

UNITED PARCEL SERVICE INC
Form 10-Q
August 07, 2009
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United States
Securities and Exchange Commission
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009, or

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

For the transition period from _____ to _____

Commission file number 001-15451

United Parcel Service, Inc.

(Exact name of registrant as specified in its charter)

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Delaware
(State or Other Jurisdiction of

58-2480149
(IRS Employer

Incorporation or Organization)

Identification No.)

55 Glenlake Parkway, NE Atlanta, Georgia
(Address of Principal Executive Offices)

30328
(Zip Code)

(404) 828-6000

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its website, 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 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 292,170,687 Class A shares, and 702,286,537 Class B shares, with a par value of \$0.01 per share, outstanding at July 30, 2009.

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UNITED PARCEL SERVICE, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2009

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****June 30, 2009 (unaudited) and December 31, 2008****(In millions)**

	June 30, 2009	December 31, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 2,818	\$ 507
Marketable securities	529	542
Accounts receivable, net	4,569	5,547
Finance receivables, net	325	480
Deferred income tax assets	630	494
Other current assets	1,311	1,275
Total Current Assets	10,182	8,845
Property, Plant and Equipment, Net	17,974	18,265
Goodwill	1,991	1,986
Intangible Assets, Net	497	511
Non-Current Finance Receivables, Net	379	476
Other Non-Current Assets	1,517	1,796
Total Assets	\$ 32,540	\$ 31,879
LIABILITIES AND SHAREOWNERS EQUITY		
Current Liabilities:		
Current maturities of long-term debt and commercial paper	\$ 2,017	\$ 2,074
Accounts payable	1,517	1,855
Accrued wages and withholdings	1,688	1,436
Self-insurance reserves	664	732
Other current liabilities	1,271	1,720
Total Current Liabilities	7,157	7,817
Long-Term Debt	8,866	7,797
Pension and Postretirement Benefit Obligations	6,465	6,323
Deferred Income Tax Liabilities	824	588
Self-Insurance Reserves	1,697	1,710
Other Non-Current Liabilities	738	864
Shareowners Equity:		
Class A common stock (296 and 314 shares issued in 2009 and 2008)	3	3
Class B common stock (701 and 684 shares issued in 2009 and 2008)	7	7
Additional paid-in capital	59	
Retained earnings	12,352	12,412
Accumulated other comprehensive loss	(5,628)	(5,642)
Deferred compensation obligations	107	121

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	6,900	6,901
Less: Treasury stock (2 shares in 2009 and 2008)	(107)	(121)
Total Shareowners' Equity	6,793	6,780
Total Liabilities and Shareowners' Equity	\$ 32,540	\$ 31,879

See notes to unaudited consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenue	\$ 10,829	\$ 13,001	\$ 21,767	\$ 25,676
Operating Expenses:				
Compensation and benefits	6,330	6,522	12,662	13,022
Repairs and maintenance	273	303	549	601
Depreciation and amortization	426	452	856	904
Purchased transportation	1,188	1,679	2,400	3,274
Fuel	539	1,167	1,035	2,117
Other occupancy	225	244	497	524
Other expenses	953	1,180	2,155	2,287
	9,934	11,547	20,154	22,729
Operating Profit	895	1,454	1,613	2,947
Other Income and (Expense):				
Investment income (loss)	(22)	14	(9)	71
Interest expense	(181)	(104)	(263)	(238)
	(203)	(90)	(272)	(167)
Income Before Income Taxes	692	1,364	1,341	2,780
Income Taxes	247	491	495	1,001
Net Income	\$ 445	\$ 873	\$ 846	\$ 1,779
Basic Earnings Per Share	\$ 0.45	\$ 0.86	\$ 0.85	\$ 1.73
Diluted Earnings Per Share	\$ 0.44	\$ 0.85	\$ 0.84	\$ 1.72

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net income	\$ 445	\$ 873	\$ 846	\$ 1,779

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Change in foreign currency translation adjustment	38	5	(37)	113
Change in unrealized gain (loss) on marketable securities, net of tax	24	(20)	21	(40)
Change in unrealized gain (loss) on cash flow hedges, net of tax	(91)	80	(49)	30
Change in unrecognized pension and postretirement benefit costs, net of tax	40	33	79	66
Comprehensive income	\$ 456	\$ 971	\$ 860	\$ 1,948

See notes to unaudited consolidated financial statements.

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

	Six months Ended June 30,	
	2009	2008
Cash Flows From Operating Activities:		
Net income	\$ 846	\$ 1,779
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	856	904
Pension and postretirement benefit expense	441	361
Pension and postretirement benefit contributions	(180)	(93)
Self-insurance reserves	(81)	66
Deferred taxes, credits and other	(39)	(51)
Stock compensation expense	219	251
Asset impairment charges	181	
Other (gains) losses	2	423
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	852	121
Income taxes receivable	55	1,076
Other current assets	46	(183)
Accounts payable	(293)	187
Accrued wages and withholdings	274	246
Other current liabilities	(96)	(57)
Other operating activities	72	(2)
Net cash from operating activities	3,155	5,028
Cash Flows From Investing Activities:		
Capital expenditures	(671)	(1,387)
Proceeds from disposals of property, plant and equipment	17	71
Purchases of marketable securities and short-term investments	(1,428)	(1,939)
Sales and maturities of marketable securities and short-term investments	1,430	1,664
Net (increase) decrease in finance receivables	155	(66)
Other investing activities	82	(282)
Net cash (used in) investing activities	(415)	(1,939)
Cash Flows From Financing Activities:		
Net change in short-term debt	(871)	(1,315)
Proceeds from long-term borrowings	3,134	5,435
Repayments of long-term borrowings	(1,360)	(4,290)
Purchases of common stock	(247)	(2,294)
Issuances of common stock	68	98
Dividends	(876)	(1,337)
Other financing activities	(283)	(283)
Net cash (used in) financing activities	(435)	(3,986)

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Effect Of Exchange Rate Changes On Cash And Cash Equivalents	6	48
Net Increase (Decrease) In Cash And Cash Equivalents	2,311	(849)
Cash And Cash Equivalents:		
Beginning of period	507	2,027
End of period	\$ 2,818	\$ 1,178

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, 2009, our results of operations for the three and six months ended June 30, 2009 and 2008, and cash flows for the six months ended June 30, 2009 and 2008. 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, 2008.

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. We had \$192 and \$191 million of restricted cash related to our self-insurance requirements, as of June 30, 2009 and December 31, 2008, respectively, which is reported in Other Non-Current Assets on the consolidated balance sheet.

Certain prior period amounts have been reclassified to conform to the current period presentation.

Accounting Estimates

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

Subsequent Events

We have evaluated the period from July 1, 2009 through August 7, 2009, the date the financial statements herein were issued, for subsequent events requiring recognition or disclosure in the financial statements. During this period, no material recognizable subsequent events were identified, other than the business acquisition discussed in Note 15 Subsequent Events .

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

Adoption of New Accounting Standards

The disclosure requirements of Statement No. 157 Fair Value Measurements (FAS 157), which took effect on January 1, 2008, are presented in Note 12. On January 1, 2009, we implemented the previously deferred provisions of FAS 157 for nonfinancial assets and liabilities recorded at fair value, as required.

The disclosure requirements of Statement No. 161 Disclosures about Derivative Instruments and Hedging Activities (FAS 161), which took effect on January 1, 2009, are presented in Note 14.

The accounting requirements of Statement No. 141(R) Business Combinations (FAS 141(R)), which took effect on January 1, 2009, were adopted but had no impact on our financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The accounting and presentation requirements of Statement No. 160 Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51 (FAS 160), which took effect on January 1, 2009, had an immaterial impact on the financial statements.

The disclosure requirements of FASB Staff Position (FSP) FAS 107-1 and APB 28-1 Interim Disclosures about Fair Value of Financial Instruments are presented in Note 12.

The accounting requirements of FSP 157-4 Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP 157-4), which took effect on April 1, 2009, were adopted but had an immaterial impact on our financial statements. The disclosure requirements of FSP 157-4 are presented in Note 4 and Note 12.

Standards Issued But Not Yet Effective

In June 2009, the FASB issued Statement No. 168, The FASB Accounting Standards Codification (Codification) and the Hierarchy of GAAP (FAS No. 168), which replaces Statement No. 162, The Hierarchy of GAAP and establishes the Codification as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. SEC rules and interpretive releases are also sources of authoritative GAAP for SEC registrants. FAS 168 modifies the GAAP hierarchy to include only two levels of GAAP: authoritative and nonauthoritative. FAS 168 is effective beginning for periods ended after September 15, 2009. As FAS 168 is not intended to change or alter existing GAAP, it will not impact our results of operations, cash flows or financial position. We will adjust historical GAAP references in our third quarter 2009 Form 10-Q to reflect accounting guidance references included in the codification.

In December 2008, the FASB issued FSP FAS 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets. This FSP amends Statement No. 132 (revised 2003), Employers Disclosures about Pensions and Other Postretirement Benefits, to provide guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan, investment policies and strategies, major categories of plan assets, inputs and valuation techniques used to measure the fair value of plan assets and significant concentrations of risk within plan assets. This FSP will be effective for fiscal years ending after December 15, 2009, with earlier application permitted. Upon initial application, the provisions of this FSP are not required for earlier periods that are presented for comparative purposes.

Other new pronouncements issued but not effective until after June 30, 2009, are not expected to have a significant effect on our consolidated financial position or results of operations.

NOTE 3. STOCK-BASED COMPENSATION

We issue employee share-based awards under the UPS Incentive Compensation Plan, which permits the grant of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, performance shares, performance units, and management incentive awards to eligible employees. The primary compensation programs offered under the UPS Incentive Compensation Plan include the UPS Management Incentive Awards Program, the UPS Long-Term Incentive Program and the UPS Long-Term Incentive Performance Award program. We also maintain an employee stock purchase plan which allows eligible employees to purchase shares of UPS class A common stock at a discount.

During the first quarter of 2009, we granted target restricted stock units (RSUs) under the UPS Long-Term Incentive Performance Award program to eligible management. Of the total 2009 target award, 90% of the target award will be divided into three substantially equal tranches, one for each calendar year in the three-year

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award cycle from 2009 to 2011, using performance criteria targets established each year. For 2009, those targets consist of consolidated operating return on invested capital and growth in consolidated revenue. The remaining 10% of the total 2009 target award will be based upon our achievement of adjusted earnings per share for the three-year award cycle compared to a target established at the beginning of the award cycle.

The number of RSUs earned each year will be the target number adjusted for the percentage achievement of performance criteria targets for the year. The percentage of achievement used to determine the RSUs earned may be a percentage less than or more than 100% of the target RSUs for each tranche. Based on the date that the eligible management population and performance targets were approved for the 2009 performance tranches, we determined the award measurement date to be March 13, 2009, and therefore the target RSU grant was valued for stock compensation expense purposes using the closing New York Stock Exchange price of \$43.09 on that date.

During the second quarter of 2009, we granted stock option and restricted performance unit (RPU) awards to eligible employees under the UPS Long-Term Incentive Program. Stock options are granted to a limited group of employees, while a larger proportion of the total award under the UPS Long-Term Incentive Program is being made in the form of RPUs. Additionally, stock option and RPU awards will generally vest over a five year period with approximately 20% of the award vesting at each anniversary date of the grant (except in the case of death, disability, or retirement, whereby immediate vesting occurs). Prior to 2008, stock option and RPU grants vested five years after the date of grant (again with the exception of death, disability, or retirement). Consistent with previous awards, the options granted will expire ten years after the date of grant. In the second quarter of 2009, we granted 0.3 million stock options and 2.2 million RPUs at a grant price of \$55.83. In the second quarter of 2008, we granted 0.2 million stock options and 1.9 million RPUs at a grant price of \$71.58. The fair value of our employee stock options granted, as determined by the Black-Scholes valuation model, was \$10.86 and \$16.77 for 2009 and 2008, respectively, using the following assumptions:

	2009	2008
Expected life (in years)	7.5	7.5
Risk-free interest rate	3.22%	3.79%
Expected volatility	23.16%	22.24%
Expected dividend yield	3.25%	2.39%

Awards granted under the Management Incentive Awards program are normally granted during the fourth quarter of each year. Compensation expense for share-based awards recognized in net income for the three months ended June 30, 2009 and 2008 was \$113 and \$134 million pre-tax, respectively. Compensation expense for share-based awards recognized in net income for the six months ended June 30, 2009 and 2008 was \$219 and \$251 million pre-tax, respectively.

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The following is a summary of marketable securities as of June 30, 2009 and December 31, 2008 (in millions):

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
June 30, 2009				
Current marketable securities:				
U.S. government and agency debt securities	\$ 150	\$ 1	\$ 1	\$ 150
Mortgage and asset-backed debt securities	158	2	5	155
Corporate debt securities	177	5	1	181
U.S. state and local municipal debt securities	22			22
Other debt and equity securities	22		1	21
Current marketable securities	529	8	8	529
Non-current marketable securities:				
Asset-backed debt securities	150		45	105
U.S. state and local municipal debt securities	116		24	92
Preferred equity securities	12		1	11
Common equity securities	19	7		26
Non-current marketable securities	297	7	70	234
Total marketable securities	\$ 826	\$ 15	\$ 78	\$ 763
December 31, 2008				
Current marketable securities:				
U.S. government and agency debt securities	\$ 93	\$ 2	\$	\$ 95
Mortgage and asset-backed debt securities	278	3	11	270
Corporate debt securities	158	5	3	160
Other debt and equity securities	30		13	17
Current marketable securities	559	10	27	542
Non-current marketable securities:				
Asset-backed debt securities	150		34	116
U.S. state and local municipal debt securities	116		29	87
Preferred equity securities	21		8	13
Common equity securities	25	3		28
Non-current marketable securities	312	3	71	244
Total marketable securities	\$ 871	\$ 13	\$ 98	\$ 786

At June 30, 2009, we have investments in auction rate securities with a carrying value of \$278 million. Some of these investments take the form of debt securities, and are structured as direct obligations of local governments or agencies (classified as U.S. state and local municipal securities). Other auction rate security investments are structured as obligations of asset-backed trusts (classified as Asset-backed debt

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securities), generally all of which are collateralized by student loans and are guaranteed by the U.S. Government or through private insurance. The remaining auction rate securities take the form of preferred stock, and are collateralized by securities issued directly by large corporations or money market securities. Substantially all of our investments in auction rate securities maintain investment-grade ratings of BBB / Baa or higher by Standard & Poor s Rating Service (Standard & Poor s) and Moody s Investors Service (Moody s), respectively.

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During the first quarter of 2008, market auctions, including auctions for substantially our entire auction rate securities portfolio, began to fail due to insufficient buyers. As a result of the persistent failed auctions, and the uncertainty of when these investments could successfully be liquidated at par, we have continued to classify all of our investments in auction rate securities as non-current marketable securities (which are reported in Other Non-Current Assets on the consolidated balance sheet), as noted in the table above, as of June 30, 2009. The securities for which auctions have failed will continue to accrue interest and be auctioned at each respective reset date until the auction succeeds, the issuer redeems the securities, or the securities mature.

Historically, the par value of the auction rate securities approximated fair value due to the frequent resetting of the interest rate. While we will continue to earn interest on these investments in failed auction rate securities (often at the maximum contractual interest rate), the estimated fair value of the auction rate securities no longer approximates par value due to the lack of liquidity. We estimated the fair value of these securities after considering several factors, including the credit quality of the securities, the rate of interest received since the failed auctions began, the yields of securities similar to the underlying auction rate securities, and the input of broker-dealers in these securities. As a result, we recorded an after-tax unrealized loss of approximately \$44 million on these securities as of June 30, 2009 in other comprehensive income (\$70 million pre-tax), reflecting the decline in the estimated fair value of these securities.

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

For the remaining auction rate securities, and equity and debt securities, we have concluded that no additional other-than-temporary impairment losses existed as of June 30, 2009. In making this determination, we considered the financial condition and prospects of the issuer, the magnitude of the losses in market value compared with the investments' cost, the length of time the investments have been in an unrealized loss position, the probability that we will be unable to collect all amounts due according to the contractual terms of the security, the credit rating of the security, and our ability and intent to hold these investments until the anticipated recovery in market value or maturity occurs.

The amortized cost and estimated fair value of marketable securities and short-term investments at June 30, 2009, by contractual maturity, are shown below (in millions). Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

	Cost	Estimated Fair Value
Due in one year or less	\$ 23	\$ 23
Due after one year through three years	181	183
Due after three years through five years	59	60
Due after five years	512	440
	775	706
Equity securities	51	57
	\$ 826	\$ 763

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Property, plant and equipment as of June 30, 2009 and December 31, 2008 consists of the following (in millions):

	2009	2008
Vehicles	\$ 5,474	\$ 5,508
Aircraft (including aircraft under capitalized leases)	13,448	14,564
Land	1,075	1,068
Buildings	2,884	2,836
Building and leasehold improvements	2,759	2,702
Plant equipment	5,838	5,720
Technology equipment	1,629	1,620
Equipment under operating leases	158	136
Construction-in-progress	1,001	944
	34,266	35,098
Less: Accumulated depreciation and amortization	(16,292)	(16,833)
	\$ 17,974	\$ 18,265

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

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

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Information about net periodic benefit cost for our pension and postretirement benefit plans is as follows for the three and six month period ended June 30, 2009 and 2008 (in millions):

Three Months Ended June 30,

	U.S. Pension Benefits		U.S. Postretirement Medical Benefits		International Pension Benefits	
	2009	2008	2009	2008	2009	2008
Net Periodic Cost:						
Service cost	\$ 173	\$ 177	\$ 22	\$ 24	\$ 5	\$ 7
Interest cost	282	263	53	50	7	8
Expected return on assets	(372)	(380)	(7)	(13)	(6)	(9)
Amortization of:						
Transition obligation	1	1				
Prior service cost	44	47	1	(1)		
Actuarial (gain) loss	12	2	4	4	1	
Settlements / curtailments	3					
Net periodic benefit cost	\$ 143	\$ 110	\$ 73	\$ 64	\$ 7	\$ 6

Six Months Ended June 30,

	U.S. Pension Benefits		U.S. Postretirement Medical Benefits		International Pension Benefits	
	2009	2008	2009	2008	2009	2008
Net Periodic Cost:						
Service cost	\$ 345	\$ 354	\$ 43	\$ 47	\$ 10	\$ 14
Interest cost	565	526	106	100	14	16
Expected return on assets	(744)	(759)	(14)	(25)	(12)	(18)
Amortization of:						
Transition obligation	2	2				
Prior service cost	89	93	3	(2)		
Actuarial (gain) loss	23	4	7	9	1	
Settlements / curtailments	3					
Net periodic benefit cost	\$ 283	\$ 220	\$ 145	\$ 129	\$ 13	\$ 12

During the first six months of 2009, we contributed \$134 and \$46 million to our company-sponsored pension and postretirement medical benefit plans, respectively. We expect to contribute \$682 and \$47 million over the remainder of the year to the pension and postretirement medical benefit plans, respectively.

NOTE 7. GOODWILL AND INTANGIBLE ASSETS

The following table indicates the allocation of goodwill by reportable segment as of June 30, 2009 and December 31, 2008 (in millions):

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	U.S. Domestic Package	International Package	Supply Chain & Freight	Consolidated
December 31, 2008 balance	\$	\$ 288	\$ 1,698	\$ 1,986
Acquired		3		3
Disposed of			(6)	(6)
Currency / Other			8	8
June 30, 2009 balance	\$	\$ 291	\$ 1,700	\$ 1,991

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The goodwill acquired in the International Package segment was due to the acquisition of an agent in Slovenia during the second quarter of 2009. The increase in goodwill in the Supply Chain & Freight segment was due to the impact of fluctuations in the U.S. Dollar with other currencies on the translation of non-U.S. Dollar goodwill balances, partially offset by the allocation of goodwill to the sale of certain non-U.S. Mail Boxes Etc. franchises.

The following is a summary of intangible assets as of June 30, 2009 and December 31, 2008 (in millions):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
June 30, 2009:			
Trademarks, licenses, patents, and other	\$ 48	\$ (43)	\$ 5
Customer lists	111	(55)	56
Franchise rights	109	(43)	66
Capitalized software	1,781	(1,411)	370
Total Intangible Assets, Net	\$ 2,049	\$ (1,552)	\$ 497
December 31, 2008:			
Trademarks, licenses, patents, and other	\$ 47	\$ (40)	\$ 7
Customer lists	113	(48)	65
Franchise rights	110	(41)	69
Capitalized software	1,728	(1,358)	370
Total Intangible Assets, Net	\$ 1,998	\$ (1,487)	\$ 511

NOTE 8. DEBT AND FINANCING ARRANGEMENTS

The carrying value of our outstanding debt as of June 30, 2009 and December 31, 2008 consists of the following (in millions):

	Maturity	2009	2008
Commercial paper	2009	\$ 1,878	\$ 2,922
4.50% senior notes	2013	1,751	1,739
3.875% senior notes	2014	1,001	
5.50% senior notes	2018	754	745
5.125% senior notes	2019	995	
8.38% debentures	2020-2030	740	741
6.20% senior notes	2038	1,480	1,479
Floating rate senior notes	2049-2053	431	438
Facility notes and bonds	2009-2036	432	433
Pound Sterling notes	2031-2050	817	730
Capital lease obligations	2009-2021	407	425
UPS Notes	2009-2027	177	198
Other debt	2009	20	21
Total debt		10,883	9,871

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Less current maturities	(2,017)	(2,074)
Long-term debt	\$ 8,866	\$ 7,797

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We are authorized to borrow up to \$10.0 billion under the U.S. commercial paper program we maintain. We had \$1.878 billion outstanding under this program as of June 30, 2009, with an average interest rate of 0.21%. As of June 30, 2009, we have classified the entire commercial paper balance as a current liability in our consolidated balance sheet. As of December 31, 2008, \$1.0 billion of commercial paper was classified as long-term debt in anticipation of the subsequent issuance of fixed rate notes, as discussed further below. We also maintain a European commercial paper program under which we are authorized to borrow up to 1.0 billion in a variety of currencies, however there were no amounts outstanding under this program as of June 30, 2009.

We maintain two credit agreements with a consortium of banks. One of these agreements provides revolving credit facilities of \$3.0 billion, and expires on April 15, 2010. Interest on any amounts we borrow under this facility would be charged at 90-day LIBOR plus a percentage determined by quotations from Markit Group Ltd. for our 1-year credit default swap spread, subject to certain minimum rates and maximum rates based on our public debt ratings from Standard & Poor's and Moody's. If our public debt ratings are A / A2 or above, the minimum applicable margin is 1.00% and the maximum applicable margin is 2.00%; if our public debt ratings are lower than A / A2, the minimum applicable margin is 1.50% and the maximum applicable margin is 3.00%.

The second agreement provides revolving credit facilities of \$1.0 billion, and expires on April 19, 2012. Interest on any amounts we borrow under this facility would be charged at 90-day LIBOR plus 15 basis points. At June 30, 2009, there were no outstanding borrowings under either of these facilities.

In addition to these credit facilities, we have an automatically effective registration statement on Form S-3 filed with the SEC that is available for registered offerings of short or long-term debt securities.

In March 2009, we completed an offering of \$1.0 billion of 3.875% senior notes due April 2014 and \$1.0 billion of 5.125% senior notes due April 2019. These notes pay interest semiannually, and we may redeem the notes at any time by paying the greater of the principal amount or a make-whole amount, plus accrued interest. After pricing and underwriting discounts, we received a total of \$1.989 billion in cash proceeds from the offering. The proceeds from the offering were used for general corporate purposes, including the reduction of our outstanding commercial paper balance.

Our existing debt instruments and credit facilities do not have cross-default or ratings triggers, however these debt instruments and credit facilities do subject us to certain financial covenants. As of June 30, 2009 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, 2009, 10% of net tangible assets is equivalent to \$2.289 billion, however we have no covered sale-leaseback transactions or secured indebtedness outstanding. Additionally, we are required to maintain a minimum net worth, as defined, of \$5.0 billion on a quarterly basis. As of June 30, 2009, our net worth, as defined, was equivalent to \$12.421 billion. We do not expect these covenants to have a material impact on our financial condition or liquidity.

NOTE 9. LEGAL PROCEEDINGS AND CONTINGENCIES

We are a defendant in a number of lawsuits filed in state and federal courts containing various class-action allegations under state wage-and-hour laws. In one of these cases, Marlo v. UPS, which was certified as a class action in a California federal court in June 2004, plaintiffs allege that they improperly were denied overtime, and seek penalties for missed meal and rest periods, and interest and attorneys' fees. Plaintiffs purport to represent a class of 1,300 full-time supervisors. In August 2005, the court granted summary judgment in favor of UPS on all claims, and plaintiffs appealed the ruling. In October 2007, the appeals court reversed the lower court's ruling. In April 2008, the Court decertified the class and vacated the trial scheduled for April 29, 2008. We have denied

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

In another case, *Hohider v. UPS*, which in July 2007 was certified as a class action in a Pennsylvania federal court, plaintiffs have challenged certain aspects of the Company's interactive process for assessing requests for reasonable accommodation under the Americans with Disabilities Act. Plaintiffs purport to represent a class of over 35,000 current and former employees, and seek back-pay, and compensatory and punitive damages, as well as attorneys' fees. In August 2007, the Third Circuit Court of Appeals granted our petition to hear the appeal of the trial court's certification order. In July 2009, the Third Circuit issued its decision decertifying the class and remanding the case to the trial court for further proceedings. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

UPS and Mail Boxes Etc., Inc. are defendants in various lawsuits brought by franchisees who operate Mail Boxes Etc. centers and The UPS Store locations. These lawsuits relate to the rebranding of Mail Boxes Etc. centers to The UPS Store, The UPS Store business model, the representations made in connection with the rebranding and the sale of The UPS Store franchises, and UPS's sale of services in the franchisees' territories. In one of the actions, which is pending in California state court, the court recently certified a class consisting of all Mail Boxes Etc. branded stores that rebranded to The UPS Store in March 2003. We have denied any liability with respect to these claims and intend to defend ourselves vigorously. At this time, we have not determined the amount of any liability that may result from these matters or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

In January 2008, a class action complaint was filed in the United States District Court for the Eastern District of New York alleging price-fixing activities relating to the provision of freight forwarding services. UPS was not named in this case. On July 21, 2009, the plaintiffs filed a first amended complaint naming numerous global freight forwarders as defendants. UPS and UPS Supply Chain Solutions are among the 60 defendants named in the amended complaint. We intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from these matters or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

We are a defendant in various other lawsuits that arose in the normal course of business. We believe that the eventual resolution of these cases will not have a material adverse effect on our financial condition, results of operations, or liquidity.

We file income tax returns in the U.S. federal jurisdiction, most U.S. state and local jurisdictions, and many non-U.S. jurisdictions. As of June 30, 2009, we had substantially resolved all U.S. federal income tax matters for tax years prior to 2003. During the second quarter of 2009, we resolved tax years 1999 through 2002 with the Internal Revenue Service (IRS) Appeals Office. In July 2008, the IRS completed its audit of the tax years 2003 through 2004, with only a limited number of issues that will be considered by the IRS Appeals Office by the end of 2009. In late 2008, the IRS began the initial planning phase of the income tax audit for tax years 2005 through 2007. Along with this audit for tax years 2005 through 2007, the IRS is currently examining non-income based taxes, including employment and excise taxes on transportation of property by air and fuel purchases, which could lead to proposed assessments. The IRS has not presented an official position with regard to these taxes at this time, and therefore we are not able to determine the technical merit of any potential assessment; however, we do not believe that the resolution of this matter would have a material adverse effect on our financial condition.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

results of operations, or liquidity. Certain foreign jurisdictions are reviewing transfer pricing transactions between U.S. and related foreign companies. The Italian Guardia di Finanza, under the authority of the Minister of Economy and Finance, has challenged whether a UPS entity has a permanent establishment in Italy beginning with tax year 2005. No final report or assessment has been issued. We disagree with the basis for these challenges and intend to defend our position vigorously. However, it is reasonably possible that the amount of unrecognized tax benefits could change within the next 12 months as we continue to pursue resolution of this matter with the Italian authorities. At this time, we do not expect this matter to have a material adverse effect on our financial condition, results of operations, or liquidity. With few exceptions, we are no longer subject to U.S. state and local and non-U.S. income tax examinations by tax authorities for tax years prior to 1999, but certain U.S. state and local matters are subject to ongoing litigation.

As of December 31, 2008, we had approximately 260,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters (Teamsters). In September 2007, we reached a new national master agreement with the Teamsters, which was ratified in December 2007. The new agreement provides for wage increases as well as contributions to healthcare and pension plans, and most economic provisions of the new five year agreement took effect on August 1, 2008, with the exception of our withdrawal from the Central States Pension Fund which occurred in 2007. We have approximately 2,900 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association, which becomes amendable at the end of 2011. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which became amendable in November 2006. We began formal negotiations with Teamsters Local 2727 in October 2006. In addition, the majority (approximately 3,000) 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). In June of 2009, we reached a new agreement with the IAM, which was subsequently ratified in July 2009. The new agreement runs through July 31, 2014.

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

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 (NYSE) under the symbol UPS . Class A and B shares both have a \$0.01 par value, and as of June 30, 2009, 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 no par value, authorized to be issued; as of June 30, 2009, no preferred shares had been issued.

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

The following is a roll-forward of our common stock, additional paid-in capital, and retained earnings accounts for the six months ended June 30, 2009 and 2008 (in millions, except per share amounts):

	2009		2008	
	Shares	Dollars	Shares	Dollars
Class A Common Stock				
Balance at beginning of period	314	\$ 3	349	\$ 3
Common stock purchases	(5)		(7)	
Stock award plans	2		3	
Common stock issuances	2		1	
Conversions of Class A to Class B common stock	(17)		(16)	
Class A shares issued at end of period	296	\$ 3	330	\$ 3
Class B Common Stock				
Balance at beginning of period	684	\$ 7	694	\$ 7
Common stock purchases			(29)	
Conversions of Class A to Class B common stock	17		16	
Class B shares issued at end of period	701	\$ 7	681	\$ 7
Additional Paid-In Capital				
Balance at beginning of period		\$		\$
Stock award plans		211		262
Common stock purchases		(248)		(349)
Common stock issuances		96		87
Balance at end of period		\$ 59		\$
Retained Earnings				
Balance at beginning of period		\$ 12,412		\$ 14,186
Net income		846		1,779
Cumulative adjustment for accounting changes				(60)
Dividends (\$0.90 and \$0.90 per share)		(906)		(927)
Common stock purchases				(2,137)
Balance at end of period		\$ 12,352		\$ 12,841

On January 1, 2008, we recognized a \$44 million reduction to retained earnings as a result of changing our measurement date under FAS 158 Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (an amendment of FASB Statements No. 87, 88, 106, and 132(R)). Also on January 1, 2008, we recognized a \$16 million reduction to retained earnings as a result of adopting FAS 159, which is discussed further in Note 12.

As a result of the uncertain economic environment, we have slowed our share repurchase activity. We currently intend to repurchase shares in 2009 at a rate that should approximately offset the dilution from our stock compensation programs. We repurchased a total of 5.1 million shares of Class A and Class B common stock for \$248 million during the six months ended June 30, 2009, and 35.7 million shares for \$2.486 billion for the six months ended June 30, 2008. As of June 30, 2009, we had \$6.324 billion of our share repurchase authorization remaining.

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS***Accumulated Other Comprehensive Income (Loss)*

We incur activity in AOCI for unrealized holding gains and losses on available-for-sale securities, foreign currency translation adjustments, unrealized gains and losses from derivatives that qualify as hedges of cash flows, and unrecognized pension and postretirement benefit costs. The activity in AOCI for the six months ended June 30, 2009 and 2008 is as follows (in millions):

	2009	2008
Foreign currency translation gain (loss):		
Balance at beginning of period	\$ (38)	\$ 81
Aggregate adjustment for the period	(37)	113
Balance at end of period	(75)	194
Unrealized gain (loss) on marketable securities, net of tax:		
Balance at beginning of period	(60)	9
Current period changes in fair value (net of tax effect of \$(6), and \$(22))	11	(38)
Reclassification to earnings (net of tax effect of \$7 and \$(1))	10	(2)
Balance at end of period	(39)	(31)
Unrealized gain (loss) on cash flow hedges, net of tax:		
Balance at beginning of period	(107)	(250)
Current period changes in fair value (net of tax effect of \$38 and \$(92))	63	(153)
Reclassification to earnings (net of tax effect of \$(67) and \$111)	(112)	183
Balance at end of period	(156)	(220)
Unrecognized pension and postretirement benefit costs, net of tax:		
Balance at beginning of period	(5,437)	(1,853)
Reclassification to earnings (net of tax effect of \$46 and \$40)	79	66
Net actuarial gain / loss and prior service cost resulting from remeasurements of plan assets and liabilities (net of tax effect of \$0 and \$8)		13
Balance at end of period	(5,358)	(1,774)
Accumulated other comprehensive income (loss) at end of period	\$ (5,628)	\$ (1,831)

Deferred Compensation Obligations and Treasury Stock

Activity in the deferred compensation program for the six months ended June 30, 2009 and 2008 is as follows (in millions):

	2009		2008	
	Shares	Dollars	Shares	Dollars
Deferred Compensation Obligations				

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Balance at beginning of period	\$	121		\$	137
Reinvested dividends		2			3
Benefit payments		(16)			(21)
Balance at end of period	\$	107		\$	119

Treasury Stock

Balance at beginning of period	(2)	\$	(121)	(2)	\$	(137)
Reinvested dividends			(2)			(3)
Benefit payments			16			21
Balance at end of period	(2)	\$	(107)	(2)	\$	(119)

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****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 200 countries and territories worldwide, including shipments wholly outside the United States, as well as shipments with either origin or distribution outside the United States. Our International Package reporting segment includes the operations of our Europe, Asia, and Americas operating segments.

Supply Chain & Freight

Supply Chain & Freight includes our forwarding and logistics operations, UPS Freight, and other aggregated business units. Our forwarding and logistics business provides services in more than 175 countries and territories worldwide, and includes supply chain design and management, freight distribution, customs brokerage, mail and consulting services. UPS Freight offers a variety of less-than-truckload (LTL) and truckload (TL) services to customers in North America. Other aggregated business units within this segment include Mail Boxes, Etc. (the franchisor of Mail Boxes, Etc. and The UPS Store) and UPS Capital.

In evaluating financial performance, we focus on operating profit as a segment's measure of profit or loss. Operating profit is before investment income, interest expense, and income taxes. The accounting policies of the reportable segments are the same as those described in the summary of accounting policies included in the financial statements in our Annual Report on Form 10-K for the year ended December 31, 2008, with certain expenses allocated between the segments using activity-based costing methods. Unallocated assets are comprised primarily of cash, marketable securities, short-term investments, and investments in limited partnerships.

Segment information for the three and six months ended June 30, 2009 and 2008 is as follows (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenue:				
U.S. Domestic Package	\$ 6,789	\$ 7,714	\$ 13,738	\$ 15,449
International Package	2,246	2,948	4,486	5,707
Supply Chain & Freight	1,794	2,339	3,543	4,520
Consolidated	\$ 10,829	\$ 13,001	\$ 21,767	\$ 25,676
Operating Profit:				
U.S. Domestic Package	\$ 476	\$ 899	\$ 860	\$ 1,858
International Package	293	407	587	828
Supply Chain & Freight	126	148	166	261

Consolidated

\$ 895 \$ 1,454 \$ 1,613 \$ 2,947

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

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As discussed in Note 5, the U.S. Domestic Package segment operating profit was adversely impacted by a \$181 million impairment charge in the first quarter of 2009, related to our McDonnell-Douglas DC-8-71 and DC-8-73 airframes, engines, and related parts.

NOTE 12. FAIR VALUE DISCLOSURES

Effective January 1, 2008, we adopted FAS 157, which requires disclosures about our assets and liabilities that are measured at fair value. Further information about such assets and liabilities is presented below. We began to apply the provisions of FAS 157 to non-financial assets and liabilities beginning January 1, 2009, in accordance with FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157 .

In February 2007, the FASB issued Statement No. 159 The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159), which gives entities the option to measure eligible financial assets, financial liabilities and firm commitments at fair value (i.e., the fair value option), on an instrument-by-instrument basis, that are otherwise not accounted for at fair value under other accounting standards. The election to use the fair value option is available at specified election dates, such as when an entity first recognizes a financial asset or financial liability or upon entering into a firm commitment. Subsequent changes in fair value must be recorded in earnings. Additionally, FAS 159 allows for a one-time election for existing positions upon adoption, with the transition adjustment recorded to beginning retained earnings. We adopted FAS 159 on January 1, 2008, and elected to apply the fair value option to our investment in certain investment partnerships that were previously accounted for under the equity method. Accordingly, we recorded a \$16 million reduction to retained earnings as of January 1, 2008, representing the cumulative effect adjustment of adopting FAS 159. These investments are reported in other non-current assets on the consolidated balance sheet.

Our assets and liabilities recorded at fair value have been categorized based upon a fair value hierarchy in accordance with FAS 157. Level 1 inputs utilize quoted prices in active markets for identical assets or liabilities. Level 2 inputs are based on other observable market data, such as quoted prices for similar assets and liabilities, and inputs other than quoted prices that are observable, such as interest rates and yield curves. Level 3 inputs are developed from unobservable data reflecting our own assumptions, and include situations where there is little or no market activity for the asset or liability.

The following is a general description of the valuation methodologies used for financial assets and liabilities measured at fair value, including the general classification of such assets and liabilities pursuant to the valuation hierarchy.

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

We have classified our auction rate securities portfolio as utilizing Level 3 inputs, as their valuation requires substantial judgment and estimation of factors that are not currently observable in the market due to the lack of trading in the securities. Valuations may be revised in future periods as market conditions evolve. These securities were valued as of June 30, 2009 considering several factors, including the credit quality of the securities, the rate of interest received since the failed auctions began, the yields of securities similar to the underlying auction rate securities, and the input of broker-dealers in these securities.

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Derivative Contracts Our foreign currency, interest rate, and energy derivatives are largely comprised of over-the-counter derivatives, which are primarily valued using pricing models that rely on market observable inputs such as yield curves, currency exchange rates, and commodity forward prices, and therefore are classified as Level 2.

Other Investments Financial assets and liabilities utilizing Level 3 inputs include our holdings in certain investment partnerships. These partnership holdings do not have any quoted prices, nor can they be valued using inputs based on observable market data. These investments are valued internally using a discounted cash flow model based on each partnership's financial statements and cash flow projections.

The following table presents information about our assets and liabilities measured at fair value on a recurring basis as of June 30, 2009, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value (in millions).

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of June 30, 2009
Assets				
Marketable securities	\$ 185	\$ 370	\$ 208	\$ 763
Derivative contracts		129		129
Other investments			312	312
Total	\$ 185	\$ 499	\$ 520	\$ 1,204
Liabilities				
Derivative contracts		\$ 23		\$ 23
Total		\$ 23		\$ 23

The following table presents the changes in Level 3 instruments measured on a recurring basis for the three and six months ended June 30, 2009 (in millions).

Three Months Ended June 30, 2009:

	Marketable Securities	Other Investments	Total
Balance on April 1, 2009	\$ 207	\$ 328	\$ 535
Transfers into (out of) Level 3			
Net realized and unrealized gains (losses):			
Included in earnings (in investment income)	(5)	(16)	(21)
Included in AOCI (pre-tax)	6		6
Purchases, issuances, and settlements			
Balance on June 30, 2009	\$ 208	\$ 312	\$ 520

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****Six Months Ended June 30, 2009:**

	Marketable Securities	Other Investments	Total
Balance on January 1, 2009	\$ 216	\$ 331	\$ 547
Transfers into (out of) Level 3	(3)		(3)
Net realized and unrealized gains (losses):			
Included in earnings (in investment income)	(5)	(19)	(24)
Included in AOCI (pre-tax)			
Purchases, issuances, and settlements			
Balance on June 30, 2009	\$ 208	\$ 312	\$ 520

Certain assets are measured at fair value on a nonrecurring basis. For the three months ended June 30, 2009, impaired finance receivables with a carrying amount of \$13 million were written down to a net fair value of \$8 million, based on the fair value for the related collateral which was determined using unobservable inputs (Level 3). In addition to these receivables, for the six months ended June 30, 2009, impaired airframes, engines, and parts with a net carrying value of \$192 million were written down to an aggregate fair value of \$11 million, as discussed further in Note 5. The fair values for the impaired airframes, engines, and parts were determined using unobservable inputs (Level 3).

The carrying value of cash and cash equivalents, accounts receivable, and accounts payable contained in the consolidated balance sheet approximates fair value. The following table sets forth our financial assets and liabilities that were not carried at fair value as of June 30, 2009 and December 31, 2008 (in millions):

	As of June 30, 2009		As of December 31, 2008	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Finance receivables	\$ 704	\$ 701	\$ 956	\$ 957
Short and long-term debt	10,883	11,127	9,871	10,287

The above fair values were computed based on comparable transactions, quoted market prices, discounted future cash flows or an estimate of the amount to be received or paid to terminate or settle the agreement, as applicable. Differences from carrying amounts are attributable to interest and or credit rate changes subsequent to when the transaction occurred.

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The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2009 and 2008 (in millions, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Numerator:				
Net income	\$ 445	\$ 873	\$ 846	\$ 1,779
Denominator:				
Weighted average shares	995	1,019	995	1,027
Deferred compensation obligations	2	2	2	2
Vested portion of restricted shares	1		1	
Denominator for basic earnings per share	998	1,021	998	1,029
Effect of dilutive securities:				
Restricted performance units	2	3	2	3
Restricted stock units	4	4	3	3
Stock option plans		1		1
Denominator for diluted earnings per share	1,004	1,029	1,003	1,036
Basic earnings per share	\$ 0.45	\$ 0.86	\$ 0.85	\$ 1.73
Diluted earnings per share	\$ 0.44	\$ 0.85	\$ 0.84	\$ 1.72

Diluted earnings per share for the three months ended June 30, 2009 and 2008 exclude the effect of 17.2 and 9.8 million shares of common stock (17.7 and 9.8 million for the six months ended June 30, 2009 and 2008), respectively, that may be issued upon the exercise of employee stock options because such effect would be antidilutive.

NOTE 14. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT*Risk Management Policies*

We are exposed to market risk, primarily related to foreign exchange rates, commodity prices, equity 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, equity prices, and interest rates. It is our policy and practice to use derivative financial instruments only to the extent necessary to manage exposures. As we use price sensitive instruments to hedge a certain portion of our existing and anticipated transactions, we expect that any loss in value for those instruments generally would be offset by increases in the value of those hedged transactions. We do not hold or issue derivative financial instruments for trading or speculative purposes.

Credit Risk Management

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

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guidelines, and monitoring counterparty credit risk to prevent concentrations of credit risk with any single counterparty. Additionally, the majority of our master agreements for derivatives provide for the early termination of any derivative transactions in the event that either the bank counterparty or UPS receives a credit rating below BBB by Standard & Poor's or Baa2 by Moody's, or ceases to be rated by either firm. We do not have any credit-risk triggers in our outstanding master agreements that require UPS or the bank counterparties to post collateral.

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

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133), requires companies to recognize all derivative instruments as assets or liabilities in the balance sheet 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 fair value hedge, a cash flow 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 income statement during the current period.

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

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

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currency exposures relate to the Euro, the British Pound Sterling, and the Canadian Dollar. We hedge portions of our forecasted revenue denominated in foreign currencies with option contracts. We have designated and account for these contracts as cash flow hedges of anticipated foreign currency denominated revenue and, therefore, the resulting gains and losses from these hedges are recognized as a component of international package revenue when the underlying sales transactions occur.

We have foreign currency denominated capital lease obligations associated with our aircraft. For some of these leases, we hedge the foreign currency denominated minimum lease payments using cross-currency interest rate swaps, which effectively convert the foreign currency denominated lease payments into U.S. Dollar denominated payments. We have designated and account for these swaps as cash flow hedges of the forecasted lease payments and, therefore, the resulting gains and losses from these hedges are recognized in the income statement when the currency remeasurement gains and losses on the underlying 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. These swaps are generally entered into concurrently with the issuance of the debt that they are intended to modify, and the notional amount, interest payment, and maturity dates of the swaps match the terms of the associated debt. Interest rate swaps allow us to maintain a target range of floating rate debt within our capital structure.

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

We periodically hedge the forecasted fixed-coupon interest payments associated with anticipated debt offerings, using forward starting interest rate swaps, interest rate locks, or similar derivatives. These agreements effectively lock a portion of our interest rate exposure between the time the agreement is entered into and the date when the debt offering is completed, thereby mitigating the impact of interest rate changes on future interest expense. These derivatives are settled commensurate with the issuance of the debt, and any gain or loss upon settlement is amortized as an adjustment to the effective interest yield on the debt.

Outstanding Positions:

As of June 30, 2009, the notional amounts of our outstanding derivative positions were as follows:

	Notional Value (in millions)
Currency Hedges:	
Euro	1,220
British Pound Sterling	£ 56
Canadian Dollar	C\$ 155
Interest Rate Hedges:	
Fixed to Floating Interest Rate Swaps	\$ 2,300
Floating to Fixed Interest Rate Swaps	\$ 28

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As of June 30, 2009, we had no outstanding commodity hedge positions. The maximum term over which we are hedging exposures to the variability of cash flow (for all forecasted transactions, excluding interest payments on variable-rate debt) is 12 months.

Balance Sheet Recognition:

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

Asset Derivatives	Balance Sheet Location	June 30, 2009 Fair Value
Derivatives designated as hedges:		
Interest rate contracts	Other current assets	\$ 1
Interest rate contracts	Other non-current assets	30
Foreign exchange contracts	Other current assets	98
Total Asset Derivatives		\$ 129

Liability Derivatives	Balance Sheet Location	June 30, 2009 Fair Value
Derivatives designated as hedges:		
Interest rate contracts	Other non-current liabilities	\$ (11)
Foreign exchange contracts	Other current liabilities	(10)
Derivatives not designated as hedges:		
Interest rate contracts	Other non-current liabilities	(2)
Total Liability Derivatives		\$ (23)

Income Statement Recognition:

The following tables indicates the amount and location in the income statement for the three and six months ended June 30, 2009 in which derivative gains and losses, as well as the related amounts reclassified from AOCI, have been recognized for those derivatives designated as cash flow hedges (in millions).

Three Months Ended June 30, 2009:

Derivative Instruments in Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
Interest rate contracts	\$ 1	Interest Expense	\$ (4)

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Foreign exchange contracts	2	Interest Expense	2
Foreign exchange contracts	(114)	Revenue	37
Commodity contracts		Revenue	
Total	\$ (111)		\$ 35

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Six Months Ended June 30, 2009:

	Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
Derivative Instruments in Cash Flow Hedging Relationships			
Interest rate contracts	\$ 127	Interest Expense	\$ (6)
Foreign exchange contracts	(1)	Interest Expense	(1)
Foreign exchange contracts	(25)	Revenue	104
Commodity contracts		Revenue	82
Total	\$ 101		\$ 179

As of June 30, 2009, \$57 million of pre-tax gains related to cash flow hedges that are currently deferred in AOCI are expected to be reclassified to income over the 12 month period ended June 30, 2010. The actual amounts that will be reclassified to income over the next 12 months will vary from this amount as a result of changes in market conditions.

The amount of ineffectiveness recognized in income on derivative instruments designated in cash flow hedging relationships was immaterial for the six months ended June 30, 2009. The derivative gains and losses, as well as the associated gains and losses on the underlying exposure, for those derivatives designated as fair value hedges were immaterial for the six months ended June 30, 2009.

Additionally, we maintain some interest rate swap and foreign exchange forward contracts that are not designated as hedges under the provisions of FAS 133. The interest rate swap contracts are intended to provide an economic hedge of a portfolio of interest bearing receivables. The foreign exchange forward contracts are intended to provide an economic offset to foreign currency remeasurement risks for certain assets and liabilities in our balance sheet. For the three and six months ended June 30, 2009, we recognized \$29 and \$9 million in losses, respectively, on the fair value of the foreign exchange forward contracts, which were reported in other operating expenses in the consolidated income statement, while the impact of the interest rate swap contracts was not material. The foreign exchange forward contracts are settled at the end of each month, and therefore no asset or liability was recorded on the balance sheet at June 30, 2009.

NOTE 15. SUBSEQUENT EVENTS

In August 2009, we completed the formation of a new joint venture headquartered in Dubai to develop and grow UPS express package, freight forwarding and contract logistics services across the Middle East, Turkey and portions of Central Asia. We own 80% of this joint venture, and we will consolidate the financial statements of the joint venture. In conjunction with the formation of this joint venture, the joint venture acquired an 80% interest in the small package operations of Unsped Paket Servisi San ve Ticaret A.S. (Unsped), our existing service agent in Turkey. We will contribute certain existing UPS operations in the region to the new joint venture, along with other consideration. We maintain an option to purchase the remaining 20% of the joint venture, and the joint venture partner maintains a put option to require us to purchase the remaining 20% interest. The base payment to exercise the option can potentially be increased based on the earnings of the joint venture. The 20% portion of the joint venture that we do not own will be recorded as a noncontrolling interest in shareowners' equity.

The express package business operations of Unsped will be included in our International Package segment, while the freight forwarding and contract logistics businesses of Unsped will be included in our Supply Chain & Freight segment. Pro forma results of operations have not been presented for this acquisition, because the effects of this transaction were not material. The results of operations of Unsped will be included in our statements of consolidated income from the date of acquisition. The purchase price allocation can be modified up to one year after the date of acquisition.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations***Revenue, Volume and Revenue Per Piece*

The following tables set forth information showing the change in revenue, average daily package volume, and average revenue per piece, both in dollars or amounts and in percentage terms:

	Three Months Ended		Change	
	2009	2008	\$	%
Revenue (in millions):				
U.S. Domestic Package:				
Next Day Air	\$ 1,315	\$ 1,648	\$ (333)	(20.2)%
Deferred	652	789	(137)	(17.4)
Ground	4,822	5,277	(455)	(8.6)
Total U.S. Domestic Package	6,789	7,714	(925)	(12.0)
International Package:				
Domestic	478	622	(144)	(23.2)
Export	1,677	2,145	(468)	(21.8)
Cargo	91	181	(90)	(49.7)
Total International Package	2,246	2,948	(702)	(23.8)
Supply Chain & Freight:				
Forwarding and Logistics	1,183	1,635	(452)	(27.6)
Freight	507	596	(89)	(14.9)
Other	104	108	(4)	(3.7)
Total Supply Chain & Freight	1,794	2,339	(545)	(23.3)
Consolidated	\$ 10,829	\$ 13,001	\$ (2,172)	(16.7)%
#				
Average Daily Package Volume (in thousands):				
U.S. Domestic Package:				
Next Day Air	1,180	1,183	(3)	(0.3)%
Deferred	879	878	1	0.1
Ground	10,406	10,999	(593)	(5.4)
Total U.S. Domestic Package	12,465	13,060	(595)	(4.6)
International Package:				
Domestic	1,079	1,127	(48)	(4.3)
Export	740	798	(58)	(7.3)
Total International Package	1,819	1,925	(106)	(5.5)
Consolidated	14,284	14,985	(701)	(4.7)%
Operating days in period	64	64		
\$				
Average Revenue Per Piece:				
U.S. Domestic Package:				
Next Day Air	\$ 17.41	\$ 21.77	\$ (4.36)	(20.0)%
Deferred	11.59	14.04	(2.45)	(17.5)

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Ground	7.24	7.50	(0.26)	(3.5)
Total U.S. Domestic Package	8.51	9.23	(0.72)	(7.8)
International Package:				
Domestic	6.92	8.62	(1.70)	(19.7)
Export	35.41	42.00	(6.59)	(15.7)
Total International Package	18.51	22.46	(3.95)	(17.6)
Consolidated	\$ 9.78	\$ 10.93	\$ (1.15)	(10.5)%

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	Six Months Ended June 30,		Change	
	2009	2008	\$	%
Revenue (in millions):				
U.S. Domestic Package:				
Next Day Air	\$ 2,696	\$ 3,286	\$ (590)	(18.0)%
Deferred	1,345	1,594	(249)	(15.6)
Ground	9,697	10,569	(872)	(8.3)
Total U.S. Domestic Package	13,738	15,449	(1,711)	(11.1)
International Package:				
Domestic	942	1,205	(263)	(21.8)
Export	3,363	4,167	(804)	(19.3)
Cargo	181	335	(154)	(46.0)
Total International Package	4,486	5,707	(1,221)	(21.4)
Supply Chain & Freight:				
Forwarding and Logistics	2,380	3,198	(818)	(25.6)
Freight	961	1,109	(148)	(13.3)
Other	202	213	(11)	(5.2)
Total Supply Chain & Freight	3,543	4,520	(977)	(21.6)
Consolidated	\$ 21,767	\$ 25,676	\$ (3,909)	(15.2)%
#				
Average Daily Package Volume (in thousands):				
U.S. Domestic Package:				
Next Day Air	1,185	1,191	(6)	(0.5)%
Deferred	890	894	(4)	(0.4)
Ground	10,495	11,069	(574)	(5.2)
Total U.S. Domestic Package	12,570	13,154	(584)	(4.4)
International Package:				
Domestic	1,088	1,114	(26)	(2.3)
Export	752	788	(36)	(4.6)
Total International Package	1,840	1,902	(62)	(3.3)
Consolidated	14,410	15,056	(646)	(4.3)%
Operating days in period	127	128		
\$				
Average Revenue Per Piece:				
U.S. Domestic Package:				
Next Day Air	\$ 17.91	\$ 21.55	\$ (3.64)	(16.9)%
Deferred	11.90	13.93	(2.03)	(14.6)

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Ground	7.28	7.46	(0.18)	(2.4)
Total U.S. Domestic Package	8.61	9.18	(0.57)	(6.2)
International Package:				
Domestic	6.82	8.45	(1.63)	(19.3)
Export	35.21	41.31	(6.10)	(14.8)
Total International Package	18.42	22.07	(3.65)	(16.5)
Consolidated	\$ 9.86	\$ 10.80	\$ (0.94)	(8.7)%

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The following table sets forth information showing the change in UPS Freight's less-than-truckload revenue, shipments, and weight hauled, both in dollars or amounts and in percentage terms:

	Three Months Ended		Change	
	June 30,		\$	%
	2009	2008		
LTL revenue (in millions)	\$ 471	\$ 564	\$ (93)	(16.5)%
LTL revenue per LTL hundredweight	\$ 17.27	\$ 19.28	\$ (2.01)	(10.4)%
LTL shipments (in thousands)	2,611	2,660	(49)	(1.9)%
LTL shipments per day (in thousands)	40.8	41.6	(0.8)	(1.9)%
LTL gross weight hauled (in millions of pounds)	2,728	2,925	(197)	(6.7)%
LTL weight per shipment	1,045	1,099	(54)	(4.9)%
Operating days in period	64	64		

	Six Months Ended		Change	
	June 30,		\$	%
	2009	2008		
LTL revenue (in millions)	\$ 895	\$ 1,048	\$ (153)	(14.6)%
LTL revenue per LTL hundredweight	\$ 17.28	\$ 18.85	\$ (1.57)	(8.3)%
LTL shipments (in thousands)	4,954	5,057	(103)	(2.0)%
LTL shipments per day (in thousands)	39.0	39.5	(0.5)	(1.3)%
LTL gross weight hauled (in millions of pounds)	5,177	5,559	(382)	(6.9)%
LTL weight per shipment	1,045	1,099	(54)	(4.9)%
Operating days in period	127	128		

Operating Profit and Operating Margin

The following tables set forth information showing the change in operating profit, both in dollars (in millions) and in percentage terms, as well as the operating margin for each reporting segment:

<i>Reporting Segment</i>	Three Months Ended		Change	
	June 30,		\$	%
	2009	2008		
U.S. Domestic Package	\$ 476	\$ 899	\$ (423)	(47.1)%
International Package	293	407	(114)	(28.0)%
Supply Chain & Freight	126	148	(22)	(14.9)%
Consolidated Operating Profit	\$ 895	\$ 1,454	\$ (559)	(38.4)%

Three Months Ended
June 30,

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<i>Reporting Segment</i>	2009	2008
U.S. Domestic Package	7.0%	11.7%
International Package	13.0%	13.8%
Supply Chain & Freight	7.0%	6.3%
Consolidated Operating Margin	8.3%	11.2%

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<i>Reporting Segment</i>	Six Months Ended June 30,		Change	
	2009	2008	\$	%
U.S. Domestic Package	\$ 860	\$ 1,858	\$ (998)	(53.7)%
International Package	587	828	(241)	(29.1)%
Supply Chain & Freight	166	261	(95)	(36.4)%
Consolidated Operating Profit	\$ 1,613	\$ 2,947	\$ (1,334)	(45.3)%

<i>Reporting Segment</i>	Six Months Ended June 30,	
	2009	2008
U.S. Domestic Package	6.3%	12.0%
International Package	13.1%	14.5%
Supply Chain & Freight	4.7%	5.8%
Consolidated Operating Margin	7.4%	11.5%

U.S. Domestic Package Operations

U.S. domestic package revenue decreased \$925 million, or 12.0%, for the quarter (\$1.711 billion, or 11.1%, year-to-date), due to a 4.6% decrease in average daily package volume and a 7.8% decrease in revenue per piece (4.4% and 6.2%, respectively, year-to-date).

Ground volume declined 5.4% during the quarter (5.2% year-to-date), primarily as a result of weakness in the U.S. economy. Continued declines in industrial production and retail sales have reduced overall demand in the U.S. small package market, resulting in decreased package volume in our domestic package operations. The Next Day Air volume decline of 0.3% and Deferred air volume increase of only 0.1% (declines of 0.5% and 0.4%, respectively, year-to-date) were also impacted by the economic recession. The decline in air volume was partially mitigated by market share gains, as a result of the recent departure of a competitor in the U.S. market.

The decrease in overall revenue per piece of 7.8% resulted primarily from lower fuel surcharge rates, lower package weights, and unfavorable shifts in product mix. Next Day Air and Deferred revenue per piece decreased 20.0% and 17.5%, respectively (16.9% and 14.6%, respectively, year-to-date), and were negatively affected by an approximate 24% decline in the fuel surcharge rate for air products (discussed further below). Additionally, the revenue per piece decline for our air products was impacted by lower average package weights and a mix shift toward lower yielding products, reflecting the economic recession in the United States. Ground revenue per piece decreased 3.5% (2.4% year-to-date), primarily due to a lower fuel surcharge rate. The factors decreasing revenue per piece for our ground and air products were partially offset by an increase in base rates that took effect during the first quarter.

In October 2008, we announced a base rate increase and a change in the fuel surcharge that took effect on January 5, 2009. We increased the base rates 6.9% on UPS Next Day Air, UPS 2nd Day Air, and UPS 3 Day Select, and 5.9% on UPS Ground. Other pricing changes included a \$0.10 increase in the residential surcharge, and an increase of \$0.10 in the delivery area surcharge on both residential and commercial services to certain ZIP codes. These rate changes are customary and occur on an annual basis.

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We also modified the fuel surcharge on domestic air services by reducing the index used to determine the fuel surcharge by 2%. This fuel surcharge continues to be based on the U.S. Energy Department's Gulf Coast spot price for a gallon of kerosene-type jet fuel. Based on published rates, the average fuel surcharge on domestic air products was 0.34% in the second quarter of 2009, a decrease from the 24.27% in the second quarter of 2008, due to the significant decrease in jet fuel prices, in addition to the 2% reduction in the index. On a year-to-date basis, the average fuel surcharge on domestic air products declined to 2.00% in 2009 from 21.55% in 2008. The ground fuel surcharge rate continues to fluctuate based on the U.S. Energy Department's On-Highway Diesel Fuel Price. Based on published rates, the average fuel surcharge on domestic ground products decreased to 2.51% in the second quarter of 2009 from 7.48% in the second quarter of 2008, due to significantly lower diesel fuel prices. On a year-to-date basis, the average fuel surcharge on domestic ground products decreased to 3.04% in 2009 from 6.82% in 2008. Total domestic fuel surcharge revenue, net of the impact of hedging, decreased by \$512 million in the second quarter of 2009 compared with the same period of 2008 (\$775 million year-to-date), primarily due to the lower fuel surcharge rates discussed above, as well as the decline in volume for our air and ground products.

U.S. Domestic Package operating profit decreased \$423 million, or 47.1%, in the second quarter of 2009 compared with the same period in 2008 (\$998 million, or 53.7%, year-to-date). Operating profit in 2009 was adversely impacted by the U.S. economic recession, decreased network efficiencies due to the decline in volume, changes in package characteristics, and a shift in product mix away from our premium services. Additionally, year-to-date operating profit was adversely impacted by a \$181 million impairment charge on our McDonnell-Douglas DC-8-71 and DC-8-73 aircraft fleets in the first quarter of 2009 (discussed further in the Operating Expenses section).

International Package Operations

International Package revenue declined \$702 million, or 23.8%, for the quarter (\$1.221 billion, or 21.4%, year-to-date), primarily as a result of a 5.5% decline in package volume and a 17.6% decrease in total revenue per piece (3.3% and 16.5%, respectively, year-to-date).

Export volume declined 7.3% for the quarter (4.6% year-to-date), primarily due to weakness in the Asia and U.S. export lanes, as the worldwide economic recession and slowdown in world trade more than offset market share gains. Transborder export volume was relatively stronger within the European Union and North American trade areas. Non-U.S. domestic volume decreased 4.3% for the quarter (2.3% year-to-date). Both export and non-U.S. domestic package volume were adversely affected by the timing of the Easter holiday.

Overall revenue per piece decreased 17.6% for the quarter (16.5% year-to-date), primarily as a result of foreign currency exchange rate movements, decreased fuel surcharge rates, and shifts in product mix. Export revenue per piece decreased 15.7% for the quarter (14.8% year-to-date), largely due to the adverse impact of currency exchange rates, lower fuel surcharge rates, and the relatively stronger volume performance of lower revenue per piece transborder products, but was partially offset by base rate increases that took effect in the first quarter of 2009. Domestic revenue per piece decreased 19.7% for the quarter (19.3% year-to-date), and was primarily caused by adverse currency exchange rate fluctuations (currency-adjusted domestic revenue per piece only declined 4.4% for the quarter), as well as the impact of lower fuel surcharge rates. Total average revenue per piece decreased 11.4% for the quarter on a currency-adjusted basis (10.5% year-to-date), and the overall quarterly change in segment revenue was negatively affected by \$193 million due to currency fluctuations, net of hedging activity (\$365 million year-to-date).

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On January 5, 2009, we increased the base rates 6.9% for international shipments originating in the United States (Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard service). Rate changes for shipments originating outside the U.S. are made throughout the year and vary by geographic market.

Additionally, we modified the fuel surcharge on certain U.S.-related international air services by reducing the index used to determine the fuel surcharge by 2%. The fuel surcharge for products originating outside the United States continues to be indexed to fuel prices in our different international regions, depending upon where the shipment takes place. Total international fuel surcharge revenue decreased by \$250 million in the second quarter (\$390 million year-to-date), due to lower fuel surcharge rates caused by decreased fuel prices as well as a decrease in international air volume.

International Package operating profit decreased \$114 million, or 28.0%, in the second quarter of 2009 compared with the same period of 2008 (\$241 million, or 29.1%, year-to-date). The decline in operating profit was affected by decreased network efficiencies resulting from volume declines, a shift in product mix away from our premium services, and volume declines in some of the longer export trade lanes. The change in operating profit was negatively affected by \$10 million during the quarter due to currency exchange rate fluctuations, net of hedging activity (positively affected by \$2 million year-to-date).

Supply Chain & Freight Operations

Supply Chain & Freight revenue decreased \$545 million, or 23.3%, for the quarter (\$977 million, or 21.6%, year-to-date). Forwarding and logistics revenue decreased \$452 million, or 27.6%, for the quarter (\$818 million, or 25.6%, year-to-date), and was impacted by weakness in demand for freight forwarding due to global economic weakness and declines in international trade. Forwarding revenue declined in all major transportation modes, including domestic and international air freight and ocean freight, and was impacted by lower volumes, lower fuel surcharges, and lower security and other accessorial charges. Additionally, the overall change in forwarding and logistics revenue was negatively affected by \$53 million during the quarter (\$126 million year-to-date) due to the strengthening of the U.S. Dollar against foreign currencies.

UPS Freight revenue declined \$89 million, or 14.9%, for the quarter (\$148 million, or 13.3%, year-to-date), primarily due to lower fuel surcharge rates and a decline in average daily LTL shipments. Total LTL weight per shipment declined 4.9% for the quarter and year-to-date periods, reflecting the weak LTL market and the ongoing economic recession in the United States in 2009. Average LTL shipments per day also declined 1.9% for the quarter (1.3% year-to-date), as market share gains were more than offset by the impact of the weak economy.

LTL revenue per hundredweight decreased 10.4% for the quarter (8.3% year-to-date), primarily as a result of the lower fuel surcharge rates, as total fuel surcharge revenue declined \$70 million for the quarter (\$113 million year-to-date) primarily resulting from lower diesel fuel prices. However, this decline was partially offset by an increase in base prices that took effect in the first quarter of 2009. On January 5, 2009, UPS Freight increased minimum charge, LTL, and TL rates an average of 5.9%, covering non-contractual shipments in the United States and Canada.

The other businesses within Supply Chain & Freight, which include our retail franchising business and our financial business, experienced a decline in revenue of 3.7% during the quarter (5.2% year-to-date). This decline in revenue was primarily in our financial business, and was impacted by lower interest rates and decreased loan volume.

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Operating profit for the Supply Chain & Freight segment decreased by \$22 million, or 14.9%, for the quarter (\$95 million, or 36.4%, year-to-date), primarily due to lower operating profit in the forwarding and logistics business and our UPS Freight unit. The lower operating profit in the forwarding and logistics business was impacted by the weak demand for forwarding services. However, the operating margin in this business experienced only a small decline as costs were reduced commensurate with the decline in revenues. Our UPS Freight unit experienced breakeven results for the second quarter, but operating losses in the year-to-date period. The decline in operating profits for these two businesses were partially offset by a net increase in combined operating income for all of our other businesses in this segment. This net increase was primarily driven by a gain on sale of substantially all of our international Mail Boxes Etc operations during the quarter. The change in operating profit for the segment was also negatively affected by \$4 million in the quarter (\$12 million year-to-date) due to the strengthening of the U.S. Dollar against foreign currencies.

Operating Expenses

Consolidated operating expenses decreased by \$1.613 billion, or 14.0%, for the quarter (\$2.575 billion, or \$11.3%, year-to-date), of which approximately \$232 million (\$481 million year-to-date) was due to currency fluctuations in our International Package and Supply Chain & Freight segments.

Compensation and benefits expense decreased by \$192 million, or 2.9%, for the quarter (\$360 million, or 2.8%, year-to-date), and was impacted by several items. A large component of this decrease was related to employee payroll costs, as union labor hours declined approximately 7% as a result of lower U.S. Domestic Package volume, and management payroll declined as a result of a reduction in the total number of management employees through attrition combined with a wage freeze. Benefits expense increased slightly due to higher employee health and welfare program costs, which were impacted by higher union contribution rates, and increased pension expense. Pension expense increases resulted from higher union contribution rates for multiemployer pension plans, combined with increased interest costs, a decrease in our expected return on plan assets and the amortization of actuarial losses for company-sponsored plans (see Note 6) to the unaudited consolidated financial statements. The increase in interest costs was impacted by changes in discount rates, while the decrease in expected return on plan assets and the actuarial losses were primarily due to the negative asset returns experienced in 2008.

The expense associated with our self-insurance accruals for workers' compensation claims was \$13 million less than the second quarter of 2008 (\$36 million less year-to-date). Insurance reserves are established for estimates of the loss that we will ultimately incur on reported claims, as well as estimates of claims that have been incurred but not yet reported. Recorded balances are based on reserve levels, which incorporate historical loss experience and judgments about the present and expected levels of cost per claim. The lower expense reflects reduced labor hours combined with favorable claims experience, which results from a strong internal safety program, including initiatives to decrease accident frequencies and continuous improvement in claims management.

Repairs and maintenance expense declined \$30 million, or 9.9%, for the quarter (\$52 million, or 8.7%, year-to-date), largely due to reduced vehicle maintenance expense resulting from a reduction in miles driven. Depreciation and amortization expense decreased \$26 million, or 5.8%, for the quarter (\$48 million, or 5.3%, year-to-date), and was influenced by several factors, including lower depreciation expense on equipment and facilities, as certain assets became fully depreciated, as well as lower software amortization resulting from fewer new capitalized software projects. This was partially offset by higher depreciation expense on aircraft and vehicles resulting from new deliveries. The \$491 million, or 29.2%, quarterly decrease in purchased transportation (\$874 million, or 26.7%, year-to-date) was driven by a combination of lower volume in our

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international package and forwarding businesses, the impact of currency exchange rates, and decreased fuel surcharge rates charged to us by third-party carriers. The \$628 million, or 53.8%, quarterly decrease in fuel expense (\$1.082 billion, or 51.1%, year-to-date) was impacted by significantly lower prices for jet-A fuel, diesel, and unleaded gasoline, as well as lower usage of these products in our operations. Other occupancy expense decreased by \$19 million, or 7.8% (\$27 million, or 5.2%, year-to-date), for the quarter and was influenced by lower electricity and natural gas costs, as well as lower rent expense.

Other operating expenses declined \$227 million, or 19.2%, in the second quarter of 2009 compared with the same period of 2008 (\$132 million, or 5.8%, year-to-date). The decline for the quarter and year-to-date periods was partially due to certain variable costs that declined as a result of lower package volume, such as the expense associated with customer claims for lost or damaged packages, rent expense for transportation equipment, cargo handling costs, and aircraft landing fees. Additionally, certain other costs declined primarily as a result of cost containment programs, such as employee expense reimbursements, office supplies, professional services, and advertising costs.

The \$132 million, or 5.8%, year-to-date decline in other operating expenses was partially offset by a \$181 million impairment charge on certain of our aircraft. We continually monitor our aircraft fleet utilization in light of current and projected volume levels, aircraft fuel prices, and other factors. In 2008, we had announced that we were in negotiations with DHL to provide air transportation services for all of DHL's express, deferred and international package volume within the United States, as well as air transportation services between the United States, Canada and Mexico. In early April 2009, UPS and DHL mutually agreed to terminate further discussions on providing these services. Additionally, our U.S. Domestic Package air delivery volume has declined since the first quarter of 2008 as a result of persistent economic weakness and shifts in product mix from our premium air services to our lower cost ground services. As a result of these factors, the utilization of certain aircraft fleet types has declined and is expected to be lower in the future.

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

Investment Income and Interest Expense

In the second quarter of 2009, we recorded an investment loss of \$22 million, compared with the investment income of \$14 million in the second quarter of 2008 (\$9 million loss year-to-date in 2009, compared to year-to-date income of \$71 million in 2008). This decline in investment income was partially due to a \$17 million impairment charge on certain preferred equity and auction rate securities. The remainder of the decline was largely due to a lower average balance of interest-earning investments, a significantly lower yield earned on our invested assets as a result of declines in short-term interest rates in the United States, and a loss on the fair value adjustments of certain real estate investment partnerships.

During the second quarter of 2009, we recorded impairment losses on certain perpetual preferred securities, and an auction rate security collateralized by preferred securities, issued by large financial institutions. The impairment charge results from conversion offers from the issuers of these securities at prices well below the

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stated redemption value of the preferred shares. These securities, which had a cost basis of \$42 million, were written down to their fair value of \$25 million as of June 30, 2009, as an other-than-temporary impairment. The \$17 million total impairment charge during the quarter was recorded in investment income (loss) on the income statement.

For the remaining auction rate securities, and equity and debt securities, we have concluded that no additional other-than-temporary impairment losses existed as of June 30, 2009. In making this determination, we considered the financial condition and prospects of the issuer, the magnitude of the losses in market value compared with the investments' cost, the length of time the investments have been in an unrealized loss position, the probability that we will be unable to collect all amounts due according to the contractual terms of the security, the credit rating of the security, and our ability and intent to hold these investments until the anticipated recovery in market value or maturity occurs.

The \$77 million, or 74.0%, increase in interest expense during the quarter was primarily due to a \$77 million non-cash, pre-tax currency remeasurement charge on certain long-term foreign currency denominated obligations. On a year-to-date basis, interest expense increased \$25 million, or 10.5%, due to the \$77 million currency remeasurement charge, which was partially offset by a lower average debt balance and a lower average interest rate incurred on our variable rate debt and interest rate swap agreements as a result of recent declines in short-term interest rates in the United States.

Income Tax Expense

Income tax expense declined by \$244 million, or 49.7%, for the quarter (\$506 million, or 50.5%, year-to-date), primarily due to lower pre-tax income. For the year-to-date 2009 period, our effective tax rate increased to 36.9% compared with 36.0% in the comparable period of 2008, due to an increase in our first quarter 2009 income tax provision as a result of providing a valuation allowance of \$14 million against certain deferred tax assets in our International Package business.

Net Income and Earnings Per Share

Net income for the second quarter of 2009 was \$445 million, a 49.0% decrease from the \$873 million earned in the second quarter of 2008, resulting in a 48.2% decrease in diluted earnings per share to \$0.44 in 2009 from \$0.85 in the second quarter of 2008. Net income for the year-to-date period of 2009 was \$846 million, a 52.4% decrease from the \$1.779 billion recorded in the comparable period of 2008, resulting in a 51.2% decrease in diluted earnings per share to \$0.84 in 2009 from the \$1.72 earned in the comparable period of 2008. The decline in net income for the quarter and year-to-date periods was primarily caused by the decline in operating profits in all three of our business segments, as previously discussed. Additionally, second quarter and year-to-date 2009 net income was reduced by \$48 million due to the after-tax effects of the currency remeasurement charge discussed previously. Year-to-date 2009 net income was also reduced by \$116 million due to the aircraft impairment charge discussed previously. These two charges reduced second quarter and year-to-date diluted earnings per share by \$0.05 and \$0.17, respectively. Earnings per share in the second quarter and year-to-date periods of 2009 was favorably impacted by a reduction in the weighted average shares outstanding of 2.3% and 3.0%, respectively, compared to the same periods of 2008, as a result of our ongoing share repurchase program.

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Liquidity and Capital Resources

Net Cash From Operating Activities

Net cash provided by operating activities decreased to \$3.155 billion in the first six months of 2009 from \$5.028 billion during the same period of 2008. The decrease in operating cash flow was impacted by approximately \$1.035 billion in cash tax benefits received in 2008 (including an \$850 million tax refund) resulting from a U.S. Federal tax deduction for the payment made to withdraw from the Central States Pension Fund in 2007. The absence of these tax benefits in 2009 adversely affected the comparison with 2008. Operating cash flow also decreased as a result of lower net income in 2009 compared with 2008.

Partially offsetting these factors were changes in our working capital position, as the collection of accounts receivable had a larger impact in the first six months of 2009 compared with the same period in 2008. Accounts receivable normally declines in the first half of each year, due to the collection of receivables generated in the seasonally strong fourth quarter, however the decline was larger in the first half of 2009 as a result of the decrease in revenue among all three of our business segments.

The contributions to our company-sponsored pension plans are expected to increase significantly in 2009, compared with 2008, primarily as a result of required minimum pension fundings for the UPS-IBT Pension Plan. As discussed in Note 6 to the unaudited consolidated financial statements, we expect to contribute \$682 million and \$47 million over the remainder of the year to our company-sponsored pension and postretirement medical benefit plans, respectively.

Net Cash Used In Investing Activities

Net cash used in investing activities decreased to \$415 million in the first six months of 2009 from \$1.939 billion during the same period of 2008. In the first six months of 2009, we had net sales of \$2 million of marketable securities, compared with \$275 million of net purchases in the comparable period of 2008, as a result of the timing of debt issuances and repayments, income tax refunds, and certain other cash receipts and disbursements.

We had capital expenditures of \$671 million in the first six months of 2009, a decrease from the \$1.387 billion in the same period of 2008. We fund our capital expenditures with our cash from operations. We have commitments for the purchase of aircraft, vehicles, technology equipment and other fixed assets to provide for the replacement of existing capacity and anticipated future growth. Capital expenditures on aircraft declined primarily as a result of fewer deliveries of new aircraft, as we took delivery of one Boeing 747-400 in the first six months of 2009, compared with five Boeing 747-400 deliveries in 2008. Vehicle deliveries and spending on information technology also declined, as a result of reduced investment needs and initiatives to reduce our capital spending. Capital expenditures on facilities and equipment decreased in 2009, primarily resulting from the completion of work on portions of our Worldport hub expansion.

Other investing activities reflected a cash inflow of \$82 million in the first six months of 2009 as compared with a \$282 million outflow in the same period of 2008, largely due to cash settlements of derivative contracts used in our energy and currency hedging programs, as well as the timing of aircraft purchase contract deposits on our Boeing 767-300 and Boeing 747-400 aircraft orders.

Net Cash Used In Financing Activities

Net cash used in financing activities decreased to \$435 million in the first six months of 2009 from \$3.986 billion during the same period in 2008. Our primary use of cash in financing activities is to repurchase shares, pay dividends, and repay debt obligations.

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We had net issuances of debt of \$903 million in the first six months of 2009, compared with net repayments of debt of \$170 million in the first six months of 2008. Issuances of debt in each period consisted primarily of commercial paper and offerings of fixed rate senior notes. Repayments of debt consisted primarily of paydowns of commercial paper, scheduled principal payments on our capitalized lease obligations and early redemptions of certain tranches of UPS Notes. We consider the overall fixed and floating interest rate mix of our portfolio and the related overall cost of borrowing when planning for future issuances and non-scheduled repayments of debt.

In March 2009, we completed an offering of \$1.0 billion of 3.875% senior notes due April 2014 and \$1.0 billion of 5.125% senior notes due April 2019. These notes pay interest semiannually, and we may redeem the notes at any time by paying the greater of the principal amount or a make-whole amount, plus accrued interest. After pricing and underwriting discounts, we received a total of \$1.989 billion in cash proceeds from the offering. The proceeds from the offering are being used for general corporate purposes, including the reduction of our outstanding commercial paper balance.

In January 2008, we completed an offering of \$1.750 billion of 4.50% senior notes due January 2013, \$750 million of 5.50% senior notes due January 2018, and \$1.500 billion of 6.20% senior notes due January 2038. After pricing and underwriting discounts, we received a total of \$3.961 billion in cash proceeds from the offering. Our debt balance increased at the end of 2007 as a result of commercial paper issuances used to fund our withdrawal from the Central States Pension Fund. In the first six months of 2008, we repaid most of this commercial paper with the proceeds from the senior notes offering, as well as the \$850 million U.S. federal tax refund received.

As a result of the uncertain economic environment, we have slowed our share repurchase activity. We currently intend to repurchase shares in 2009 at a rate that should approximately offset the dilution from our stock compensation programs. We repurchased a total of 5.1 million shares of Class A and Class B common stock for \$248 million for the first six months of 2009, compared with repurchases of 35.7 million shares for \$2.486 billion for the comparable period of 2008 (\$247 million and \$2.294 billion are reported on the cash flow statement for 2009 and 2008, respectively, due to the timing of settlements). As of June 30, 2009, we had \$6.324 billion of our share repurchase authorization remaining.

The declaration of dividends is subject to the discretion of the Board of Directors and will depend on various factors, including our net income, financial condition, cash requirements, future prospects, and other relevant factors. We maintained our quarterly cash dividend payment at \$0.45 per share in 2009, consistent with the rate in 2008. We expect to continue the practice of paying regular cash dividends.

Our total cash dividends paid for the first six months of 2009 declined to \$876 million from \$1.337 billion in 2008. This decline was primarily a result of three dividend payments being made in the first six months of 2008, compared with only two dividend payments being made in the first six months of 2009, due to a change in our dividend payment schedule. We also had a reduction in the number of outstanding shares on which dividends are paid, as a result of our share repurchase program.

The cash outflows in other financing activities primarily relate to hedging activities. In conjunction with the senior fixed rate debt offerings in the first quarter of 2009 and 2008, we settled several interest rate derivatives that were designated as hedges of these debt offerings, which resulted in cash outflows of \$243 and \$84 million in 2009 and 2008, respectively. In the second quarter of 2008, we entered into a forward purchase agreement for UPS Class B shares for \$220 million, which was completed on July 31, 2008. A total of 3.6 million shares were repurchased under this agreement, approximately 0.8 million of which were in the second quarter of 2008. The cash outflow for the forward purchase agreement that had not been used on share repurchases as of June 30, 2008 (approximately \$167 million) was reported in other financing activities on the cash flow statement.

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Sources of Credit

We are authorized to borrow up to \$10.0 billion under our U.S. commercial paper program. We had \$1.878 billion outstanding under this program as of June 30, 2009, with an average interest rate of 0.21%. All of this commercial paper was classified as a current liability as of June 30, 2009. At December 31, 2008, we classified \$1.0 billion of our commercial paper as long-term debt on our balance sheet, based on our intent and ability to refinance this debt on a long-term basis in the future. We also maintain a European commercial paper program under which we are authorized to borrow up to 1.0 billion in a variety of currencies, however no amounts were outstanding under this program as of June 30, 2009.

We maintain two credit agreements with a consortium of banks. One of these agreements provides revolving credit facilities of \$3.0 billion, and expires on April 15, 2010. Interest on any amounts we borrow under this facility would be charged at 90-day LIBOR plus a percentage determined by quotations from Markit Group Ltd. for our 1-year credit default swap spread, subject to certain minimum rates and maximum rates based on our public debt ratings from Standard & Poor's and Moody's. If our public debt ratings are A / A2 or above, the minimum applicable margin is 1.00% and the maximum applicable margin is 2.00%; if our public debt ratings are lower than A / A2, the minimum applicable margin is 1.50% and the maximum applicable margin is 3.00%.

The second agreement provides revolving credit facilities of \$1.0 billion, and expires on April 19, 2012. Interest on any amounts we borrow under this facility would be charged at 90-day LIBOR plus 15 basis points. At June 30, 2009, there were no outstanding borrowings under either of these facilities.

In addition to these credit facilities, we have an automatically effective registration statement on Form S-3 filed with the SEC that is available for registered offerings of short or long-term debt securities.

Our Moody's and Standard & Poor's short-term credit ratings are P-1 and A-1+, respectively. Our Moody's and Standard & Poor's long-term credit ratings are Aa3 and AA-, respectively. We have a stable outlook from both of these credit rating agencies.

Our existing debt instruments and credit facilities do not have cross-default or ratings triggers, however these debt instruments and credit facilities do subject us to certain financial covenants. As of June 30, 2009 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, 2009, 10% of net tangible assets is equivalent to \$2.289 billion, however we have no covered sale-leaseback transactions or secured indebtedness outstanding. Additionally, we are required to maintain a minimum net worth, as defined, of \$5.0 billion on a quarterly basis. As of June 30, 2009, our net worth, as defined, was equivalent to \$12.421 billion. We do not expect these covenants to have a material impact on our financial condition or liquidity.

Except as described in this quarterly report, the nature and amounts of our payment obligations under our debt, capital and operating lease agreements, purchase commitments, and other liabilities as of June 30, 2009 have not materially changed from those at December 31, 2008, as described in our Annual Report on Form 10-K for the year ended December 31, 2008.

Contingencies

We are a defendant in a number of lawsuits filed in state and federal courts containing various class-action allegations under state wage-and-hour laws. In one of these cases, Marlo v. UPS, which was certified as a class action in a California federal court in June 2004, plaintiffs allege that they improperly were denied overtime, and

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seek penalties for missed meal and rest periods, and interest and attorneys' fees. Plaintiffs purport to represent a class of 1,300 full-time supervisors. In August 2005, the court granted summary judgment in favor of UPS on all claims, and plaintiffs appealed the ruling. In October 2007, the appeals court reversed the lower court's ruling. In April 2008, the Court decertified the class and vacated the trial scheduled for April 29, 2008. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

In another case, *Hohider v. UPS*, which in July 2007 was certified as a class action in a Pennsylvania federal court, plaintiffs have challenged certain aspects of the Company's interactive process for assessing requests for reasonable accommodation under the Americans with Disabilities Act. Plaintiffs purport to represent a class of over 35,000 current and former employees, and seek back-pay, and compensatory and punitive damages, as well as attorneys' fees. In August 2007, the Third Circuit Court of Appeals granted our petition to hear the appeal of the trial court's certification order. In July 2009, the Third Circuit issued its decision decertifying the class and remanding the case to the trial court for further proceedings. We have denied any liability with respect to these claims and intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from this matter or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

UPS and Mail Boxes Etc., Inc. are defendants in various lawsuits brought by franchisees who operate Mail Boxes Etc. centers and The UPS Store locations. These lawsuits relate to the rebranding of Mail Boxes Etc. centers to The UPS Store, The UPS Store business model, the representations made in connection with the rebranding and the sale of The UPS Store franchises, and UPS's sale of services in the franchisees territories. In one of the actions, which is pending in California state court, the court recently certified a class consisting of all Mail Boxes Etc. branded stores that rebranded to The UPS Store in March 2003. We have denied any liability with respect to these claims and intend to defend ourselves vigorously. At this time, we have not determined the amount of any liability that may result from these matters or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

In January 2008, a class action complaint was filed in the United States District Court for the Eastern District of New York alleging price-fixing activities relating to the provision of freight forwarding services. UPS was not named in this case. On July 21, 2009, the plaintiffs filed a first amended complaint naming numerous global freight forwarders as defendants. UPS and UPS Supply Chain Solutions are among the 60 defendants named in the amended complaint. We intend to vigorously defend ourselves in this case. At this time, we have not determined the amount of any liability that may result from these matters or whether such liability, if any, would have a material adverse effect on our financial condition, results of operations, or liquidity.

We are a defendant in various other lawsuits that arose in the normal course of business. We believe that the eventual resolution of these cases will not have a material adverse effect on our financial condition, results of operations, or liquidity.

We file income tax returns in the U.S. federal jurisdiction, most U.S. state and local jurisdictions, and many non-U.S. jurisdictions. As of June 30, 2009, we had substantially resolved all U.S. federal income tax matters for tax years prior to 2003. During the second quarter of 2009, we resolved tax years 1999 through 2002 with the Internal Revenue Service (IRS) Appeals Office. In July 2008, the IRS completed its audit of the tax years 2003 through 2004, with only a limited number of issues that will be considered by the IRS Appeals Office by the end of 2009. In late 2008, the IRS began the initial planning phase of the income tax audit for tax years 2005 through

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2007. Along with this audit for tax years 2005 through 2007, the IRS is currently examining non-income based taxes, including employment taxes and excise taxes on transportation of property by air and fuel purchases, which could lead to proposed assessments. The IRS has not presented an official position with regard to these taxes at this time, and therefore we are not able to determine the technical merit of any potential assessment; however, we do not believe that the resolution of this matter would have a material adverse effect on our financial condition, results of operations, or liquidity. Certain foreign jurisdictions are reviewing transfer pricing transactions between U.S. and related foreign companies. The Italian Guardia di Finanza, under the authority of the Minister of Economy and Finance, has challenged whether a UPS entity has a permanent establishment in Italy beginning with tax year 2005. No final report or assessment has been issued. We disagree with the basis for these challenges and intend to defend our position vigorously. However, it is reasonably possible that the amount of unrecognized tax benefits could change within the next 12 months as we continue to pursue resolution of this matter with the Italian authorities. At this time, we do not expect this matter to have a material adverse effect on our financial condition, results of operations, or liquidity. With few exceptions, we are no longer subject to U.S. state and local and non-U.S. income tax examinations by tax authorities for tax years prior to 1999, but certain U.S. state and local matters are subject to ongoing litigation.

As of December 31, 2008, we had approximately 260,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters (Teamsters). In September 2007, we reached a new national master agreement with the Teamsters, which was ratified in December 2007. The new agreement provides for wage increases as well as contributions to healthcare and pension plans, and most economic provisions of the new five year agreement took effect on August 1, 2008, with the exception of our withdrawal from the Central States Pension Fund which occurred in 2007. We have approximately 2,900 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association, which becomes amendable at the end of 2011. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which became amendable in November 2006. We began formal negotiations with Teamsters Local 2727 in October 2006. In addition, the majority (approximately 3,000) 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). In June of 2009, we reached a new agreement with the IAM, which was subsequently ratified in July 2009. The new agreement runs through July 31, 2014.

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

Other Matters

We received grand jury subpoenas from the Antitrust Division of the U.S. Department of Justice (DOJ) regarding the DOJ's investigations into certain pricing practices in the air cargo industry in July 2006, and into certain pricing practices in the freight forwarding industry in December 2007. In October 2007, June 2008, and February 2009, we received information requests from the European Commission relating to its investigation of certain pricing practices in the freight forwarding industry. We also received and responded to related information requests from competition authorities in other jurisdictions. We are cooperating with these inquiries.

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

Recent Accounting Pronouncements

Adoption of New Accounting Standards

The disclosure requirements of Statement No. 157 Fair Value Measurements (FAS 157), which took effect on January 1, 2008, are presented in Note 12 to the unaudited consolidated financial statements. On January 1, 2009, we implemented the previously deferred provisions of FAS 157 for nonfinancial assets and liabilities recorded at fair value, as required.

The disclosure requirements of Statement No. 161 Disclosures about Derivative Instruments and Hedging Activities (FAS 161), which took effect on January 1, 2009, are presented in Note 14 to the unaudited consolidated financial statements.

The accounting requirements of Statement No. 141(R) Business Combinations (FAS 141(R)), which took effect on January 1, 2009, were adopted but had no impact on our financial statements.

The accounting and presentation requirements of Statement No. 160 Noncontrolling Interests in Consolidated Financial Statements an amendment of Accounting Research Bulletin No. 51 (FAS 160), which took effect on January 1, 2009, had an immaterial impact on the financial statements.

The disclosure requirements of FASB Staff Position (FSP) FAS 107-1 and APB 28-1 Interim Disclosures about Fair Value of Financial Instruments are presented in Note 12 to the unaudited consolidated financial statements.

The accounting requirements of FSP 157-4 Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly (FSP 157-4), which took effect on April 1, 2009, were adopted but had an immaterial impact on our financial statements. The disclosure requirements of FSP 157-4 are presented in Note 4 and Note 12 to the unaudited consolidated financial statements.

Standards Issued But Not Yet Effective

In June 2009, the FASB issued Statement No. 168, The FASB Accounting Standards Codification (Codification) and the Hierarchy of GAAP (FAS No. 168), which replaces Statement No. 162, The Hierarchy of GAAP and establishes the Codification as the single source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. SEC rules and interpretive releases are also sources of authoritative GAAP for SEC registrants. FAS 168 modifies the GAAP hierarchy to include only two levels of GAAP: authoritative and nonauthoritative. FAS 168 is effective beginning for periods ended after September 15, 2009. As FAS 168 is not intended to change or alter existing GAAP, it will not impact our results of operations, cash flows or financial position. We will adjust historical GAAP references in our third quarter 2009 Form 10-Q to reflect accounting guidance references included in the codification.

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In December 2008, the FASB issued FSP FAS 132(R)-1, Employers' Disclosures about Postretirement Benefit Plan Assets. This FSP amends Statement No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits, to provide guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan, investment policies and strategies, major categories of plan assets, inputs and valuation techniques used to measure the fair value of plan assets and significant concentrations of risk within plan assets. This FSP will be effective for fiscal years ending after December 15, 2009, with earlier application permitted. Upon initial application, the provisions of this FSP are not required for earlier periods that are presented for comparative purposes.

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Other new pronouncements issued but not effective until after June 30, 2009, are not expected to have a significant effect on our consolidated financial position or results of operations.

Forward-Looking Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this report contain forward-looking statements about matters that inherently are difficult to predict. The words believes, expects, anticipates, and similar expressions are intended to identify forward-looking statements. These statements include statements regarding our intent, belief and current expectations about our strategic direction, prospects and future results. We have described some of the important factors that affect these statements as we discussed each subject. Forward-looking statements involve risks and uncertainties, and certain factors may cause actual results to differ materially from those contained in the forward-looking statements. Some of the factors that could cause our actual results to differ materially from the expected results are described in our Annual Report on Form 10-K for the year ended December 31, 2008.

Table of Contents**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, 2009	December 31, 2008
Energy Derivatives	\$	\$
Currency Derivatives	88	241
Interest Rate Derivatives	18	(388)
	\$ 106	\$ (147)

Other than noted below, our market risks, hedging strategies, and financial instrument positions at June 30, 2009 have not materially changed from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008. In the first quarter of 2009, we settled several interest rate hedges in conjunction with issuing five and ten year notes and made a cash payment of \$243 million. In the second quarter of 2009, we entered into interest rate swap agreements for a notional amount of \$2.250 billion that effectively converted the fixed interest rate on the associated debt instruments to a variable interest rate. The potential change in annual interest expense resulting from a hypothetical 100 basis point change in short-term interest rates applied to our floating rate debt (including commercial paper) and swap instruments as of June 30, 2009 would be approximately \$49 million. The market risk sensitivities of the currency derivative contracts noted above are not materially different from the amounts described in our Annual Report on Form 10-K for the year ended December 31, 2008.

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 do not expect to incur 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 47-48 of our consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2008, is hereby incorporated by reference in this Quarterly Report on Form 10-Q.

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, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

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

Item 1A. Risk Factors

There have been no material changes to the risk factors described in Part 1, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2008.

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 2009 is as follows (in millions, except per share amounts):

		Total Number of Shares Purchased(1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program
April 1	April 30, 2009	0.9	\$ 52.95	0.9	\$ 6,413
May 1	May 31, 2009	0.9	53.14	0.8	6,368
June 1	June 30, 2009	0.9	49.47	0.9	6,324
Total	April 1 - June 30, 2009	2.7	\$ 51.83	2.6	

(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.

In January 2008, we announced a new financial policy regarding our capital structure to enhance shareowner value. We intend to manage our balance sheet to a target debt ratio of approximately 50%-60% funds from operations to total debt. In connection with this policy, the Board of Directors authorized an increase in our share repurchase authorization to \$10.0 billion. Share repurchases may take the form of accelerated share repurchases, open market purchases, or other such methods as we deem appropriate. The timing of our share repurchases will depend upon market conditions. Unless terminated earlier by the resolution of our Board, the program will expire when we have purchased all shares authorized for repurchase under the program.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

Our annual meeting of shareowners was held on May 7, 2009.

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Proxies for the meeting were solicited pursuant to Regulation 14A under the Securities Exchange Act of 1934. There was no solicitation in opposition to management's nominees for director as listed in Item No. 1 in the proxy statement, and all of such nominees were elected.

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1. The results of the voting by the shareowners for directors are presented below.

Director		Number of Votes	Percent of Total
F. Duane Ackerman	For	2,401,893,386	94.92%
	Withheld	128,625,414	5.08%
Michael J. Burns		2,435,841,055	96.26%
	For		
	Withheld	94,677,745	3.74%
D. Scott Davis	For	2,424,832,196	95.82%
	Withheld	105,686,604	4.18%
Stuart E. Eizenstat	For	2,415,374,504	95.45%
	Withheld	115,144,296	4.55%
Michael L. Eskew	For	2,432,449,198	96.12%
	Withheld	98,069,602	3.88%
William R. Johnson	For	2,416,098,444	95.48%
	Withheld	114,420,356	4.52%
Ann M. Livermore	For	2,414,811,743	95.43%
	Withheld	115,707,057	4.57%
Rudy A. Markham	For	2,428,970,164	95.99%
	Withheld	101,548,636	4.01%
John W. Thompson	For	2,410,912,896	95.27%
	Withheld	119,605,904	4.73%
Carol B. Tomé	For	2,415,599,330	95.46%
	Withheld	114,919,470	4.54%

2. The proposal and the results of the voting by the shareowners for ratification of our appointment of independent registered public accountants are presented below.

		Number of Votes	Percent of Total
To ratify the appointment of Deloitte & Touche LLP, as the independent registered public accountants for the Company for the year ending December 31, 2009	For	2,463,997,254	97.37%
	Against	41,067,096	1.62%
	Abstain	25,454,450	1.01%

3. The proposal and the results of the voting by the shareowners for the approval of the 2009 Omnibus Incentive Compensation Plan are presented below.

		Number of Votes	Percent of Total
To approve the 2009 Omnibus Incentive Compensation Plan	For	2,040,406,067	80.63%
	Against	286,119,087	11.31%
	Abstain	89,301,441	3.53%
	Non-Votes	114,692,205	4.53%

Item 5. Other Information

None.

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Item 6. Exhibits

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

Index to Exhibits:

- 3.1 Form of Restated Certificate of Incorporation of United Parcel Service, Inc. (incorporated by reference to Exhibit 3.2 to Form 10-Q for the Quarter Ended September 30, 2002).
- 3.2 Form of Bylaws of United Parcel Service, Inc. (incorporated by reference to Exhibit 3.1 to Form 8-K, filed on November 12, 2008).
- 4.1 Underwriting agreement relating to 3.875% Senior Notes due April 1, 2014 and 5.125% Senior Notes due April 1, 2019 (incorporated by reference to Exhibit 1.1 to Form 8-K, filed on March 24, 2009).
- 4.2 Form of Note for 3.875% Senior Notes due April 1, 2014 (incorporated by reference to Exhibit 4.1 to Form 8-K, filed on March 24, 2009).
- 4.3 Form of Note for 5.125% Senior Notes due April 1, 2019 (incorporated by reference to Exhibit 4.2 to Form 8-K, filed on March 24, 2009).
- 10.1 Credit Agreement (364-Day Facility) dated April 16, 2009 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Securities Inc. as joint arrangers and book managers, Barclays Bank PLC and BNP Paribas as co-documentation agents, Citibank, N.A. as administrative agent, and JPMorgan Chase Bank, N.A., as syndication agent (incorporated by reference to Exhibit 10.1 to Form 10-Q for the Quarter Ended March 31, 2009).
- 10.2 Credit Agreement (5-Year Facility) dated April 19, 2007 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Securities Inc. as joint arrangers and book managers, Barclays Bank PLC, BNP Paribas, Mellon Bank N.A., and Wells Fargo Bank, N.A. as co-documentation agents, Citibank, N.A. as administrative agent, and JPMorgan Chase Bank, N.A., as syndication agent (incorporated by reference to Exhibit 10.2 to Form 10-Q for the Quarter Ended March 31, 2009).
- 10.3 Form of Restricted Stock Unit Award Agreement for the 2009 Long-Term Incentive Performance (LTIP) Awards (incorporated by reference to Exhibit 10.1 to Form 8-K, filed on February 17, 2009).
- 11 Statement regarding Computation of per Share Earnings (incorporated by reference to Note 13 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, 2009, 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, tagged as blocks of text.

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 7, 2009

By:

/s/ KURT P. KUEHN
Kurt P. Kuehn

Senior Vice President,

Chief Financial Officer and Treasurer

(Duly Authorized Officer and

Principal Accounting Officer)