UNITED PARCEL SERVICE INC
Form 10-Q
November 06, 2009
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United States

Securities and Exchange Commission

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 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)

Delaware	**58-2480149**
(State or Other Jurisdiction of	*(IRS Employer*
Incorporation or Organization)	*Identification No.)*
55 Glenlake Parkway, NE Atlanta, Georgia	**30328**
(Address of Principal Executive Offices)	*(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 þ 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 þ 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 þ 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 þ

There were 286,578,274 Class A shares, and 706,225,998 Class B shares, with a par value of $0.01 per share, outstanding at October 29, 2009.

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UNITED PARCEL SERVICE, INC.

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

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PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

September 30, 2009 (unaudited) and December 31, 2008

(In millions)

	September 30, 2009	December 31, 2008
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 2,242	$ 507
Marketable securities	546	542
Accounts receivable, net	4,851	5,547
Finance receivables, net	305	480
Deferred income tax assets	698	494
Other current assets	924	1,275
Total Current Assets	9,566	8,845
Property, Plant and Equipment, Net	18,092	18,265
Goodwill	2,111	1,986
Intangible Assets, Net	509	511
Non-Current Finance Receivables, Net	362	476
Other Non-Current Assets	1,571	1,796
Total Assets	$ 32,211	$ 31,879
LIABILITIES AND SHAREOWNERS EQUITY		
Current Liabilities:		
Current maturities of long-term debt and commercial paper	$ 1,397	$ 2,074
Accounts payable	1,486	1,855
Accrued wages and withholdings	1,787	1,436
Self-insurance reserves	791	732
Other current liabilities	1,313	1,720
Total Current Liabilities	6,774	7,817
Long-Term Debt	8,908	7,797
Pension and Postretirement Benefit Obligations	6,048	6,323
Deferred Income Tax Liabilities	927	588
Self-Insurance Reserves	1,620	1,710
Other Non-Current Liabilities	888	864
Shareowners Equity:		
Class A common stock (290 and 314 shares issued in 2009 and 2008)	3	3
Class B common stock (705 and 684 shares issued in 2009 and 2008)	7	7
Additional paid-in capital	49	
Retained earnings	12,453	12,412
Accumulated other comprehensive loss	(5,531)	(5,642)
Deferred compensation obligations	108	121

Less: Treasury stock (2 shares in 2009 and 2008)	(108)	(121)
Total Equity for Controlling Interests	6,981	6,780
Noncontrolling Interests	65	
Total Shareowners Equity	7,046	6,780
Total Liabilities and Shareowners Equity	$ 32,211	$ 31,879

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED INCOME

(In millions, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Revenue	$ 11,153	$ 13,113	$ 32,920	$ 38,789
Operating Expenses:				
Compensation and benefits	6,341	6,425	19,003	19,447
Repairs and maintenance	265	289	814	890
Depreciation and amortization	441	456	1,297	1,360
Purchased transportation	1,298	1,680	3,698	4,954
Fuel	635	1,209	1,670	3,326
Other occupancy	241	247	738	771
Other expenses	1,003	1,175	3,158	3,462
	10,224	11,481	30,378	34,210
Operating Profit	929	1,632	2,542	4,579
Other Income and (Expense):				
Investment income (loss)	6	(13)	(3)	58
Interest expense	(93)	(104)	(356)	(342)
	(87)	(117)	(359)	(284)
Income Before Income Taxes	842	1,515	2,183	4,295
Income Taxes	293	545	788	1,546
Net Income	$ 549	$ 970	$ 1,395	$ 2,749
Basic Earnings Per Share	$ 0.55	$ 0.96	$ 1.40	$ 2.69
Diluted Earnings Per Share	$ 0.55	$ 0.96	$ 1.39	$ 2.67

STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME

(In millions)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Net income	$ 549	$ 970	$ 1,395	$ 2,749

Change in foreign currency translation adjustment	163	(33)	126	80
Change in unrealized gain (loss) on marketable securities, net of tax	12	(10)	33	(50)
Change in unrealized gain (loss) on cash flow hedges, net of tax	(117)	223	(166)	253
Change in unrecognized pension and postretirement benefit costs, net of tax	39	32	118	98
Comprehensive income	$ 646	$ 1,182	$ 1,506	$ 3,130

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED CASH FLOWS

(In millions)

(unaudited)

	Nine Months Ended September 30, 2009	2008
Cash Flows From Operating Activities:		
Net income	$ 1,395	$ 2,749
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,297	1,360
Pension and postretirement benefit expense	659	542
Pension and postretirement benefit contributions	(758)	(119)
Self-insurance reserves	(31)	(15)
Deferred taxes, credits and other	352	113
Stock compensation expense	312	374
Asset impairment charges	181	
Other (gains) losses	65	581
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	550	51
Other current assets	161	961
Accounts payable	(319)	106
Accrued wages and withholdings	266	355
Other current liabilities	33	(69)
Other operating activities	70	(41)
Net cash from operating activities	4,233	6,948
Cash Flows From Investing Activities:		
Capital expenditures	(1,185)	(2,108)
Proceeds from disposals of property, plant and equipment	40	104
Purchases of marketable securities and short-term investments	(1,866)	(2,514)
Sales and maturities of marketable securities and short-term investments	1,854	2,228
Net (increase) decrease in finance receivables	206	(132)
Other investing activities	72	(271)
Net cash (used in) investing activities	(879)	(2,693)
Cash Flows From Financing Activities:		
Net change in short-term debt	(1,161)	(1,602)
Proceeds from long-term borrowings	3,140	7,189
Repayments of long-term borrowings	(1,753)	(5,582)
Purchases of common stock	(395)	(3,284)
Issuances of common stock	104	135
Dividends	(1,313)	(1,781)
Other financing activities	(283)	(112)
Net cash (used in) financing activities	(1,661)	(5,037)
Effect Of Exchange Rate Changes On Cash And Cash Equivalents	42	(6)

Net Increase (Decrease) In Cash And Cash Equivalents	1,735	(788)
Cash And Cash Equivalents:		
Beginning of period	507	2,027
End of period	$ 2,242	$ 1,239

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. BASIS OF PRESENTATION

Principles of Consolidation

In our opinion, the accompanying interim, unaudited, consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly our financial position as of September 30, 2009, our results of operations for the three and nine months ended September 30, 2009 and 2008, and cash flows for the nine months ended September 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.

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 October 1, 2009 through November 6, 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.

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, the FASB issued Statement No. 168, The FASB Accounting Standards Codification and the Hierarchy of GAAP (FAS 168), which replaces Statement No. 162, The Hierarchy of GAAP and establishes the Accounting Standards Codification (ASC) 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. The codification was developed to organize GAAP pronouncements by topic so that users can more easily access authoritative accounting guidance. FAS 168 became effective for the third quarter of 2009, and all accounting standard references have been updated in this report with ASC references.

Adoption of New Accounting Standards

Certain disclosure requirements of ASC 820, *Fair Value Measurements and Disclosures*, took effect on January 1, 2008 and are presented in Notes 4 and 12. On January 1, 2009, we implemented the previously deferred provisions of ASC 820 for nonfinancial assets and liabilities recorded at fair value.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

The accounting requirements for determining fair value when the volume and level of activity for an asset or liability have significantly decreased, and for identifying transactions that are not orderly, contained in ASC 820 were adopted on April 1, 2009, but had an immaterial impact on our financial statements.

Certain disclosure requirements of ASC 815, *Derivatives and Hedging,* took effect on January 1, 2009 and are presented in Note 14.

The new accounting requirements of ASC 805, *Business Combinations*, which took effect on January 1, 2009, were adopted but had no impact on our financial statements.

The accounting and presentation requirements for noncontrolling interests in ASC 810, *Consolidation*, which took effect on January 1, 2009, had an immaterial impact on the financial statements.

The disclosure requirements of ASC 825, *Financial Instruments,* are presented in Note 12.

Standards Issued But Not Yet Effective

Beginning in the fourth quarter of 2009, provisions of ASC 715, *Compensation-Retirement Benefits,* will be adopted that require 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.

Other new pronouncements issued but not effective until after September 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 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.

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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. 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 September 30, 2009 and 2008 was $93 and $123 million pre-tax, respectively. Compensation expense for share-based awards recognized in net income for the nine months ended September 30, 2009 and 2008 was $312 and $374 million pre-tax, respectively.

NOTE 4. MARKETABLE SECURITIES

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

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
September 30, 2009				
Current marketable securities:				
U.S. government and agency debt securities	$ 129	$ 2	$ 1	$ 130
Mortgage and asset-backed debt securities	151	3	2	152
Corporate debt securities	212	7		219
U.S. state and local municipal debt securities	22			22
Other debt and equity securities	21	2		23
Current marketable securities	535	14	3	546
Non-current marketable securities:				
Asset-backed debt securities	150		41	109
U.S. state and local municipal debt securities	115		24	91
Preferred equity securities	12			12
Common equity securities	18	10		28
Non-current marketable securities	295	10	65	240
Total marketable securities	$ 830	$ 24	$ 68	$ 786

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
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 September 30, 2009, we have investments in auction rate securities with a carrying value of $277 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 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.

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 September 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 have recorded a cumulative after-tax unrealized loss of approximately $41 million ($65 million pre-tax) on these securities as of September 30, 2009 in accumulated other comprehensive income (AOCI), reflecting the decline in the estimated fair value of these securities.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 second quarter was recorded in investment income (loss) on the income statement.

During the third quarter of 2008, we recorded impairment losses on two auction rate securities that were collateralized by preferred stock issued by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). The impairment resulted from actions by the U.S. Treasury Department and the Federal Housing Finance Agency with respect to FNMA and FHLMC. Additionally, we recorded impairment losses on a municipal auction rate security and on holdings of several medium term notes issued by Lehman Brothers Inc., which declared bankruptcy during the third quarter of 2008. The total of these credit-related impairment losses during the quarter was $23 million, which 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 September 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 at September 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	$ 22	$ 23
Due after one year through three years	199	202
Due after three years through five years	67	69
Due after five years	492	431
	780	725
Equity securities	50	61
	$ 830	$ 786

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

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. PROPERTY, PLANT AND EQUIPMENT

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

	2009	2008
Vehicles	$ 5,458	$ 5,508
Aircraft (including aircraft under capitalized leases)	13,692	14,564
Land	1,085	1,068
Buildings	3,001	2,836
Building and leasehold improvements	2,792	2,702
Plant equipment	6,328	5,720
Technology equipment	1,643	1,620
Equipment under operating leases	156	136
Construction-in-progress	553	944
	34,708	35,098
Less: Accumulated depreciation and amortization	(16,616)	(16,833)
	$ 18,092	$ 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 had declined for several quarters as a result of persistent economic weakness and shifts in product mix from our premium air services to our lower cost ground services. As a result of these factors, the utilization of certain aircraft fleet types had declined and was expected to be lower in the future.

Based on the factors noted above, as well as FAA aging aircraft directives that would require significant future maintenance expenditures, we determined that a triggering event had occurred that required an impairment assessment of our McDonnell-Douglas DC-8-71 and DC-8-73 aircraft fleets. We conducted an impairment analysis as of March 31, 2009, and determined that the 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. D