,202 ) |

The valuation allowance increased by \$15, \$2 and \$30 million during the years ended December 31, 2012, 2011 and 2010, respectively.

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

|   | 2012  | 2011  |
|---|-------|-------|
| U.S. state and local operating loss carryforwards | \$608 | \$859 |
| U.S. state and local credit carryforwards         | \$61  | \$77  |

The operating loss carryforwards expire at varying dates through 2032. The state credits can be carried forward for periods ranging from three years to indefinitely.



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We also have non-U.S. loss carryforwards of approximately \$842 million as of December 31, 2012, 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 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 \$3.575 billion at December 31, 2012. 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.

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

|  | Tax   | Interest | Penalties |
|--|-------|----------|-----------|
| Balance at January 1, 2010                       | \$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         |
| Additions for tax positions of the current year  | 13    | —        | —         |
| Additions for tax positions of prior years       | 7     | 9        | 1         |
| Reductions for tax positions of prior years for: |       |          |           |
| Changes based on facts and circumstances         | (22   | ) (18    | ) —       |
| Settlements during the period                    | (3    | ) (7     | ) —       |
| Lapses of applicable statute of limitations      | (15   | ) (4     | ) —       |
| Balance at December 31, 2012                     | \$232 | \$53     | \$4       |

The total amount of gross unrecognized tax benefits as of December 31, 2012, 2011 and 2010 that, if recognized, would affect the effective tax rate was \$224, \$247 and \$283 million, respectively. We also had gross recognized tax benefits of \$280, \$291 and \$326 million recorded as of December 31, 2012, 2011 and 2010, 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 \$23, \$27 and \$32 million for the recognized tax benefits associated with outstanding refund claims as of December 31, 2012, 2011 and 2010, 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.

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In June 2011, we received an IRS Revenue Agent Report (RAR) covering income taxes for tax years 2005 through 2007, in addition to the excise tax matters described in note 8. The income tax RAR proposed adjustments related to the value of acquired software and intangibles, research credit expenditures, and the amount of deductible costs associated with our British Pound Sterling Notes exchange offer completed in May 2007. Receipt of the RAR represents only the conclusion of the examination process. We disagree with some of the proposed adjustments related to these matters. Therefore, we filed protests and, in the third quarter of 2011, the IRS responded to our protests and forwarded the case to IRS Appeals.

We expect to begin discussions of these income tax matters with IRS Appeals within the next twelve months. It should be noted, however, that the ultimate resolution of these matters will result in a refund to UPS - even according to the adjustments proposed by the IRS.

At this time, we do not believe the ultimate resolution of these income tax matters will have a material effect on our financial condition, results of operations, or liquidity.

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

## NOTE 13. EARNINGS PER SHARE

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

|   | 2012   | 2011    | 2010    |
|---|--------|---------|---------|
| Numerator:                                    |        |         |         |
| Net income attributable to common shareowners | \$807  | \$3,804 | \$3,338 |
| Denominator:                                  |        |         |         |
| Weighted average shares                       | 957    | 977     | 991     |
| Deferred compensation obligations             | 1      | 2       | 2       |
| Vested portion of restricted shares           | 2      | 2       | 1       |
| Denominator for basic earnings per share      | 960    | 981     | 994     |
| Effect of dilutive securities:                |        |         |         |
| Restricted performance units                  | 3      | 3       | 3       |
| Restricted stock units                        | 5      | 6       | 6       |
| Stock options                                 | 1      | 1       | —       |
| Denominator for diluted earnings per share    | 969    | 991     | 1,003   |
| Basic earnings per share                      | \$0.84 | \$3.88  | \$3.36  |
| Diluted earnings per share                    | \$0.83 | \$3.84  | \$3.33  |

Diluted earnings per share for the years ended December 31, 2012, 2011, and 2010 exclude the effect of 2.6, 7.4 and 11.1 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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NOTE 14. 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, 2012, we held cash collateral of \$59 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, 2012 the aggregate fair value of the instruments covered by these contractual features that were in a net liability position was \$129 million; however, we were not required to post any collateral with our counterparties as of that date.

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

Accounting Policy for Derivative Instruments

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

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

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



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

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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 designate 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, Canadian Dollar, Chinese Renminbi and Hong Kong Dollar. We hedge portions of our forecasted revenue denominated in foreign currencies with option contracts. We have designated and account for these contracts as cash flow hedges of anticipated foreign currency denominated revenue and, therefore, the resulting gains and losses from these hedges are recognized as a component of international package revenue when the underlying sales transactions occur.

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

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

Interest Rate Risk Management

Our indebtedness under our various financing arrangements creates interest rate risk. We use a combination of derivative instruments, including interest rate swaps and cross-currency interest rate swaps, as part of our program to manage the fixed and floating interest rate mix of our total debt portfolio and related overall cost of borrowing. The notional amount, interest payment 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.

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## Outstanding Positions

The notional amounts of our outstanding derivative positions were as follows as of December 31, 2012 and 2011 (in millions):

|                             |     | 2012  | 2011  |
|-----------------------------|-----|-------|-------|
| Currency Hedges:            |     |       |       |
| Euro                        | EUR | 1,783 | 1,685 |
| British Pound Sterling      | GBP | 797   | 870   |
| Canadian Dollar             | CAD | 341   | 318   |
| United Arab Emirates Dirham | AED | 551   | —     |
| Malaysian Ringgit           | MYR | 500   | —     |

## Interest Rate Hedges:

|                                       |     |       |       |
|---------------------------------------|-----|-------|-------|
| Fixed to Floating Interest Rate Swaps | USD | 7,274 | 6,424 |
| Floating to Fixed Interest Rate Swaps | USD | 781   | 791   |
| Interest Rate Basis Swaps             | USD | 2,500 | —     |

As of December 31, 2012, we had no outstanding commodity hedge positions. The maximum term over which we are hedging exposures to the variability of cash flow is 37 years.

## Balance Sheet Recognition

The following table indicates the location on the balance sheet in which our derivative assets and liabilities have been recognized, and the related fair values of those derivatives as of December 31, 2012 and 2011 (in millions). The table is segregated between those derivative instruments that qualify and are designated as hedging instruments and those that are not, as well as by type of contract and whether the derivative is in an asset or liability position.

| Asset Derivatives                     | Balance Sheet Location        | Fair Value Hierarchy Level | 2012  | 2011  |
|---------------------------------------|-------------------------------|----------------------------|-------|-------|
|                                       |                               |                            |       |       |
| Derivatives designated as hedges:     |                               |                            |       |       |
| Foreign exchange contracts            | Other current assets          | Level 2                    | \$27  | \$164 |
| Interest rate contracts               | Other current assets          | Level 2                    | 1     | —     |
| Foreign exchange contracts            | Other non-current assets      | Level 2                    | 14    | —     |
| Interest rate contracts               | Other non-current assets      | Level 2                    | 420   | 401   |
| Derivatives not designated as hedges: |                               |                            |       |       |
| Foreign exchange contracts            | Other current assets          | Level 2                    | 3     | 2     |
| Interest rate contracts               | Other non-current assets      | Level 2                    | 101   | 82    |
| Total Asset Derivatives               |                               |                            | \$566 | \$649 |
|                                       |                               |                            |       |       |
| Liability Derivatives                 | Balance Sheet Location        | Fair Value Hierarchy Level | 2012  | 2011  |
|                                       |                               |                            |       |       |
| Derivatives designated as hedges:     |                               |                            |       |       |
| Foreign exchange contracts            | Other non-current liabilities | Level 2                    | 103   | 185   |
| Interest rate contracts               | Other non-current liabilities | Level 2                    | 14    | 13    |
| Derivatives not designated as hedges: |                               |                            |       |       |
| Foreign exchange contracts            | Other current liabilities     | Level 2                    | 1     | —     |
| Interest rate contracts               | Other non-current liabilities | Level 2                    | 41    | 10    |
| Total Liability Derivatives           |                               |                            | \$159 | \$208 |



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 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, 2012 and 2011 (in millions):

| Derivative Instruments in Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion) |         | Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) |         |
|---|---|---------|---|---|---------|
|   | 2012  | 2011    |   | 2012  | 2011    |
| Interest rate contracts                                   | \$(71 )   | \$(6 )  | Interest Expense  | \$(22 )   | \$(19 ) |
| Foreign exchange contracts                                | 84  | (85 )   | Interest Expense  | 24  | 13      |
| Foreign exchange contracts                                | (5 )  | 5       | Other Operating Expense   | —   | —       |
| Foreign exchange contracts                                | (76 )   | 35      | Revenue   | 61  | (101 )  |
| Commodity contracts                                       | —   | 9       | Fuel Expense  | —   | 9       |
| Total   | \$(68 )   | \$(42 ) |   | \$63  | \$(98 ) |

As of December 31, 2012, \$58 million of pre-tax losses related to cash flow hedges that are currently deferred in AOCI are expected to be reclassified to income over the 12 month period ended December 31, 2013. 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, 2012, 2011 and 2010.

The following table indicates the amount and location in the statements of consolidated income in which derivative gains and losses, as well as the associated gains and losses on the underlying exposure, have been recognized for those derivatives designated as fair value hedges for the years ended December 31, 2012 and 2011 (in millions):

| Derivative Instruments in Fair Value Hedging Relationships | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income |       | Hedged Items in Fair Value Hedging Relationships | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income |          |
|--|--|--|-------|--|--|--|----------|
|  |  | 2012                                       | 2011  |  |  | 2012                                       | 2011     |
| Interest rate contracts                                    | Interest Expense                             | \$20                                       | \$320 | Fixed-Rate Debt and Capital Leases               | Interest Expense                             | \$(20 )                                    | \$(320 ) |

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.

We have entered into several interest rate basis swaps, which effectively convert cash flows based on variable LIBOR-based interest rates to cash flows based on the prevailing federal funds interest rate. These swaps are not designated as hedges, and all amounts related to fair value changes and settlements are recorded to interest expense in the statements of consolidated income.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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, 2012 and 2011 (in millions):

| Derivative Instruments Not Designated in Hedging Relationships | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income |        |
|--|--|--|--------|
|  |  | 2012                                       | 2011   |
| Foreign exchange contracts                                     | Revenue                                      | \$2  | \$—    |
| Foreign exchange contracts                                     | Other Operating Expenses                     | 19   | 2      |
| Foreign exchange contracts                                     | Investment Income                            | (22  | ) —    |
| Interest rate contracts  | Interest Expense                             | (12  | ) (8   |
| Total  |  | \$(13                                      | ) \$(6 |

## Fair Value Measurements

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, 2012 and 2011 by hedge type are as follows (in millions):

|                            | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|----------------------------|--|---|---|-------|
| 2012                       |  |   |   |       |
| Assets                     |  |   |   |       |
| Foreign Exchange Contracts | \$ —   | \$44  | \$—                                       | \$44  |
| Interest Rate Contracts    | —  | 522   | —   | 522   |
| Total                      | \$ —   | \$566   | \$—                                       | \$566 |
| Liabilities                |  |   |   |       |
| Foreign Exchange Contracts | \$ —   | \$104   | \$—                                       | \$104 |
| Interest Rate Contracts    | —  | 55  | —   | 55    |
| Total                      | \$ —   | \$159   | \$—                                       | \$159 |

|                            | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|----------------------------|--|---|---|-------|
| 2011                       |  |   |   |       |
| Assets                     |  |   |   |       |
| Foreign Exchange Contracts | \$ —   | \$166   | \$—                                       | \$166 |
| Interest Rate Contracts    | —  | 483   | —   | 483   |
| Total                      | \$ —   | \$649   | \$—                                       | \$649 |
| Liabilities                |  |   |   |       |
| Foreign Exchange Contracts | \$ —   | \$185   | \$—                                       | \$185 |
| Interest Rate Contracts    | —  | 23  | —   | 23    |
| Total                      | \$ —   | \$208   | \$—                                       | \$208 |





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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. 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 16. SUBSEQUENT EVENTS

On January 30, 2013, the European Commission issued a formal decision prohibiting our proposed acquisition of TNT Express N.V. (“TNT Express”). As a result of the prohibition by the European Commission, the condition of our offer requiring European Union competition clearance was not fulfilled, and our proposed acquisition of TNT Express could not be completed. Given this outcome, UPS and TNT Express entered a separate agreement to terminate the merger protocol, and we withdrew our formal offer for TNT Express. Under this termination agreement, we have paid a break-up fee to TNT Express of €200 million (approximately \$268 million) in the first quarter of 2013.

In January 2013, we purchased the noncontrolling interest in our joint venture that operates in the Middle East, Turkey, and portions of the Central Asia region (see note 9), for \$70 million. After this transaction, we own 100% of this entity.



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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 17. 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 |         |
|-------------------------------|---------------|---------|----------------|---------|---------------|---------|----------------|---------|
|                               | 2012          | 2011    | 2012           | 2011    | 2012          | 2011    | 2012           | 2011    |
| Revenue:                      |               |         |                |         |               |         |                |         |
| U.S. Domestic Package         | \$8,004       | \$7,543 | \$8,058        | \$7,737 | \$7,861       | \$7,767 | \$8,933        | \$8,670 |
| International Package         | 2,966         | 2,900   | 3,014          | 3,139   | 2,943         | 3,057   | 3,201          | 3,153   |
| Supply Chain & Freight        | 2,166         | 2,139   | 2,277          | 2,315   | 2,267         | 2,342   | 2,437          | 2,343   |
| Total revenue                 | 13,136        | 12,582  | 13,349         | 13,191  | 13,071        | 13,166  | 14,571         | 14,166  |
| Operating profit (loss):      |               |         |                |         |               |         |                |         |
| U.S. Domestic Package         | 995           | 880     | 1,134          | 997     | 129           | 1,046   | (1,799 )       | 841     |
| International Package         | 408           | 453     | 454            | 505     | 449           | 417     | (442 )         | 334     |
| Supply Chain & Freight        | 166           | 139     | 202            | 243     | 188           | 203     | (541 )         | 22      |
| Total operating profit (loss) | 1,569         | 1,472   | 1,790          | 1,745   | 766           | 1,666   | (2,782 )       | 1,197   |
| Net income (loss)             | \$970         | \$915   | \$1,116        | \$1,092 | \$469         | \$1,072 | \$(1,748 )     | \$725   |
| Net income (loss) per share:  |               |         |                |         |               |         |                |         |
| Basic                         | \$1.01        | \$0.92  | \$1.16         | \$1.11  | \$0.49        | \$1.10  | \$(1.83 )      | \$0.75  |
| Diluted                       | \$1.00        | \$0.91  | \$1.15         | \$1.09  | \$0.48        | \$1.09  | \$(1.83 )      | \$0.74  |

Operating profit for the quarter ended September 30, 2012 was impacted by a charge for the establishment of a withdrawal liability related to our withdrawal from the New England Teamsters and Trucking Industry Pension Fund, a multiemployer pension plan. This charge reduced the operating profit for the U.S. Domestic Package segment by \$896 million, net income by \$559 million and basic and diluted earnings per share by \$0.58.

Operating profit for the quarter ended December 31, 2012 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 \$4.831 billion (allocated as follows—U.S. Domestic Package \$3.177 billion, International Package \$941 million, Supply Chain & Freight \$713 million). This loss reduced net income by \$3.023 billion, and basic and diluted earnings per share by \$3.16.

Operating profit for the quarter ended June 30, 2011 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.

Operating profit for the quarter ended December 31, 2011 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.

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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, 2012 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, 2012. 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, 2012 and the related consolidated statements of income, comprehensive income and cash flows for the year ended December 31, 2012, has issued an attestation report on the Company's internal control over financial reporting, which is included herein.

/s/ United Parcel Service, Inc.

February 28, 2013

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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, 2012, 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, 2012, 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 financial statements as of and for the year ended December 31, 2012 of the Company and our report dated February 28, 2013 expressed an unqualified opinion on those financial statements.

/s/ Deloitte & Touche LLP

Atlanta, Georgia

February 28, 2013

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## Item 9B. Other Information

None.

## PART III

## Item 10. Directors, Executive Officers and Corporate Governance

## Executive Officers of the Registrant

| Name and Office   | Age | Principal Occupation and Employment For the Last Five Years   |
|---|-----|---|
| David P. Abney<br>Senior Vice President and Chief Operating Officer               | 57  | 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            | 57  | Senior Vice President and Chief Information Officer (2005 – present).   |
| Daniel J. Brutto<br>Senior Vice President and President, UPS International        | 56  | 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                            | 61  | 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   | 54  | 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   | 55  | Senior Vice President, U.S. Operations (2009 – present), Vice President, Americas Region (2008 – 2009), Vice President, North Central Region (2004 – 2008).   |
| Kurt P. Kuehn<br>Senior Vice President and Chief Financial Officer                | 58  | 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 | 49  | Senior Vice President of Legal, Compliance and Public Affairs, General Counsel and Corporate Secretary (2006 – present), Corporate Legal Department Manager (2005 – 2006).  |
| John J. McDevitt<br>Senior Vice President   | 54  | Senior Vice President, Human Resources and Labor Relations (2012 – Present), Senior Vice President, Global Transportation Services and Labor Relations (2005 – 2011).   |

Christine M. Owens  
Senior Vice President

57 Senior Vice President, Communications and Brand  
Management (2005 – present).

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 2, 2013 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 2, 2013 and is incorporated herein by reference.

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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 2, 2013 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 2, 2013 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 2, 2013 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 2, 2013 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 2, 2013 and is incorporated herein by reference.

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 2, 2013 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 2, 2013 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.

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## 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 28, 2013

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.

| Signature   | Title  | Date                 |
|---|--|----------------------|
| /S/ F.<br>DUANE ACKERMAN<br>F. Duane Ackerman     | Director   | February 28,<br>2013 |
| /S/ MICHAEL J.<br>BURNS<br>Michael J. Burns       | Director   | February 28,<br>2013 |
| /S/ D. SCOTT DAVIS<br>D. Scott Davis              | Chairman, Chief Executive Officer and Director (Principal Executive Officer) | February 28,<br>2013 |
| /S/ STUART E.<br>EIZENSTAT<br>Stuart E. Eizenstat | Director   | February 28,<br>2013 |
| /S/ MICHAEL L.<br>ESKEW<br>Michael L. Eskew       | Director   | February 28,<br>2013 |
| /S/ WILLIAM R.<br>JOHNSON<br>William R. Johnson   | Director   | February 28,<br>2013 |
| /S/ CANDACE B.<br>KENDLE<br>Candace B. Kendle     | Director   | February 28,<br>2013 |
| /S/ KURT P. KUEHN<br>Kurt P. Kuehn                | Chief Financial Officer (Principal Financial and Accounting Officer)         | February 28,<br>2013 |
| /S/ ANN M.<br>LIVERMORE                           | Director   | February 28,<br>2013 |

Ann M. Livermore

|   |          |                      |
|---|----------|----------------------|
| /S/ RUDY MARKHAM<br>Rudy Markham                  | Director | February 28,<br>2013 |
| /S/ CLARK T. RANDT,<br>JR.<br>Clark T. Randt, Jr. | Director | February 28,<br>2013 |
| /S/ JOHN W.<br>THOMPSON<br>John W. Thompson       | Director | February 28,<br>2013 |
| /S/ CAROL B. TOMÉ<br>Carol B. Tomé                | Director | February 28,<br>2013 |
| /S/ KEVIN M. WARSH<br>Kevin M. Warsh              | Director | February 28,<br>2013 |

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EXHIBIT INDEX

| Exhibit No. | Description  |
|-------------|--|
| 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         | Merger Protocol, dated as of March 19, 2012, between United Parcel Service, Inc. and TNT Express N.V. (incorporated by reference to Form 8-K, filed on March 19, 2012).  |
| †2.3        | Termination Agreement, dated as of January 22, 2013, between United Parcel Service, Inc. and TNT Express N.V.  |
| 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         | 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).   |
| 4.2         | Indenture relating to Exchange Offer Notes Due 2030 (incorporated by reference to Exhibit T-3C to Form T-3 filed December 18, 1997).   |
| 4.3         | 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).   |
| 4.4         | 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).  |
| 4.5         | 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).   |
| 4.6         | 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).  |
| 4.7         | 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).   |
| 4.8         | 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).   |
| 4.9         | 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).   |
| 4.10        | —  |

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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).

4.11 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).

4.12 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).

4.13 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).

4.14 Form of Note for 1.125% Senior Notes due October 1, 2017 (incorporated by reference to Exhibit 4.1 to Form 8-K filed on September 27, 2012).

4.15 Form of Note for 2.450% Senior Notes due October 1, 2022 (incorporated by reference to Exhibit 4.2 to Form 8-K filed on September 27, 2012).

4.16 Form of Note for 3.625% Senior Notes due October 1, 2042 (incorporated by reference to Exhibit 4.3 to Form 8-K filed on September 27, 2012).

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).

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(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).

(2) Amendment No. 2 to the UPS Retirement Plan (incorporated by reference to Exhibit 10.1(2) to the 2011 Annual Report on Form 10-K).

(3) Amendment No. 3 to the UPS Retirement Plan (incorporated by reference to Exhibit 10.1(3) to the 2011 Annual Report on Form 10-K).

†(4) Amendment No. 4 to the UPS Retirement Plan.

†(5) Amendment No. 5 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).

(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).

(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).

(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).

(4) Amendment No. 4 to the UPS Savings Plan (incorporated by reference to Exhibit 10.2(4) to the 2011 Annual Report on Form 10-K).

(5) Amendment No. 5 to the UPS Savings Plan (incorporated by reference to Exhibit 10.2(5) to the 2011 Annual Report on Form 10-K).

†(6) Amendment No. 6 to the UPS Savings Plan.

10.3 Credit Agreement (364-Day Facility) dated April 12, 2012 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Securities LLC as joint lead arrangers and joint bookrunners, 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 JPMorgan Chase Bank, N.A. as syndication agent (incorporated by reference to Exhibit 10.1 to Form 10-Q for the Quarter Ended March 31, 2012).

10.4 Credit Agreement (5-Year Facility) dated April 12, 2012 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Securities LLC as joint lead arrangers and joint bookrunners, 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 JPMorgan Chase Bank, N.A. as syndication agent (incorporated by reference to Exhibit 10.2 to Form 10-Q for the Quarter Ended March 31, 2012).

†10.5 —UPS Excess Coordinating Benefit Plan, as amended and restated.

- 10.6 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).
- (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).
  - (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).
  - (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).
  - (4) UPS Stock Option Program Terms and Conditions effective as of January 1, 2012 (incorporated by reference to Exhibit 10.7(4) to the 2011 Annual Report on Form 10-K).
  - (5) UPS Long-Term Incentive Performance Program Terms and Conditions effective as of January 1, 2012 (incorporated by reference to Exhibit 10.7(5) to the 2011 Annual Report on Form 10-K).
- 10.7 Form of UPS Deferred Compensation Plan (incorporated by reference to Exhibit 10.11 to the 2010 Annual Report on Form 10-K).
- †(1) Amendment No. 1 to the UPS Deferred Compensation Plan.

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| 10.8  | 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).  |
| 10.9  | –Discounted Employee Stock Purchase Plan, as amended and restated, effective October 1, 2002.   |
|       | (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).  |
|       | (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).  |
|       | †(3) Amendment No. 3 to the Discounted Employee Stock Purchase Plan.  |
| 10.10 | 2012 Omnibus Incentive Compensation Plan (incorporated by reference to Annex A to the proxy statement filed on March 12, 2012).   |
| 11    | Statement regarding Computation of per Share Earnings (incorporated by reference to note 13 to Part I, Item 8 “Financial Statements and Supplementary Data” of this Annual Report on Form 10-K).  |
| †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.