

UNITED PARCEL SERVICE INC

Form 10-Q

August 02, 2013

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United States

Securities and Exchange Commission

Washington, D.C. 20549

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Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013, 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)

Delaware

(State or Other Jurisdiction of

Incorporation or Organization)

58-2480149

(IRS Employer

Identification No.)

55 Glenlake Parkway, NE Atlanta, Georgia

(Address of Principal Executive Offices)

(404) 828-6000

(Registrant's telephone number, including area code)

30328

(Zip Code)

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

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

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

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

Non-accelerated filer ☒ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

There were 216,729,216 Class A shares, and 721,546,655 Class B shares, with a par value of \$0.01 per share, outstanding at July 23, 2013.

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UNITED PARCEL SERVICE, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2013

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PART I. FINANCIAL INFORMATION

Cautionary Statement About Forward-Looking Statements

This report includes certain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Statements in the future tense, and all statements accompanied by terms such as “believe,” “project,” “expect,” “estimate,” “assume,” “intend,” “anticipate,” “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 on Form 10-K for the year ended December 31, 2012 and in our other filings with the Securities and Exchange Commission contain some forward-looking statements regarding our intent, belief and current expectations about our strategic direction, prospects and future results. From time to time, we also provide forward-looking statements in other materials we release as well as oral forward-looking statements. Such statements give our current expectations or forecasts of future events; they do not relate strictly to historical or current facts. Management believes that these forward-looking statements are reasonable as and when made. However, caution should be taken not to place undue reliance on any such forward-looking statements because such statements speak only as of the date when made.

Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or anticipated results. These risks and uncertainties include, but are not limited to: general economic conditions, both in the U.S. and internationally; significant competition on a local, regional, national, and international basis; the existing complex and stringent regulation in the U.S. and internationally, changes to which can impact our business; increased security requirements that may increase our costs of operations and reduce operating efficiencies; legal, regulatory or market responses to global climate change; negotiation and ratification of labor contracts; strikes, work stoppages and slowdowns by our employees; the effects of changing prices of energy, including gasoline, diesel and jet fuel, and interruptions in supplies of these commodities; changes in exchange rates or interest rates; our ability to maintain the image of our brand; breaches in data security; disruptions to the Internet or our technology infrastructure; our ability to accurately forecast our future capital investment needs; exposure to changing economic, political and social developments in international and emerging markets; changes in business strategy, government regulations, or economic or market conditions that may result in further substantial impairment write-downs of our assets; increases in our expenses relating to employee health and retiree health and our contributions to pension benefits; the potential for various claims and litigation related to labor and employment, personal injury, property damage, business practices, environmental liability and other matters; our ability to realize the anticipated benefits from acquisitions, joint ventures or strategic alliances; our ability to manage insurance and claims expenses; and other risks discussed in our filings with the Securities and Exchange Commission from time to time, including our Annual Report on Form 10-K for the year ended December 31, 2012, in Part II, “Item 1A. Risk Factors” of this Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2013, and may also be described from time to time in our future reports filed with the Securities and Exchange Commission. You should consider the limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of predictions contained in such forward-looking statements. We do not undertake any obligation to update forward-looking statements to reflect events, circumstances, changes in expectations, or the occurrence of unanticipated events after the date of those statements.

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## Item 1. Financial Statements

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

June 30, 2013 (unaudited) and December 31, 2012

(In millions)

|                                                                   | June 30,<br>2013 | December 31,<br>2012 |
|-------------------------------------------------------------------|------------------|----------------------|
| <b>ASSETS</b>                                                     |                  |                      |
| Current Assets:                                                   |                  |                      |
| Cash and cash equivalents                                         | \$4,808          | \$7,327              |
| Marketable securities                                             | 1,384            | 597                  |
| Accounts receivable, net                                          | 5,438            | 6,111                |
| Deferred income tax assets                                        | 564              | 583                  |
| Other current assets                                              | 1,032            | 973                  |
| Total Current Assets                                              | 13,226           | 15,591               |
| Property, Plant and Equipment, Net                                | 17,880           | 17,894               |
| Goodwill                                                          | 2,149            | 2,173                |
| Intangible Assets, Net                                            | 678              | 603                  |
| Non-Current Investments and Restricted Cash                       | 406              | 307                  |
| Derivative Assets                                                 | 331              | 535                  |
| Deferred Income Tax Assets                                        | 963              | 684                  |
| Other Non-Current Assets                                          | 1,070            | 1,076                |
| Total Assets                                                      | \$36,703         | \$38,863             |
| <b>LIABILITIES AND SHAREOWNERS' EQUITY</b>                        |                  |                      |
| Current Liabilities:                                              |                  |                      |
| Current maturities of long-term debt and commercial paper         | \$1,086          | \$1,781              |
| Accounts payable                                                  | 2,008            | 2,278                |
| Accrued wages and withholdings                                    | 1,858            | 1,927                |
| Self-insurance reserves                                           | 749              | 763                  |
| Income taxes payable                                              | 221              | 399                  |
| Other current liabilities                                         | 1,261            | 1,242                |
| Total Current Liabilities                                         | 7,183            | 8,390                |
| Long-Term Debt                                                    | 10,837           | 11,089               |
| Pension and Postretirement Benefit Obligations                    | 11,426           | 11,068               |
| Self-Insurance Reserves                                           | 1,998            | 1,980                |
| Other Non-Current Liabilities                                     | 1,629            | 1,603                |
| Shareowners' Equity:                                              |                  |                      |
| Class A common stock (218 and 225 shares issued in 2013 and 2012) | 2                | 3                    |
| Class B common stock (721 and 729 shares issued in 2013 and 2012) | 7                | 7                    |
| Additional paid-in capital                                        | —                | —                    |
| Retained earnings                                                 | 7,185            | 7,997                |
| Accumulated other comprehensive loss                              | (3,577)          | (3,354)              |
| Deferred compensation obligations                                 | 67               | 78                   |
| Less: Treasury stock (1 share in 2013 and 2012)                   | (67)             | (78)                 |
| Total Equity for Controlling Interests                            | 3,617            | 4,653                |
| Total Equity for Non-Controlling Interests                        | 13               | 80                   |
| Total Shareowners' Equity                                         | 3,630            | 4,733                |
| Total Liabilities and Shareowners' Equity                         | \$36,703         | \$38,863             |

See notes to unaudited consolidated financial statements.

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## STATEMENTS OF CONSOLIDATED INCOME

(In millions, except per share amounts)

(unaudited)

|                                  | Three Months Ended |          | Six Months Ended |          |
|----------------------------------|--------------------|----------|------------------|----------|
|                                  | June 30,           |          | June 30,         |          |
|                                  | 2013               | 2012     | 2013             | 2012     |
| Revenue                          | \$13,507           | \$13,349 | \$26,941         | \$26,485 |
| Operating Expenses:              |                    |          |                  |          |
| Compensation and benefits        | 6,981              | 6,747    | 13,949           | 13,582   |
| Repairs and maintenance          | 309                | 303      | 618              | 605      |
| Depreciation and amortization    | 466                | 459      | 940              | 918      |
| Purchased transportation         | 1,731              | 1,733    | 3,511            | 3,450    |
| Fuel                             | 992                | 1,014    | 1,998            | 2,039    |
| Other occupancy                  | 225                | 213      | 478              | 450      |
| Other expenses                   | 1,061              | 1,090    | 2,125            | 2,082    |
| Total Operating Expenses         | 11,765             | 11,559   | 23,619           | 23,126   |
| Operating Profit                 | 1,742              | 1,790    | 3,322            | 3,359    |
| Other Income and (Expense):      |                    |          |                  |          |
| Investment income                | 3                  | 6        | 8                | 12       |
| Interest expense                 | (98                | ) (92    | ) (194           | ) (186   |
| Total Other Income and (Expense) | (95                | ) (86    | ) (186           | ) (174   |
| Income Before Income Taxes       | 1,647              | 1,704    | 3,136            | 3,185    |
| Income Tax Expense               | 576                | 588      | 1,028            | 1,099    |
| Net Income                       | \$1,071            | \$1,116  | \$2,108          | \$2,086  |
| Basic Earnings Per Share         | \$1.14             | \$1.16   | \$2.22           | \$2.17   |
| Diluted Earnings Per Share       | \$1.13             | \$1.15   | \$2.21           | \$2.15   |

## STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME

(In millions)

(unaudited)

|                                                                             | Three Months Ended |         | Six Months Ended |         |
|-----------------------------------------------------------------------------|--------------------|---------|------------------|---------|
|                                                                             | June 30,           |         | June 30,         |         |
|                                                                             | 2013               | 2012    | 2013             | 2012    |
| Net income                                                                  | \$1,071            | \$1,116 | \$2,108          | \$2,086 |
| Change in foreign currency translation adjustment, net of tax               | (24                | ) (158  | ) (327           | ) (67   |
| Change in unrealized gain (loss) on marketable securities, net of tax       | (6                 | ) 2     | (8               | ) 1     |
| Change in unrealized gain (loss) on cash flow hedges, net of tax            | 20                 | (43     | ) 58             | (84     |
| Change in unrecognized pension and postretirement benefit costs, net of tax | 28                 | 27      | 54               | 61      |
| Comprehensive income                                                        | \$1,089            | \$944   | \$1,885          | \$1,997 |
| See notes to unaudited consolidated financial statements.                   |                    |         |                  |         |

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## STATEMENTS OF CONSOLIDATED CASH FLOWS

(In millions)

(unaudited)

|                                                                            | Six Months Ended<br>June 30, |         |
|----------------------------------------------------------------------------|------------------------------|---------|
|                                                                            | 2013                         | 2012    |
| Cash Flows From Operating Activities:                                      |                              |         |
| Net income                                                                 | \$2,108                      | \$2,086 |
| Adjustments to reconcile net income to net cash from operating activities: |                              |         |
| Depreciation and amortization                                              | 940                          | 918     |
| Pension and postretirement benefit expense                                 | 562                          | 473     |
| Pension and postretirement benefit contributions                           | (114)                        | (450)   |
| Self-insurance reserves                                                    | 4                            | 70      |
| Deferred taxes, credits and other                                          | (328)                        | (148)   |
| Stock compensation expense                                                 | 288                          | 295     |
| Other (gains) losses                                                       | (98)                         | 115     |
| Changes in assets and liabilities, net of effect of acquisitions:          |                              |         |
| Accounts receivable                                                        | 542                          | 490     |
| Other current assets                                                       | (15)                         | (50)    |
| Accounts payable                                                           | (209)                        | (163)   |
| Accrued wages and withholdings                                             | (49)                         | (34)    |
| Other current liabilities                                                  | (134)                        | 304     |
| Other operating activities                                                 | (66)                         | (56)    |
| Net cash from operating activities                                         | 3,431                        | 3,850   |
| Cash Flows From Investing Activities:                                      |                              |         |
| Capital expenditures                                                       | (990)                        | (949)   |
| Proceeds from disposals of property, plant and equipment                   | 24                           | 32      |
| Purchases of marketable securities                                         | (1,615)                      | (1,940) |
| Sales and maturities of marketable securities                              | 717                          | 2,604   |
| Net decrease in finance receivables                                        | 19                           | 42      |
| Cash paid for business acquisitions                                        | —                            | (100)   |
| Other investing activities                                                 | (8)                          | 4       |
| Net cash used in investing activities                                      | (1,853)                      | (307)   |
| Cash Flows From Financing Activities:                                      |                              |         |
| Net change in short-term debt                                              | 1,045                        | 1,877   |
| Proceeds from long-term borrowings                                         | 100                          | 4       |
| Repayments of long-term borrowings                                         | (1,861)                      | (8)     |
| Purchases of common stock                                                  | (1,867)                      | (885)   |
| Issuances of common stock                                                  | 293                          | 194     |
| Dividends                                                                  | (1,140)                      | (1,068) |
| Other financing activities                                                 | (611)                        | 44      |
| Net cash provided by (used in) financing activities                        | (4,041)                      | 158     |
| Effect Of Exchange Rate Changes On Cash And Cash Equivalents               | (56)                         | (17)    |
| Net Increase (Decrease) In Cash And Cash Equivalents                       | (2,519)                      | 3,684   |
| Cash And Cash Equivalents:                                                 |                              |         |
| Beginning of period                                                        | 7,327                        | 3,034   |
| End of period                                                              | \$4,808                      | \$6,718 |



See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

Principles of Consolidation

In our opinion, the accompanying interim, unaudited, consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly our financial position as of June 30, 2013, our results of operations for the three and six months ended June 30, 2013 and 2012, and cash flows for the six months ended June 30, 2013 and 2012. The results reported in these consolidated financial statements should not be regarded as necessarily indicative of results that may be expected for the entire year. The interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012.

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

Fair Value of Financial Instruments

The carrying amounts of our cash and cash equivalents, accounts receivable, finance receivables and accounts payable approximate fair value as of June 30, 2013. The fair values of our investment securities are disclosed in note 4, our short and long-term debt in note 8 and our derivative instruments in note 13. We utilized Level 1 inputs in the fair value hierarchy of valuation techniques to determine the fair value of our cash and cash equivalents, and Level 2 inputs to determine the fair value of our accounts receivable, finance receivables and accounts payable.

Accounting Estimates

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

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

Adoption of New Accounting Standards

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 was effective for us beginning in the first quarter of 2013, and we have included the applicable disclosures in note 10.

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

Accounting Standards Issued But Not Yet Effective

Accounting pronouncements issued, but not effective until after June 30, 2013, are not expected to have a significant impact on our consolidated financial position or results of operations.

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 3. STOCK-BASED COMPENSATION

We issue employee share-based awards under the UPS Incentive Compensation Plan, which permits the grant of nonqualified and incentive stock options, stock appreciation rights, restricted stock and stock units, and restricted performance shares and performance units, to eligible employees (Restricted stock and stock units, and restricted performance shares and performance units are herein referred to as "Restricted Units"). The primary compensation programs offered under the UPS Incentive Compensation Plan include the UPS Management Incentive Award program, the UPS Long-Term Incentive Performance Award program and the UPS Stock Option program. We also maintain an employee stock purchase plan which allows eligible employees to purchase shares of UPS class A common stock at a discount. Additionally, our matching contributions to the primary employee defined contribution plan are made in shares of UPS class A common stock.

**Management Incentive Award**

During the first quarter of 2013, we granted Restricted Units under the Management Incentive Award program to eligible U.S.-based management employees. Restricted Units under the Management Incentive Award program will generally vest over a five-year period with approximately 20% of the award vesting on January 15th of each of the years following the grant date (except in the case of death, disability, or retirement, in which case immediate vesting occurs). The entire grant is expensed on a straight-line basis over the requisite service period. Based on the date that the eligible management population and performance targets were approved for the Management Incentive Award program, we determined the award measurement date to be February 5, 2013 (for U.S.-based employees) and April 1, 2013 (for international-based employees); therefore, the Restricted Unit grant was valued for stock compensation expense purposes using the closing New York Stock Exchange price of \$80.80 and \$84.47 on those dates, respectively.

**Long-Term Incentive Performance Award**

During the first quarter of 2013, we granted target Restricted Units under the UPS Long-Term Incentive Performance Award program to eligible management employees. Of the total 2013 target award, 90% of the target award will be divided into three substantially equal tranches, one for each calendar year in the three-year award cycle from 2013 to 2015, using performance criteria targets established each year. For 2013, those targets consist of consolidated operating return on invested capital and growth in consolidated revenue. The remaining 10% of the total 2013 target award will be based upon our achievement of adjusted earnings per share in 2015 compared to a target established at the grant date.

The number of Restricted Units earned each year will be the target number adjusted for the percentage achievement of performance criteria targets for the year. The percentage of achievement used to determine the Restricted Units earned may be a percentage less than or more than 100% of the target Restricted Units for each tranche. Based on the date that the eligible management population and performance targets were approved for the 2013 performance tranches, we determined the award measurement date to be March 1, 2013; therefore the target Restricted Units grant was valued for stock compensation expense purposes using the closing New York Stock Exchange price of \$82.87 on that date.

**Nonqualified Stock Options**

During the first quarter of 2013, we granted nonqualified stock option awards to a limited group of eligible senior management employees under the UPS Stock Option program. Stock option awards generally vest over a five-year period with approximately 20% of the award vesting at each anniversary date of the grant (except in the case of death, disability, or retirement, in which case immediate vesting occurs). The options granted will expire ten years after the date of the grant. In the first quarter of 2013 and 2012, we granted 0.2 million stock options each year at a weighted average grant price of \$82.93 and \$76.94, respectively. The weighted average fair value of our employee stock options granted, as determined by the Black-Scholes valuation model, was \$15.50 and \$14.88 for 2013 and 2012, respectively, using the following assumptions:

2013

2012

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|                          |       |   |       |   |
|--------------------------|-------|---|-------|---|
| Expected life (in years) | 7.5   |   | 7.5   |   |
| Risk-free interest rate  | 1.38  | % | 1.63  | % |
| Expected volatility      | 24.85 | % | 25.06 | % |
| Expected dividend yield  | 2.75  | % | 2.77  | % |

Compensation expense for share-based awards recognized in net income for the three months ended June 30, 2013 and 2012 was \$131 and \$133 million pre-tax, respectively. Compensation expense for share-based awards recognized in net income for the six months ended June 30, 2013 and 2012 was \$288 and \$295 million pre-tax, respectively.

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 4. INVESTMENTS AND RESTRICTED CASH

The following is a summary of marketable securities classified as available-for-sale as of June 30, 2013 and December 31, 2012 (in millions):

|                                                | Cost    | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|------------------------------------------------|---------|---------------------|----------------------|-------------------------|
| June 30, 2013                                  |         |                     |                      |                         |
| Current marketable securities:                 |         |                     |                      |                         |
| U.S. government and agency debt securities     | \$352   | \$1                 | \$(2)                | \$351                   |
| Mortgage and asset-backed debt securities      | 75      | —                   | (1)                  | 74                      |
| Corporate debt securities                      | 874     | 1                   | (2)                  | 873                     |
| U.S. state and local municipal debt securities | 17      | —                   | —                    | 17                      |
| Other debt and equity securities               | 69      | —                   | —                    | 69                      |
| Total marketable securities                    | \$1,387 | \$2                 | \$(5)                | \$1,384                 |

|                                                | Cost  | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|------------------------------------------------|-------|---------------------|----------------------|-------------------------|
| December 31, 2012                              |       |                     |                      |                         |
| 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                   |

## Investment Other-Than-Temporary Impairments

We have concluded that no other-than-temporary impairment losses existed as of June 30, 2013. In making this determination, we considered the financial condition and prospects of the issuers, the magnitude of the losses compared with the investments' cost, the length of time the investments have been in an unrealized loss position, the probability that we will be unable to collect all amounts due according to the contractual terms of the securities, the credit rating of the securities and our ability and intent to hold these investments until the anticipated recovery in market value occurs.

## Maturity Information

The amortized cost and estimated fair value of marketable securities at June 30, 2013, 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                  | \$832   | \$833                   |
| Due after one year through three years   | 413     | 412                     |
| Due after three years through five years | 23      | 22                      |
| Due after five years                     | 117     | 115                     |
|                                          | 1,385   | 1,382                   |
| Equity securities                        | 2       | 2                       |
|                                          | \$1,387 | \$1,384                 |



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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Non-Current Investments and Restricted Cash

We had \$387 and \$288 million of restricted cash related to our self-insurance requirements as of June 30, 2013 and December 31, 2012, respectively, which is reported in “Non-Current Investments and Restricted Cash” on the consolidated balance sheets. This restricted cash is invested in money market funds and similar cash-equivalent type assets.

At June 30, 2013 and December 31, 2012, we held a \$19 million investment in a variable life insurance policy to fund benefits for the UPS Excess Coordinating Benefit Plan. This investment is classified as “Non-Current Investments and Restricted Cash” in the consolidated balance sheets with the quarterly change in investment value recognized in the statements of consolidated income.

## Fair Value Measurements

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

We 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) the 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 8.44% and 7.75% as of June 30, 2013 and December 31, 2012, 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 June 30, 2013 and December 31, 2012, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value (in millions):

|                                                | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Balance |
|------------------------------------------------|-------------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|---------|
| June 30, 2013                                  |                                                                               |                                                     |                                                    |         |
| Marketable Securities:                         |                                                                               |                                                     |                                                    |         |
| U.S. government and agency debt securities     | \$350                                                                         | \$ 1                                                | \$—                                                | \$351   |
| Mortgage and asset-backed debt securities      | —                                                                             | 74                                                  | —                                                  | 74      |
| Corporate debt securities                      | —                                                                             | 873                                                 | —                                                  | 873     |
| U.S. state and local municipal debt securities | —                                                                             | 17                                                  | —                                                  | 17      |
| Other debt and equity securities               | —                                                                             | 69                                                  | —                                                  | 69      |
| Total marketable securities                    | 350                                                                           | 1,034                                               | —                                                  | 1,384   |
| Other investments                              | 19                                                                            | —                                                   | 136                                                | 155     |
| Total                                          | \$369                                                                         | \$ 1,034                                            | \$136                                              | \$1,539 |

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

|                                                | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>(Level 1) | Significant Other<br>Observable Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Balance |
|------------------------------------------------|-------------------------------------------------------------------------------|-----------------------------------------------------|----------------------------------------------------|---------|
| December 31, 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   |

The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the three months ended June 30, 2013 and 2012 (in millions):

|                                                              | Marketable<br>Securities | Other<br>Investments | Total |
|--------------------------------------------------------------|--------------------------|----------------------|-------|
| Balance on April 1, 2013                                     | \$—                      | \$150                | \$150 |
| Transfers into (out of) Level 3                              | —                        | —                    | —     |
| Net realized and unrealized gains (losses):                  |                          |                      |       |
| Included in earnings (in investment income)                  | —                        | (14                  | ) (14 |
| Included in accumulated other comprehensive income (pre-tax) | —                        | —                    | —     |
| Purchases                                                    | —                        | —                    | —     |
| Sales                                                        | —                        | —                    | —     |
| Balance on June 30, 2013                                     | \$—                      | \$136                | \$136 |
|                                                              | Marketable<br>Securities | Other<br>Investments | Total |
| Balance on April 1, 2012                                     | \$—                      | \$204                | \$204 |
| Transfers into (out of) Level 3                              | —                        | —                    | —     |
| Net realized and unrealized gains (losses):                  |                          |                      |       |
| Included in earnings (in investment income)                  | —                        | (14                  | ) (14 |
| Included in accumulated other comprehensive income (pre-tax) | —                        | —                    | —     |
| Purchases                                                    | —                        | —                    | —     |
| Sales                                                        | —                        | —                    | —     |
| Balance on June 30, 2012                                     | \$—                      | \$190                | \$190 |



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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the six months ended June 30, 2013 and 2012 (in millions):

|                                                              | Marketable<br>Securities | Other<br>Investments | Total |
|--------------------------------------------------------------|--------------------------|----------------------|-------|
| Balance on January 1, 2013                                   | \$—                      | 163                  | 163   |
| Transfers into (out of) Level 3                              | —                        | —                    | —     |
| Net realized and unrealized gains (losses):                  |                          |                      |       |
| Included in earnings (in investment income)                  | —                        | (27)                 | (27)  |
| Included in accumulated other comprehensive income (pre-tax) | —                        | —                    | —     |
| Purchases                                                    | —                        | —                    | —     |
| Sales                                                        | —                        | —                    | —     |
| Balance on June 30, 2013                                     | \$—                      | \$136                | \$136 |

|                                                              | Marketable<br>Securities | Other<br>Investments | Total |
|--------------------------------------------------------------|--------------------------|----------------------|-------|
| Balance on January 1, 2012                                   | \$—                      | 217                  | 217   |
| Transfers into (out of) Level 3                              | —                        | —                    | —     |
| Net realized and unrealized gains (losses):                  |                          |                      |       |
| Included in earnings (in investment income)                  | —                        | (27)                 | (27)  |
| Included in accumulated other comprehensive income (pre-tax) | —                        | —                    | —     |
| Purchases                                                    | —                        | —                    | —     |
| Sales                                                        | —                        | —                    | —     |
| Balance on June 30, 2012                                     | \$—                      | \$190                | \$190 |

There were no transfers of investments between Level 1 and Level 2 during the three and six months ended June 30, 2013 and 2012.

## NOTE 5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of June 30, 2013 and December 31, 2012 consist of the following (in millions):

|                                                 | 2013     | 2012     |
|-------------------------------------------------|----------|----------|
| Vehicles                                        | \$6,445  | \$6,344  |
| Aircraft                                        | 15,544   | 15,164   |
| Land                                            | 1,122    | 1,122    |
| Buildings                                       | 3,199    | 3,138    |
| Building and leasehold improvements             | 3,072    | 3,049    |
| Plant equipment                                 | 7,101    | 7,010    |
| Technology equipment                            | 1,608    | 1,675    |
| Equipment under operating leases                | 60       | 69       |
| Construction-in-progress                        | 348      | 470      |
|                                                 | 38,499   | 38,041   |
| Less: Accumulated depreciation and amortization | (20,619) | (20,147) |
|                                                 | \$17,880 | \$17,894 |

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 exceeds the fair value. There were no indicators of impairment in our property, plant and equipment, and no impairment charges were recorded, during the three and six months ended June 30, 2013 and 2012.



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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 6. EMPLOYEE BENEFIT PLANS

## Company-Sponsored Benefit Plans

Information about net periodic benefit cost for our company-sponsored pension and postretirement benefit plans is as follows for the three and six months ended June 30, 2013 and 2012 (in millions):

|                             | U.S. Pension Benefits |       | U.S. Postretirement Medical Benefits |       | International Pension Benefits |      |
|-----------------------------|-----------------------|-------|--------------------------------------|-------|--------------------------------|------|
|                             | 2013                  | 2012  | 2013                                 | 2012  | 2013                           | 2012 |
| Three Months Ended June 30: |                       |       |                                      |       |                                |      |
| Service cost                | \$337                 | \$250 | \$26                                 | \$22  | \$11                           | \$14 |
| Interest cost               | 363                   | 352   | 47                                   | 52    | 11                             | 10   |
| Expected return on assets   | (537)                 | (493) | (9)                                  | (5)   | (14)                           | (12) |
| Amortization of:            |                       |       |                                      |       |                                |      |
| Transition obligation       | —                     | —     | —                                    | —     | —                              | —    |
| Prior service cost          | 43                    | 44    | 1                                    | 1     | —                              | —    |
| Other net (gain) loss       | —                     | —     | —                                    | —     | —                              | —    |
| Actuarial (gain) loss       | —                     | —     | —                                    | —     | —                              | —    |
| Net periodic benefit cost   | \$206                 | \$153 | \$65                                 | \$70  | \$8                            | \$12 |
| Six Months Ended June 30:   |                       |       |                                      |       |                                |      |
| Service cost                | \$675                 | \$499 | \$52                                 | \$44  | \$26                           | \$29 |
| Interest cost               | 725                   | 705   | 93                                   | 104   | 22                             | 21   |
| Expected return on assets   | (1,074)               | (985) | (17)                                 | (9)   | (28)                           | (24) |
| Amortization of:            |                       |       |                                      |       |                                |      |
| Transition obligation       | —                     | —     | —                                    | —     | —                              | —    |
| Prior service cost          | 86                    | 87    | 2                                    | 2     | —                              | —    |
| Other net (gain) loss       | —                     | —     | —                                    | —     | —                              | —    |
| Actuarial (gain) loss       | —                     | —     | —                                    | —     | —                              | —    |
| Net periodic benefit cost   | \$412                 | \$306 | \$130                                | \$141 | \$20                           | \$26 |

During the first six months of 2013, we contributed \$53 million and \$61 million to our company-sponsored pension and postretirement medical benefit plans, respectively. We also expect to contribute \$48 and \$50 million over the remainder of the year to the pension and U.S. postretirement medical benefit plans, respectively.

## 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. On April 25, 2013, we reached a tentative agreement with the Teamsters on two new five-year contracts in the U.S. Domestic Package and UPS Freight business units. During the second quarter, UPS Teamster-represented employees in the U.S. Domestic Package business unit voted to approve the new agreement, while some local U.S. Domestic Package agreements and the agreement covering UPS Freight employees will require additional negotiation and approval before the new agreement is ratified. Before expiration, the Company and the Teamsters agreed to extensions of both existing five-year contracts and all local riders, supplements, and addenda. The extensions are open-ended and can be terminated by either party on thirty days' notice. Subject to ratification by the UPS Teamster-represented employees, the new agreements will be retroactively effective as of August 1, 2013. As of the date of this filing, there can be no assurance that our efforts will be

successful or that the ultimate resolution of these matters will not adversely affect our business, financial position, results of operations or liquidity.

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

We have approximately 2,600 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association, 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.

**NOTE 7. GOODWILL AND INTANGIBLE ASSETS**

The following table indicates the allocation of goodwill by reportable segment as of June 30, 2013 and December 31, 2012 (in millions):

|                    | U.S. Domestic<br>Package | International<br>Package | Supply Chain &<br>Freight | Consolidated |
|--------------------|--------------------------|--------------------------|---------------------------|--------------|
| December 31, 2012: | \$—                      | \$430                    | \$ 1,743                  | \$2,173      |
| Acquired           | —                        | —                        | —                         | —            |
| Currency / Other   | —                        | (16                      | ) (8                      | ) (24        |
| June 30, 2013:     | \$—                      | \$414                    | \$ 1,735                  | \$2,149      |

The 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.

The following is a summary of intangible assets as of June 30, 2013 and December 31, 2012 (in millions):

|                                          | Gross Carrying<br>Amount | Accumulated<br>Amortization | Net Carrying<br>Value |
|------------------------------------------|--------------------------|-----------------------------|-----------------------|
| June 30, 2013:                           |                          |                             |                       |
| Trademarks, licenses, patents, and other | \$200                    | \$(89                       | ) \$111               |
| Customer lists                           | 130                      | (84                         | ) 46                  |
| Franchise rights                         | 117                      | (67                         | ) 50                  |
| Capitalized software                     | 2,331                    | (1,860                      | ) 471                 |
| Total Intangible Assets, Net             | \$2,778                  | \$(2,100                    | ) \$678               |
| December 31, 2012:                       |                          |                             |                       |
| Trademarks, licenses, patents, and other | \$163                    | \$(80                       | ) \$83                |
| Customer lists                           | 131                      | (79                         | ) 52                  |
| Franchise rights                         | 117                      | (64                         | ) 53                  |
| Capitalized software                     | 2,197                    | (1,782                      | ) 415                 |
| Total Intangible Assets, Net             | \$2,608                  | \$(2,005                    | ) \$603               |

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 8. DEBT AND FINANCING ARRANGEMENTS

The carrying value of our outstanding debt as of June 30, 2013 and December 31, 2012 consists of the following (in millions):

|                            | Principal<br>Amount | Maturity  | Carrying Value |          |
|----------------------------|---------------------|-----------|----------------|----------|
|                            |                     |           | 2013           | 2012     |
| Commercial paper           | \$1,045             | 2013      | \$1,045        | \$—      |
| Fixed-rate senior notes:   |                     |           |                |          |
| 4.50% senior notes         | —                   | 2013      | —              | 1,751    |
| 3.875% senior notes        | 1,000               | 2014      | 1,020          | 1,033    |
| 1.125% senior notes        | 375                 | 2017      | 365            | 373      |
| 5.50% senior notes         | 750                 | 2018      | 823            | 851      |
| 5.125% senior notes        | 1,000               | 2019      | 1,090          | 1,140    |
| 3.125% senior notes        | 1,500               | 2021      | 1,606          | 1,655    |
| 2.45% senior notes         | 1,000               | 2022      | 934            | 996      |
| 6.20% senior notes         | 1,500               | 2038      | 1,481          | 1,480    |
| 4.875% senior notes        | 500                 | 2040      | 489            | 489      |
| 3.625% senior notes        | 375                 | 2042      | 367            | 367      |
| 8.375% Debentures:         |                     |           |                |          |
| 8.375% debentures          | 424                 | 2020      | 486            | 512      |
| 8.375% debentures          | 276                 | 2030      | 283            | 284      |
| Pound Sterling notes:      |                     |           |                |          |
| 5.50% notes                | 101                 | 2031      | 97             | 103      |
| 5.13% notes                | 693                 | 2050      | 660            | 699      |
| Floating rate senior notes | 377                 | 2049-2053 | 373            | 374      |
| Capital lease obligations  | 481                 | 2013-3004 | 481            | 440      |
| Facility notes and bonds   | 320                 | 2015-2036 | 320            | 320      |
| Other debt                 | 3                   | 2013-2022 | 3              | 3        |
| Total Debt                 | \$11,720            |           | 11,923         | 12,870   |
| Less: Current Maturities   |                     |           | (1,086         | ) (1,781 |
| Long-term Debt             |                     |           | \$10,837       | \$11,089 |

## Debt Repayments

On January 15, 2013, our \$1.75 billion 4.5% senior notes matured and were repaid in full.

## Debt Classification

We have classified our 3.875% senior notes with a principal balance of \$1.0 billion due in April 2014 as a long-term liability, based on our intent and ability to refinance the debt as of June 30, 2013.

## Sources of Credit

We are authorized to borrow up to \$10.0 billion under the U.S. commercial paper program we maintain. We had \$1.045 billion outstanding under this program as of June 30, 2013, with an average interest rate of 0.05%. We also maintain a European commercial paper program under which we are authorized to borrow up to €5.0 billion in a variety of currencies. As of June 30, 2013, there were no amounts outstanding under this program. As of June 30, 2013, we have classified the entire commercial paper balance as a current liability in our consolidated balance sheets.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 March 28, 2014. 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 the highest of (1) JPMorgan Chase Bank's publicly announced prime rate, (2) the Federal Funds effective rate plus 0.50%, and (3) LIBOR for a one month interest period plus 1.00%, 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 prime 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 June 30, 2013.

The second agreement provides revolving credit facilities of \$1.0 billion, and expires on March 29, 2018. 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 the highest of (1) JPMorgan Chase Bank's publicly announced prime rate, (2) the Federal Funds effective rate plus 0.50%, and (3) LIBOR for a one month interest period plus 1.00%, 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%, per annum. The applicable margin for advances bearing interest based on the prime 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 June 30, 2013.

**Debt Covenants**

Our existing debt instruments and credit facilities subject us to certain financial covenants. As of June 30, 2013 and for all prior periods, we have satisfied these financial covenants. These covenants limit the amount of secured indebtedness that we may incur, and limit the amount of attributable debt in sale-leaseback transactions, to 10% of net tangible assets. As of June 30, 2013, 10% of net tangible assets was equivalent to \$2.669 billion; however, we have no covered sale-leaseback transactions or secured indebtedness outstanding. 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, was approximately \$13.086 and \$14.658 billion as of June 30, 2013 and December 31, 2012, 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 9. LEGAL PROCEEDINGS AND CONTINGENCIES**

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

Although there can be no assurance as to the ultimate outcome, we have generally denied, or believe we have a meritorious defense and will deny, liability in all litigation pending against us, including (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.



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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 (1) 125 individual franchisees who did not rebrand to The UPS Store and (2) a certified class of all franchisees who did rebrand. With respect to the 125 individual franchisees described in (1) above, the trial court entered judgment against a bellwether individual plaintiff, which was affirmed in January 2012. In March 2013, we reached a settlement in principle with the remaining individual plaintiffs who did not rebrand. We believe this settlement will not have a material adverse effect on our financial condition, results of operations or liquidity. The trial court granted our motion for summary judgment against the certified class described in (2) above, which was reversed in January 2012. We have not reached a settlement with this class of franchisees, and the claims of the class remain pending.

There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from the remaining aspects of this case, 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 February 2014. 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) briefing of dispositive motions 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 also has been dismissed. We deny all liability and are vigorously defending the one outstanding case in Ontario. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from this matter, including: (1) we are vigorously defending ourselves and believe 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 this matter. Accordingly, at this time, we are not able to estimate a

possible loss or range of loss that may result from this matter or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operation or liquidity.

Other Matters

On March 29, 2013, we entered into a Non-Prosecution Agreement (“NPA”) with the United States Attorney's Office in the Northern District of California in connection with an investigation by the Drug Enforcement Administration of shipments by illicit online pharmacies. Under the NPA, we forfeited \$40 million to the government, admitted to a Statement of Facts describing the conduct leading to the agreement, and agreed to implement an online pharmacy compliance program. The term of the NPA is two years, although we can petition the government to shorten that term in its discretion to one year. The NPA did not have a material impact on our results of operations in 2013.

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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. UPS responded to that request in January 2013.

We are cooperating with each of these investigations, and intend to continue to vigorously defend ourselves. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) we are vigorously defending each matter and believe that we have a number of meritorious legal defenses; (2) there are unresolved questions of law that could be of importance to the ultimate resolutions of these matters, including the calculation of any potential fine; and (3) there is uncertainty about the time period that is the subject of the investigations. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

In January 2008, a class action complaint was filed in the United States District Court for the Eastern District of New York alleging price-fixing activities relating to the provision of freight forwarding services. UPS was not named in this case. In July 2009, the plaintiffs filed a First Amended Complaint naming numerous global freight forwarders as defendants. UPS and UPS Supply Chain Solutions are among the 60 defendants named in the amended complaint. 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 filed another motion to dismiss, which is currently pending before the Court, and will 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 14. 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.

Beginning in the third quarter of 2012 and continuing through the first quarter of 2013, we had settlement discussions with the Appeals team. In the first quarter of 2013, we reached settlement terms for a complete resolution of all excise tax matters and correlative income tax refund claims for the 2003 through 2007 tax years. The final resolution of these matters did not materially impact our financial condition, results of operations or liquidity.



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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## NOTE 10. SHAREOWNERS' EQUITY

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

We maintain two classes of common stock, which are distinguished from each other primarily by their respective voting rights. Class A shares are entitled to 10 votes per share, whereas class B shares are entitled to one vote per share. Class A shares are primarily held by UPS employees and retirees, and these shares are fully convertible into class B shares at any time. Class B shares are publicly traded on the New York Stock Exchange under the symbol "UPS". Class A and B shares both have a \$0.01 par value, and as of June 30, 2013, there were 4.6 billion class A shares and 5.6 billion class B shares authorized to be issued. Additionally, there are 200 million preferred shares, with a \$0.01 par value, authorized to be issued; as of June 30, 2013, no preferred shares had been issued.

The following is a rollforward of our common stock, additional paid-in capital and retained earnings accounts for the six months ended June 30, 2013 and 2012 (in millions, except per share amounts):

|                                                           | 2013   |         | 2012   |          |   |
|-----------------------------------------------------------|--------|---------|--------|----------|---|
|                                                           | Shares | Dollars | Shares | Dollars  |   |
| Class A Common Stock                                      |        |         |        |          |   |
| Balance at beginning of period                            | 225    | \$3     | 240    | \$3      |   |
| Common stock purchases                                    | (4     | ) (1    | (3     | ) —      |   |
| Stock award plans                                         | 5      | —       | 4      | —        |   |
| Common stock issuances                                    | 2      | —       | 2      | —        |   |
| Conversions of class A to class B common stock            | (10    | ) —     | (8     | ) —      |   |
| Class A shares issued at end of period                    | 218    | \$2     | 235    | \$3      |   |
| Class B Common Stock                                      |        |         |        |          |   |
| Balance at beginning of period                            | 729    | \$7     | 725    | \$7      |   |
| Common stock purchases                                    | (18    | ) —     | (8     | ) —      |   |
| Conversions of class A to class B common stock            | 10     | —       | 8      | —        |   |
| Class B shares issued at end of period                    | 721    | \$7     | 725    | \$7      |   |
| Additional Paid-In Capital                                |        |         |        |          |   |
| Balance at beginning of period                            |        | \$—     |        | \$—      |   |
| Stock award plans                                         |        | 364     |        | 291      |   |
| Common stock purchases                                    |        | (114    | )      | (606     | ) |
| Common stock issuances                                    |        | 149     |        | 144      |   |
| Option premiums received (paid)                           |        | (399    | )      | 206      |   |
| Unsettled portion of accelerated stock repurchase program |        | —       |        | (35      | ) |
| Balance at end of period                                  |        | \$—     |        | \$—      |   |
| Retained Earnings                                         |        |         |        |          |   |
| Balance at beginning of period                            |        | \$7,997 |        | \$10,128 |   |
| Net income attributable to common shareowners             |        | 2,108   |        | 2,086    |   |
| Dividends (\$1.24 and \$1.14 per share)                   |        | (1,199  | )      | (1,123   | ) |
| Common stock purchases                                    |        | (1,721  | )      | (264     | ) |
| Balance at end of period                                  |        | \$7,185 |        | \$10,827 |   |

In total, we repurchased 21.8 million shares of class A and class B common stock for \$1.836 billion during the six months ended June 30, 2013, and 11.3 million shares for \$870 million during the six months ended June 30, 2012. On February 14, 2013, the Board of Directors approved a new share repurchase authorization of \$10.0 billion, which replaced an authorization previously announced in 2012. The new share repurchase authorization has no expiration date. Share repurchases may take the form of accelerated share repurchases, open market purchases, or other such methods as we deem appropriate. The timing of our share repurchases will depend upon market conditions. Unless

terminated earlier by the resolution of our Board, the program will expire when we have purchased all shares authorized for repurchase under the program.

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From time to time, we enter into share repurchase programs with large financial institutions to assist in our buyback of company stock. These programs allow us to repurchase our shares at a price below the weighted average UPS share price for a given period. During the second quarter of 2013, we entered into an accelerated share repurchase program, which allowed us to repurchase \$500 million of shares (5.8 million shares). The program was completed in June 2013. 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. As of June 30, 2013, we paid premiums of \$400 million on options for the purchase of 5.3 million shares that will settle in the second half of 2013. During the six months ended June 30, 2013, we settled options that resulted in the receipt of \$1 million in premiums (in excess of our initial investment). During the six months ended June 30, 2012, we received \$206 million in premiums for options that were entered into during 2011 that expired in 2012, including \$6 million in premiums in excess of our initial investment.

## Accumulated Other Comprehensive Income (Loss)

We experience activity in AOCI for unrealized holding gains and losses on available-for-sale securities, foreign currency translation adjustments, unrealized gains and losses from derivatives that qualify as hedges of cash flows and unrecognized pension and postretirement benefit costs. The activity in AOCI for the six months ended June 30, 2013 and 2012 is as follows (in millions):

|                                                                                        | 2013      | 2012        |
|----------------------------------------------------------------------------------------|-----------|-------------|
| Foreign currency translation gain (loss):                                              |           |             |
| Balance at beginning of period                                                         | \$ 134    | \$(160)     |
| Reclassification to earnings (no tax impact in either period)                          | (161)     | ) —         |
| Translation adjustment (net of tax effect of \$3 and \$(3))                            | (166)     | ) (67)      |
| Balance at end of period                                                               | (193)     | ) (227)     |
| Unrealized gain (loss) on marketable securities, net of tax:                           |           |             |
| Balance at beginning of period                                                         | 6         | 6           |
| Current period changes in fair value (net of tax effect of \$(5) and \$(2))            | (8)       | ) 4         |
| Reclassification to earnings (net of tax effect of \$0 and \$(1))                      | —         | (3)         |
| Balance at end of period                                                               | (2)       | ) 7         |
| Unrealized gain (loss) on cash flow hedges, net of tax:                                |           |             |
| Balance at beginning of period                                                         | (286)     | ) (204)     |
| Current period changes in fair value (net of tax effect of \$(14) and \$(57))          | (22)      | ) (94)      |
| Reclassification to earnings (net of tax effect of \$48 and \$(6))                     | 80        | 10          |
| Balance at end of period                                                               | (228)     | ) (288)     |
| Unrecognized pension and postretirement benefit costs, net of tax:                     |           |             |
| Balance at beginning of period                                                         | (3,208)   | ) (2,745)   |
| Reclassification to earnings (net of tax effect of \$34 and \$(34))                    | 54        | 55          |
| Adjustment for Early Retirement Reinsurance Program (net of tax effect of \$0 and \$4) | —         | 6           |
| Balance at end of period                                                               | (3,154)   | ) (2,684)   |
| Accumulated other comprehensive income (loss) at end of period                         | \$(3,577) | ) \$(3,192) |





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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Detail of the gains (losses) reclassified from AOCI to the statements of consolidated income for the three and six months ended June 30, 2013 and 2012 is as follows (in millions):

Three Months Ended June 30:

|                                                        | 2013<br>Amount<br>Reclassified<br>from AOCI | 2012<br>Amount<br>Reclassified<br>from AOCI | Affected Line Item in the<br>Income Statement |
|--------------------------------------------------------|---------------------------------------------|---------------------------------------------|-----------------------------------------------|
| Foreign currency translation gain (loss):              |                                             |                                             |                                               |
| Liquidation of foreign subsidiary                      | \$—                                         | \$—                                         | Other expenses                                |
| Income tax (expense) benefit                           | —                                           | —                                           | Income tax expense                            |
| Impact on net income                                   | —                                           | —                                           | Net income                                    |
| Unrealized gain (loss) on marketable securities:       |                                             |                                             |                                               |
| Realized gain (loss) on sale of securities             | —                                           | 1                                           | Investment income                             |
| Income tax (expense) benefit                           | —                                           | —                                           | Income tax expense                            |
| Impact on net income                                   | —                                           | 1                                           | Net income                                    |
| Unrealized gain (loss) on cash flow hedges:            |                                             |                                             |                                               |
| Interest rate contracts                                | (5                                          | ) (5                                        | ) Interest expense                            |
| Foreign exchange contracts                             | 6                                           | (19                                         | ) Interest expense                            |
| Foreign exchange contracts                             | (12                                         | ) 9                                         | Revenue                                       |
| Commodity contracts                                    | (38                                         | ) —                                         | Fuel expense                                  |
| Income tax (expense) benefit                           | 18                                          | 6                                           | Income tax expense                            |
| Impact on net income                                   | (31                                         | ) (9                                        | ) Net income                                  |
| Unrecognized pension and postretirement benefit costs: |                                             |                                             |                                               |
| Prior service costs                                    | (44                                         | ) (45                                       | ) Compensation and benefits                   |
| Income tax (expense) benefit                           | 16                                          | 18                                          | Income tax expense                            |
| Impact on net income                                   | (28                                         | ) (27                                       | ) Net income                                  |
| Total amount reclassified for the period               | \$(59                                       | ) \$(35                                     | ) Net income                                  |

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Six Months Ended June 30:

|                                                        | 2013<br>Amount<br>Reclassified<br>from AOCI | 2012<br>Amount<br>Reclassified<br>from AOCI | Affected Line Item in the<br>Income Statement |
|--------------------------------------------------------|---------------------------------------------|---------------------------------------------|-----------------------------------------------|
| Foreign currency translation gain (loss):              |                                             |                                             |                                               |
| Liquidation of foreign subsidiary                      | \$161                                       | \$—                                         | Other expenses                                |
| Income tax (expense) benefit                           | —                                           | —                                           | Income tax expense                            |
| Impact on net income                                   | 161                                         | —                                           | Net income                                    |
| Unrealized gain (loss) on marketable securities:       |                                             |                                             |                                               |
| Realized gain (loss) on sale of securities             | —                                           | 4                                           | Investment income                             |
| Income tax (expense) benefit                           | —                                           | (1                                          | ) Income tax expense                          |
| Impact on net income                                   | —                                           | 3                                           | Net income                                    |
| Unrealized gain (loss) on cash flow hedges:            |                                             |                                             |                                               |
| Interest rate contracts                                | (10                                         | ) (10                                       | ) Interest expense                            |
| Foreign exchange contracts                             | (44                                         | ) (3                                        | ) Interest expense                            |
| Foreign exchange contracts                             | (26                                         | ) (3                                        | ) Revenue                                     |
| Commodity contracts                                    | (48                                         | ) —                                         | Fuel expense                                  |
| Income tax (expense) benefit                           | 48                                          | 6                                           | Income tax expense                            |
| Impact on net income                                   | (80                                         | ) (10                                       | ) Net income                                  |
| Unrecognized pension and postretirement benefit costs: |                                             |                                             |                                               |
| Prior service costs                                    | (88                                         | ) (89                                       | ) Compensation and benefits                   |
| Income tax (expense) benefit                           | 34                                          | 34                                          | Income tax expense                            |
| Impact on net income                                   | (54                                         | ) (55                                       | ) Net income                                  |
| Total amount reclassified for the period               | \$27                                        | \$(62                                       | ) Net income                                  |

## Deferred Compensation Obligations and Treasury Stock

Activity in the deferred compensation program for the six months ended June 30, 2013 and 2012 is as follows (in millions):

|                                    | 2013   |         | 2012   |         |   |
|------------------------------------|--------|---------|--------|---------|---|
|                                    | Shares | Dollars | Shares | Dollars |   |
| Deferred Compensation Obligations: |        |         |        |         |   |
| Balance at beginning of period     |        | \$78    |        | \$88    |   |
| Reinvested dividends               |        | 2       |        | 2       |   |
| Benefit payments                   |        | (13     | )      | (14     | ) |
| Balance at end of period           |        | \$67    |        | \$76    |   |
| Treasury Stock:                    |        |         |        |         |   |
| Balance at beginning of period     | (1     | ) \$(78 | ) (2   | ) \$(88 | ) |
| Reinvested dividends               | —      | (2      | ) —    | (2      | ) |
| Benefit payments                   | —      | 13      | —      | 14      |   |
| Balance at end of period           | (1     | ) \$(67 | ) (2   | ) \$(76 | ) |

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Noncontrolling Interests:

We have noncontrolling interests in certain consolidated subsidiaries in our International Package and Supply Chain & Freight segments. The activity related to our noncontrolling interests is presented below for the six months ended June 30, 2013 and 2012 (in millions):

|                                                     | 2013 | 2012 |
|-----------------------------------------------------|------|------|
| Noncontrolling Interests:                           |      |      |
| Balance at beginning of period                      | \$80 | \$73 |
| Acquired noncontrolling interests                   | (67  | ) 7  |
| Dividends attributable to noncontrolling interests  | —    | —    |
| Net income attributable to noncontrolling interests | —    | —    |
| Balance at end of period                            | \$13 | \$80 |

The reduction in our noncontrolling interests in 2013 primarily relates to our purchase of the remaining noncontrolling interest in a joint venture that operates in the Middle East, Turkey and portions of the Central Asia region for \$70 million. After this transaction, we own 100% of this entity.

## NOTE 11. SEGMENT INFORMATION

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

## U.S. Domestic Package

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

## International Package

International Package operations include delivery to more than 220 countries and territories worldwide, including shipments wholly outside the United States, as well as U.S. export and U.S. import shipments. Our International Package reporting segment includes the operations of our Europe, Asia and Americas operating segments.

## Supply Chain &amp; Freight

Supply Chain & Freight includes the operations of our forwarding, logistics and freight units, as well as other aggregated businesses. Our forwarding and logistics business provides services in more than 195 countries and territories worldwide, and includes supply chain design and management, freight distribution, customs brokerage, mail and consulting services. UPS Freight offers a variety of less-than-truckload ("LTL") and truckload ("TL") services to customers in North America. Other aggregated business units within this segment include The UPS Store and UPS Capital.

In evaluating financial performance, we focus on operating profit as a segment's measure of profit or loss. Operating profit is before investment income, interest expense and income taxes. The accounting policies of the reportable segments are the same as those described in the summary of accounting policies included in the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012, with certain expenses allocated between the segments using activity-based costing methods. Unallocated assets are comprised primarily of cash, marketable securities and investments in limited partnerships.

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Segment information for the three and six months ended June 30, 2013 and 2012 is as follows (in millions):

|                        | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|------------------------|--------------------------------|----------|------------------------------|----------|
|                        | 2013                           | 2012     | 2013                         | 2012     |
| Revenue:               |                                |          |                              |          |
| U.S. Domestic Package  | \$8,241                        | \$8,058  | \$16,512                     | \$16,062 |
| International Package  | 3,062                          | 3,014    | 6,040                        | 5,980    |
| Supply Chain & Freight | 2,204                          | 2,277    | 4,389                        | 4,443    |
| Consolidated           | \$13,507                       | \$13,349 | \$26,941                     | \$26,485 |
| Operating Profit:      |                                |          |                              |          |
| U.S. Domestic Package  | \$1,132                        | \$1,134  | \$2,217                      | \$2,129  |
| International Package  | 451                            | 454      | 803                          | 862      |
| Supply Chain & Freight | 159                            | 202      | 302                          | 368      |
| Consolidated           | \$1,742                        | \$1,790  | \$3,322                      | \$3,359  |

## NOTE 12. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2013 and 2012 (in millions, except per share amounts):

|                                               | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|-----------------------------------------------|--------------------------------|---------|------------------------------|---------|
|                                               | 2013                           | 2012    | 2013                         | 2012    |
| Numerator:                                    |                                |         |                              |         |
| Net income attributable to common shareowners | \$1,071                        | \$1,116 | \$2,108                      | \$2,086 |
| Denominator:                                  |                                |         |                              |         |
| Weighted average shares                       | 941                            | 959     | 945                          | 959     |
| Deferred compensation obligations             | 1                              | 2       | 1                            | 2       |
| Vested portion of restricted shares           | 1                              | 1       | 2                            | 1       |
| Denominator for basic earnings per share      | 943                            | 962     | 948                          | 962     |
| Effect of dilutive securities:                |                                |         |                              |         |
| Restricted shares                             | 8                              | 8       | 7                            | 9       |
| Stock options                                 | 1                              | 1       | 1                            | 1       |
| Denominator for diluted earnings per share    | 952                            | 971     | 956                          | 972     |
| Basic earnings per share                      | \$1.14                         | \$1.16  | \$2.22                       | \$2.17  |
| Diluted earnings per share                    | \$1.13                         | \$1.15  | \$2.21                       | \$2.15  |

Diluted earnings per share for the three months ended June 30, 2013 and 2012 exclude the effect of 0.0 and 2.6 million shares of common stock (0.1 and 2.6 million for the six months ended June 30, 2013 and 2012), respectively, that may be issued upon the exercise of employee stock options because such effect would be antidilutive.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

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NOTE 13. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT

Risk Management Policies

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

Credit Risk Management

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 all of our active counterparties (covering the majority of our derivative positions) containing early termination rights and/or zero threshold bilateral collateral provisions whereby cash is required based on the net fair value of derivatives associated with those counterparties. Events such as a counterparty credit rating downgrade (depending on the ultimate rating level) could also allow us to take additional protective measures such as the early termination of trades. At June 30, 2013, we held cash collateral of \$164 million under these agreements. In connection with the agreements described above, we could also be required to provide collateral or terminate transactions with certain counterparties in the event of a downgrade of our credit rating. The amount of collateral required would be determined by the net fair value of the associated derivatives with each counterparty. At June 30, 2013, the aggregate fair value of the instruments covered by these contractual features that were in a net liability position was \$198 million; and we were required to post \$10 million in 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 other AOCI. The remainder of the change in value of such instruments is recorded in earnings.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Types of Hedges

Commodity Risk Management

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

Foreign Currency Risk Management

To protect against the reduction in value of forecasted foreign currency cash flows from our international package business, we maintain a foreign currency cash flow hedging program. Our most significant foreign currency exposures relate to the Euro, 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; 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; therefore, the resulting gains and losses from these hedges are recognized in the statements of consolidated income when the currency remeasurement gains and losses on the underlying debt obligations and leases are incurred.

Interest Rate Risk Management

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

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

We periodically hedge the forecasted fixed-coupon interest payments associated with anticipated debt offerings, using forward starting interest rate swaps, interest rate locks or similar derivatives. These agreements effectively lock a portion of our interest rate exposure between the time the agreement is entered into and the date when the debt

offering is completed, thereby mitigating the impact of interest rate changes on future interest expense. These derivatives are settled commensurate with the issuance of the debt, and any gain or loss upon settlement is amortized as an adjustment to the effective interest yield on the debt.



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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

## Outstanding Positions

As of June 30, 2013 and December 31, 2012, the notional amounts of our outstanding derivative positions were as follows (in millions):

|                             | June 30, 2013 | December 31, 2012 |
|-----------------------------|---------------|-------------------|
| Currency hedges:            |               |                   |
| British Pound Sterling      | GBP 915       | GBP 797           |
| Canadian Dollar             | CAD 296       | CAD 341           |
| Euro                        | EUR 2,061     | EUR 1,783         |
| Indian Rupee                | INR 985       | INR —             |
| Malaysian Ringgit           | MYR 700       | MYR 500           |
| Mexican Peso                | MXN 3,340     | MXN —             |
| United Arab Emirates Dirham | AED —         | AED 551           |

## Interest rate hedges:

|                                       |          |          |
|---------------------------------------|----------|----------|
| Fixed to Floating Interest Rate Swaps | \$ 6,049 | \$ 7,274 |
| Floating to Fixed Interest Rate Swaps | \$ 781   | \$ 781   |
| Interest Rate Basis Swaps             | \$ 2,500 | \$ 2,500 |

## Balance Sheet Recognition and Fair Value Measurements

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

We have master netting arrangements with substantially all of our counterparties giving us the right of offset for our derivative positions. However, we have not elected to offset the fair value positions of our derivative contracts recorded on our consolidated balance sheets. The columns labeled "Net Amounts if Right of Offset had been Applied" indicate the potential net fair value positions by type of contract and location on the consolidated balance sheets had we elected to apply the right of offset.

| Asset Derivatives                     | Balance Sheet Location   | Fair Value Hierarchy Level | Gross Amounts Presented in Consolidated Balance Sheets |                   | Net Amounts if Right of Offset had been Applied |                   |
|---------------------------------------|--------------------------|----------------------------|--------------------------------------------------------|-------------------|-------------------------------------------------|-------------------|
|                                       |                          |                            | June 30, 2013                                          | December 31, 2012 | June 30, 2013                                   | December 31, 2012 |
| Derivatives designated as hedges:     |                          |                            |                                                        |                   |                                                 |                   |
| Foreign exchange contracts            | Other current assets     | Level 2                    | \$64                                                   | \$27              | \$64                                            | \$27              |
| Interest rate contracts               | Other current assets     | Level 2                    | 21                                                     | 1                 | 21                                              | 1                 |
| Foreign exchange contracts            | Other non-current assets | Level 2                    | 34                                                     | 14                | 34                                              | 12                |
| Interest rate contracts               | Other non-current assets | Level 2                    | 236                                                    | 420               | 162                                             | 406               |
| Derivatives not designated as hedges: |                          |                            |                                                        |                   |                                                 |                   |
| Foreign exchange contracts            | Other current assets     | Level 2                    | 22                                                     | 3                 | 21                                              | 3                 |
| Interest rate contracts               | Other non-current assets | Level 2                    | 61                                                     | 101               | 58                                              | 91                |
| Total Asset Derivatives               |                          |                            | \$438                                                  | \$566             | \$360                                           | \$540             |



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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

| Liability Derivatives                 | Balance Sheet Location        | Fair Value Hierarchy Level | Gross Amounts Presented in Consolidated Balance Sheets |                   | Net Amounts if Right of Offset had been Applied |                   |
|---------------------------------------|-------------------------------|----------------------------|--------------------------------------------------------|-------------------|-------------------------------------------------|-------------------|
|                                       |                               |                            | June 30, 2013                                          | December 31, 2012 | June 30, 2013                                   | December 31, 2012 |
| Derivatives designated as hedges:     |                               |                            |                                                        |                   |                                                 |                   |
| Foreign exchange contracts            | Other non-current liabilities | Level 2                    | \$113                                                  | \$103             | \$113                                           | \$101             |
| Interest rate contracts               | Other non-current liabilities | Level 2                    | 79                                                     | 14                | 5                                               | —                 |
| Derivatives not designated as hedges: |                               |                            |                                                        |                   |                                                 |                   |
| Foreign exchange contracts            | Other current liabilities     | Level 2                    | 1                                                      | 1                 | —                                               | 1                 |
| Interest rate contracts               | Other current liabilities     | Level 2                    | 1                                                      | —                 | 1                                               | —                 |
| Interest rate contracts               | Other non-current liabilities | Level 2                    | 4                                                      | 41                | 1                                               | 31                |
| Total Liability Derivatives           |                               |                            | \$198                                                  | \$159             | \$120                                           | \$133             |

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; therefore, these derivatives are classified as Level 2.

**Income Statement and Other Comprehensive Income Recognition**

The following table indicates the amount of gains and losses that have been recognized in other comprehensive income for the three and six months ended June 30, 2013 and 2012 for those derivatives designated as cash flow hedges (in millions):

**Three Months Ended June 30:**

|                                                           | 2013                                                                      | 2012                                                                      |
|-----------------------------------------------------------|---------------------------------------------------------------------------|---------------------------------------------------------------------------|
| Derivative Instruments in Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion) | Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion) |
| Interest rate contracts                                   | \$2                                                                       | \$(53)                                                                    |
| Foreign exchange contracts                                | 10                                                                        | (31)                                                                      |
| Commodity contracts                                       | (30)                                                                      | ) —                                                                       |
| Total                                                     | \$(18)                                                                    | ) \$(84)                                                                  |

**Six Months Ended June 30:**

|                                                           | 2013                                                                      | 2012                                                                      |
|-----------------------------------------------------------|---------------------------------------------------------------------------|---------------------------------------------------------------------------|
| Derivative Instruments in Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion) | Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion) |
| Interest rate contracts                                   | \$3                                                                       | \$(61)                                                                    |
| Foreign exchange contracts                                | 9                                                                         | (90)                                                                      |
| Commodity contracts                                       | (48)                                                                      | ) —                                                                       |
| Total                                                     | \$(36)                                                                    | ) \$(151)                                                                 |

As of June 30, 2013, \$21 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 June 30, 2014. 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 maximum term over which we are hedging exposures to the variability of cash flow is 37 years.

The amount of ineffectiveness recognized in income on derivative instruments designated in cash flow hedging relationships was immaterial for the three and six months ended June 30, 2013 and 2012.

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## UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The following table indicates the amount and location in the statements of consolidated income in which derivative gains and losses, as well as the associated gains and losses on the underlying exposure, have been recognized for those derivatives designated as fair value hedges for the three and six months ended June 30, 2013 and 2012 (in millions):

| Derivative Instruments in Fair Value Hedging Relationships | Location of Gain (Loss) Recognized in Income | 2013                                       | 2012                                       | Hedged Items in Fair Value Hedging Relationships | Location of Gain (Loss) Recognized In Income | 2013                                       | 2012                                       |
|------------------------------------------------------------|----------------------------------------------|--------------------------------------------|--------------------------------------------|--------------------------------------------------|----------------------------------------------|--------------------------------------------|--------------------------------------------|
|                                                            |                                              | Amount of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income |                                                  |                                              | Amount of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income |
| Three Months Ended June 30:                                |                                              |                                            |                                            |                                                  |                                              |                                            |                                            |
| Interest rate contracts                                    | Interest Expense                             | \$(187                                     | ) \$72                                     | Fixed-Rate Debt and Capital Leases               | Interest Expense                             | \$187                                      | \$(72 )                                    |
| Six Months Ended June 30:                                  |                                              |                                            |                                            |                                                  |                                              |                                            |                                            |
| Interest rate contracts                                    | Interest Expense                             | \$(233                                     | ) \$36                                     | Fixed-Rate Debt and Capital Leases               | Interest Expense                             | \$233                                      | \$(36 )                                    |

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

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

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.

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

| Derivative Instruments not Designated in Hedging Relationships | Location of Gain (Loss) Recognized in Income | 2013                                       | 2012                                       |
|----------------------------------------------------------------|----------------------------------------------|--------------------------------------------|--------------------------------------------|
|                                                                |                                              | Amount of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income |
| Three Months Ended June 30:                                    |                                              |                                            |                                            |
| Interest rate contracts                                        | Interest Expense                             | \$ (4)                                     | \$ (2)                                     |
| Foreign exchange contracts                                     | Other Operating Expenses                     | (3)                                        | 42                                         |
| Foreign exchange contracts                                     | Investment Income                            | 20                                         | —                                          |
|                                                                |                                              | \$ 13                                      | \$ 40                                      |
| Six Months Ended June 30:                                      |                                              |                                            |                                            |
| Interest rate contracts                                        | Interest Expense                             | \$ (4)                                     | \$ (5)                                     |
| Foreign exchange contracts                                     | Other Operating Expenses                     | 84                                         | 34                                         |

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|                            |                   |      |      |
|----------------------------|-------------------|------|------|
| Foreign exchange contracts | Investment Income | 15   | —    |
|                            |                   | \$95 | \$29 |

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14. INCOME TAXES

Our effective tax rate increased to 35.0% in the second quarter of 2013 compared with 34.5% in the same period of 2012, primarily due to a decrease in U.S. Federal and state tax credits relative to total pre-tax income, as well as unfavorable changes in the proportion of our taxable income in certain non-U.S. jurisdictions relative to total pre-tax income.

On a year-to-date basis, our effective tax rate declined to 32.8% in 2013 from 34.5% in 2012, as a portion of the gain from liquidating a foreign subsidiary was non-taxable (discussed further in note 15).

In June 2011, we received a RAR covering income taxes for tax years 2005 through 2007, in addition to the excise tax matters described in note 9. 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 15. TERMINATION OF TNT TRANSACTION

TNT Termination Fee and Related Costs

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. We paid a termination fee to TNT Express of €200 million (\$268 million) under this agreement, and also incurred transaction-related expenses of \$16 million during the first quarter of 2013. The combination of these items resulted in a pre-tax charge of \$284 million (\$177 million after-tax), which impacted our International Package segment.

Gain upon the Liquidation of a Foreign Subsidiary

Subsequent to the termination of the merger protocol, we liquidated a foreign subsidiary that would have been used to acquire the outstanding shares of TNT Express in connection with the proposed acquisition. Upon the liquidation of this subsidiary in the first quarter of 2013, we realized a pre-tax foreign currency gain of \$245 million (\$213 million after-tax), which impacted our International Package segment.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16. SUBSEQUENT EVENTS

Cemelog Ltd.

In July 2013, we completed the acquisition of Cemelog Ltd. (“Cemelog”), a Hungary-based medical logistics provider that operates in Central and Eastern Europe. The acquisition will add 255,000 square feet of dedicated healthcare logistics facilities in Budapest, Hungary, and further our ability to offer customers expanded access to regional healthcare logistics expertise. Cemelog will be included in our Supply Chain & Freight reporting segment beginning in the third quarter of 2013. The acquisition was not material to our consolidated financial position or results of operations.



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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

## Overview

The U.S. economic expansion has continued at a slow pace through the second quarter of 2013. Continued growth in retail sales (particularly among e-commerce retailers) has provided for expansion in the overall U.S. small package delivery market; however, slowing export growth and industrial production, and a lack of significant inventory replenishment, have negatively impacted the growth in commercial shipments. Given these trends, our products most aligned with business-to-consumer shipments have experienced the strongest growth, while growth in our business-to-business volume has remained weak.

Outside of the U.S., economic growth has remained slow largely due to fiscal austerity measures, particularly in Europe. This slower economic growth has created an environment in which customers are more likely to trade-down from premium express products to standard delivery products in both Europe and Asia. Additionally, the uneven nature of economic growth worldwide combined with the trend towards more international trade being conducted regionally, has led to shifting trade patterns and resulted in overcapacity in certain trade lanes. 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 remained challenging in 2013, 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 transportation network and utilized newly expanded operating facilities to improve time-in-transit for shipments in each region. We have also continued to leverage the new air route authority we have gained over the last several years and to take full advantage of faster growing trade lanes.

Our consolidated results are presented in the table below:

|                                             | Three Months Ended<br>June 30, |          |       | Change | Six Months Ended<br>June 30, |          |       | Change |
|---------------------------------------------|--------------------------------|----------|-------|--------|------------------------------|----------|-------|--------|
|                                             | 2013                           | 2012     |       | %      | 2013                         | 2012     |       | %      |
| Revenue (in millions)                       | \$13,507                       | \$13,349 | 1.2   | %      | \$26,941                     | \$26,485 | 1.7   | %      |
| Operating Expenses (in millions)            | 11,765                         | 11,559   | 1.8   | %      | 23,619                       | 23,126   | 2.1   | %      |
| Operating Profit (in millions)              | \$1,742                        | \$1,790  | (2.7) | )%     | \$3,322                      | \$3,359  | (1.1) | )%     |
| Operating Margin                            | 12.9                           | % 13.4   | %     |        | 12.3                         | % 12.7   | %     |        |
| Average Daily Package Volume (in thousands) | 15,722                         | 15,356   | 2.3   | %      | 15,971                       | 15,474   | 3.2   | %      |
| Average Revenue Per Piece                   | \$11.08                        | \$11.12  | (0.4) | )%     | \$10.97                      | \$10.99  | (0.2) | )%     |
| Net Income (in millions)                    | \$1,071                        | \$1,116  | (4.0) | )%     | \$2,108                      | \$2,086  | 1.1   | %      |
| Basic Earnings Per Share                    | \$1.14                         | \$1.16   | (1.7) | )%     | \$2.22                       | \$2.17   | 2.3   | %      |
| Diluted Earnings Per Share                  | \$1.13                         | \$1.15   | (1.7) | )%     | \$2.21                       | \$2.15   | 2.8   | %      |

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

## Items Affecting Comparability

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

|                                                   | Three Months Ended<br>June 30, |      | Six Months Ended<br>June 30, |      |
|---------------------------------------------------|--------------------------------|------|------------------------------|------|
|                                                   | 2013                           | 2012 | 2013                         | 2012 |
| Operating Expenses:                               |                                |      |                              |      |
| TNT Termination Fee and Related Expenses          | \$—                            | \$—  | \$284                        | \$—  |
| Gain Upon Liquidation of Foreign Subsidiary       | —                              | —    | (245)                        | ) —  |
| Income Tax Expense:                               |                                |      |                              |      |
| Income Tax Expense (Benefit) from the Items Above | —                              | —    | (75)                         | ) —  |

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

## TNT Termination Fee and Related Expenses

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. We paid a termination fee to TNT Express of €200 million (\$268 million) under this agreement, and also incurred transaction-related expenses of \$16 million during the first quarter of 2013. The combination of these items resulted in a pre-tax charge of \$284 million (\$177 million after-tax), which impacted our International Package segment.

## Gain upon the Liquidation of a Foreign Subsidiary

Subsequent to the termination of the merger protocol, we liquidated a foreign subsidiary that would have been used to acquire the outstanding shares of TNT Express in connection with the proposed acquisition. Upon the liquidation of this subsidiary in the first quarter of 2013, we realized a pre-tax foreign currency gain of \$245 million (\$213 million after-tax), which impacted our International Package segment.

## 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. From time to time, we supplement the reporting of our financial information determined under generally accepted accounting principles ("GAAP") with certain non-GAAP financial measures, including operating profit, operating margin, pre-tax income, effective tax rate, net income and earnings per share adjusted for the non-comparable items discussed above. We believe that these adjusted measures provide meaningful information to assist investors and analysts in understanding our financial results and assessing our prospects for future performance. We believe these adjusted financial measures are important indicators of our results of operations because they exclude items that may not be indicative of, or are unrelated to, our core operating results, and provide a better baseline for analyzing trends in our underlying businesses.

Certain operating expenses are allocated between our reporting segments based on activity-based costing methods. These activity-based costing methods require us to make estimates that impact the amount of each expense category that is attributed to each segment. Changes in these estimates will directly impact the amount of expense allocated to each segment, and therefore the operating profit of each reporting segment. There were no significant changes in our expense allocation methodology during 2013 or 2012.



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

## U.S. Domestic Package Operations

|                                              | Three Months Ended<br>June 30, |         | Change |    | Six Months Ended<br>June 30, |          | Change |    |
|----------------------------------------------|--------------------------------|---------|--------|----|------------------------------|----------|--------|----|
|                                              | 2013                           | 2012    | %      |    | 2013                         | 2012     | %      |    |
| Average Daily Package Volume (in thousands): |                                |         |        |    |                              |          |        |    |
| Next Day Air                                 | 1,213                          | 1,231   | (1.5)  | )% | 1,224                        | 1,222    | 0.2    | %  |
| Deferred                                     | 937                            | 924     | 1.4    | %  | 978                          | 954      | 2.5    | %  |
| Ground                                       | 11,176                         | 10,920  | 2.3    | %  | 11,373                       | 10,981   | 3.6    | %  |
| Total Avg. Daily Package Volume              | 13,326                         | 13,075  | 1.9    | %  | 13,575                       | 13,157   | 3.2    | %  |
| Average Revenue Per Piece:                   |                                |         |        |    |                              |          |        |    |
| Next Day Air                                 | \$20.52                        | \$20.42 | 0.5    | %  | \$20.32                      | \$20.24  | 0.4    | %  |
| Deferred                                     | 13.31                          | 13.60   | (2.1)  | )% | 12.96                        | 13.30    | (2.6)  | )% |
| Ground                                       | 8.18                           | 8.08    | 1.2    | %  | 8.13                         | 8.02     | 1.4    | %  |
| Total Avg. Revenue Per Piece                 | \$9.66                         | \$9.63  | 0.3    | %  | \$9.58                       | \$9.54   | 0.4    | %  |
| Operating Days in Period                     | 64                             | 64      |        |    | 127                          | 128      |        |    |
| Revenue (in millions):                       |                                |         |        |    |                              |          |        |    |
| Next Day Air                                 | \$1,593                        | \$1,609 | (1.0)  | )% | \$3,159                      | \$3,166  | (0.2)  | )% |
| Deferred                                     | 798                            | 804     | (0.7)  | )% | 1,610                        | 1,624    | (0.9)  | )% |
| Ground                                       | 5,850                          | 5,645   | 3.6    | %  | 11,743                       | 11,272   | 4.2    | %  |
| Total Revenue                                | \$8,241                        | \$8,058 | 2.3    | %  | \$16,512                     | \$16,062 | 2.8    | %  |
| Operating Expenses (in millions)             | \$7,109                        | \$6,924 | 2.7    | %  | \$14,295                     | \$13,933 | 2.6    | %  |
| Operating Profit (in millions)               | \$1,132                        | \$1,134 | (0.2)  | )% | \$2,217                      | \$2,129  | 4.1    | %  |
| Operating Margin                             | 13.7                           | % 14.1  | %      |    | 13.4                         | % 13.3   | %      |    |
| Revenue                                      |                                |         |        |    |                              |          |        |    |

The change in overall revenue was impacted by the following factors for the second quarter and year-to-date periods of 2013 compared with the corresponding periods of 2012:

|                              | Volume |   | Rates /<br>Product Mix |   | Fuel<br>Surcharge |    | Total<br>Revenue<br>Change |   |
|------------------------------|--------|---|------------------------|---|-------------------|----|----------------------------|---|
| Net Revenue Change Drivers:  |        |   |                        |   |                   |    |                            |   |
| Second quarter 2013 vs. 2012 | 1.9    | % | 1.2                    | % | (0.8)             | )% | 2.3                        | % |
| Year-to-date 2013 vs. 2012   | 2.4    | % | 0.9                    | % | (0.5)             | )% | 2.8                        | % |
| Volume                       |        |   |                        |   |                   |    |                            |   |

Our overall volume increased in the second quarter and year-to-date periods of 2013 compared with 2012, largely due to continued solid growth in e-commerce and overall retail sales; however, the increase in volume was hindered by slow overall U.S. economic and industrial production growth. Business-to-consumer shipments, which represent over 40% of total U.S. Domestic Package volume, grew approximately 5% for the quarter and drove increases in both air and ground shipments. Business-to-business volume was flat in the second quarter of 2013, as industrial production continued to slow. Labor negotiations with the Teamsters hindered volume growth during the second quarter, delaying our ability to gain new customers. Additionally, these negotiations caused a minor amount of volume diversion among our existing customers.

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Among our air products, volume declined slightly in the second quarter of 2013 compared with 2012, as growth in our deferred products was more than offset by a decline in our Next Day Air services. Solid air volume growth continued for those products most aligned with business-to-consumer shipping, including our residential Next Day Air Saver and residential Second Day Air package products. Next Day Air letter volume decreased over 5%, and was negatively impacted by increased competition in the industry. Our business-to-business air volume continued to be impacted by sluggish economic conditions in the U.S., low levels of inventory replenishment among our customers and changes in our customers' supply chain networks. The combination of these factors influence their sensitivity towards the price and speed of shipments, and therefore the use of our premium air services.

The increase in ground volume in the second quarter of 2013 was primarily attributed to our traditional and lightweight residential service offerings. Demand for these residential products continues to be driven by business-to-consumer shipping activity from e-commerce retailers and other large customers. Business-to-business ground volume also showed a small increase, and was positively impacted by the overall expansion of the U.S. retail sector; however, the recent slowdown in industrial production hindered growth. The increased use of omni-channel retailing (including ship-from-store and ship-to-store models) by customers is also positively impacting volume growth for both our residential and commercial ground products.

**Rates and Product Mix**

Overall revenue per piece increased 0.3% for the second quarter of 2013 compared with the same period of 2012 (0.4% year-to-date), and was impacted by changes in base rates, customer and product mix, and fuel surcharge rates. Revenue per piece for our ground and air products was positively impacted by an increase in base rates that took effect on December 31, 2012. We increased the base rates 6.5% 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. 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.

In the second quarter of 2013, revenue per piece increased slightly for Next Day Air, while declining for our deferred products, as the impact of the base rate increase was more than offset by declines in fuel surcharge rates and changes in customer and product mix. Revenue per piece was adversely impacted by the relatively stronger growth in our lower-yielding Next Day Air Saver and deferred products, compared with our premium Next Day Air services, as well as the faster growth in lighter-weight business-to-consumer shipments.

Ground revenue per piece increased for the second quarter of 2013, compared with the corresponding period of 2012, primarily due to the base rate increase; however, this was partially offset by customer and product mix changes, as a greater portion of our overall volume in 2013, relative to 2012, came from lighter-weight shipments and larger customers. Fuel surcharge rate changes adversely impacted ground revenue per piece growth in the second quarter of 2013 compared with 2012.

**Fuel Surcharges**

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

|                         | Three Months Ended |        |         | Change | Six Months Ended |        |         | Change |
|-------------------------|--------------------|--------|---------|--------|------------------|--------|---------|--------|
|                         | June 30,           |        |         |        | June 30,         |        |         |        |
|                         | 2013               | 2012   | % Point |        | 2013             | 2012   | % Point |        |
| Next Day Air / Deferred | 11.0               | % 14.3 | % (3.3  | )%     | 11.0             | % 13.7 | % (2.7  | )%     |
| Ground                  | 7.5                | % 8.3  | % (0.8  | )%     | 7.4              | % 8.2  | % (0.8  | )%     |

On December 31, 2012, in connection with our base rate increase, we modified the fuel surcharge on air and ground services by reducing the index used to determine the fuel surcharge by 2% and 1%, respectively. Total domestic fuel

surcharge revenue decreased by \$66 million in the second quarter of 2013 compared with the same period of 2012 (\$88 million year-to-date) primarily due to the lower fuel surcharge rates; however, this was partially offset by the increase in package volume for the quarter and year-to-date periods. These decreased fuel surcharge rates were due to lower jet and diesel fuel prices, as well as the reduction in the index on the air and ground surcharges made in conjunction with our base rate increase.

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Operating Expenses

Operating expenses for the segment increased \$185 million for the second quarter of 2013 compared with the same period of 2012 (\$362 million year-to-date). This increase was primarily due to pick-up and delivery costs, which grew \$131 million, as well as the cost of operating our domestic integrated air and ground network, which increased \$28 million for the second quarter (\$269 million and \$88 million on a year-to-date basis, respectively). 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 average daily driver hours (up 2.0%) and an increase in employee pension and healthcare costs.

Cost increases have been mitigated as we adjust our air and ground networks to better match higher volume levels and utilize technology to increase package sorting efficiency. Improved pick-up and delivery densities, particularly for our residential products, have also contained increases in cost. These network efficiency improvements allowed us to process increased volume (up 1.9%) at a faster rate than the increase in average daily union labor hours (up 0.9%), aircraft block hours (down 0.3%) and miles driven (up 1.0%) in the second quarter of 2013 compared with the same period of 2012. The total cost per piece increased 0.8% for the second quarter of 2013 (0.2% year-to-date).

Operating Profit and Margin

Operating profit was approximately flat for the second quarter of 2013, compared with the second quarter of 2012, as the volume growth and productivity improvements discussed previously were offset by pressure on revenue per piece, the adverse impact of fuel and an increase in pension costs. Revenue per piece was negatively impacted by changes in product and customer mix, which slowed the growth in revenue. The net impact of fuel adversely affected operating profit by approximately \$60 million in the second quarter of 2013 compared with 2012, as fuel surcharge revenue decreased at a faster rate than fuel expense. Additionally, pension costs for this segment increased approximately \$50 million in the second quarter of 2013 compared with 2012. These factors combined to decrease the operating margin by 40 basis points.

On a year-to-date basis, operating profit increased 4.1%, and was driven by the revenue growth and productivity improvements discussed previously. Overall volume growth allowed us to better leverage our transportation network, resulting in greater productivity and better pick-up and delivery density, which drove a 10 basis point increase in our operating margin; however, these trends were partially offset by changes in customer and product mix, which combined to pressure our revenue per piece. Operating profit was also negatively impacted by having one less operating day in 2013 compared with the same period of 2012.

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## International Package Operations

|                                                       | Three Months Ended<br>June 30, |         | Change |       | Six Months Ended<br>June 30, |         | Change |       |   |
|-------------------------------------------------------|--------------------------------|---------|--------|-------|------------------------------|---------|--------|-------|---|
|                                                       | 2013                           | 2012    | %      |       | 2013                         | 2012    | %      |       |   |
| Average Daily Package Volume (in thousands):          |                                |         |        |       |                              |         |        |       |   |
| Domestic                                              | 1,427                          | 1,358   | 5.1    | %     | 1,422                        | 1,384   | 2.7    | %     |   |
| Export                                                | 969                            | 923     | 5.0    | %     | 974                          | 933     | 4.4    | %     |   |
| Total Avg. Daily Package Volume                       | 2,396                          | 2,281   | 5.0    | %     | 2,396                        | 2,317   | 3.4    | %     |   |
| Average Revenue Per Piece:                            |                                |         |        |       |                              |         |        |       |   |
| Domestic                                              | \$7.06                         | \$7.08  | (0.3   | )%    | \$7.12                       | \$7.08  | 0.6    | %     |   |
| Export                                                | 36.51                          | 38.12   | (4.2   | )%    | 35.97                        | 37.24   | (3.4   | )%    |   |
| Total Avg. Revenue Per Piece                          | \$18.97                        | \$19.64 | (3.4   | )%    | \$18.85                      | \$19.23 | (2.0   | )%    |   |
| Operating Days in Period                              | 64                             | 64      |        |       | 127                          | 128     |        |       |   |
| Revenue (in millions):                                |                                |         |        |       |                              |         |        |       |   |
| Domestic                                              | \$645                          | \$615   | 4.9    | %     | \$1,286                      | \$1,255 | 2.5    | %     |   |
| Export                                                | 2,264                          | 2,252   | 0.5    | %     | 4,450                        | 4,447   | 0.1    | %     |   |
| Cargo                                                 | 153                            | 147     | 4.1    | %     | 304                          | 278     | 9.4    | %     |   |
| Total Revenue                                         | \$3,062                        | \$3,014 | 1.6    | %     | \$6,040                      | \$5,980 | 1.0    | %     |   |
| Operating Expenses (in millions):                     |                                |         |        |       |                              |         |        |       |   |
| Operating Expenses                                    | \$2,611                        | \$2,560 | 2.0    | %     | \$5,237                      | \$5,118 | 2.3    | %     |   |
| TNT Termination Fee and Related Expenses              | —                              | —       |        |       | (284                         | )       | —      |       |   |
| Gain Upon Liquidation of Foreign Subsidiary           | —                              | —       |        |       | 245                          | —       |        |       |   |
| Adjusted Operating Expenses                           | \$2,611                        | \$2,560 | 2.0    | %     | \$5,198                      | \$5,118 | 1.6    | %     |   |
| Operating Profit (in millions) and Operating Margin:  |                                |         |        |       |                              |         |        |       |   |
| Operating Profit                                      | \$451                          | \$454   | (0.7   | )%    | \$803                        | \$862   | (6.8   | )%    |   |
| Adjusted Operating Profit                             | \$451                          | \$454   | (0.7   | )%    | \$842                        | \$862   | (2.3   | )%    |   |
| Operating Margin                                      | 14.7                           | % 15.1  | %      |       | 13.3                         | % 14.4  | %      |       |   |
| Adjusted Operating Margin                             | 14.7                           | % 15.1  | %      |       | 13.9                         | % 14.4  | %      |       |   |
| Currency Translation Benefit / (Cost)—(in millions)*: |                                |         |        | \$    |                              |         |        | \$    |   |
| Revenue                                               |                                |         |        | \$(19 | )                            |         |        | \$(19 | ) |
| Operating Expenses                                    |                                |         |        | (2    | )                            |         |        | (5    | ) |
| Operating Profit                                      |                                |         |        | \$(21 | )                            |         |        | \$(24 | ) |

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



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## Revenue

The change in overall revenue was impacted by the following factors for the second quarter and year-to-date periods of 2013 compared with the corresponding periods of 2012:

|                              | Volume | Rates /<br>Product Mix | Fuel<br>Surcharge | Currency | Total<br>Revenue<br>Change |
|------------------------------|--------|------------------------|-------------------|----------|----------------------------|
| Net Revenue Change Drivers:  |        |                        |                   |          |                            |
| Second quarter 2013 vs. 2012 | 5.0    | % (1.5 )               | % (1.3 )          | % (0.6 ) | % 1.6                      |
| Year-to-date 2013 vs. 2012   | 2.6    | % (0.1 )               | % (1.2 )          | % (0.3 ) | % 1.0                      |

## Volume

Our overall average daily volume increased in the second quarter and year-to-date periods of 2013 compared with the corresponding periods of 2012, largely due to growth in key markets in Asia and Europe.

Export volume increased in the second quarter and year-to-date periods of 2013. 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. Our international customers continue to be impacted by economic pressures and changes in their supply chain networks, and the combination of these factors influence their sensitivity towards the price and speed of shipments. Export volume growth was driven by Asia (largely in the Asia-to-Europe, Asia-to-U.S. and intra-Asia trade lanes) and Europe (primarily intra-Europe). However, U.S. export volume growth continued to remain weak, and decreased slightly for the second quarter of 2013.

Domestic volume increased in the second quarter and year-to-date periods of 2013 compared to 2012. Results were driven by solid volume growth in several key markets, including Italy, Canada, the U.K. and Turkey.

## Rates and Product Mix

Total average revenue per piece decreased 2.8% for the second quarter of 2013 on a currency-adjusted basis (1.6% year-to-date), and was impacted by changes in base rates, customer and product mix, and fuel surcharge rates.

On December 31, 2012, we increased the base rates 6.5% for international shipments originating in the United States (Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard service), while reducing fuel surcharge indices. Rate changes for shipments originating outside the U.S. are made throughout the year and vary by geographic market.

Currency-adjusted export revenue per piece decreased 3.4% for the second quarter (2.9% year-to-date), 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 small reduction in the average weight per piece (due to changes in customer mix towards lighter-weight shipments), as well as a small impact on pricing from overcapacity in the Asia outbound freight market.

Currency-adjusted domestic revenue per piece decreased 0.4% for the second quarter (increased 0.3% year-to-date). Domestic revenue per piece was positively impacted by base rate increases; however, these base rate increases were offset by the faster domestic volume growth in our lower-yielding standard service, as well as product and customer mix changes in several developed markets.

## Fuel Surcharges

On December 31, 2012, in connection with our base rate increases, we modified the fuel surcharge on certain U.S., South and Central America, and Asia-related international air services by reducing the index used to determine the fuel surcharge by 2%. 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 decreased by \$38 million for the second quarter of 2013 when compared with 2012 (\$69 million year-to-date), primarily due to reduced fuel surcharge rates caused by

declining fuel prices and the reduction in the index; however, this was partially offset by increased international air volume.

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Operating Expenses

Overall adjusted operating expenses for the segment increased \$51 million for the second quarter of 2013 compared with the same period in 2012 (\$80 million year-to-date). This increase was driven by the cost of pick-up and delivery, which increased \$38 million for the second quarter (\$52 million year-to-date), largely due to higher package volume. The cost of operating our international integrated air and ground network increased \$11 million for the quarter (\$9 million year-to-date), also largely due to higher package volume; however, network costs were mitigated by a 1.2% reduction in average daily aircraft block hours resulting from ongoing modifications to our air network. This was achieved even with a 5.0% increase in second quarter international export volume and several air product service enhancements that occurred during 2013.

The remaining increases in adjusted operating expenses for the quarter and year-to-date periods were largely due to the costs of package sorting, which was impacted by volume growth, and indirect operating costs, which were affected by increased expenses associated with aviation security.

Excluding the impact of currency exchange rate changes, the total adjusted cost per piece for the segment decreased 3.0% for the second quarter of 2013 compared with the same period of 2012 (1.1% year-to-date).

Operating Profit and Margin

Adjusted operating profit contracted by 0.7% for the second quarter of 2013 compared with 2012 (2.3% year-to-date), while the adjusted operating margin decreased 40 basis points (50 basis points year-to-date). The solid volume growth in 2013 was largely offset by reductions in revenue per piece, leading to only slight growth in revenue. The net impact of fuel (fuel surcharge revenue decreased at a faster rate than fuel expense) and currency remeasurement and translation losses resulted in an adverse impact on operating profit of approximately \$55 million when comparing the second quarter of 2013 with 2012 (\$85 million year-to-date). The combination of low revenue growth and the adverse impact of fuel and currency led to the reduction in operating margin.

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

### Supply Chain & Freight Operations

|                                                         | Three Months Ended<br>June 30, |         | Change |   | Six Months Ended<br>June 30, |         | Change |   |
|---------------------------------------------------------|--------------------------------|---------|--------|---|------------------------------|---------|--------|---|
|                                                         | 2013                           | 2012    | %      |   | 2013                         | 2012    | %      |   |
| Freight LTL Statistics:                                 |                                |         |        |   |                              |         |        |   |
| Revenue (in millions)                                   | \$635                          | \$597   | 6.4    | % | \$1,231                      | \$1,155 | 6.6    | % |
| Revenue Per Hundredweight                               | \$21.61                        | \$21.50 | 0.5    | % | \$21.73                      | \$21.48 | 1.2    | % |
| Shipments (in thousands)                                | 2,717                          | 2,583   | 5.2    | % | 5,235                        | 5,051   | 3.6    | % |
| Shipments Per Day (in thousands)                        | 42.5                           | 40.4    | 5.2    | % | 41.2                         | 39.5    | 4.3    | % |
| Gross Weight Hauled (in millions of lbs)                | 2,939                          | 2,778   | 5.8    | % | 5,668                        | 5,375   | 5.5    | % |
| Weight Per Shipment (in lbs)                            | 1,082                          | 1,076   | 0.6    | % | 1,083                        | 1,064   | 1.8    | % |
| Operating Days in Period                                | 64                             | 64      |        |   | 127                          | 128     |        |   |
| Revenue (in millions):                                  |                                |         |        |   |                              |         |        |   |
| Forwarding and Logistics                                | \$1,333                        | \$1,485 | (10.2) | % | \$2,693                      | \$2,909 | (7.4)  | % |
| Freight                                                 | 731                            | 660     | 10.8   | % | 1,419                        | 1,278   | 11.0   | % |
| Other                                                   | 140                            | 132     | 6.1    | % | 277                          | 256     | 8.2    | % |
| Total Revenue                                           | \$2,204                        | \$2,277 | (3.2)  | % | \$4,389                      | \$4,443 | (1.2)  | % |
| Operating Expenses (in millions):                       | \$2,045                        | \$2,075 | (1.4)  | % | \$4,087                      | \$4,075 | 0.3    | % |
| Operating Profit (in millions)                          | \$159                          | \$202   | (21.3) | % | \$302                        | \$368   | (17.9) | % |
| Operating Margin                                        | 7.2                            | % 8.9   | %      |   | 6.9                          | % 8.3   | %      |   |
| Currency Translation Benefit / (Cost) – (in millions)*: |                                |         | \$     |   |                              |         | \$     |   |
| Revenue                                                 |                                |         | \$(5   | ) |                              |         | \$(12  | ) |
| Operating Expenses                                      |                                |         | 5      |   |                              |         | 11     |   |
| Operating Profit                                        |                                |         | \$—    |   |                              |         | \$(1   | ) |

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

### Revenue

Forwarding and logistics revenue decreased \$152 million in the second quarter of 2013 compared with the corresponding period in 2012 (\$216 million year-to-date). Forwarding revenue decreased in the second quarter and year-to-date periods of 2013, primarily due to lower tonnage and rates charged to our customers in our international air forwarding business. The reduction in tonnage was impacted by weak overall market demand and increased competition for air forwarding services, while the reduction in rates was largely due to industry overcapacity in key trade lanes, particularly the Asia-outbound market. Revenue for our logistics products increased in the second quarter and year-to-date periods of 2013 compared with 2012, as we experienced solid growth in our mail services and healthcare distribution solutions.

Freight revenue increased \$71 million for the second quarter of 2013 (\$141 million year to date), driven by an increase in LTL revenue per hundredweight, tonnage and average daily LTL shipments; however, these factors were partially offset by having one less operating day in the year-to-date period of 2013 compared with 2012. The increase in LTL revenue per hundredweight was largely due to our focus on yield management, as well as general rate increases averaging 5.9% that took effect on July 16, 2012 and on June 10, 2013, covering non-contractual shipments in the United States, Canada and Mexico. Fuel surcharge revenue increased by \$5 million for the second quarter of 2013 compared with the corresponding period of the prior year (\$15 million year-to-date), due to changes in diesel fuel prices and overall LTL shipment volume. In addition, our Truckload division experienced increased volume and revenue, primarily related to our dedicated and non-dedicated service offerings.



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The other businesses within Supply Chain & Freight increased revenue by \$8 million for the quarter (\$21 million year-to-date), primarily due to growth at UPS Capital, The UPS Store and UPS Customer Solutions.

**Operating Expenses**

Forwarding and logistics operating expenses decreased \$106 million for the second quarter of 2013 compared with the same period of 2012 (\$115 million year-to-date), due to several factors. Purchased transportation expense declined by \$63 million in the second quarter (\$75 million year-to-date), primarily due to lower tonnage in our international air freight forwarding business. Compensation and benefits expense declined by \$16 million in the second quarter (\$23 million year-to-date), largely due to reduced payroll costs. The remaining decrease in expense was impacted by lower fuel costs, bad debt expense, and various other items.

Freight operating expenses increased \$73 million in the second quarter of 2013 (\$122 million year-to-date), while the total cost per LTL shipment increased 2.2% (1.8% year-to-date). The largest component of this increase related to the cost of operating our linehaul network, which grew by \$18 million for the second quarter (\$36 million year-to-date), as a result of a 5.8% average daily tonnage increase, coupled with wage and purchased transportation increases. Our Truckload division experienced a \$15 million increase in costs for the quarter (\$27 million year-to-date), largely related to the expansion of our dedicated and non-dedicated services. The remaining increase in expense for the second quarter and year-to-date periods of 2013 was impacted by increases in pick-up and delivery costs, healthcare costs and pension expense.

Operating expenses for the other businesses within Supply Chain & Freight increased \$3 million in the second quarter of 2013 compared with 2012 (\$5 million year-to-date).

**Operating Profit and Margin**

Operating profit for the forwarding and logistics unit decreased by \$46 million in the second quarter of 2013 compared to the same period in 2012 (\$101 million year-to-date). This decrease was primarily due to reduced profitability in our international air forwarding business, which resulted from increased competition combined with weak overall air freight market demand due to continued economic weakness in Europe, slowing growth in China and a sluggish U.S. economy. Additionally, our customer concentration among the technology and military sectors negatively impacted our results, as demand in these sectors was relatively weaker than the remainder of the air freight market. 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 compression in our operating margin. Operating profit for our logistics business declined in the second quarter and year-to-date periods of 2013 compared with 2012, largely due to increased investments in facilities and information technology platforms in our healthcare logistics business, as well as the gain on the sale of a facility in 2012.

Operating profit for our freight unit was flat in the second quarter of 2013 compared to the same period in 2012, while increasing \$19 million on a year-to-date basis. For the year-to-date period of 2013 compared with 2012, operating profit increased as improvements in average daily LTL volume, yields and productivity measures (including gains in pick-up and delivery stops per hour, dock bills per hour and linehaul network utilization), more than offset the impact of having one less operating day.

The combined operating profit for all of our other businesses in this segment increased \$5 million during the second quarter (\$16 million year-to-date), primarily due to higher operating profit at UPS Capital and The UPS Store.

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## Consolidated Operating Expenses

|                                             | Three Months Ended<br>June 30, |          | Change |    | Six Months Ended<br>June 30, |          | Change |    |
|---------------------------------------------|--------------------------------|----------|--------|----|------------------------------|----------|--------|----|
|                                             | 2013                           | 2012     | %      |    | 2013                         | 2012     | %      |    |
| Operating Expenses (in millions):           |                                |          |        |    |                              |          |        |    |
| Compensation and Benefits                   | \$6,981                        | \$6,747  | 3.5    | %  | \$13,949                     | \$13,582 | 2.7    | %  |
| Repairs and Maintenance                     | 309                            | 303      | 2.0    | %  | 618                          | 605      | 2.1    | %  |
| Depreciation and Amortization               | 466                            | 459      | 1.5    | %  | 940                          | 918      | 2.4    | %  |
| Purchased Transportation                    | 1,731                          | 1,733    | (0.1)  | )% | 3,511                        | 3,450    | 1.8    | %  |
| Fuel                                        | 992                            | 1,014    | (2.2)  | )% | 1,998                        | 2,039    | (2.0)  | )% |
| Other Occupancy                             | 225                            | 213      | 5.6    | %  | 478                          | 450      | 6.2    | %  |
| Other Expenses                              | 1,061                          | 1,090    | (2.7)  | )% | 2,125                        | 2,082    | 2.1    | %  |
| TNT Termination Fee and Related Expenses    | —                              | —        |        |    | (284)                        | ) —      |        |    |
| Gain Upon Liquidation of Foreign Subsidiary | —                              | —        |        |    | 245                          | —        |        |    |
| Adjusted Other Expenses                     | 1,061                          | 1,090    | (2.7)  | )% | 2,086                        | 2,082    | 0.2    | %  |
| Total Operating Expenses                    | \$11,765                       | \$11,559 | 1.8    | %  | \$23,619                     | \$23,126 | 2.1    | %  |
| Adjusted Total Operating Expenses           | \$11,765                       | \$11,559 | 1.8    | %  | 23,580                       | \$23,126 | 2.0    | %  |
|                                             |                                |          | \$     |    |                              |          | \$     |    |
| Currency Translation (Benefit) Cost         |                                |          | \$(3   | )  |                              |          | \$(6   | )  |

## Compensation and Benefits

Employee payroll costs increased \$123 million for the second quarter of 2013 compared with 2012 (\$227 million year-to-date), largely due to contractual union wage rate increases, a 0.9% increase in average daily union labor hours, and a merit salary increase for management employees; however, this was partially offset by an overall reduction in the number of management personnel.

Benefits expense increased \$111 million for the second quarter of 2013 compared with 2012 (\$140 million year-to-date), primarily due to higher pension expense, increased vacation, holiday and excused absence expense, and higher health and welfare costs; however, these items were partially offset by changes in the expense associated with our self-insurance for worker's compensation claims. These factors are discussed further as follows:

Pension expense increased \$68 million for the second quarter of 2013 compared with 2012 (\$131 million year-to-date), 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.

Vacation, holiday and excused absence expense increased \$32 million for the second quarter compared with 2012 (\$34 million year-to-date), due to increased vacation entitlements earned based on employees' years of service.

Health and welfare costs increased \$5 million for the second quarter of 2013 compared with 2012 (\$49 million year-to-date), largely due to higher medical claims and the impact of several provisions of the Patient Protection and Affordable Care Act of 2010.

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The expense associated with our self-insurance programs for worker's compensation claims decreased \$3 million for the second quarter of 2013 compared with 2012 (\$92 million year-to-date). Insurance reserves are established for estimates of the loss that we will ultimately incur on reported worker's compensation claims, as well as estimates of claims that have been incurred but not reported, and take into account a number of factors including our history of claim losses, payroll growth and the impact of safety improvement initiatives. In 2013, we experienced favorable actuarial expense adjustments as the frequency and severity of claims was less than previously projected, due to the impact of ongoing safety improvement and claim management initiatives.

**Repairs and Maintenance**

The increase in repairs and maintenance expense was largely due to increased automotive maintenance costs in our global package and freight operations. These increased costs were impacted by the increase in miles driven in the second quarter and year-to-date periods of 2013 compared with 2012.

**Depreciation and Amortization**

The increase in depreciation and amortization expense for the second quarter of 2013 was primarily due to a \$13 million increase in depreciation expense on vehicles (\$23 million year-to-date). This increase was driven by 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 and UPS Freight operations.

**Purchased Transportation**

Purchased transportation expense charged to us by third-party air, ocean and truck carriers was approximately flat for the second quarter of 2013 compared with 2012, but increased \$61 million year-to-date. The changes in expense for the second quarter and year-to-date periods were driven by several factors:

- The purchased transportation expense for our forwarding & logistics business declined \$63 million for the second quarter (\$75 million year-to-date), largely due to lower tonnage in our international air freight forwarding business.

- Our U.S. Domestic Package segment incurred a \$13 million expense increase for the quarter (\$50 million year-to-date), primarily due to higher rates passed to us from rail carriers, and higher fees paid to the U.S. Postal Service associated with the volume growth in our SurePost product.

- Our International Package segment incurred a \$31 million expense increase for the quarter (\$44 million year-to-date) primarily due to international volume growth.

- Our UPS Freight business incurred a \$20 million increase for the quarter (\$42 million year-to-date) largely due to growth in LTL volume and higher rates passed to us from rail carriers.

**Fuel**

The decrease in fuel expense for the second quarter of 2013 was primarily due to the decline in prices for jet-A fuel and diesel, which decreased expense by \$27 million (\$29 million year-to-date), net of hedging. This was partially offset during the second quarter by an increase in vehicle miles driven and lower fuel efficiency, which increased expense by \$5 million; however, usage decreased for the year-to-date period of 2013 compared with 2012 by \$12 million, primarily due to a reduction in aircraft block hours.

**Other Occupancy**

The increase in other occupancy expense in the second quarter and year-to-date periods of 2013 was primarily due to increases in real estate and vehicle taxes, higher snow removal costs at our operating facilities, and an increase in utilities expenses. The relatively cold winter in the United States in 2013 compared with 2012 impacted the increase in snow removal costs, while higher natural gas and electricity prices affected the increase in utilities expenses.

**Other Expenses**

The decrease in adjusted other expenses for the second quarter of 2013 compared with 2012 was largely due to decreases in outside professional fees and bad debt expense. Outside professional fees had increased in the second quarter of 2012 related to our proposed TNT Express N.V. acquisition.





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On a year-to-date basis, adjusted other expenses increased slightly in 2013 compared with 2012. This increase was largely due to increases in auto liability insurance, foreign currency remeasurement losses and transportation equipment rentals; however, these factors were largely offset by a reduction in bad debt expense, outside professional fees and employee expense reimbursements.

## Investment Income and Interest Expense

|                   | Three Months Ended<br>June 30, |       |       | Change | Six Months Ended<br>June 30, |        |       | Change |
|-------------------|--------------------------------|-------|-------|--------|------------------------------|--------|-------|--------|
| (in millions)     | 2013                           | 2012  |       | %      | 2013                         | 2012   |       | %      |
| Investment Income | \$3                            | \$6   | (50.0 | )%     | \$8                          | \$12   | (33.3 | )%     |
| Interest Expense  | \$(98                          | \$(92 | ) 6.5 | %      | \$(194                       | \$(186 | ) 4.3 | %      |

## Investment Income

The decrease in investment income for the second quarter and year-to-date periods of 2013 compared with the same periods of 2012 was primarily due to lower interest rates earned on invested assets, as well as a decline in realized gains on sales of investments. These declines were partially offset by an increase in the average balance of invested assets in the second quarter and year-to-date periods of 2013 compared with 2012.

## Interest Expense

Interest expense increased in the second quarter and year-to-date periods of 2013 compared to 2012, largely due to the imputation of interest expense on the multiemployer pension withdrawal liability related to the New England Pension Fund. This was partially offset by a lower effective interest rate incurred on our variable rate debt and interest rate swaps in the second quarter and year-to-date periods of 2013 compared with 2012.

## Income Tax Expense

|                                             | Three Months Ended<br>June 30, |        |      | Change | Six Months Ended<br>June 30, |         |      | Change |
|---------------------------------------------|--------------------------------|--------|------|--------|------------------------------|---------|------|--------|
| (in millions)                               | 2013                           | 2012   |      | %      | 2013                         | 2012    |      | %      |
| Income Tax Expense                          | \$576                          | \$588  | (2.0 | )%     | \$1,028                      | \$1,099 | (6.5 | )%     |
| TNT Termination Fee and Related Expenses    | —                              | —      |      |        | 107                          | —       |      |        |
| Gain Upon Liquidation of Foreign Subsidiary | —                              | —      |      |        | (32                          | ) —     |      |        |
| Adjusted Income Tax Expense                 | \$576                          | \$588  | (2.0 | )%     | \$1,103                      | \$1,099 | 0.4  | %      |
| Effective Tax Rate                          | 35.0                           | % 34.5 | %    |        | 32.8                         | % 34.5  | %    |        |
| Adjusted Effective Tax Rate                 | 35.0                           | % 34.5 | %    |        | 34.7                         | % 34.5  | %    |        |

Our effective tax rate increased by 50 basis points for the second quarter of 2013 compared with the same period of 2012, primarily due to a decrease in U.S. Federal and state tax credits relative to total pre-tax income, as well as unfavorable changes in the proportion of our taxable income in certain non-U.S. jurisdictions relative to total pre-tax income.

On a year-to-date basis, our effective tax rate declined to 32.8% in 2013 from 34.5% in 2012, as a portion of the gain from liquidating a foreign subsidiary was non-taxable. Our adjusted effective tax rate on a year-to-date basis increased to 34.7% in 2013 compared with 34.5% in 2012, due to the aforementioned trends with U.S. Federal and state tax credits and non-U.S. taxable income relative to total pre-tax income.



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## Liquidity and Capital Resources

## Net Cash From Operating Activities

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

|                                                                        | Six Months Ended |         |
|------------------------------------------------------------------------|------------------|---------|
|                                                                        | June 30,         |         |
|                                                                        | 2013             | 2012    |
| Net income                                                             | \$2,108          | \$2,086 |
| Non-cash operating activities (a)                                      | 1,368            | 1,723   |
| Pension and postretirement plan contributions (UPS-sponsored plans)    | (114)            | (450)   |
| Income tax receivables and payables                                    | (163)            | 259     |
| Changes in working capital and other noncurrent assets and liabilities | 298              | 288     |
| Other sources (uses) of cash from operating activities                 | (66)             | (56)    |
| Net cash from operating activities                                     | \$3,431          | \$3,850 |

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

Operating cash flow was negatively impacted in 2013, compared with 2012, by certain TNT Express transaction-related charges, as well as changes in income tax receivables and payables. We paid a termination fee to TNT Express of €200 million (\$268 million) under the agreement to terminate the merger protocol in the first quarter of 2013. The cash payments for income taxes increased in 2013 compared with 2012, and were impacted by the timing of current tax deductions.

The adverse impact of these items on our operating cash flow in 2013 compared with 2012 was partially offset by reduced pension and postretirement medical defined benefit plan contributions. Contributions to our company-sponsored defined benefit plans have varied based primarily on whether any minimum funding requirements are present for the individual plans. The decline in contributions to our defined benefit plans was largely related to the UPS IBT Pension Plan (\$355 million in contributions in the first six months of 2012; no contributions in 2013). The remaining contributions in both years were largely related to our international pension and U.S. postretirement medical plans. As discussed in note 6 to the unaudited consolidated financial statements, we expect to contribute \$98 million to our company-sponsored pension and postretirement medical benefit plans over the remainder of 2013.

As of June 30, 2013, the total of our worldwide holdings of cash and cash equivalents was \$4.808 billion.

Approximately 45%-55% of our cash and cash equivalents are typically 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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## Net Cash Used In Investing Activities

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

|                                        | Six Months Ended<br>June 30, |   |        |   |
|----------------------------------------|------------------------------|---|--------|---|
|                                        | 2013                         |   | 2012   |   |
| Net cash used in investing activities  | \$(1,853                     | ) | \$(307 | ) |
| Capital Expenditures:                  |                              |   |        |   |
| Buildings and facilities               | \$(183                       | ) | \$(217 | ) |
| Aircraft and parts                     | (274                         | ) | (368   | ) |
| Vehicles                               | (281                         | ) | (147   | ) |
| Information technology                 | (252                         | ) | (217   | ) |
|                                        | \$(990                       | ) | \$(949 | ) |
| Capital Expenditures as a % of Revenue | 3.7                          | % | 3.6    | % |

## Other Investing Activities:

|                                                          |        |   |        |   |
|----------------------------------------------------------|--------|---|--------|---|
| Proceeds from disposals of property, plant and equipment | \$24   |   | \$32   |   |
| Net decrease in finance receivables                      | \$19   |   | \$42   |   |
| Net sales (purchases) of marketable securities           | \$(898 | ) | \$664  |   |
| Cash paid for business acquisitions                      | \$—    |   | \$(100 | ) |
| Other sources (uses) of cash for investing activities    | \$(8   | ) | \$4    |   |

We have commitments for the purchase of aircraft, vehicles, equipment and real estate to provide for the replacement of existing capacity and anticipated future growth. We generally fund our capital expenditures with our cash from operations. Capital spending on real estate declined in 2013 compared with 2012, as the expansion of our Cologne air hub nears completion. Capital spending on aircraft is primarily related to contract deposits and final payments associated with the delivery of aircraft under our Boeing 767-300 order, which will be completed in 2013. Capital spending on vehicles increased in 2013 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 spending on technology increased in 2013, largely due to new capitalized software projects.

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.

The net decrease in finance receivables was primarily due to loan sales in our business credit 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 was primarily related to our acquisition of Kiala S.A. Other investing activities include the cash settlement of derivative contracts used in our currency and commodity hedging programs, as well as capital contributions into certain investment partnerships.

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## Net Cash Provided by Financing Activities

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

|                                                       | Six Months Ended<br>June 30, |            |
|-------------------------------------------------------|------------------------------|------------|
|                                                       | 2013                         | 2012       |
| Net cash provided by (used in) financing activities   | \$(4,041 )                   | \$158      |
| Share Repurchases:                                    |                              |            |
| Cash expended for shares repurchased                  | \$(1,867 )                   | \$(885 )   |
| Number of shares repurchased                          | (21.8 )                      | (11.3 )    |
| Shares outstanding at period end                      | 938                          | 958        |
| Percent reduction in shares outstanding               | (1.6 )%                      | (0.5 )%    |
| Dividends:                                            |                              |            |
| Dividends declared per share                          | \$1.24                       | \$1.14     |
| Cash expended for dividend payments                   | \$(1,140 )                   | \$(1,068 ) |
| Borrowings:                                           |                              |            |
| Net borrowings (repayment) of debt principal          | \$(716 )                     | \$1,873    |
| Other Financing Activities:                           |                              |            |
| Cash received for common stock issuances              | \$293                        | \$194      |
| Other sources (uses) of cash for financing activities | \$(611 )                     | \$44       |
| Capitalization (as of June 30 each year):             |                              |            |
| Total debt outstanding at period end                  | \$11,923                     | \$13,023   |
| Total shareowners' equity at period end               | 3,630                        | 7,725      |
| Total capitalization                                  | \$15,553                     | \$20,748   |
| Debt to Total Capitalization %                        | 76.7 %                       | 62.8 %     |

We repurchased a total of 21.8 million shares of class A and class B common stock for \$1.836 billion in the first six months of 2013, and 11.3 million shares for \$870 million for the first six months of 2012 (\$1.867 billion and \$885 million in repurchases for 2013 and 2012, respectively, are reported on the cash flow statement due to the timing of settlements). On February 14, 2013, the Board of Directors approved a new share repurchase authorization of \$10.0 billion, which replaced an authorization previously announced in 2012. The new share repurchase authorization has no expiration date. As of June 30, 2013, we had \$8.825 billion of this share repurchase authorization available. Share repurchases may take the form of accelerated share repurchases, open market purchases, or other such methods as we deem appropriate. The timing of our share repurchases will depend upon market conditions. Unless terminated earlier by the resolution of our Board, the program will expire when we have purchased all shares authorized for repurchase under the program. 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 increased our quarterly cash dividend payment to \$0.62 per share in 2013, compared with the previous \$0.57 quarterly dividend rate in 2012. We expect to continue the practice of paying regular cash dividends.

Issuances of debt in the first six months of 2013 and 2012 consisted primarily of commercial paper. Repayments of debt in 2013 consisted primarily of the \$1.75 billion 4.5% senior notes that matured in January 2013. 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.

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The cash outflows in other financing activities were primarily due to premiums paid and received on capped call options for the purchase of UPS class B shares, and the purchase of noncontrolling interests. During the first six months of 2013, we paid premiums of \$400 million on options for the purchase of 5.3 million shares that will settle in the second half of 2013. During the first six months of 2012, we received \$206 million in premiums for options that were entered into during 2011 that expired in 2012. Additionally, we paid \$70 million in 2013 to purchase the noncontrolling interest in a joint venture that operates in the Middle East, Turkey and portions of the Central Asia region. The remaining cash outflows in other financing activities for both 2013 and 2012 were related to tax withholdings on vested employee stock awards.

Sources of Credit

We are authorized to borrow up to \$10.0 billion under the U.S. commercial paper program we maintain. We had \$1.045 billion outstanding under this program as of June 30, 2013, with an average interest rate of 0.05%. We also maintain a European commercial paper program under which we are authorized to borrow up to €5.0 billion in a variety of currencies. As of June 30, 2013, there were no amounts outstanding under this program.

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 March 28, 2014. 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 the highest of (1) JPMorgan Chase Bank's publicly announced prime rate, (2) the Federal Funds effective rate plus 0.50%, and (3) LIBOR for a one month interest period plus 1.00%, 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 prime 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 June 30, 2013.

The second agreement provides revolving credit facilities of \$1.0 billion, and expires on March 29, 2018. 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 the highest of (1) JPMorgan Chase Bank's publicly announced prime rate, (2) the Federal Funds effective rate plus 0.50%, and (3) LIBOR for a one month interest period plus 1.00%, 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%, per annum. The applicable margin for advances bearing interest based on the prime 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 June 30, 2013.

Our Moody's and Standard & Poor's short-term credit ratings are P-1 and A-1, respectively. Our Moody's and Standard & Poor's long-term credit ratings are Aa3 and A+, respectively. We currently have a negative outlook from Standard & Poor's and a stable outlook from Moody's.

Our existing debt instruments and credit facilities subject us to certain financial covenants. As of June 30, 2013 and for all prior periods, we have satisfied these financial covenants. These covenants limit the amount of secured

indebtedness that we may incur, and limit the amount of attributable debt in sale-leaseback transactions, to 10% of net tangible assets. As of June 30, 2013, 10% of net tangible assets was equivalent to \$2.669 billion; however, we have no covered sale-leaseback transactions or secured indebtedness outstanding. We do not expect these covenants to have a material impact on our financial condition or liquidity.

Except as described in this quarterly report, the nature and amounts of our payment obligations under our debt, capital and operating lease agreements, purchase commitments, and other liabilities as of June 30, 2013 have not materially changed from those described in our Annual Report on Form 10-K for the year ended December 31, 2012.



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

**Guarantees and Other Off-Balance Sheet Arrangements**

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

**Contingencies**

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

Although there can be no assurance as to the ultimate outcome, we have generally denied, or believe we have a meritorious defense and will deny, liability in all litigation pending against us, including (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 (1) 125 individual franchisees who did not rebrand to The UPS Store and (2) a certified class of all franchisees who did rebrand. With respect to the 125 individual franchisees described in (1) above, the trial court entered judgment against a bellwether individual plaintiff, which was affirmed in January 2012. In March 2013, we reached a settlement in principle with the remaining individual plaintiffs who did not rebrand. We believe this settlement will not have a material adverse effect on our financial condition, results of operations or liquidity. The trial court granted our motion for summary judgment against the certified class described in (2) above, which was reversed in January 2012. We have not reached a settlement with this class of franchisees, and the claims of the class remain pending.

There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from the remaining aspects of this case, 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 February 2014. 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) briefing of dispositive motions 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 also has been dismissed. We deny all liability and are vigorously defending the one outstanding case in Ontario. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from this matter, including: (1) we are vigorously defending ourselves and believe 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 this matter. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from this matter or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operation or liquidity.

Other Matters

On March 29, 2013, we entered into a Non-Prosecution Agreement ("NPA") with the United States Attorney's Office in the Northern District of California in connection with an investigation by the Drug Enforcement Administration of shipments by illicit online pharmacies. Under the NPA, we forfeited \$40 million to the government, admitted to a Statement of Facts describing the conduct leading to the agreement, and agreed to implement an online pharmacy compliance program. The term of the NPA is two years, although we can petition the government to shorten that term in its discretion to one year. The NPA did not have a material impact on our results of operations in 2013.

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. UPS responded to that request in January 2013.

We are cooperating with each of these investigations, and intend to continue to vigorously defend ourselves. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) we are vigorously defending each matter and believe that we have a number of meritorious legal defenses; (2) there are unresolved questions of law that could be of importance to the ultimate resolutions of these matters, including the calculation of any potential fine; and (3) there is uncertainty about the time period that is the subject of the investigations. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

In January 2008, a class action complaint was filed in the United States District Court for the Eastern District of New York alleging price-fixing activities relating to the provision of freight forwarding services. UPS was not named in this case. In July 2009, the plaintiffs filed a First Amended Complaint naming numerous global freight forwarders as defendants. UPS and UPS Supply Chain Solutions are among the 60 defendants named in the amended complaint. 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 filed another motion to dismiss, which is

currently pending before the Court, and will 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.

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

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.

**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. On April 25, 2013, we reached a tentative agreement with the Teamsters on two new five-year contracts in the U.S. Domestic Package and UPS Freight business units. During the second quarter, UPS Teamster-represented employees in the U.S. Domestic Package business unit voted to approve the new agreement, while some local U.S. Domestic Package agreements and the agreement covering UPS Freight employees will require additional negotiation and approval before the new agreement is ratified. Before expiration, the Company and the Teamsters agreed to extensions of both existing five-year contracts and all local riders, supplements, and addenda. The extensions are open-ended and can be terminated by either party on thirty days' notice. Subject to ratification by the UPS Teamster-represented employees, the new agreements will be retroactively effective as of August 1, 2013. As of the date of this filing, there can be no assurance that our efforts will be successful or that the ultimate resolution of these matters will not adversely affect our business, financial position, results of operations or liquidity.

We have approximately 2,600 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association, 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.

**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 14 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.

Beginning in the third quarter of 2012 and continuing through the first quarter of 2013, we had settlement discussions with the Appeals team. In the first quarter of 2013, we reached settlement terms for a complete resolution of all excise tax matters and correlative income tax refund claims for the 2003 through 2007 tax years. The final resolution of these matters did not materially impact our financial condition, results of operations or liquidity.

**Recent Accounting Pronouncements**

**Adoption of New Accounting Standards**

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 was effective for us beginning in the first quarter of 2013, and we have included the applicable disclosures in note 10 to the consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

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

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

Accounting Standards Issued But Not Yet Effective

Accounting pronouncements issued, but not effective until after June 30, 2013, are not expected to have a significant impact on our consolidated financial position or results of operations.

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## Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

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

|                           | June 30,<br>2013 | December 31,<br>2012 |
|---------------------------|------------------|----------------------|
| Currency Derivatives      | \$6              | \$(60 )              |
| Commodity Derivatives     | —                | —                    |
| Interest Rate Derivatives | 234              | 467                  |
|                           | \$240            | \$407                |

Our market risks, hedging strategies and financial instrument positions at June 30, 2013 have not materially changed from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012. In 2013, we entered into several heating oil and diesel fuel swaps, and also entered into new currency options on the Euro, British Pound Sterling and Canadian Dollar, as well as terminated positions that expired during the first six months of 2013. The remaining fair value changes between December 31, 2012 and June 30, 2013 in the preceding table are primarily due to interest rate and foreign currency exchange rate changes between those dates.

The forward contracts, swaps, and options previously discussed contain an element of risk that the counterparties may be unable to meet the terms of the agreements; however, we minimize such risk exposures for these instruments by limiting the counterparties to banks and financial institutions that meet established credit guidelines.

We have agreements with substantially all of our active counterparties containing early termination rights and/or zero threshold bilateral collateral provisions whereby cash is required based on the net fair value of derivatives associated with those counterparties. Events, such as a credit rating downgrade (depending on the ultimate rating level) could also allow us to take additional protective measures such as the early termination of trades. At June 30, 2013, we held cash collateral of \$164 million under these agreements.

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

The information concerning market risk under the caption “Quantitative and Qualitative Disclosures about Market Risk” on pages 53-54 of our consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2012, is hereby incorporated by reference in this report.

## Item 4. Controls and Procedures

## Evaluation of Disclosure Controls and Procedures:

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

## Changes in Internal Control over Financial Reporting:

There were no changes in the Company’s internal controls over financial reporting during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.



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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

Item 1A. Risk Factors

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 2 and our Consolidated Financial Statements and related notes in Item 1.

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. While UPS employees in the U.S. Domestic Package business unit voted to approve a new national master agreement during the second quarter of 2013, we are in the midst of negotiating certain local U.S. Domestic Package supplemental agreements and the agreement covering UPS Freight employees with the Teamsters. 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. The new national master agreement with the Teamsters, which is subject to ratification, includes changes that are designed to mitigate certain of these health care expenses, but there can be no assurance that our efforts will be successful or that the failure or success of these efforts will not adversely affect our business, financial position, results of operations or liquidity.

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



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

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

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

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

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

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

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

(c) A summary of our repurchases of our class A and class B common stock during the second quarter of 2013 is as follows (in millions, except per share amounts):

|                               | Total Number<br>of Shares<br>Purchased(1) | Average<br>Price Paid<br>Per Share | Total Number<br>of Shares Purchased<br>as Part of Publicly<br>Announced Program | Approximate Dollar<br>Value of Shares that<br>May Yet be<br>Purchased<br>Under the Program |
|-------------------------------|-------------------------------------------|------------------------------------|---------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| April 1 – April 30, 2013      | 7.3                                       | \$85.35                            | 6.8                                                                             | \$ 9,066                                                                                   |
| May 1 – May 31, 2013          | 1.7                                       | 87.08                              | 1.1                                                                             | 8,972                                                                                      |
| June 1 – June 30, 2013        | 1.7                                       | 88.92                              | 1.7                                                                             | 8,825                                                                                      |
| Total April 1 – June 30, 2013 | 10.7                                      | \$86.17                            | 9.6                                                                             |                                                                                            |

(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 an authorization previously announced in 2012. The new share repurchase authorization has no expiration date. Share repurchases may take the form of accelerated share repurchases, open market purchases, or other such methods as we deem appropriate. The timing of our share repurchases will depend upon market conditions. Unless terminated earlier by the resolution of our Board, the program will expire when we have purchased all shares authorized for repurchase under the program. We anticipate repurchasing approximately \$4.0 billion of shares in 2013.





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Item 3. Defaults Upon Senior Securities

None.

Item 5. Other Information

None.

Item 6. Exhibits

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

Index to Exhibits:

|       |   |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|-------|---|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1   | — | Termination Agreement, dated as of January 22, 2013, between United Parcel Service, Inc. and TNT Express N.V. (incorporated by reference to Exhibit 2.3 to the 2012 Annual Report on Form 10-K).                                                                                                                                                                                                                                                                                                                                                                              |
| 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 February 14, 2013 (incorporated by reference to Exhibit 3.1 to Form 8-K, filed on February 19, 2013).                                                                                                                                                                                                                                                                                                                                                                                                        |
| 10.1  | — | Credit Agreement (364-Day Facility) dated March 29, 2013 among United Parcel Service, Inc., the initial lenders named therein, J.P. Morgan Securities LLC and Citigroup Global Markets, Inc. as joint lead arrangers and joint bookrunners, Barclays Bank PLC and BNP Paribas Securities Corp. as co-lead arrangers, Barclays Bank PLC and BNP Paribas as co-documentation agents, Citibank, N.A. as syndication agent, and JPMorgan Chase Bank, N.A. as administrative agent (incorporated by reference to Exhibit 10.1 to Form 10-Q for the Quarter Ending March 31, 2013). |
| 10.2  | — | Credit Agreement (5 Year Facility) dated March 29, 2013 among United Parcel Service, Inc., the initial lenders named therein, J.P. Morgan Securities LLC and Citigroup Global Markets, Inc. as joint lead arrangers and joint bookrunners, Barclays Bank PLC and BNP Paribas Securities Corp. as co-lead arrangers, Barclays Bank PLC and BNP Paribas as co-documentation agents, Citibank, N.A. as syndication agent, and JPMorgan Chase Bank, N.A. as administrative agent (incorporated by reference to Exhibit 10.2 to Form 10-Q for the Quarter Ending March 31, 2013).  |
| 11    | — | Statement regarding Computation of per Share Earnings (incorporated by reference to Note 12 to “Item 1. Financial Statements” of this quarterly report on Form 10-Q).                                                                                                                                                                                                                                                                                                                                                                                                         |
| †12   | — | Computation of Ratio of Earnings to Fixed Charges.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| †31.1 | — | Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                                                                                                |
| †31.2 | — | Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                                                                                                |
| †32.1 | — | Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                                                                                        |
| †32.2 | — | Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                                                                                                                                                                                                                                                                                                                                                                                                        |

††101 — The following financial information from the Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, 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.

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† Filed herewith.

†† Furnished electronically herewith

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SIGNATURES

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

UNITED PARCEL SERVICE, INC.  
(Registrant)

Date: August 2, 2013

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