

**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 March 31, 2020 or

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

For the transition period from _____ to _____
Commission file number 001-15451



United Parcel Service, Inc.
(Exact name of registrant as specified in its charter)

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

58-2480149
(IRS Employer
Identification No.)
30328
(Zip Code)

(404) 828-6000
(Registrant's telephone number, including area code)

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

| Title of Each Class | Trading Symbol | Name of Each Exchange on Which Registered |
|--|----------------|---|
| Class B common stock, par value \$0.01 per share | UPS | New York Stock Exchange |
| Floating-Rate Senior Notes due 2020 | UPS20A | New York Stock Exchange |
| 1.625% Senior Notes due 2025 | UPS25 | New York Stock Exchange |
| 1% Senior Notes due 2028 | UPS28 | New York Stock Exchange |
| 0.375% Senior Notes due 2023 | UPS23A | New York Stock Exchange |
| 1.500% Senior Notes due 2032 | UPS32 | New York Stock Exchange |

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit 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, or an emerging growth company. See definitions of "accelerated filer", "large accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. Check one:

| | | | |
|-------------------------|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input checked="" type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> | Smaller reporting company | <input type="checkbox"/> |
| | | Emerging growth company | <input type="checkbox"/> |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 158,059,668 Class A shares, and 704,116,869 Class B shares, with a par value of \$0.01 per share, outstanding at April 23, 2020.

TABLE OF CONTENTS

| | | |
|----------|---|--------------------|
| | PART I—FINANCIAL INFORMATION | |
| | Cautionary Statement About Forward-Looking Statements | 1 |
| Item 1. | Financial Statements | 2 |
| | Consolidated Balance Sheets | 2 |
| | Statements of Consolidated Income | 3 |
| | Statements of Consolidated Comprehensive Income (Loss) | 3 |
| | Statements of Consolidated Cash Flows | 4 |
| | Notes to Unaudited, Consolidated Financial Statements | 5 |
| | Note 1—Basis of Presentation and Accounting Policies | 5 |
| | Note 2—Recent Accounting Pronouncements | 6 |
| | Note 3—Revenue Recognition | 7 |
| | Note 4—Stock-Based Compensation | 10 |
| | Note 5—Cash and Investments | 12 |
| | Note 6—Property, Plant and Equipment | 15 |
| | Note 7—Employee Benefit Plans | 16 |
| | Note 8—Goodwill and Intangible Assets | 19 |
| | Note 9—Debt and Financing Arrangements | 20 |
| | Note 10—Leases | 23 |
| | Note 11—Legal Proceedings and Contingencies | 27 |
| | Note 12—Shareowners’ Equity | 29 |
| | Note 13—Segment Information | 33 |
| | Note 14—Earnings Per Share | 34 |
| | Note 15—Derivative Instruments and Risk Management | 35 |
| | Note 16—Income Taxes | 40 |
| | Note 17—Transformation Strategy Costs | 41 |
| Item 2. | Management’s Discussion and Analysis of Financial Condition and Results of Operations | 42 |
| | Overview | 42 |
| | Supplemental Information - Items Affecting Comparability | 44 |
| | Results of Operations - Segment Review | 45 |
| | U.S. Domestic Package Operations | 46 |
| | International Package Operations | 49 |
| | Supply Chain & Freight Operations | 52 |
| | Consolidated Operating Expenses | 54 |
| | Other Income and (Expense) | 57 |
| | Income Tax Expense | 58 |
| | Liquidity and Capital Resources | 59 |
| | Cash Flows From Operating Activities | 59 |
| | Cash Flows From Investing Activities | 61 |
| | Cash Flows From Financing Activities | 62 |
| | Sources of Credit | 63 |
| | Guarantees and Other Off-Balance Sheet Arrangements | 63 |
| | Legal Proceedings and Contingencies | 63 |
| | Collective Bargaining Agreements | 63 |
| | Recent Accounting Pronouncements | 63 |
| | Rate Adjustments | 64 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 65 |
| Item 4. | Controls and Procedures | 66 |
| | PART II—OTHER INFORMATION | |
| Item 1. | Legal Proceedings | 67 |
| Item 1A. | Risk Factors | 67 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 68 |
| Item 6. | Exhibits | 69 |

PART I. FINANCIAL INFORMATION

Cautionary Statement About Forward-Looking Statements

This report, our Annual Report on Form 10-K for the year ended December 31, 2019 and our other filings with the Securities and Exchange Commission contain and refer to “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Statements other than those of current or historical fact, and all statements accompanied by terms such as “believe,” “project,” “expect,” “estimate,” “assume,” “intend,” “anticipate,” “target,” “plan,” and variations thereof, and similar terms, are intended to be forward-looking statements. Forward-looking statements are made subject to the safe harbor provisions of the federal securities laws pursuant to Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

From time to time, we also include forward-looking statements in other publicly disclosed materials. Such statements may relate to our intent, belief and current expectations about our strategic direction, prospects and future results, and give our current expectations or forecasts of future events; they do not relate strictly to historical or current facts. Management believes that these forward-looking statements are reasonable as and when made. However, caution should be taken not to place undue reliance on any forward-looking statements because such statements speak only as of the date when made.

Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience, present expectations or anticipated results. These risks and uncertainties, many of which are outside of our control, include, but are not limited to: uncertainties related to the impact of the COVID-19 pandemic on our business and operations, financial condition, financial results and financial position, our customers and suppliers, and on the global economy; changes in general economic conditions, in the U.S. or internationally; significant competition on a local, regional, national and international basis; changes in our relationships with our significant customers; changes in the complex and stringent regulation in the U.S. and internationally (including tax laws and regulations); increased physical or data security requirements that may increase our costs of operations and reduce operating efficiencies; legal, regulatory or market responses to global climate change; results of negotiations and ratifications of labor contracts; strikes, work stoppages or slowdowns by our employees; the effects of changing prices of energy, including gasoline, diesel and jet fuel, and interruptions in supplies of these commodities; changes in exchange rates or interest rates; uncertainty from the expected discontinuance of LIBOR and transition to any other interest rate benchmark; our ability to maintain the image of our brand; breaches in data security; disruptions to the Internet or our technology infrastructure; interruptions in or impacts on our business from natural or man-made events or disasters including terrorist attacks, epidemics or pandemics; our ability to accurately forecast our future capital investment needs; exposure to changing economic, political and social developments in international and emerging markets; changes in business strategy, government regulations, or economic or market conditions that may result in substantial impairment of our assets; increases in our expenses or funding obligations relating to employee health, retiree health and/or pension benefits; potential additional tax liabilities in the U.S. or internationally; the potential for various claims and litigation related to labor and employment, personal injury, property damage, business practices, environmental liability and other matters; our ability to realize the anticipated benefits from acquisitions, joint ventures or strategic alliances; our ability to realize the anticipated benefits from our transformation initiatives; cyclical and seasonal fluctuations in our operating results; our ability to manage insurance and claims expenses; and other risks discussed in our filings with the Securities and Exchange Commission from time to time, including our Annual Report on Form 10-K for the year ended December 31, 2019, this Quarterly Report on Form 10-Q for the quarter ended March 31, 2020 and subsequently filed reports. You should consider the limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of information contained in such forward-looking statements. We do not undertake any obligation to update forward-looking statements to reflect events, circumstances, changes in expectations, or the occurrence of unanticipated events after the date of those statements, except as required by law.

Item 1. Financial Statements

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
March 31, 2020 (unaudited) and December 31, 2019 (In millions)

| | March 31, 2020 | December 31, 2019 |
|---|-------------------|----------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 8,955 | \$ 5,238 |
| Marketable securities | 505 | 503 |
| Accounts receivable | 8,245 | 9,645 |
| Less: Allowance for credit losses | (119) | (93) |
| Accounts receivable, net | 8,126 | 9,552 |
| Other current assets | 1,803 | 1,810 |
| Total Current Assets | 19,389 | 17,103 |
| Property, Plant and Equipment, Net | 30,908 | 30,482 |
| Operating Lease Right-Of-Use Assets | 3,041 | 2,856 |
| Goodwill | 3,776 | 3,813 |
| Intangible Assets, Net | 2,176 | 2,167 |
| Investments and Restricted Cash | 23 | 24 |
| Deferred Income Tax Assets | 299 | 330 |
| Other Non-Current Assets | 1,283 | 1,082 |
| Total Assets | \$ 60,895 | \$ 57,857 |
| LIABILITIES AND SHAREOWNERS' EQUITY | | |
| Current Liabilities: | | |
| Current maturities of long-term debt, commercial paper and finance leases | \$ 4,405 | \$ 3,420 |
| Current maturities of operating leases | 526 | 538 |
| Accounts payable | 4,779 | 5,555 |
| Accrued wages and withholdings | 2,606 | 2,552 |
| Self-insurance reserves | 980 | 914 |
| Accrued group welfare and retirement plan contributions | 790 | 793 |
| Other current liabilities | 1,760 | 1,641 |
| Total Current Liabilities | 15,846 | 15,413 |
| Long-Term Debt and Finance Leases | 24,196 | 21,818 |
| Non-Current Operating Leases | 2,493 | 2,391 |
| Pension and Postretirement Benefit Obligations | 10,477 | 10,601 |
| Deferred Income Tax Liabilities | 1,787 | 1,632 |
| Other Non-Current Liabilities | 2,783 | 2,719 |
| Shareowners' Equity: | | |
| Class A common stock (158 and 156 shares issued in 2020 and 2019, respectively) | 2 | 2 |
| Class B common stock (703 and 701 shares issued in 2020 and 2019, respectively) | 7 | 7 |
| Additional paid-in capital | 29 | 150 |
| Retained earnings | 9,137 | 9,105 |
| Accumulated other comprehensive loss | (5,876) | (5,997) |
| Deferred compensation obligations | 19 | 26 |
| Less: Treasury stock (0.4 shares in 2020 and 2019) | (19) | (26) |
| Total Equity for Controlling Interests | 3,299 | 3,267 |
| Noncontrolling interests | 14 | 16 |
| Total Shareowners' Equity | 3,313 | 3,283 |
| Total Liabilities and Shareowners' Equity | \$ 60,895 | \$ 57,857 |

See notes to unaudited, consolidated financial statements.

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

| | Three Months Ended March 31, | |
|----------------------------------|---------------------------------|-----------|
| | 2020 | 2019 |
| Revenue | \$ 18,035 | \$ 17,160 |
| Operating Expenses: | | |
| Compensation and benefits | 10,086 | 9,317 |
| Repairs and maintenance | 563 | 434 |
| Depreciation and amortization | 648 | 568 |
| Purchased transportation | 2,931 | 2,966 |
| Fuel | 761 | 770 |
| Other occupancy | 383 | 371 |
| Other expenses | 1,591 | 1,340 |
| Total Operating Expenses | 16,963 | 15,766 |
| Operating Profit | 1,072 | 1,394 |
| Other Income and (Expense): | | |
| Investment income and other | 345 | 215 |
| Interest expense | (167) | (169) |
| Total Other Income and (Expense) | 178 | 46 |
| Income Before Income Taxes | 1,250 | 1,440 |
| Income Tax Expense | 285 | 329 |
| Net Income | \$ 965 | \$ 1,111 |
| Basic Earnings Per Share | \$ 1.12 | \$ 1.28 |
| Diluted Earnings Per Share | \$ 1.11 | \$ 1.28 |

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

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2020 | 2019 |
| Net Income | \$ 965 | \$ 1,111 |
| Change in foreign currency translation adjustment, net of tax | (141) | 53 |
| Change in unrealized gain (loss) on marketable securities, net of tax | 2 | 4 |
| Change in unrealized gain (loss) on cash flow hedges, net of tax | 217 | 76 |
| Change in unrecognized pension and postretirement benefit costs, net of tax | 43 | 43 |
| Comprehensive Income | \$ 1,086 | \$ 1,287 |

See notes to unaudited, consolidated financial statements.

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

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------------|
| | 2020 | 2019 |
| Cash Flows From Operating Activities: | | |
| Net income | \$ 965 | \$ 1,111 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization | 648 | 568 |
| Pension and postretirement benefit expense | 160 | 188 |
| Pension and postretirement benefit contributions | (222) | (214) |
| Self-insurance reserves | 124 | (74) |
| Deferred tax (benefit) expense | 86 | 78 |
| Stock compensation expense | 231 | 308 |
| Other (gains) losses | 33 | 40 |
| Changes in assets and liabilities, net of effects of business acquisitions: | | |
| Accounts receivable | 1,223 | 1,301 |
| Other assets | 209 | 128 |
| Accounts payable | (1,101) | (1,143) |
| Accrued wages and withholdings | 83 | (94) |
| Other liabilities | 102 | 87 |
| Other operating activities | 9 | (7) |
| Net cash from operating activities | <u>2,550</u> | <u>2,277</u> |
| Cash Flows From Investing Activities: | | |
| Capital expenditures | (933) | (1,514) |
| Proceeds from disposals of property, plant and equipment | 1 | 4 |
| Purchases of marketable securities | (80) | (248) |
| Sales and maturities of marketable securities | 80 | 349 |
| Net change in finance receivables | 3 | 10 |
| Cash paid for business acquisitions, net of cash and cash equivalents acquired | — | (1) |
| Other investing activities | (5) | (16) |
| Net cash used in investing activities | <u>(934)</u> | <u>(1,416)</u> |
| Cash Flows From Financing Activities: | | |
| Net change in short-term debt | (91) | (1,217) |
| Proceeds from long-term borrowings | 4,253 | 2,141 |
| Repayments of long-term borrowings | (687) | (439) |
| Purchases of common stock | (220) | (246) |
| Issuances of common stock | 70 | 47 |
| Dividends | (840) | (799) |
| Other financing activities | (318) | (182) |
| Net cash from (used in) financing activities | <u>2,167</u> | <u>(695)</u> |
| Effect of Exchange Rate Changes on Cash, Cash Equivalents and Restricted Cash | <u>(65)</u> | <u>9</u> |
| Net Increase (Decrease) in Cash, Cash Equivalents and Restricted Cash | <u>3,718</u> | <u>175</u> |
| Cash, Cash Equivalents and Restricted Cash: | | |
| Beginning of period | 5,238 | 4,367 |
| End of period | <u>\$ 8,956</u> | <u>\$ 4,542</u> |

See notes to unaudited, consolidated financial statements.

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

NOTE 1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

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 ("GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These interim unaudited, consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly our financial position as of March 31, 2020, our results of operations for the three months ended March 31, 2020 and 2019, and our cash flows for the three months ended March 31, 2020 and 2019. The results reported in these interim, unaudited, consolidated financial statements should not be regarded as indicative of results that may be expected for any other period or the entire year. The interim unaudited, 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, 2019.

Fair Value of Financial Instruments

The carrying amounts of our cash and cash equivalents, accounts receivable, finance receivables and accounts payable approximate fair value as of March 31, 2020 and December 31, 2019. The fair values of our investment securities are disclosed in note 5, our recognized multiemployer pension withdrawal liabilities in note 7, our short- and long-term debt in note 9 and our derivative instruments in note 15. We utilized Level 1 inputs in the fair value hierarchy of valuation techniques to determine the fair value of our cash and cash equivalents, and Level 2 inputs to determine the fair value of our accounts receivable, finance receivables and accounts payable.

Use of 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 these financial statements, as well as the reported amounts of revenues and expenses during the reporting period.

Although our estimates contemplate current and expected future conditions, as applicable, it is reasonably possible that actual conditions could differ from our expectations, which could materially affect our results of operations and financial position. In particular, a number of estimates have been and will continue to be affected by the ongoing COVID-19 pandemic. The severity, magnitude and duration of the COVID-19 pandemic, and the resulting economic consequences, are uncertain, rapidly changing and difficult to predict. As a result, our accounting estimates and assumptions may change over time as a consequence of the effects of COVID-19.

Such changes could result in future impairments of goodwill, intangible assets, long-lived assets and investment securities, incremental credit losses on financial assets, decreases in the carrying amount of our tax assets, increases in our self-insurance liabilities or increases in our net pension obligations at the time of a measurement event.

For interim unaudited, consolidated financial statement purposes, we provide for accruals under our various employee benefit plans for each three month period based on one quarter of the estimated annual expense.

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

NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS*Adoption of New Accounting Standards*

In June 2016, the Financial Accounting Standards Board ("FASB") issued an accounting standards update ("ASU") introducing an expected credit loss methodology for the measurement of financial assets not accounted for at fair value. The methodology replaced the probable, incurred loss model for those assets. We adopted this standard on January 1, 2020. Upon adoption, we updated our process for calculating our allowance for credit losses to include reasonable and supportable forecasts that could affect expected collectability. In the first quarter of 2020, we increased our allowance for credit losses by \$23 million based upon our current forecasts that reflect increased economic uncertainty resulting from the COVID-19 pandemic.

In January 2017, the FASB issued an ASU to simplify the accounting for goodwill impairment by eliminating the requirement to calculate the implied fair value of goodwill using a hypothetical purchase price allocation. Under this ASU, goodwill impairment is the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. We adopted this standard on January 1, 2020. Upon adoption, this ASU did not have a material impact on our consolidated financial position, results of operations or cash flows.

For accounting standards adopted in the period ended March 31, 2019, refer to note 1 to our audited, consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2019.

Other accounting pronouncements adopted during the periods covered by the unaudited, consolidated financial statements did not have a material impact on our consolidated financial position, results of operations or cash flows.

Accounting Standards Issued But Not Yet Effective

In December 2019, the FASB issued an ASU to simplify the accounting for income taxes. The update removes certain exceptions to the general income tax principles. The standard will be effective for us in the first quarter of 2021. We are evaluating the impact of its adoption on our consolidated financial statements and internal control over financial reporting environment, but do not expect this ASU to have a material impact on our consolidated financial position, results of operations or cash flows.

In March 2020, the FASB issued an ASU to provide optional guidance to temporarily ease the potential burden in accounting for reference rate reform. The update provides optional expedients and exceptions for applying GAAP to contracts, hedging relationships and other transactions affected by reference rate reform. The guidance was effective upon issuance and generally can be applied through December 31, 2022. We are evaluating the impact of this update on our consolidated financial position, results of operations and cash flows.

Other accounting pronouncements issued, but not effective until after March 31, 2020, are not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

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

NOTE 3. REVENUE RECOGNITION*Revenue Recognition*

Substantially all of our revenues are from contracts associated with the pick-up, transportation and delivery of packages and freight (“transportation services”), whether carried out by or arranged by UPS, either domestically or internationally, which generally occurs over a short period of time. Additionally, we provide value-added logistics services to customers, both domestically and internationally, through our global network of company-owned and leased distribution centers and field stocking locations.

Disaggregation of Revenue

| | Three Months Ended March 31, | |
|------------------------|---|------------------|
| | 2020 | 2019 |
| Revenue: | | |
| Next Day Air | \$ 2,055 | \$ 1,841 |
| Deferred | 1,197 | 1,089 |
| Ground | 8,204 | 7,550 |
| U.S. Domestic Package | 11,456 | 10,480 |
| Domestic | 688 | 690 |
| Export | 2,561 | 2,631 |
| Cargo & Other | 134 | 138 |
| International Package | 3,383 | 3,459 |
| Forwarding | 1,373 | 1,416 |
| Logistics | 845 | 832 |
| Freight | 766 | 773 |
| Other | 212 | 200 |
| Supply Chain & Freight | 3,196 | 3,221 |
| Consolidated revenue | <u>\$ 18,035</u> | <u>\$ 17,160</u> |

We account for a contract when both parties have approved the contract and are committed to perform their obligations, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

Performance Obligations

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the basis of revenue recognition in accordance with GAAP. To determine the proper revenue recognition method for contracts, we evaluate whether two or more contracts should be combined and accounted for as a single contract, and whether the combined or single contract should be accounted for as more than one performance obligation. This evaluation requires judgment, and the decision to combine a group of contracts or separate the combined or single contract into multiple performance obligations could change the amount of revenue and profit recorded in a given period. Within most of our contracts, the customer contracts with us to provide distinct services, such as transportation services. The vast majority of our contracts with customers for transportation services include only one performance obligation; the transportation services themselves. However, if a contract is separated into more than one performance obligation, we allocate the total transaction price to each performance obligation based on the estimated relative standalone selling prices of the promised goods or services underlying each performance obligation. We frequently sell standard transportation services with observable standalone sales prices. In these instances, the observable standalone sales are used to determine the standalone selling price.

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

In certain business units, such as Logistics, we sell customized, customer-specific solutions in which we integrate a complex set of tasks and components into a single capability (even if that single capability results in the delivery of multiple units). Hence, the entire contract is accounted for as one performance obligation. In these cases we typically use the expected cost plus a margin approach to estimate the standalone selling price of each performance obligation.

Satisfaction of Performance Obligations

We generally recognize revenue over time as we perform the services in the contract because of the continuous transfer of control to the customer. Our customers receive the benefit of our services as the goods are transported from one location to another. Further, if we were unable to complete delivery to the final location, another entity would not need to re-perform the transportation service already performed.

As control transfers over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. The selection of the method to measure progress towards completion requires judgment and is based on the nature of the products or services to be provided. We use the cost-to-cost measure of progress for our package delivery contracts because it best depicts the transfer of control to the customer which occurs as we incur costs on our contracts. Under the cost-to-cost measure of progress, the extent of progress towards completion is measured based on the ratio of costs incurred to date to the total estimated costs at completion of the performance obligation. Revenues, including ancillary or accessorial fees and reductions for estimated customer incentives, are recorded proportionally as costs are incurred. Costs to fulfill include labor and other direct costs and an allocation of indirect costs. For our freight and freight forwarding contracts, an output method of progress based on time-in-transit is utilized as the timing of costs incurred does not best depict the transfer of control to the customer. In our Logistics business, we have a right to consideration from customers in an amount that corresponds directly with the value to the customers of our performance completed to date, and as such we recognize revenue in the amount to which we have a right to invoice the customer.

Variable Consideration

It is common for our contracts to contain customer incentives, guaranteed service refunds or other provisions that can either increase or decrease the transaction price. These variable amounts are generally dependent upon achievement of certain incentive tiers or performance metrics. We estimate variable consideration at the most likely amount to which we expect to be entitled. We include estimated amounts of revenue, which may be reduced by incentives or other contract provisions, in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based on an assessment of anticipated customer spending and all information (historical, current and forecasted) that is reasonably available to us.

Contract Modifications

Contracts are often modified to account for changes in the rates we charge our customers or to add additional distinct services. We consider contract modifications to exist when the modification either creates new, or changes the existing, enforceable rights and obligations. Contract modifications that add additional distinct goods or services are treated as separate contracts. Contract modifications that do not add distinct goods or services typically change the price of existing services. These contract modifications are accounted for prospectively as the remaining performance obligations are distinct.

Payment Terms

Under the typical payment terms of our customer contracts, the customer pays at periodic intervals (i.e. every 14 days, 30 days, 45 days, etc.) for shipments included on invoices received. Invoices are generated each week on the week-ending day, which is Saturday for the majority of our U.S. Domestic Package business, but could be another day depending on the business unit or the specific agreement with the customer. It is not customary business practice to extend payment terms past 90 days, and as such, we do not have a practice of including a significant financing component within our contracts with customers.

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

Principal vs. Agent Considerations

In our transportation businesses, we utilize independent contractors and third-party carriers in the performance of some transportation services. GAAP requires us to evaluate, using a control model, whether our businesses themselves promise to transfer services to the customer (as the principal) or to arrange for services to be provided by another party (as the agent). Based on our evaluation of the control model, we determined that all of our major businesses act as the principal rather than the agent within their revenue arrangements. Revenue and the associated purchased transportation costs are both reported on a gross basis within our statements of consolidated income.

Accounts Receivable, Net

Accounts receivable, net, include amounts billed and currently due from customers. The amounts due are stated at their net estimated realizable value. Losses on accounts receivable are recognized when reasonable and supportable forecasts affect the expected collectability. This requires us to make our best estimate of the current expected losses inherent in our accounts receivable at each balance sheet date. These estimates require consideration of historical loss experience, adjusted for current conditions, forward looking indicators, trends in customer payment frequency and judgments about the probable effects of relevant observable data, including present and future economic conditions and the financial health of specific customers and market sectors. Our risk management process includes standards and policies for reviewing major account exposures and concentrations of risk.

In the first quarter of 2020, we increased our allowance for credit losses by \$23 million based upon current forecasts that reflect increased economic uncertainty resulting from the COVID-19 pandemic. Our allowance for credit losses as of March 31, 2020 and December 31, 2019 was \$119 and \$93 million, respectively. Our provision for credit losses charged to expense before recoveries during the quarters ended March 31, 2020 and 2019 was \$69 and \$37 million, respectively.

Contract Assets and Liabilities

Contract assets include billed and unbilled amounts resulting from in-transit packages, as we have an unconditional right to payment only once all performance obligations have been completed (i.e., packages have been delivered), and our right to payment is not solely based on the passage of time. Amounts may not exceed their net realizable value. Contract assets are generally classified as current and the full balance is converted each quarter based on the short-term nature of the transactions.

Contract liabilities consist of advance payments and billings in excess of revenue as well as deferred revenue. Advance payments and billings in excess of revenue represent payments received from our customers that will be earned over the contract term. Deferred revenue represents the amount of consideration due from customers related to in-transit shipments that has not yet been recognized as revenue based on our selected measure of progress. We classify advance payments and billings in excess of revenue as either current or long-term, depending on the period over which the advance payment will be earned. We classify deferred revenue as current based on the timing of when we expect to recognize revenue, which typically occurs within a short window after period-end. The full balance of deferred revenue is converted each quarter based on the short-term nature of the transactions. Our contract assets and liabilities are reported in a net position on a contract-by-contract basis at the end of each reporting period. In order to determine revenue recognized in the period from contract liabilities, we first allocate revenue to the individual contract liability balance outstanding at the beginning of the period until the revenue exceeds that deferred revenue balance.

Contract assets related to in-transit packages were \$222 and \$272 million at March 31, 2020 and December 31, 2019, respectively, net of deferred revenue related to in-transit packages of \$298 and \$264 million at March 31, 2020 and December 31, 2019, respectively. Contract assets are included within "Other current assets" in the consolidated balance sheets. Short-term contract liabilities related to advance payments from customers were \$7 million at both March 31, 2020 and December 31, 2019. Short-term contract liabilities are included within "Other current liabilities" in the consolidated balance sheets. Long-term contract liabilities related to advance payments from customers were \$26 million at both March 31, 2020 and December 31, 2019. Long-term contract liabilities are included within "Other Non-Current Liabilities" in the consolidated balance sheets.

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

NOTE 4. STOCK-BASED COMPENSATION

We issue employee share-based awards under various incentive compensation plans, which permit the grant of non-qualified and incentive stock options, stock appreciation rights, restricted stock and stock units, and restricted performance shares and performance units to eligible employees (restricted stock and stock units, restricted performance shares and performance units are herein referred to as "Restricted Units"). Upon vesting, Restricted Units result in the issuance of the equivalent number of UPS class A common shares after required tax withholdings. Dividends accrued on Restricted Units are reinvested in additional Restricted Units at each dividend payable date, and are subject to the same vesting and forfeiture conditions as the underlying Restricted Units upon which they are earned.

The primary compensation programs offered under the UPS Incentive Compensation Plan include the UPS Management Incentive Award program, the UPS Long-Term Incentive Performance Award program and the UPS Stock Option program. We also maintain an employee stock purchase plan which allows eligible employees to purchase shares of UPS class A common stock at a discount. Additionally, our matching contributions to the primary employee defined contribution savings plan are made in shares of UPS class A common stock.

Management Incentive Award Program ("MIP")

We award Restricted Units under the MIP to certain eligible management employees. For Restricted Units granted under the MIP prior to 2019, vesting generally occurs ratably over a five-year period on January 15th of each of the years following the grant date (except in the case of death, disability or retirement, in which case immediate vesting occurs). The grant value is expensed on a straight-line basis (less estimated forfeitures) over the requisite service period (except in the case of death, disability or retirement, in which case immediate expensing occurs). These historical awards will continue to vest through 2023.

Beginning with the MIP grant in the first quarter of 2019, Restricted Units vest one year following the grant date (except in the case of death, disability or retirement, in which case immediate vesting occurs). The grant value is expensed on a straight-line basis (less estimated forfeitures) over the requisite service period (except in the case of death, disability or retirement, in which case immediate expensing occurs).

Based on the date that the eligible management population and performance targets were approved for the MIP, we determined the award measurement dates to be February 6, 2020 (for U.S.-based employees), February 12, 2020 (for management committee employees) and March 23, 2020 (for international-based employees); therefore, the Restricted Units awarded were valued for stock compensation expense purposes using the closing New York Stock Exchange ("NYSE") price of \$106.51, \$105.54 and \$91.90 on those dates, respectively.

Long-Term Incentive Performance Award Program ("LTIP")

We award Restricted Units under the LTIP to certain eligible management employees. These Restricted Units generally vest at the end of a three-year performance period (except in the case of death, disability or retirement, in which case immediate vesting occurs on a prorated basis). For outstanding awards, the number of Restricted Units earned will be based on the achievement of the performance targets established on the grant date. These performance targets are equally-weighted among consolidated operating return on invested capital ("ROIC"), growth in currency-constant consolidated revenue and total shareholder return ("RTSR") relative to a peer group of companies.

For the two-thirds of the award related to ROIC and growth in currency-constant consolidated revenue, we recognize the grant date fair value of these Restricted Units (less estimated forfeitures) as compensation expense ratably over the vesting period, based on the number of awards expected to be earned. The remaining one-third of the award related to RTSR is valued using a Monte Carlo model. We recognize the grant date fair value of this portion of the award (less estimated forfeitures) as compensation expense ratably over the vesting period.

There were no awards granted under the LTIP in the first quarter of 2020.

Based on the date that the eligible management employees and performance targets were approved for the 2019 LTIP award, we determined the award measurement date to be March 22, 2019; therefore, the target Restricted Units awarded for the ROIC and growth in currency-constant consolidated revenue portions of the award were valued for stock compensation expense using the closing NYSE price of \$107.35 on that date.

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

During the third quarter of 2019, we awarded a one-time grant of Restricted Units that will vest over the same period as the 2019 LTIP award. Based on the date that the Compensation Committee approved this award, we determined the award measurement date to be July 1, 2019; therefore, the target Restricted Units awarded for the ROIC and growth in currency-constant consolidated revenue portions of the award were valued for stock compensation expense using the closing NYSE price of \$102.97 on that date.

The weighted-average assumptions used and the calculated weighted-average fair values of the RTSR portion of the LTIP awards granted in 2019 are as follows:

| | 2019 |
|--|-------------|
| Risk-free interest rate | 2.23 % |
| Expected volatility | 19.64 % |
| Weighted-average fair value of units granted | \$ 123.44 |
| Share payout | 115.04 % |

There is no expected dividend yield as units earn dividend equivalents.

Non-Qualified Stock Options

We grant non-qualified stock option awards to a limited group of eligible senior management employees under the UPS Stock Option program. Stock option awards generally vest over a five-year period with approximately 20% of the award vesting at each anniversary of the grant date (except in the case of death, disability or retirement, in which case immediate vesting occurs). The options granted expire 10 years after the date of the grant. In the first quarter of 2020, we granted 0.3 million stock options at a grant price of \$105.54, which is based on the closing NYSE price on February 12, 2020. In the first quarter of 2019, we granted 0.3 million stock options at a grant price of \$111.80, which is based on the closing NYSE price on February 14, 2019.

The fair value of each option grant is estimated using the Black-Scholes option pricing model. The weighted-average assumptions used and the calculated weighted-average fair values of options granted in 2020 and 2019 are as follows:

| | 2020 | 2019 |
|--|-------------|-------------|
| Expected dividend yield | 3.47 % | 2.94 % |
| Risk-free interest rate | 1.50 % | 2.60 % |
| Expected life (in years) | 7.5 | 7.5 |
| Expected volatility | 18.64 % | 17.79 % |
| Weighted-average fair value of options granted | \$ 11.93 | \$ 16.34 |

Compensation expense for share-based awards recognized in "Compensation and benefits" on the statements of consolidated income for the three months ended March 31, 2020 and 2019 was \$231 and \$308 million pre-tax, respectively.

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

NOTE 5. CASH AND INVESTMENTS

The following is a summary of marketable securities classified as trading and available-for-sale as of March 31, 2020 and December 31, 2019 (in millions):

| | <u>Cost</u> | <u>Unrealized Gains</u> | <u>Unrealized Losses</u> | <u>Estimated Fair Value</u> |
|--|---------------|-----------------------------|------------------------------|---------------------------------|
| March 31, 2020: | | | | |
| Current trading marketable securities: | | | | |
| Corporate debt securities | \$ 110 | \$ — | \$ — | \$ 110 |
| Equity securities | 2 | — | — | 2 |
| Total trading marketable securities | <u>112</u> | <u>—</u> | <u>—</u> | <u>112</u> |
| Current available-for-sale securities: | | | | |
| U.S. government and agency debt securities | 194 | 7 | — | 201 |
| Mortgage and asset-backed debt securities | 42 | 2 | (1) | 43 |
| Corporate debt securities | 138 | 1 | (1) | 138 |
| Non-U.S. government debt securities | 11 | — | — | 11 |
| Total available-for-sale marketable securities | <u>385</u> | <u>10</u> | <u>(2)</u> | <u>393</u> |
| Total current marketable securities | <u>\$ 497</u> | <u>\$ 10</u> | <u>\$ (2)</u> | <u>\$ 505</u> |
| | <u>Cost</u> | <u>Unrealized Gains</u> | <u>Unrealized Losses</u> | <u>Estimated Fair Value</u> |
| December 31, 2019: | | | | |
| Current trading marketable securities: | | | | |
| Corporate debt securities | \$ 112 | \$ — | \$ — | \$ 112 |
| Equity securities | 2 | — | — | 2 |
| Total trading marketable securities | <u>114</u> | <u>—</u> | <u>—</u> | <u>114</u> |
| Current available-for-sale securities: | | | | |
| U.S. government and agency debt securities | 191 | 2 | — | 193 |
| Mortgage and asset-backed debt securities | 46 | 1 | — | 47 |
| Corporate debt securities | 130 | 3 | — | 133 |
| Non-U.S. government debt securities | 16 | — | — | 16 |
| Total available-for-sale marketable securities | <u>383</u> | <u>6</u> | <u>—</u> | <u>389</u> |
| Total current marketable securities | <u>\$ 497</u> | <u>\$ 6</u> | <u>\$ —</u> | <u>\$ 503</u> |

Investment Impairments

We have concluded that no material impairment losses existed as of March 31, 2020. In making this determination, we considered the financial condition and prospects of each issuer, the magnitude of the losses compared with the cost, the probability that we will be unable to collect all amounts due according to the contractual terms of the security, the credit rating of the security and our ability and intent to hold these investments until the anticipated recovery in market value occurs.

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

Maturity Information

The amortized cost and estimated fair value of marketable securities at March 31, 2020, 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 with or without prepayment penalties.

| | Cost | Estimated Fair Value |
|--|---------------|-------------------------|
| Due in one year or less | \$ 125 | \$ 124 |
| Due after one year through three years | 323 | 330 |
| Due after three years through five years | 6 | 6 |
| Due after five years | 41 | 43 |
| | <u>495</u> | <u>503</u> |
| Equity securities | 2 | 2 |
| | <u>\$ 497</u> | <u>\$ 505</u> |

Non-Current Investments and Restricted Cash

We held a \$19 and \$21 million investment in a variable life insurance policy to fund benefits for the UPS Excess Coordinating Benefit Plan at March 31, 2020 and December 31, 2019, respectively. The quarterly change in investment fair value is recognized in "Investment income and other" in the statements of consolidated income. Additionally, we held escrowed cash related to the acquisition and disposition of certain assets of \$2 and \$3 million as of March 31, 2020 and December 31, 2019, respectively. We previously held various marketable securities and cash equivalents as collateral under an escrow agreement to guarantee our self-insurance obligations. In 2019 we liquidated this investment balance and pledged the required collateral with a surety bond. At March 31, 2020 and December 31, 2019, we had \$1 and \$0 million, respectively, in restricted cash.

A reconciliation of cash and cash equivalents and restricted cash from the consolidated balance sheets to the statements of consolidated cash flows is shown below (in millions):

| | March 31, 2020 | December 31, 2019 | March 31, 2019 |
|--|-----------------|-------------------|-----------------|
| Cash and cash equivalents | \$ 8,955 | \$ 5,238 | \$ 4,399 |
| Restricted cash | 1 | — | 143 |
| Total cash, cash equivalents and restricted cash | <u>\$ 8,956</u> | <u>\$ 5,238</u> | <u>\$ 4,542</u> |

Fair Value Measurements

Marketable securities valued 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 valued utilizing Level 2 inputs include asset-backed securities, corporate bonds and municipal bonds. These securities are valued using market corroborated pricing, matrix pricing or other models that utilize observable inputs such as yield curves.

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

The following table presents information about our investments measured at fair value on a recurring basis as of March 31, 2020 and December 31, 2019, 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 |
|--|--|---|--|---------|
| March 31, 2020: | | | | |
| Marketable Securities: | | | | |
| U.S. government and agency debt securities | \$ 201 | \$ — | \$ — | \$ 201 |
| Mortgage and asset-backed debt securities | — | 43 | — | 43 |
| Corporate debt securities | — | 248 | — | 248 |
| Equity securities | — | 2 | — | 2 |
| Non-U.S. government debt securities | — | 11 | — | 11 |
| Total marketable securities | 201 | 304 | — | 505 |
| Other non-current investments | 19 | — | — | 19 |
| Total | \$ 220 | \$ 304 | \$ — | \$ 524 |

December 31, 2019:

| | | | | |
|--|--------|--------|------|--------|
| Marketable Securities: | | | | |
| U.S. government and agency debt securities | \$ 193 | \$ — | \$ — | \$ 193 |
| Mortgage and asset-backed debt securities | — | 47 | — | 47 |
| Corporate debt securities | — | 245 | — | 245 |
| Equity securities | — | 2 | — | 2 |
| Non-U.S. government debt securities | — | 16 | — | 16 |
| Total marketable securities | 193 | 310 | — | 503 |
| Other non-current investments | 21 | — | 1 | 22 |
| Total | \$ 214 | \$ 310 | \$ 1 | \$ 525 |

There were no transfers of investments between Level 1 and Level 2 during the three months ended March 31, 2020 or 2019.

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

NOTE 6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of March 31, 2020 and December 31, 2019 consisted of the following (in millions):

| | 2020 | 2019 |
|---|------------------|------------------|
| Vehicles | \$ 10,309 | \$ 10,613 |
| Aircraft | 19,151 | 19,045 |
| Land | 2,088 | 2,087 |
| Buildings | 5,430 | 5,046 |
| Building and leasehold improvements | 4,804 | 4,898 |
| Plant equipment | 13,429 | 13,849 |
| Technology equipment | 2,601 | 2,206 |
| Construction-in-progress | 2,650 | 1,983 |
| | <u>60,462</u> | <u>59,727</u> |
| Less: Accumulated depreciation and amortization | (29,554) | (29,245) |
| | <u>\$ 30,908</u> | <u>\$ 30,482</u> |

Property, plant and equipment purchased on account was \$743 million and \$372 million as of March 31, 2020 and December 31, 2019, respectively.

We continually monitor our aircraft fleet utilization in light of current and projected volume levels, aircraft fuel prices and other factors. Additionally, we monitor all other property, plant and equipment categories for any indicators that the carrying value of the assets may not be recoverable. No impairment charges on property, plant and equipment were recorded during the three months ended March 31, 2020 or 2019.

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

NOTE 7. EMPLOYEE BENEFIT PLANS*Company-Sponsored Benefit Plans*

Information about net periodic benefit cost for our company-sponsored pension and postretirement benefit plans is as follows for the three months ended March 31, 2020 and 2019 (in millions):

| | U.S. Pension Benefits | | U.S. Postretirement Medical Benefits | | International Pension Benefits | |
|-------------------------------------|-----------------------|--------|---|-------|-----------------------------------|-------|
| | 2020 | 2019 | 2020 | 2019 | 2020 | 2019 |
| Three Months Ended March 31: | | | | | | |
| Service cost | \$ 464 | \$ 359 | \$ 7 | \$ 6 | \$ 16 | \$ 14 |
| Interest cost | 494 | 517 | 23 | 27 | 10 | 12 |
| Expected return on assets | (888) | (782) | (2) | (2) | (21) | (19) |
| Amortization of prior service cost | 55 | 54 | 2 | 2 | — | — |
| Net periodic benefit cost | \$ 125 | \$ 148 | \$ 30 | \$ 33 | \$ 5 | \$ 7 |

During the first three months of 2020, we contributed \$19 and \$203 million to our company-sponsored pension and U.S. postretirement medical benefit plans, respectively. We currently expect to contribute approximately \$1.1 billion over the remainder of the year to our pension benefit plans. Subject to market conditions, we continually evaluate opportunities for additional discretionary pension contributions.

The components of net periodic benefit cost other than current service cost are presented within “Investment income and other” in the statements of consolidated income.

Multiemployer Benefit Plans

We contribute to a number of multiemployer defined benefit and health and welfare plans under the terms of collective bargaining agreements that cover our union-represented employees. Our current collective bargaining agreements set forth the annual contribution increases allotted to the plans that we participate in, and we are in compliance with these contribution rates. These limitations on annual contribution rates will remain in effect throughout the terms of the existing collective bargaining agreements.

As of March 31, 2020 and December 31, 2019 we had \$843 and \$845 million, respectively, recorded in “Other Non-Current Liabilities” as well as \$7 million as of both March 31, 2020 and December 31, 2019, recorded in “Other current liabilities” on our consolidated balance sheets associated with our previous withdrawal from a multiemployer pension plan. This liability is payable in equal monthly installments over a remaining term of approximately 43 years. Based on the borrowing rates currently available to us for long-term financing of a similar maturity, the fair value of this withdrawal liability as of March 31, 2020 and December 31, 2019 was \$907 and \$929 million, respectively. We utilized Level 2 inputs in the fair value hierarchy of valuation techniques to determine the fair value of this liability.

UPS was a contributing employer to the Central States Pension Fund (“CSPF”) until 2007 when we withdrew from the CSPF and fully funded our allocable share of unfunded vested benefits by paying a \$6.1 billion withdrawal liability. Under a collective bargaining agreement with the International Brotherhood of Teamsters (“IBT”), UPS agreed to provide coordinating benefits in the UPS/IBT Full Time Employee Pension Plan (“UPS/IBT Plan”) for UPS participants whose last employer was UPS and who had not retired as of January 1, 2008 (“the UPS Transfer Group”) in the event that benefits are lawfully reduced by the CSPF in the future consistent with the terms of our withdrawal agreement with the CSPF. Under our withdrawal agreement with the CSPF, benefits to the UPS Transfer Group cannot be reduced without our consent and can only be reduced in accordance with applicable law.

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

In December 2014, Congress passed the Multiemployer Pension Reform Act (“MPRA”). This change in law for the first time permitted multiemployer pension plans to reduce benefit payments to retirees, subject to specific guidelines in the statute and government approval. In September 2015, the CSPF submitted a proposed pension benefit reduction plan to the U.S. Department of the Treasury (“Treasury”). In May 2016, Treasury rejected the proposed plan submitted by the CSPF. In the first quarter of 2018, Congress established a Joint Select Committee to develop a recommendation to improve the solvency of multiemployer plans and the Pension Benefit Guaranty Corporation (“PBGC”) before a November 30, 2018 deadline. While the Committee’s efforts failed to meet its deadline, the Committee made significant progress towards finding solutions that will address the long-term solvency of multiemployer pension plans. In the third quarter of 2019, the U.S. House of Representatives passed the Rehabilitation for Multiemployer Pensions Act of 2019 to provide assistance to critical and declining multiemployer pension plans. This bill is now with the U.S. Senate for consideration. UPS will continue to work with all stakeholders, including legislators and regulators, to implement an acceptable solution.

The CSPF has said that it believes a legislative solution to its funded status is necessary or that it will become insolvent in 2025, and we expect that the CSPF will continue to explore options to avoid insolvency. Numerous factors could affect the CSPF’s funded status and UPS’s potential obligation to pay coordinating benefits under the UPS/IBT Plan. Any obligation to pay coordinating benefits will be subject to a number of significant uncertainties, including whether the CSPF submits a revised MPRA filing and the terms thereof, or whether it otherwise seeks federal government assistance, as well as the terms of any applicable legislation, the extent to which benefits are paid by the PBGC and our ability to successfully defend legal positions we may take in the future under the MPRA, including the suspension ordering provisions, our withdrawal agreement and other applicable law.

We account for the potential obligation to pay coordinating benefits to the UPS Transfer Group under Accounting Standards Codification Topic 715-Compensation- Retirement Benefits (“ASC 715”), which requires us to provide a best estimate of various actuarial assumptions, including the eventual outcome of this matter, in measuring our pension benefit obligation at the December 31st measurement date. While we currently believe the most likely outcome to this matter and the broader systemic problems facing multiemployer pension plans is intervention by the federal government, ASC 715 does not permit anticipation of changes in law in making a best estimate of pension liabilities.

As such, our best estimate of the next most likely outcome at the December 31, 2019 measurement date was that the CSPF would submit and implement another benefit reduction plan under the MPRA during 2020. We believe any MPRA filing would be designed to forestall insolvency by reducing benefits to participants other than the UPS Transfer Group to the maximum extent permitted, and then reducing benefits to the UPS Transfer Group by a lesser amount.

We evaluated this outcome using a deterministic cash flow projection, reflecting updated estimated CSPF cash flows and investment earnings, the lack of legislative action and the absence of a MPRA filing by the CSPF in 2019. As a result, at the December 31, 2019 measurement date, the best estimate of our projected benefit obligation for coordinating benefits that may be required to be directly provided by the UPS/IBT Plan to the UPS Transfer Group was \$2.6 billion.

The future value of this estimate will be influenced by the terms and timing of any MPRA filing, changes in our discount rate, rate of return on assets and other actuarial assumptions, presumed solvency of the PBGC, as well as potential solutions resulting from federal government intervention. Any such event may result in a decrease or an increase in the best estimate of our projected benefit obligation. If the uncertainties are not resolved, it is reasonably possible that our projected benefit obligation could increase by approximately \$2.2 billion, resulting in a total obligation for coordinating benefits of approximately \$4.8 billion. If a future change in law occurs, it may be a significant event requiring an interim remeasurement of the UPS/IBT Plan at the date the law is enacted. We will continue to assess the impact of these uncertainties on our projected benefit obligation in accordance with ASC 715.

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

Collective Bargaining Agreements

We have approximately 290,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the Teamsters. The current National Master Agreement ("NMA") was ratified on April 28, 2019, and runs through July 31, 2023. Most of the economic provisions of the NMA are retroactive to August 1, 2018, which is the effective date of the NMA. The UPS Freight business unit national master agreement was ratified on November 11, 2018.

We have approximately 2,900 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association ("IPA"). On March 31, 2020, a two-year contract extension was ratified by the IPA, resulting in the collective bargaining agreement becoming amendable September 1, 2023.

We have approximately 1,500 airline mechanics who are covered by a collective bargaining agreement with Teamsters Local 2727 which becomes amendable November 1, 2023. In addition, approximately 3,300 of our auto and maintenance 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"). The collective bargaining agreement with the IAM runs through July 31, 2024.

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

NOTE 8. GOODWILL AND INTANGIBLE ASSETS

The following table indicates the allocation of goodwill by reportable segment as of March 31, 2020 and December 31, 2019 (in millions):

| | U.S. Domestic Package | International Package | Supply Chain & Freight | Consolidated |
|---------------------------|--------------------------|--------------------------|---------------------------|--------------|
| December 31, 2019: | \$ 715 | \$ 416 | \$ 2,682 | \$ 3,813 |
| Acquired | — | — | — | — |
| Currency / Other | — | (7) | (30) | (37) |
| March 31, 2020: | \$ 715 | \$ 409 | \$ 2,652 | \$ 3,776 |

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

The following is a summary of intangible assets as of March 31, 2020 and December 31, 2019 (in millions):

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
|-------------------------------|--------------------------|-----------------------------|-----------------------|
| March 31, 2020: | | | |
| Capitalized software | \$ 4,198 | \$ (2,734) | \$ 1,464 |
| Licenses | 115 | (71) | 44 |
| Franchise rights | 146 | (110) | 36 |
| Customer relationships | 710 | (287) | 423 |
| Trade name | 200 | — | 200 |
| Trademarks, patents and other | 24 | (15) | 9 |
| Total Intangible Assets, Net | \$ 5,393 | \$ (3,217) | \$ 2,176 |
| December 31, 2019: | | | |
| Capitalized software | \$ 4,125 | \$ (2,704) | \$ 1,421 |
| Licenses | 117 | (64) | 53 |
| Franchise rights | 146 | (109) | 37 |
| Customer relationships | 730 | (282) | 448 |
| Trade name | 200 | — | 200 |
| Trademarks, patents and other | 29 | (21) | 8 |
| Total Intangible Assets, Net | \$ 5,347 | \$ (3,180) | \$ 2,167 |

As of March 31, 2020, we had a trade name with a carrying value of \$200 million and licenses with a carrying value of \$4 million, which are deemed to be indefinite-lived intangible assets and are included in the table above. Impairment tests for finite-lived intangible assets are performed when a triggering event occurs that may indicate that the carrying value of the intangible asset may not be recoverable. There was no impairment of finite-lived assets in 2020 or 2019.

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

NOTE 9. DEBT AND FINANCING ARRANGEMENTS

The carrying value of our outstanding debt as of March 31, 2020 and December 31, 2019 consists of the following (in millions):

| | Principal Amount | Maturity | Carrying Value | |
|------------------------------------|---------------------|-----------|------------------|------------------|
| | | | 2020 | 2019 |
| Commercial paper | \$ 3,256 | 2020 | \$ 3,245 | \$ 3,234 |
| Fixed-rate senior notes: | | | | |
| 3.125% senior notes | 1,500 | 2021 | 1,530 | 1,524 |
| 2.050% senior notes | 700 | 2021 | 699 | 699 |
| 2.450% senior notes | 1,000 | 2022 | 1,033 | 1,003 |
| 2.350% senior notes | 600 | 2022 | 598 | 598 |
| 2.500% senior notes | 1,000 | 2023 | 996 | 995 |
| 2.800% senior notes | 500 | 2024 | 497 | 497 |
| 2.200% senior notes | 400 | 2024 | 398 | 398 |
| 3.900% senior notes | 1,000 | 2025 | 994 | — |
| 2.400% senior notes | 500 | 2026 | 498 | 498 |
| 3.050% senior notes | 1,000 | 2027 | 992 | 992 |
| 3.400% senior notes | 750 | 2029 | 745 | 745 |
| 2.500% senior notes | 400 | 2029 | 397 | 397 |
| 4.450% senior notes | 750 | 2030 | 743 | — |
| 6.200% senior notes | 1,500 | 2038 | 1,483 | 1,483 |
| 5.200% senior notes | 500 | 2040 | 493 | — |
| 4.875% senior notes | 500 | 2040 | 490 | 490 |
| 3.625% senior notes | 375 | 2042 | 368 | 368 |
| 3.400% senior notes | 500 | 2046 | 491 | 491 |
| 3.750% senior notes | 1,150 | 2047 | 1,137 | 1,136 |
| 4.250% senior notes | 750 | 2049 | 742 | 742 |
| 3.400% senior notes | 700 | 2049 | 688 | 688 |
| 5.300% senior notes | 1,250 | 2050 | 1,230 | — |
| Floating-rate senior notes: | | | | |
| Floating-rate senior notes | 350 | 2021 | 349 | 349 |
| Floating-rate senior notes | 400 | 2022 | 399 | 399 |
| Floating-rate senior notes | 500 | 2023 | 499 | 499 |
| Floating-rate senior notes | 1,041 | 2049-2067 | 1,028 | 1,028 |
| 8.375% Debentures: | | | | |
| 8.375% debentures | 424 | 2020 | 424 | 426 |
| 8.375% debentures | 276 | 2030 | 281 | 281 |
| Pound Sterling notes: | | | | |
| 5.500% notes | 82 | 2031 | 81 | 86 |
| 5.125% notes | 562 | 2050 | 533 | 566 |
| Euro senior notes: | | | | |
| 0.375% notes | 767 | 2023 | 764 | 779 |
| 1.625% notes | 767 | 2025 | 764 | 779 |
| 1.000% notes | 548 | 2028 | 545 | 556 |
| 1.500% notes | 548 | 2032 | 545 | 556 |
| Floating-rate senior notes | 548 | 2020 | 548 | 559 |
| Canadian senior notes: | | | | |
| 2.125% notes | 529 | 2024 | 527 | 571 |
| Finance lease obligations | 500 | 2020-2210 | 500 | 498 |
| Facility notes and bonds | 320 | 2029-2045 | 320 | 320 |
| Other debt | 7 | 2020-2025 | 7 | 8 |
| Total debt | \$ 28,750 | | 28,601 | 25,238 |
| Less: Current maturities | | | (4,405) | (3,420) |
| Long-term debt | | | \$ 24,196 | \$ 21,818 |

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

Commercial Paper

We are authorized to borrow up to \$10.0 billion under a U.S. commercial paper program and €5.0 billion (in a variety of currencies) under a European commercial paper program. We had the following amounts outstanding under these programs as of March 31, 2020: \$2.3 billion with an average interest rate of 1.55% and €818 million (\$896 million) with an average interest rate of -0.42%. As of March 31, 2020, we have classified the entire commercial paper balance as a current liability on our consolidated balance sheets.

Debt Classification

We have classified our 3.125% senior notes due January 2021 with a principal balance of \$1.5 billion as long-term debt based on our intent and ability to refinance the debt as of March 31, 2020. We have classified certain floating-rate senior notes that are puttable by the note holders as long-term debt due to our intent and ability to refinance the debt if the put option is exercised by the note holders.

Debt Issuance

On March 24, 2020 we issued four series of notes, in the following principal amounts: \$1.0 billion, \$750 million, \$500 million and \$1.25 billion. These notes bear interest at 3.90%, 4.45%, 5.20% and 5.30%, respectively, and will mature on April 1, 2025, April 1, 2030, April 1, 2040 and April 1, 2050, respectively. Interest on the notes is payable semi-annually, beginning October 2020. Each series of notes is callable at our option at a redemption price equal to the greater of 100% of the principal amount, or the sum of the present values of scheduled payments of principal and interest, plus accrued and unpaid interest.

In such event, the present values of scheduled principal and interest payments are discounted to the redemption date on a semi-annual basis at the discount rate of the Treasury Rate plus 50 basis points, and are determined as follows:

- On the 3.90% notes, payments from the redemption date until one month prior to maturity
- On the 4.45% notes, payments from the redemption date until three months prior to maturity
- On the 5.20% and 5.30% notes, payments from the redemption date until six months prior to maturity

Sources of Credit

We maintain two credit agreements with a consortium of banks. One of these agreements provides revolving credit facilities of \$2.0 billion, and expires on December 8, 2020. Generally, amounts outstanding under this facility bear interest at a periodic fixed rate equal to LIBOR for the applicable interest period and currency denomination, plus an applicable margin. Alternatively, a fluctuating rate of interest equal to the highest of (1) the rate of interest last quoted by The Wall Street Journal as the prime rate in the United States; (2) the Federal Funds effective rate plus 0.50%; and (3) LIBOR for a one month interest period plus 1.00%, plus an applicable margin, may be used at our discretion. In each case, the applicable margin for advances bearing interest based on LIBOR is a percentage determined by quotations from Markit Group Ltd. for our one-year credit default swap spread, subject to a minimum rate of 0.25% and a maximum rate of 1.00%. The applicable margin for advances bearing interest based on the prime rate is 1.00% below the applicable margin for LIBOR advances (but not lower than 0%). We are also able to request advances under this facility based on competitive bids for the applicable interest rate. There were no amounts outstanding under this facility as of March 31, 2020.

The second agreement provides revolving credit facilities of \$2.5 billion, and expires on December 11, 2023. Generally, amounts outstanding under this facility bear interest at a periodic fixed rate equal to LIBOR for the applicable interest period and currency denomination, plus an applicable margin. Alternatively, a fluctuating rate of interest equal to the highest of (1) the rate of interest last quoted by The Wall Street Journal as the prime rate in the United States; (2) the Federal Funds effective rate plus 0.50%; and (3) LIBOR for a one month interest period plus 1.00%, plus an applicable margin, may be used at our discretion. In each case, the applicable margin for advances bearing interest based on LIBOR is a percentage determined by quotations from Markit Group Ltd. for our one-year credit default swap spread, interpolated for a period from the date of determination of such credit default swap spread in connection with a new interest period until the latest maturity date of this facility then in effect (but not less than a period of one year). The minimum applicable margin rate is 0.10% and the maximum applicable margin rate is 0.75% per annum. The applicable margin for advances bearing interest based on the prime rate is 1.00% below the applicable margin for LIBOR advances (but not less than 0%). We are also able to request advances under this facility based on competitive bids. There were no amounts outstanding under this facility as of March 31, 2020.

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

Debt Covenants

Our existing debt instruments and credit facilities subject us to certain financial covenants. As of March 31, 2020, and for all periods presented, we have satisfied these financial covenants. These covenants limit the amount of secured indebtedness that we may incur, and limit the amount of attributable debt in sale-leaseback transactions, to 10% of net tangible assets. As of March 31, 2020, 10% of net tangible assets was equivalent to \$3.9 billion; however, we had no covered sale-leaseback transactions or secured indebtedness outstanding. We do not expect these covenants to have a material impact on our financial condition or liquidity.

Fair Value of Debt

Based on the borrowing rates currently available to us for debt with similar terms and maturities, the fair value of long-term debt, including current maturities, was approximately \$30.9 and \$26.9 billion as of March 31, 2020 and December 31, 2019, respectively. We utilized Level 2 inputs in the fair value hierarchy of valuation techniques to determine the fair value of all of our debt instruments.

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

NOTE 10. LEASES

We recognize a right-of-use ("ROU") asset and lease liability for all leases. Some of our leases contain both lease and non-lease components, which we have elected to treat as a single lease component. We have also elected not to recognize leases that have an original lease term, including reasonably certain renewal or purchase options, of twelve months or less in our consolidated balance sheets for all classes of underlying assets. Lease costs for short-term leases are recognized on a straight-line basis over the lease term. We elected the package of transition practical expedients for existing contracts, which allowed us to carry forward our historical assessments of whether contracts are, or contain, leases, lease classification and determination of initial direct costs.

We lease property and equipment under finance and operating leases. We have finance and operating leases for package centers, airport facilities, warehouses, office space, aircraft, aircraft engines, information technology equipment (primarily mainframes, servers and copiers), vehicles and various other equipment used in operating our business. Certain leases for real estate and aircraft contain options to purchase, extend or terminate the lease. Determining the lease term and amount of lease payments to include in the calculation of the ROU asset and lease liability for leases containing options requires the use of judgment to determine whether the exercise of an option is reasonably certain, and if the optional period and payments should be included in the calculation of the associated ROU asset and lease liability. In making this determination, we consider all relevant economic factors that would compel us to exercise or not exercise an option.

When our leases contain future payments that are dependent on an index or rate, such as the consumer price index, we initially measure the lease liability and ROU asset using the index or rate at the commencement date. In subsequent periods, lease payments dependent on an index or rate are not remeasured. Rather, changes to payments due to a change in an index or rate are recognized in our statements of consolidated income in the period of the change.

When available, we use the rate implicit in the lease to discount lease payments; however, the rate implicit in the lease is not readily determinable for substantially all of our leases. For these leases, we use an estimate of our incremental borrowing rate to discount lease payments based on information available at lease commencement. The incremental borrowing rate is derived using multiple inputs including our credit rating, the impact of full collateralization, lease term and denominated currency. The remaining lease terms vary from 1 month to 190 years.

Aircraft

In addition to the aircraft that we own, we have leases for 323 aircraft. Of these leased aircraft, 27 are classified as finance leases, 15 are classified as operating leases and the remaining 281 are classified as short-term leases. A majority of the obligations associated with the aircraft classified as finance leases have been legally defeased. Most of our long-term aircraft operating leases are operated by a third party to handle package and cargo volume in geographic regions where, due to government regulations, we are restricted from operating an airline.

In order to meet customers' needs, we charter aircraft to handle package and cargo volume on certain international trade lanes and domestic routes. Due to the nature of these agreements, primarily being that either party can cancel the agreement with short notice, we have classified these as short-term leases. Additionally, the lease payments associated with these charter agreements are variable in nature based on the number of hours flown.

Real Estate

We have operating and finance leases for package centers, airport facilities, warehouses, office space and expansion facilities utilized during peak shipping periods. Many of our leases contain charges for common area maintenance or other miscellaneous expenses that are updated based on landlord estimates. Due to this variability, the cash flows associated with these charges are not included in the minimum lease payments used in determining the ROU asset and associated lease liability.

Some of our real estate leases contain options to renew or extend the lease or terminate the lease before the expiration date. These options are factored into the determination of the lease term and lease payments when their exercise is considered to be reasonably certain.

We also enter into real estate leases that contain lease incentives, such as tenant improvement allowances or move-in allowances, that are received or receivable at lease commencement. These incentives reduce lease payments for classification purposes and reduce the initial ROU asset. When lease incentives are receivable at lease commencement, they also reduce the initial lease liability.

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

From time to time, we enter into leases with the intention of purchasing the property, either through purchase options with a fixed price or a purchase agreement negotiated contemporaneously with the lease agreement. We classify these leases as finance leases and include the purchase date and purchase price in the lease term and lease payments, respectively, when the option to exercise or purchase is reasonably certain.

Transportation equipment and other equipment

We enter into both long-term and short-term leases for transportation equipment to supplement our capacity or meet contractual demands. Some of these assets are leased on a month-to-month basis and the leases can be terminated without penalty. The lease term for these types of leases is determined by the length of the underlying customer contract or based on the judgment of the business unit. We also enter into multi-year leases for trailers to increase capacity during periods of high demand, which are typically only used for 90-120 days during the year. These leases are treated as short-term as the cumulative right-of-use is less than 12 months over the term of the contract.

The remainder of our leases are primarily related to equipment used in our air operations, vehicles required to meet capacity needs during periods of higher demand for our shipping services, technology equipment and office equipment used in our facilities.

Some of our transportation and technology equipment leases require us to make additional lease payments based on the underlying usage of the assets. Due to the variable nature of these costs, these are expensed as incurred and are not included in the ROU asset and lease liability.

The components of lease expense for the three months ended March 31, 2020 and 2019 were as follows (in millions):

| | Three Months Ended | |
|-------------------------------|---------------------------|---------------|
| | March 31, | |
| | 2020 | 2019 |
| Operating lease costs | \$ 175 | \$ 157 |
| Finance lease costs: | | |
| Amortization of assets | 18 | 19 |
| Interest on lease liabilities | 5 | 5 |
| Total finance lease costs | 23 | 24 |
| Variable lease costs | 58 | 48 |
| Short-term lease costs | 203 | 230 |
| Total lease costs | <u>\$ 459</u> | <u>\$ 459</u> |

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

Supplemental information related to leases and location within our consolidated balance sheets are as follows (in millions, except lease term and discount rate):

| | March 31, 2020 | December 31, 2019 |
|---|-------------------|----------------------|
| Operating Leases: | | |
| Operating lease right-of-use assets | \$ 3,041 | \$ 2,856 |
| Current maturities of operating leases | \$ 526 | \$ 538 |
| Non-current operating leases | 2,493 | 2,391 |
| Total operating lease liabilities | <u>\$ 3,019</u> | <u>\$ 2,929</u> |
| Finance Leases: | | |
| Property, plant and equipment, net | \$ 1,387 | \$ 1,502 |
| Current maturities of long-term debt, commercial paper and finance leases | \$ 181 | \$ 181 |
| Long-term debt and finance leases | 319 | 317 |
| Total finance lease liabilities | <u>\$ 500</u> | <u>\$ 498</u> |
| Weighted average remaining lease term (in years): | | |
| Operating leases | 9.6 | 9.7 |
| Finance leases | 8.6 | 8.9 |
| Weighted average discount rate: | | |
| Operating leases | 2.81 % | 2.78 % |
| Finance leases | 4.05 % | 4.03 % |

Supplemental cash flow information related to leases is as follows (in millions):

| | Three Months Ended March 31, | |
|--|---------------------------------|--------|
| | 2020 | 2019 |
| Cash paid for amounts included in measurement of liabilities: | | |
| Operating cash flows from operating leases | \$ 175 | \$ 153 |
| Operating cash flows from finance leases | 2 | 2 |
| Financing cash flows from finance leases | 6 | 4 |
| Right-of-use assets obtained in exchange for lease liabilities: | | |
| Operating leases | \$ 305 | \$ 34 |
| Finance leases | 10 | 1 |

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

Maturities of lease liabilities as of March 31, 2020 are as follows (in millions):

| | Finance Leases | Operating Leases |
|-----------------------------|-----------------------|-------------------------|
| 2020 | \$ 191 | \$ 454 |
| 2021 | 47 | 576 |
| 2022 | 41 | 489 |
| 2023 | 39 | 397 |
| 2024 | 36 | 289 |
| Thereafter | 259 | 1,413 |
| Total lease payments | 613 | 3,618 |
| Less: Imputed interest | (113) | (599) |
| Total lease obligations | 500 | 3,019 |
| Less: Current obligations | (181) | (526) |
| Long-term lease obligations | \$ 319 | \$ 2,493 |

As of March 31, 2020, we have additional leases which have not commenced. These leases will commence when we are granted access to the property, such as when leasehold improvements are completed by the lessor or a certificate of occupancy is obtained. These leases will commence in 2020.

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

NOTE 11. LEGAL PROCEEDINGS AND CONTINGENCIES

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

Although there can be no assurance as to the ultimate outcome, we have generally denied, or believe we have a meritorious defense and will deny, liability in all pending matters, including (except as otherwise noted herein) the matters described below, and we intend to vigorously defend each matter. We accrue amounts associated with legal proceedings when and to the extent a loss becomes probable and can be reasonably estimated. The actual costs of resolving legal proceedings may be substantially higher or lower than the amounts accrued on those claims.

For matters as to which we are not able to estimate a possible loss or range of losses, we are not able to determine whether any such loss will have a material adverse effect on our business, financial condition, results of operations or liquidity. For matters in this category, we have indicated in the descriptions that follow the reasons that we are unable to estimate the possible loss or range of losses.

Judicial Proceedings

In February 2015, the State and City of New York filed suit against UPS in the U.S. District Court for the Southern District of New York, arising from alleged shipments of cigarettes to New York State and City residents. The complaint asserted claims under various federal and state laws. The complaint also included a claim that UPS violated the Assurance of Discontinuance it entered into with the New York Attorney General in 2005 concerning cigarette deliveries. On March 24, 2017, the District Court issued an opinion and order finding liability against UPS on each of the plaintiffs' causes of action. On May 25, 2017, the District Court issued a corrected opinion and order on liability and an order awarding the plaintiffs damages of \$9 million and penalties of \$238 million. Following an appeal, on November 7, 2019, the U.S. Court of Appeals for the Second Circuit issued an order awarding the plaintiffs damages of \$19 million and penalties of \$79 million. An accrual of \$100 million with respect to this matter is included on our consolidated balance sheets at both March 31, 2020 and December 31, 2019. We estimate that the amount of losses could be up to \$247 million, plus interest; however, the amount of penalties ultimately payable, if any, is subject to a variety of complex factors and potential outcomes that could be determined in future legal proceedings, which would include a petition for a writ of certiorari with the U.S. Supreme Court.

We are a defendant in a number of lawsuits filed in state and federal courts containing various class action allegations under state wage-and-hour laws. At this time, we do not believe that any loss associated with any matter would have a material adverse effect on our financial condition, results of operations or liquidity. One of these matters, Hughes v. UPS Supply Chain Solutions, Inc. and United Parcel Service, Inc. had previously been certified as a class action in Kentucky state court. In the second quarter of 2019, the court granted our motion for judgment on the pleadings related to the wage-and-hour claims. The plaintiffs have appealed this decision.

Other Matters

In October 2015, the Department of Justice ("DOJ") informed us of an industry-wide inquiry into the transportation of mail under the United States Postal Service ("USPS") International Commercial Air contracts. In October 2017, we received a Civil Investigative Demand seeking certain information relating to our contracts. The DOJ has indicated it is investigating potential violations of the False Claims Act or other statutes. We are cooperating with the DOJ. We are unable to predict what action, if any, might be taken in the future by any government authorities as a result of their investigation. Accordingly, at this time, we are not able to estimate a possible loss or range of losses that may result from this matter or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

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

In August 2016, Spain's National Markets and Competition Commission ("CNMC") announced an investigation into 10 companies in the commercial delivery and parcel industry, including UPS, related to alleged nonaggression agreements to allocate customers. In May 2017, UPS received a Statement of Objections issued by the CNMC. In July 2017, UPS received a Proposed Decision from the CNMC. On March 8, 2018, the CNMC adopted a final decision, finding an infringement and imposing a fine on UPS of €19 million. UPS appealed the decision and in September 2018, obtained a suspension of the implementation of the decision (including payment of the fine). The appeal is pending. There are multiple factors that prevent us from being able to estimate a possible loss or range of losses, that may result from this matter or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity including: (1) we are vigorously defending ourselves and believe that we have a number of meritorious legal defenses; and (2) there are unresolved questions of law and fact that could be important to the ultimate resolution of this matter.

In February 2018, the Turkish Competition Authority ("Authority") opened an investigation into nine companies in the small package industry, including UPS, related to alleged customer allocations in violation of Turkish competition law. In April 2018, the Authority consolidated this investigation with two other investigations involving similar allegations. The consolidated investigation involves over 30 companies. In January 2020, the Authority held a hearing and announced a summary decision, finding an infringement and imposing an immaterial fine on UPS. We do not believe that any loss associated with this matter will have a material adverse effect on our financial condition, results of operations or liquidity.

We are a party in various other matters that arose in the normal course of business. We do not believe that the eventual resolution of these other matters (either individually or in the aggregate), including any reasonably possible losses in excess of current accruals, will have a material adverse effect on our financial condition, results of operations or liquidity.

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

NOTE 12. SHAREOWNERS' EQUITY
Capital Stock, Additional Paid-In Capital, Retained Earnings and Non-Controlling Minority Interest

We maintain two classes of common stock, which are distinguished from each other by their respective voting rights. Class A shares of UPS are entitled to 10 votes per share, whereas class B shares are entitled to one vote per share. Class A shares are primarily held by UPS employees and retirees, as well as trusts and descendants of the Company's founders, and these shares are fully convertible into class B shares at any time. Class B shares are publicly traded on the NYSE under the symbol "UPS". Class A and B shares both have a \$0.01 par value, and as of March 31, 2020, there were 4.6 billion class A shares and 5.6 billion class B shares authorized to be issued. Additionally, there are 200 million preferred shares authorized to be issued, with a par value of \$0.01 per share. As of March 31, 2020, no preferred shares had been issued.

The following is a rollforward of our common stock, additional paid-in capital, retained earnings and non-controlling minority interest accounts for the three months ended March 31, 2020 and 2019 (in millions, except per share amounts):

| | 2020 | | 2019 | |
|--|------------|-----------------|------------|-----------------|
| | Shares | Dollars | Shares | Dollars |
| Class A Common Stock | | | | |
| Balance at beginning of period | 156 | \$ 2 | 163 | \$ 2 |
| Common stock purchases | — | — | (1) | — |
| Stock award plans | 4 | — | 3 | — |
| Common stock issuances | 2 | — | 2 | — |
| Conversions of class A to class B common stock | (4) | — | (3) | — |
| Class A shares issued at end of period | <u>158</u> | <u>\$ 2</u> | <u>164</u> | <u>\$ 2</u> |
| Class B Common Stock | | | | |
| Balance at beginning of period | 701 | \$ 7 | 696 | \$ 7 |
| Common stock purchases | (2) | — | (2) | — |
| Conversions of class A to class B common stock | 4 | — | 3 | — |
| Class B shares issued at end of period | <u>703</u> | <u>7</u> | <u>697</u> | <u>7</u> |
| Additional Paid-In Capital | | | | |
| Balance at beginning of period | | \$ 150 | | \$ — |
| Common stock purchases | | (217) | | (251) |
| Stock award plans | | (67) | | 169 |
| Common stock issuances | | 163 | | 114 |
| Option premiums paid | | — | | (5) |
| Balance at end of period | | <u>\$ 29</u> | | <u>\$ 27</u> |
| Retained Earnings | | | | |
| Balance at beginning of period | | \$ 9,105 | | 8,006 |
| Net income attributable to common shareowners | | 965 | | 1,111 |
| Dividends (\$1.01 and \$0.96 per share) ⁽¹⁾ | | (933) | | (867) |
| Other | | — | | (1) |
| Balance at end of period | | <u>\$ 9,137</u> | | <u>\$ 8,249</u> |
| Non-Controlling Minority Interest | | | | |
| Balance at beginning of period | | \$ 16 | | \$ 16 |
| Change in non-controlling minority interest | | (2) | | 2 |
| Balance at end of period | | <u>\$ 14</u> | | <u>\$ 18</u> |

⁽¹⁾ The dividend per share amount is the same for both class A and class B common stock. Dividends include \$93 and \$68 million as of March 31, 2020 and March 31, 2019 respectively, that were settled in shares of class A common stock.

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

In May 2016, the Board of Directors approved a share repurchase authorization of \$8.0 billion for shares of class A and class B common stock, which has no expiration date. As of March 31, 2020, we had \$2.1 billion of this share repurchase authorization available.

Share repurchases may be in the form of accelerated share repurchase programs, open market purchases or other such methods as we deem appropriate. The timing of share repurchases will depend upon market conditions. Unless terminated earlier by the Board, the program will expire when we have purchased all shares authorized for repurchase under the program.

We repurchased 2.1 and 2.4 million shares of class A and class B common stock for \$217 and \$251 million during the three months ended March 31, 2020 and 2019 (\$220 million and \$246 million in repurchases for 2020 and 2019, respectively, are reported on the statements of consolidated cash flows due to the timing of settlements).

From time to time, we enter into share repurchase programs with large financial institutions to assist in our buyback of company stock. These programs may allow us to repurchase our shares at a price below the weighted average UPS share price for a given period. During the first quarter of 2020, we did not enter into any accelerated share repurchase transactions.

In order to lower the average cost of acquiring shares in our ongoing share repurchase program, we periodically enter into structured repurchase agreements involving the use of capped call options for the purchase of UPS class B shares. We pay a fixed sum of cash upon execution of each agreement in exchange for the right to receive either a pre-determined amount of cash or stock. Upon expiration of each agreement, if the closing market price of our common stock is above the pre-determined price, we will have our initial investment returned with a premium in either cash or shares (at our election). If the closing market price of our common stock is at or below the pre-determined price, we will receive the number of shares specified in the agreement. We paid net premiums of \$5 million during the first three months of 2019, related to entering into and settling capped call options for the purchase of class B shares. As of March 31, 2020, we had no capped call options outstanding.

On April 28, 2020 we announced our intention to suspend stock repurchases for the remainder of 2020.

Movements in Additional Paid-In Capital in respect of stock award plans comprise accruals for unvested awards, offset by adjustments for awards that vest during the period. The reduction in the first quarter of 2020 was driven by changes in the vesting schedule for certain of our awards.

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

Accumulated Other Comprehensive Income (Loss)

We recognize 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 three months ended March 31, 2020 and 2019 is as follows (in millions):

| Three Months Ended March 31: | 2020 | 2019 |
|---|-------------|-------------|
| Foreign currency translation gain (loss), net of tax: | | |
| Balance at beginning of period | \$ (1,078) | \$ (1,126) |
| Translation adjustment (net of tax effect of \$13 and \$9) | (141) | 53 |
| Balance at end of period | (1,219) | (1,073) |
| Unrealized gain (loss) on marketable securities, net of tax: | | |
| Balance at beginning of period | 4 | (2) |
| Current period changes in fair value (net of tax effect of \$0 and \$0) | 2 | 4 |
| Balance at end of period | 6 | 2 |
| Unrealized gain (loss) on cash flow hedges, net of tax: | | |
| Balance at beginning of period | 112 | 40 |
| Current period changes in fair value (net of tax effect of \$83 and \$28) | 263 | 89 |
| Reclassification to earnings (net of tax effect of \$(15) and \$(4)) | (46) | (13) |
| Balance at end of period | 329 | 116 |
| Unrecognized pension and postretirement benefit costs, net of tax: | | |
| Balance at beginning of period | (5,035) | (3,906) |
| Reclassification to earnings (net of tax effect of \$14 and \$13) | 43 | 43 |
| Balance at end of period | (4,992) | (3,863) |
| Accumulated other comprehensive income (loss) at end of period | \$ (5,876) | \$ (4,818) |

Detail of the gains (losses) reclassified from AOCI to the statements of consolidated income for the three months ended March 31, 2020 and 2019 is as follows (in millions):

Three Months Ended March 31:

| | Amount Reclassified from AOCI | | Affected Line Item in the Income Statement |
|---|--------------------------------------|-------------|---|
| | 2020 | 2019 | |
| Unrealized gain (loss) on cash flow hedges: | | | |
| Interest rate contracts | (3) | (6) | Interest expense |
| Foreign exchange contracts | 64 | 23 | Revenue |
| Income tax (expense) benefit | (15) | (4) | Income tax expense |
| Impact on net income | 46 | 13 | Net income |
| Unrecognized pension and postretirement benefit costs: | | | |
| Prior service costs | (57) | (56) | Investment income and other |
| Income tax (expense) benefit | 14 | 13 | Income tax expense |
| Impact on net income | (43) | (43) | Net income |
| Total amount reclassified for the period | \$ 3 | \$ (30) | Net income |

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

Deferred Compensation Obligations and Treasury Stock

Activity in the deferred compensation program for the three months ended March 31, 2020 and 2019 is as follows (in millions):

| Three Months Ended March 31: | 2020 | | 2019 | |
|---|----------|--------------|------------|--------------|
| | Shares | Dollars | Shares | Dollars |
| Deferred Compensation Obligations: | | | | |
| Balance at beginning of period | | \$ 26 | | \$ 32 |
| Reinvested dividends | | — | | 1 |
| Benefit payments | | (7) | | (8) |
| Balance at end of period | | <u>\$ 19</u> | | <u>\$ 25</u> |
| Treasury Stock: | | | | |
| Balance at beginning of period | — | \$ (26) | (1) | \$ (32) |
| Reinvested dividends | — | — | — | (1) |
| Benefit payments | — | 7 | — | 8 |
| Balance at end of period | <u>—</u> | <u>(19)</u> | <u>(1)</u> | <u>(25)</u> |

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

NOTE 13. SEGMENT INFORMATION

We report our operations in three segments: U.S. Domestic Package, International Package and Supply Chain & Freight. 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 products within their geographic area.

U.S. Domestic Package

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

International Package

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

Supply Chain & Freight

Supply Chain & Freight includes Forwarding, Logistics, Coyote, Marken, UPS Mail Innovations, UPS Freight and other aggregated business units. Our Forwarding, Logistics and UPS Mail Innovations business units provide services in more than 200 countries and territories worldwide and include international air and ocean freight forwarding, customs brokerage, distribution and post-sales services, mail and consulting services. UPS Freight offers a variety of less-than-truckload ("LTL") and truckload ("TL") services to customers in North America. Coyote offers truckload brokerage services primarily in the United States. Marken is a global provider of supply chain solutions to the life sciences industry. Other aggregated business units within this segment include The UPS Store and UPS Capital.

In evaluating financial performance, we focus on operating profit as a segment's measure of profit or loss. Operating profit is before investment income and other, 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 audited, consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2019, and in the "Results of Operations - Segment Review" section of Management's Discussion and Analysis included in this report. Certain expenses are allocated between the segments using activity-based costing methods.

Segment information for the three months ended March 31, 2020 and 2019 is as follows (in millions):

| | Three Months Ended | |
|--------------------------|---------------------------|------------------|
| | March 31, | |
| | 2020 | 2019 |
| Revenue: | | |
| U.S. Domestic Package | \$ 11,456 | \$ 10,480 |
| International Package | 3,383 | 3,459 |
| Supply Chain & Freight | 3,196 | 3,221 |
| Consolidated | <u>\$ 18,035</u> | <u>\$ 17,160</u> |
| Operating Profit: | | |
| U.S. Domestic Package | \$ 364 | \$ 666 |
| International Package | 551 | 528 |
| Supply Chain & Freight | 157 | 200 |
| Consolidated | <u>\$ 1,072</u> | <u>\$ 1,394</u> |

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

NOTE 14. EARNINGS PER SHARE

The earnings per share amounts are the same for class A and class B common shares as the holders of each class are legally entitled to equal per share distributions whether through dividends or in liquidation.

The following table sets forth the computation of basic and diluted earnings per share for the three months ended March 31, 2020 and 2019 (in millions, except per share amounts):

| | Three Months Ended March 31, | |
|---|---------------------------------|----------------|
| | 2020 | 2019 |
| Numerator: | | |
| Net income attributable to common shareowners | \$ 965 | \$ 1,111 |
| Denominator: | | |
| Weighted average shares | 858 | 860 |
| Deferred compensation obligations | — | 1 |
| Vested portion of restricted units | 6 | 5 |
| Denominator for basic earnings per share | 864 | 866 |
| Effect of dilutive securities: | | |
| Restricted units | 5 | 3 |
| Stock options | — | — |
| Denominator for diluted earnings per share | 869 | 869 |
| Basic earnings per share | \$ 1.12 | \$ 1.28 |
| Diluted earnings per share | \$ 1.11 | \$ 1.28 |

Diluted earnings per share for the three months ended March 31, 2020 and 2019 excluded the effect of 1.2 and 0.9 million shares of common stock, respectively, that may be issued upon the exercise of employee stock options because such effect would be antidilutive.

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

NOTE 15. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT*Risk Management Policies*

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

Credit Risk Management

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

We have agreements with all of our active counterparties (covering the majority of our derivative positions) containing early termination rights and/or zero threshold bilateral collateral provisions whereby cash is required based on the net fair value of derivatives associated with those counterparties.

At March 31, 2020 and December 31, 2019, we held cash collateral of \$706 and \$495 million, respectively, under these agreements; this collateral is included in "Cash and cash equivalents" in the consolidated balance sheets and its use by UPS is not restricted. At each of March 31, 2020 and December 31, 2019, respectively, no additional collateral was required to be posted with our counterparties.

Events such as a counterparty credit rating downgrade (depending on the ultimate rating level) could also allow us to take additional protective measures such as the early termination of trades. Alternatively, we could be required to provide additional collateral or terminate transactions with certain counterparties in the event of a downgrade of our credit rating. The amount of collateral required would be determined by the net fair value of the associated derivatives with each counterparty. We have not historically incurred, and do not expect to incur in the future, any losses as a result of counterparty default.

At March 31, 2020 and December 31, 2019 there were no instruments in a net liability position that were not covered by the zero threshold bilateral collateral provisions.

*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. In order to mitigate the impact of fuel surcharges imposed on us by outside carriers, we regularly adjust the rates we charge for our freight brokerage, inter-modal and truckload services. We periodically enter into derivative 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 normally designate and account for these contracts as cash flow hedges of the underlying forecasted transactions involving these fuel products and, therefore, the resulting gains and losses from these hedges are recognized as a component of fuel expense or revenue when the underlying transactions occur.

Foreign Currency Risk Management

To protect against the reduction in value of forecasted foreign currency cash flows from our international package business, we maintain a foreign currency cash flow hedging program. Our most significant foreign currency exposures relate to the Euro, British Pound Sterling, Canadian Dollar, Chinese Renminbi and Hong Kong Dollar. We hedge portions of our forecasted revenue denominated in foreign currencies with option and forward contracts. We normally designate 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.

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

We also hedge portions of our anticipated cash settlements of intercompany transactions and interest payments on certain debt subject to foreign currency remeasurement using foreign currency forward contracts. We normally designate and account for these contracts as cash flow hedges of forecasted foreign currency denominated transactions; therefore, the resulting gains and losses from these hedges are recognized as a component of investment income and other when the underlying transactions are subject to currency remeasurement.

We hedge our net investment in certain foreign operations with foreign currency denominated debt instruments. The use of foreign denominated debt as the hedging instrument allows the debt to be remeasured to foreign currency translation adjustment within AOCI to offset the translation risk from those investments. Balances in the cumulative translation adjustment accounts remain until the sale or substantially complete liquidation of the foreign entity, upon which they are recognized as a component of investment income and other.

Interest Rate Risk Management

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

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

We periodically hedge the forecasted fixed-coupon interest payments associated with anticipated debt offerings by 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 March 31, 2020 and December 31, 2019, the notional amounts of our outstanding derivative positions were as follows (in millions):

| | | March 31, 2020 | | December 31, 2019 |
|---------------------------------------|-----|-----------------------|-----|--------------------------|
| Currency hedges: | | | | |
| Euro | EUR | 4,018 | EUR | 4,571 |
| British Pound Sterling | GBP | 1,399 | GBP | 1,494 |
| Canadian Dollar | CAD | 1,369 | CAD | 1,402 |
| Hong Kong Dollar | HKD | 3,270 | HKD | 3,327 |
| Interest rate hedges: | | | | |
| Fixed to Floating Interest Rate Swaps | USD | 3,674 | USD | 3,674 |
| Floating to Fixed Interest Rate Swaps | USD | 778 | USD | 778 |

As of March 31, 2020 and December 31, 2019, we had no outstanding commodity hedge positions.

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

Balance Sheet Recognition

The following table indicates the location in the consolidated balance sheets where our derivative assets and liabilities have been recognized, the fair value hierarchy level applicable to each derivative type and the related fair values of those derivatives (in millions).

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

| Asset Derivatives | Balance Sheet Location | Fair Value Hierarchy Level | Gross Amounts Presented in Consolidated Balance Sheets | | Net Amounts if Right of Offset had been Applied | |
|--|--------------------------|----------------------------|--|-------------------|---|-------------------|
| | | | March 31, 2020 | December 31, 2019 | March 31, 2020 | December 31, 2019 |
| Derivatives designated as hedges: | | | | | | |
| Foreign exchange contracts | Other current assets | Level 2 | \$ 230 | \$ 138 | \$ 229 | \$ 131 |
| Interest rate contracts | Other current assets | Level 2 | 24 | 2 | 24 | 2 |
| Foreign exchange contracts | Other non-current assets | Level 2 | 427 | 252 | 426 | 236 |
| Interest rate contracts | Other non-current assets | Level 2 | 34 | 21 | 31 | 20 |
| Derivatives not designated as hedges: | | | | | | |
| Foreign exchange contracts | Other current assets | Level 2 | 3 | 7 | 3 | 7 |
| Interest rate contracts | Other current assets | Level 2 | 15 | — | 13 | — |
| Interest rate contracts | Other non-current assets | Level 2 | — | 12 | — | 11 |
| Total Asset Derivatives | | | \$ 733 | \$ 432 | \$ 726 | \$ 407 |

| Liability Derivatives | Balance Sheet Location | Fair Value Hierarchy Level | Gross Amounts Presented in Consolidated Balance Sheets | | Net Amounts if Right of Offset had been Applied | |
|--|-------------------------------|----------------------------|--|-------------------|---|-------------------|
| | | | March 31, 2020 | December 31, 2019 | March 31, 2020 | December 31, 2019 |
| Derivatives designated as hedges: | | | | | | |
| Foreign exchange contracts | Other current liabilities | Level 2 | \$ 1 | \$ 7 | \$ — | \$ — |
| Foreign exchange contracts | Other non-current liabilities | Level 2 | 1 | 16 | — | — |
| Interest rate contracts | Other non-current liabilities | Level 2 | 15 | 11 | 12 | 10 |
| Derivatives not designated as hedges: | | | | | | |
| Interest rate contracts | Other current liabilities | Level 2 | 8 | — | 6 | — |
| Interest rate contracts | Other non-current liabilities | Level 2 | — | 3 | — | 2 |
| Total Liability Derivatives | | | \$ 25 | \$ 37 | \$ 18 | \$ 12 |

Our foreign exchange, interest rate and investment market price 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 investment forward prices; therefore, these derivatives are classified as Level 2. At March 31, 2020 and December 31, 2019 we did not have any derivatives that were classified as Level 1 (valued using quoted prices in active markets for identical assets) or Level 3 (valued using significant unobservable inputs).

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

Balance Sheet Location of Hedged Item in Fair Value Hedges

The following table indicates the amounts that were recorded in the consolidated balance sheets related to cumulative basis adjustments for fair value hedges as of March 31, 2020 and December 31, 2019 (in millions):

| Line Item in the Consolidated Balance Sheets in Which the Hedged Item is Included | Carrying Amount of Hedged Liabilities | Cumulative Amount of Fair Value Hedge Adjustments | Carrying Amount of Hedged Liabilities | Cumulative Amount of Fair Value Hedge Adjustments |
|---|---------------------------------------|---|---------------------------------------|---|
| | March 31, 2020 | March 31, 2020 | December 31, 2019 | December 31, 2019 |
| Long-term debt and finance leases | \$ 3,267 | \$ 73 | \$ 3,234 | \$ 40 |

The cumulative amount of fair value hedging losses remaining for any hedged assets and liabilities for which hedge accounting has been discontinued as of March 31, 2020 is \$14 million. These amounts will be recognized over the next 11 years.

Income Statement and AOCI Recognition

The following table indicates the amount of gains and (losses) that have been recognized in the income statement for the fair value and cash flow hedges, as well as the associated gain or (loss) for the underlying hedged item for fair value hedges for the three months ended March 31, 2020 and 2019 (in millions):

| Location and Amount of Gain (Loss) Recognized in Income on Fair Value and Cash Flow Hedging Relationships | Three Months Ended March 31, | | | |
|---|------------------------------|------------------|--------------|------------------|
| | 2020 | | 2019 | |
| | Revenue | Interest Expense | Revenue | Interest Expense |
| Gain or (loss) on fair value hedging relationships: | | | | |
| Interest Contracts: | | | | |
| Hedged items | \$ — | \$ (36) | \$ — | \$ (15) |
| Derivatives designated as hedging instruments | — | 36 | — | 15 |
| Gains or (loss) on cash flow hedging relationships: | | | | |
| Interest Contracts: | | | | |
| Amount of gain or (loss) reclassified from accumulated other comprehensive income | — | (3) | — | (6) |
| Foreign Exchange Contracts: | | | | |
| Amount of gain or (loss) reclassified from accumulated other comprehensive income | 64 | — | 23 | — |
| Total amounts of income and expense line items presented in the statement of income in which the effects of fair value or cash flow hedges are recorded | <u>\$ 64</u> | <u>\$ (3)</u> | <u>\$ 23</u> | <u>\$ (6)</u> |

The following table indicates the amount of gains and (losses) that have been recognized in AOCI for the three months ended March 31, 2020 and 2019 for those derivatives designated as cash flow hedges (in millions):

Three Months Ended March 31:

| Derivative Instruments in Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in AOCI on Derivatives | |
|---|---|---------------|
| | 2020 | 2019 |
| Interest rate contracts | \$ (1) | \$ 13 |
| Foreign exchange contracts | 347 | 104 |
| Total | <u>\$ 346</u> | <u>\$ 117</u> |

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

As of March 31, 2020, there were \$293 million of pre-tax gains related to cash flow hedges deferred in AOCI that are expected to be reclassified to income over the 12 month period ending March 31, 2021. The actual amounts that will be reclassified to income over the next 12 months will vary from this amount as a result of changes in market conditions. The maximum term over which we are hedging exposures to the variability of cash flows is approximately 13 years.

The following table indicates the amount of gains and (losses) that have been recognized in AOCI within foreign currency translation adjustment for the three months ended March 31, 2020 and 2019 for those instruments designated as net investment hedges (in millions):

Three Months Ended March 31:

| Non-derivative Instruments in Net Investment Hedging Relationships | Amount of Gain (Loss) Recognized in AOCI on Debt | |
|---|---|-------------|
| | 2020 | 2019 |
| Foreign denominated debt | \$ 150 | \$ 73 |
| Total | \$ 150 | \$ 73 |

Additionally, we maintain interest rate swaps, foreign exchange forwards and investment market price forward contracts that are not designated as hedges. The interest rate swap contracts are intended to provide an economic hedge of portions of our outstanding debt. The foreign exchange forward contracts are intended to provide an economic offset to foreign currency remeasurement and settlement risk for certain assets and liabilities on our consolidated balance sheets. The investment market price forward contracts are intended to provide an economic offset to fair value fluctuations of certain investments in marketable securities.

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

The following is a summary of the amounts recorded in the statements of consolidated income related to fair value changes and settlements of these interest rate swaps, foreign currency forward and investment market price forward contracts not designated as hedges for the three months ended March 31, 2020 and 2019 (in millions):

| Derivative Instruments Not Designated in Hedging Relationships | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income | |
|---|---|---|-------------|
| | | 2020 | 2019 |
| Three Months Ended March 31: | | | |
| Interest rate contracts | Interest expense | \$ (2) | \$ (2) |
| Foreign exchange contracts | Investment income and other | (51) | (1) |
| Total | | \$ (53) | \$ (3) |

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

NOTE 16. INCOME TAXES

Our effective tax rate for both the three months ended March 31, 2020 and March 31, 2019 was approximately 22.8%. The recognition in income tax of excess tax benefits related to share-based compensation reduced our effective rate by 0.7% for the three months ended March 31, 2020 compared to 0.4% in the same period of 2019. Other items that impacted our effective tax rate in the first quarter of 2020 compared to 2019 include unfavorable changes in uncertain tax positions.

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2019, we have recognized liabilities for uncertain tax positions. We reevaluate these uncertain tax positions on a quarterly basis. A number of years may elapse before an uncertain tax position is audited and ultimately settled. It is difficult to predict the ultimate outcome or the timing of resolution for uncertain tax positions. It is reasonably possible that the amount of unrecognized tax benefits could significantly increase or decrease within the next twelve months. However, an estimate of the range of reasonably possible outcomes cannot be made. Items that may cause changes to unrecognized tax benefits include the timing of interest deductions and the allocation of income and expense between tax jurisdictions. These changes could result from the settlement of ongoing litigation, the completion of ongoing examinations, the expiration of the statutes of limitations, additional regulatory guidance on the Tax Cuts and Jobs Act or other unforeseen circumstances.

As discussed in note 17, we recognized pre-tax transformation strategy costs of \$45 million in the first quarter of 2020 compared to \$123 million in the first quarter of 2019. As a result, we recorded an additional income tax benefit of \$10 million in the first quarter of 2020 compared to \$30 million in the first quarter of 2019. This benefit was generated at a higher average tax rate than the U.S. federal statutory tax rate primarily due to the effect of U.S. state and local taxes and foreign taxes.

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

NOTE 17. TRANSFORMATION STRATEGY COSTS

In the first quarter of 2018, we launched the first phase of a multi-year, enterprise-wide transformation strategy impacting our organization. Over the next several years additional phases will be implemented. The program includes investments, as well as changes in processes and technology, that impact global direct and indirect operating costs.

The table below presents the transformation strategy costs for the three months ended March 31, 2020 and 2019 (in millions):

| | Three Months Ended March 31, | |
|---|---|---------------|
| | 2020 | 2019 |
| Transformation Strategy Costs: | | |
| Compensation and benefits | \$ 12 | \$ 106 |
| Total other expenses | 33 | 17 |
| Total Transformation Strategy Costs | \$ 45 | \$ 123 |
| Income Tax Benefit from Transformation Strategy Costs | (10) | (30) |
| After Tax Transformation Strategy Costs | \$ 35 | \$ 93 |

The income tax effects of transformation strategy costs are calculated by multiplying the amount of the adjustments by the statutory tax rates applicable in each tax jurisdiction.

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

During the first quarter of 2020, a pandemic caused by a novel strain of coronavirus ("COVID-19") and the resulting actions taken by governments around the world to attempt to contain the spread of the virus impacted our business globally. In particular, shutdowns and other restrictions implemented in many countries impacted the overall mix of demand for our services, with business-to-business activity declining and business-to-consumer activity increasing significantly as consumers migrated online.

This change in customer and product mix impacted our U.S. Domestic operations in particular, with revenue per piece declining. In addition, expenses reflect increases in average daily union hours, lower delivery density, higher average daily miles and increased average daily delivery stops. These factors weighed on our overall operating profit for the quarter.

We expect the elevated level of residential deliveries to continue, although we are unable to predict how long these circumstances will persist. If we are unable to adjust our costs in response to the lower delivery density resulting from this change in mix, operating margins may be compressed, both in the U.S. and internationally.

In our Supply Chain & Freight segment, margins are strongly influenced by the market rates at which we can buy and sell transportation services. If customer demand weakens and market capacity continues to be constrained, our buy-sell spreads may narrow, resulting in lower overall operating margins.

Toward the end of the quarter, we also experienced impacts on our accounts receivable collections as the effects of shutdowns in response to the COVID-19 pandemic disrupted global business activity. As a result, we recorded an incremental allowance for credit losses of \$23 million. As global macroeconomic trends evolve, it is possible that we will experience further adverse developments in our allowances for credit losses or be required to recognize impairments of goodwill or other long-lived assets. Separately, we may also continue to experience adverse developments in our casualty self-insurance reserves.

We believe that we remain well positioned for long-term growth, however we cannot reasonably estimate the duration or severity of this pandemic or its ultimate impact on the global economy and our business results and liquidity. For additional information on these risks and uncertainties, see Part II, Item 1A "Risk Factors" in this report.

Highlights of our consolidated results for the first quarter follow:

| | Three Months Ended March 31, | | Change | |
|---|------------------------------|-----------|-----------|----------|
| | 2020 | 2019 | \$ | % |
| Revenue (in millions) | \$ 18,035 | \$ 17,160 | \$ 875 | 5.1 % |
| Operating Expenses (in millions) | 16,963 | 15,766 | 1,197 | 7.6 % |
| Operating Profit (in millions) | \$ 1,072 | \$ 1,394 | \$ (322) | (23.1) % |
| Operating Margin | 5.9 % | 8.1 % | | |
| Net Income (in millions) | \$ 965 | \$ 1,111 | \$ (146) | (13.1) % |
| Basic Earnings Per Share | \$ 1.12 | \$ 1.28 | \$ (0.16) | (12.5) % |
| Diluted Earnings Per Share | \$ 1.11 | \$ 1.28 | \$ (0.17) | (13.3) % |
| Average Daily Package Volume (in thousands) | 21,125 | 19,770 | | 6.9 % |
| Average Revenue Per Piece | \$ 10.88 | \$ 11.08 | \$ (0.20) | (1.8) % |

- Consolidated revenue increased 5.1%, driven by growth in business-to-consumer shipments.
- Average daily package volume increased 6.9%, primarily driven by increases in our U.S. Domestic Package segment.
- In our U.S. Domestic Package segment, average revenue per piece decreased as a result of changes in customer and product mix and lower average billable weight per piece. Currency movements negatively impacted revenue per piece in our International Package segment.

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

- Operating expenses increased primarily due to the shift in customer and product mix described above and higher casualty self-insurance accruals.
- Operating profit and margin decreased.
- We reported net income of \$965 million and diluted earnings per share of \$1.11. Excluding the after-tax impact of transformation strategy costs of \$35 million, adjusted diluted earnings per share was \$1.15.
- Net cash from operations increased \$273 million to \$2.6 billion. In response to ongoing economic uncertainties, we have reduced our anticipated capital expenditures by \$1.0 billion for 2020. In addition, we have suspended our stock repurchase program for the remainder of the year.

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

Supplemental Information - Items Affecting Comparability

We supplement the reporting of our financial information determined under generally accepted accounting principles ("GAAP") with certain non-GAAP financial measures including "adjusted" compensation and benefits, operating expenses, operating profit, operating margin, other income (expense), income before income taxes, income tax expense, effective tax rate, net income and earnings per share. We believe that these non-GAAP measures provide additional meaningful information to assist users of our financial statements in understanding our financial results and assessing our ongoing performance, because they exclude items that may not be indicative of, or are unrelated to, our underlying operations, and may provide a useful baseline for analyzing trends in our underlying businesses. Additionally, these non-GAAP measures are used internally by management for the determination of incentive compensation awards, business unit operating performance analysis and business unit resource allocation.

Amounts presented on an adjusted basis reflect the following:

| Non-GAAP Adjustments | Three Months Ended March 31, | |
|---|-------------------------------------|--------------|
| | 2020 | 2019 |
| Operating Expenses: | | |
| Transformation Strategy Costs | \$ 45 | \$ 123 |
| Total Adjustments to Operating Expenses | 45 | 123 |
| Income Tax Benefit from Transformation Strategy Costs | (10) | (30) |
| Total Adjustments to Net Income | <u>\$ 35</u> | <u>\$ 93</u> |

For additional information regarding our transformation strategy costs, see note 17 to the unaudited, consolidated financial statements included in this report.

We also supplement the reporting of revenue, revenue per piece and operating profit with non-GAAP measures that exclude the period over period impact of foreign currency exchange rate changes and hedging activities. We believe currency-neutral revenue, revenue per piece and operating profit information allows users of our financial statements to understand growth trends in our products and results. We evaluate the performance of our International Package and Supply Chain & Freight segments on this currency-neutral basis.

Currency-neutral revenue, revenue per piece and operating profit are calculated by dividing current period reported U.S. dollar revenue, revenue per piece and operating profit by the current period average exchange rates to derive current period local currency revenue, revenue per piece and operating profit. The derived amounts are then multiplied by the average foreign exchange rates used to translate the comparable results for each month in the prior year period (including the period over period impact of foreign currency revenue hedging activities). The difference between the current period reported U.S. dollar revenue, revenue per piece and operating profit and the derived current period U.S. dollar revenue, revenue per piece and operating profit is the period over period impact of currency fluctuations.

Non-GAAP financial measures should not be considered in isolation or as a substitute for the related GAAP measures. Our non-GAAP financial measures may differ from similar measures used by other companies.

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

Results of Operations - Segment Review

The results and discussions that follow are reflective of how our executive management monitors and evaluates the performance of our reporting segments.

Certain operating expenses are allocated among our reporting segments using activity-based costing methods. These activity-based costing methods require us to make estimates that impact the amount of each expense that is attributed to each segment. Changes in these estimates would directly impact the amount of expense allocated to each segment and therefore the operating profit of each reporting segment. Our allocation methodologies are refined periodically, as necessary, to reflect changes in our business. Beginning in 2020, we updated our cost allocation methodology for the Ground with Freight Pricing ("GFP") product. The cost associated with GFP that is allocated from the U.S. Domestic Package segment to UPS Freight, within the Supply Chain & Freight segment, was adjusted to better reflect operational activities associated with this product. As a result, an additional \$3 million of expense was allocated to UPS Freight for the quarter ended March 31, 2020. There were no significant changes in our expense allocation methodologies in 2019.

We are monitoring the impact of COVID-19 on the fair value of our reporting units and indefinite-lived intangible assets. As of March 31, 2020, we concluded that no events had occurred that would more likely than not reduce the fair value of any reporting unit or indefinite-lived intangible asset below its carrying value as of that date. However, the economic outlook is uncertain. If our future expectations for revenue, earnings and cash flows from our reporting units decrease, it is reasonably possible that goodwill or indefinite-lived intangible assets in one or more of these reporting units could be impaired.

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

U.S. Domestic Package Operations

| | Three Months Ended March 31, | | Change | |
|---|------------------------------|-----------|-----------|----------|
| | 2020 | 2019 | \$ | % |
| Average Daily Package Volume (in thousands): | | | | |
| Next Day Air | 1,883 | 1,563 | | 20.5 % |
| Deferred | 1,492 | 1,384 | | 7.8 % |
| Ground | 14,669 | 13,684 | | 7.2 % |
| Total Average Daily Package Volume | 18,044 | 16,631 | | 8.5 % |
| Average Revenue Per Piece: | | | | |
| Next Day Air | \$ 17.05 | \$ 18.70 | \$ (1.65) | (8.8) % |
| Deferred | 12.54 | 12.49 | 0.05 | 0.4 % |
| Ground | 8.74 | 8.76 | (0.02) | (0.2) % |
| Total Average Revenue Per Piece | \$ 9.92 | \$ 10.00 | \$ (0.08) | (0.8) % |
| Operating Days in Period | 64 | 63 | | |
| Revenue (in millions): | | | | |
| Next Day Air | \$ 2,055 | \$ 1,841 | \$ 214 | 11.6 % |
| Deferred | 1,197 | 1,089 | 108 | 9.9 % |
| Ground | 8,204 | 7,550 | 654 | 8.7 % |
| Total Revenue | \$ 11,456 | \$ 10,480 | \$ 976 | 9.3 % |
| Operating Expenses (in millions): | | | | |
| Operating Expenses | \$ 11,092 | \$ 9,814 | \$ 1,278 | 13.0 % |
| Transformation Strategy Costs | (37) | (28) | (9) | 32.1 % |
| Adjusted Operating Expense | \$ 11,055 | \$ 9,786 | \$ 1,269 | 13.0 % |
| Operating Profit (in millions) and Operating Margin: | | | | |
| Operating Profit | \$ 364 | \$ 666 | \$ (302) | (45.3) % |
| Adjusted Operating Profit | \$ 401 | \$ 694 | \$ (293) | (42.2) % |
| Operating Margin | 3.2 % | 6.4 % | | |
| Adjusted Operating Margin | 3.5 % | 6.6 % | | |

Revenue

The change in overall revenue was due to the following factors:

| | Volume | Rates / Product Mix | Fuel Surcharge | Total Revenue Change |
|--------------------------------|--------|------------------------|-------------------|-------------------------|
| Revenue Change Drivers: | | | | |
| First quarter 2020 vs. 2019 | 10.2 % | (0.8) % | (0.1) % | 9.3 % |

Volume

Volume increased across all products in the first quarter of 2020, led by strong growth in our Next Day Air services driven by one additional operating day and the continuing structural shift to faster delivery options in e-commerce. Growth was driven primarily from a number of large customers, including Amazon. Volume from small- and medium-sized business customers remained flat, largely due to the widespread shutdown measures initiated in response to the COVID-19 pandemic.

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

Business-to-consumer shipments, which represented approximately 55% of the total U.S. Domestic Package average daily volume in the quarter, as compared to approximately 50% in the first quarter of 2019, grew 19.0% driven by growth in e-commerce. In particular, we experienced a significant increase in business-to-consumer volume late in the quarter as restrictions implemented in response to COVID-19 drove more consumers online. Business-to-business shipments decreased 1.9%, driven by lower volume in our ground products as a result of declines in returns services; in part offset by growth in our air products.

Within our air products, overall average daily volume increased in the first quarter of 2020 for both our Next Day Air and Deferred services. Strong air volume growth continued primarily in residential Next Day Air and Second Day Package products, as consumers and businesses continued to demand faster e-commerce delivery options. This demand further increased in the last month of the quarter, as the impacts of COVID-19 drove a significant increase in business-to-consumer volume. This growth was slightly offset by declines in Second Day Letter volume due to shifts in customer preferences.

Residential ground volume also increased in the first quarter of 2020, driven by changes in customer mix resulting from continued growth in e-commerce, which also intensified as COVID-19 restrictions came into effect. Ground commercial volume declined in the latter part of the first quarter as many businesses closed in response to government restrictions.

Rates and Product Mix

Overall revenue per piece decreased for the first quarter of 2020 due to changes in customer and product mix and fuel surcharge rates, partially offset by changes in base rates.

Revenue per piece for ground and air products was positively impacted by a base rate increase in December 2019. Ground rates and air services rates increased an average net 4.9%.

Revenue per piece for our Next Day Air products decreased in the first quarter of 2020. This decrease was primarily driven by a shift in customer and product mix and a decrease in average billable weight per piece, which was partially offset by the increase in base rates described above.

Revenue per piece for our Deferred products increased slightly in the first quarter of 2020 due to the increase in base rates, partially offset by a shift in customer and product mix and a decrease in average billable weight per piece.

Revenue per piece for our Ground products decreased slightly for the first quarter primarily due to customer mix and a decrease in average billable weight per piece, partially offset by base rate increases and product mix.

Fuel Surcharges

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

| | Three Months Ended March 31, | | Change |
|-------------------------|-------------------------------------|-------------|----------------|
| | 2020 | 2019 | % Point |
| Next Day Air / Deferred | 5.9 % | 7.2 % | (1.3) % |
| Ground | 7.2 % | 7.1 % | 0.1 % |

Effective March 2, 2020, the fuel surcharges for U.S. air and ground services increased.

While fluctuations in fuel surcharge percentages can be significant from period to period, fuel surcharges are only one of the many individual components of our pricing structure that impact our overall revenue and yield. Additional components include the mix of services sold, the base price and additional charges, for these services and the pricing discounts offered.

Total domestic fuel surcharge revenue decreased by \$6 million in the first quarter of 2020 as a result of lower fuel surcharge indices, largely offset by increases in package volume and shifts in product mix.

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

Operating Expenses

Operating expenses, and operating expenses excluding the year over year impact of transformation strategy costs, increased in the first quarter of 2020, primarily due to pickup and delivery costs (up \$723 million), the costs of operating our domestic integrated air and ground network (up \$284 million), the costs of package sorting (up \$156 million) and other indirect operating costs (up \$106 million). The increase in expense was driven by several factors:

- Higher employee compensation and benefit costs largely resulting from:
 - volume growth driven by an increase in business-to-consumer shipments, which resulted in an increase in average daily union labor hours of 8.6%;
 - union pay rate increases; and
 - growth in the overall size of the workforce.

We incurred higher employee benefit expenses due to additional headcount, contractual contribution rate increases to union multiemployer plans, changes in benefit eligibility for certain union employees and higher service costs for our company-sponsored pension and postretirement plans, primarily driven by lower discount rates used to measure the projected benefit obligations of these plans. Workers' compensation expense increased \$102 million as a result of additional headcount, medical and wage inflation and claims experience.

- Higher costs for outside contract carriers were driven by enhancements to our network.
- Self-insured automobile liability losses increased by \$102 million compared to the first quarter of 2019 due to business growth and increases in both the frequency and severity of incidents. Insurance reserves are established based on actuarial estimates of the loss that we will ultimately incur on reported claims, as well as estimates of claims that have been incurred but not reported, and take into account a number of factors including our history of claim losses, total miles driven and the impact of safety improvement initiatives.

Total cost per piece, and total cost per piece excluding the impact of transformation strategy costs, increased 2.5% for the first quarter of 2020. Cost per piece increased as the elevated level of residential deliveries, driven by restrictions introduced in response to COVID-19, negatively impacted our delivery density, particularly during March. This contributed to a 14.9% increase in package delivery stops per day and a 9.4% increase in average daily miles.

Operating Profit and Margin

As a result of the factors described above, operating profit decreased \$302 million for the first quarter of 2020, with operating margins decreasing 320 basis points to 3.2%. Excluding the year over year impact of transformation strategy costs, adjusted operating profit decreased \$293 million for the first quarter, with adjusted operating margins decreasing 310 basis points to 3.5%.

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

International Package Operations

| | Three Months Ended March 31, | | Change | |
|---|------------------------------|----------|-----------|---------|
| | 2020 | 2019 | \$ | % |
| Average Daily Package Volume (in thousands): | | | | |
| Domestic | 1,668 | 1,688 | | (1.2)% |
| Export | 1,413 | 1,451 | | (2.6)% |
| Total Average Daily Package Volume | 3,081 | 3,139 | | (1.8)% |
| Average Revenue Per Piece: | | | | |
| Domestic | \$ 6.44 | \$ 6.49 | \$ (0.05) | (0.8)% |
| Export | 28.32 | 28.78 | (0.46) | (1.6)% |
| Total Average Revenue Per Piece | \$ 16.48 | \$ 16.79 | \$ (0.31) | (1.8)% |
| Operating Days in Period | 64 | 63 | | |
| Revenue (in millions): | | | | |
| Domestic | \$ 688 | \$ 690 | \$ (2) | (0.3)% |
| Export | 2,561 | 2,631 | (70) | (2.7)% |
| Cargo and Other | 134 | 138 | (4) | (2.9)% |
| Total Revenue | \$ 3,383 | \$ 3,459 | \$ (76) | (2.2)% |
| Operating Expenses (in millions): | | | | |
| Operating Expenses | \$ 2,832 | \$ 2,931 | \$ (99) | (3.4)% |
| Transformation Strategy Costs | (7) | (84) | 77 | (91.7)% |
| Adjusted Operating Expenses | \$ 2,825 | \$ 2,847 | \$ (22) | (0.8)% |
| Operating Profit (in millions) and Operating Margin: | | | | |
| Operating Profit | \$ 551 | \$ 528 | \$ 23 | 4.4 % |
| Adjusted Operating Profit | \$ 558 | \$ 612 | \$ (54) | (8.8)% |
| Operating Margin | 16.3 % | 15.3 % | | |
| Adjusted Operating Margin | 16.5 % | 17.7 % | | |
| Currency Benefit / (Cost) – (in millions)*: | | | | |
| Revenue | | | \$ (19) | |
| Operating Expenses | | | | 41 |
| Operating Profit | | | \$ 22 | |

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

Revenue

The change in revenue was due to the following:

| | Volume | Rates / Product Mix | Fuel Surcharge | Currency | Total Revenue Change |
|--------------------------------|--------|------------------------|-------------------|----------|-------------------------|
| Revenue Change Drivers: | | | | | |
| First quarter 2020 vs. 2019 | (0.3)% | (1.3)% | — % | (0.6)% | (2.2)% |

Volume

Average daily volume decreased in the first quarter of 2020 for both domestic and export products. Business-to-consumer volume increased throughout the first quarter, with notably strong growth in March, as isolation measures introduced by many countries in response to COVID-19 drove consumers online. This growth was more than offset by a decrease in business-to-business shipments as the pandemic negatively impacted business operations globally.

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

Average daily volume was impacted by lower demand across a number of sectors, particularly manufacturing and technology. These declines were partially offset by higher demand in the online retail and government sectors.

Export volume decreased in the first quarter of 2020 across most major trade lanes. Exports from China grew strongly in March, as China began to resume economic activity following the widespread shutdown triggered by COVID-19. However, these gains were not significant enough to overcome the large declines experienced elsewhere. Export volume for the quarter grew slightly in our non-premium expedited and standard products such as Worldwide Expedited and Transborder Standard, offset by larger declines in our premium Worldwide and Transborder Express services.

Domestic volume also decreased in the majority of our markets in the first quarter of 2020 as a result of the COVID-19 pandemic. The decline in domestic volumes was driven by Europe, with significant declines occurring in the second half of March.

Rates and Product Mix

In December 2019 we implemented an average 4.9% net increase in base and accessorial rates for international shipments originating in the United States. Rate changes for shipments originating outside the U.S. are made throughout the year and vary by geographic market.

Total average revenue per piece decreased 1.8% in the first quarter of 2020, of which 0.5% was attributable to currency movements. Excluding the impact of currency, revenue per piece decreased 1.3%. Revenue per piece for the first quarter was negatively impacted by declines in fuel surcharge indices, as well as the continued shift from our premium to non-premium products.

Domestic revenue per piece decreased 0.8% in the first quarter of 2020, of which 1.7% was attributable to currency movements. Excluding the impact of currency, revenue per piece increased 0.9% due to increases in base rates.

Export revenue per piece decreased 1.6% in the first quarter of 2020, of which 0.2% was attributable to currency movements. Excluding the impact of currency, revenue per piece decreased 1.4%. In the first quarter, the trend towards our non-premium services drove a decrease in export revenue per piece which more than offset base rate increases.

We are implementing changes to our international rates to better reflect the rapidly changing environment. We constantly monitor rates and makes adjustments where feasible.

Fuel Surcharges

We apply fuel surcharges on our international air and ground services. The fuel surcharges for international air services originating inside or outside the United States are largely indexed to the DOE's Gulf Coast spot price for a gallon of kerosene-type jet fuel. The fuel surcharges for ground products originating outside the United States are indexed to fuel prices in the region or country where the shipment originates.

While fluctuations in fuel surcharge percentages can be significant from period to period, fuel surcharges represent one of the many individual components of our pricing structure that impact our overall revenue and yield. Additional components include the mix of services sold, the base price and extra service charges and the pricing discounts offered. Total international fuel surcharge revenue decreased \$7 million in the first quarter of 2020 due to the overall decrease in volume and declines in fuel surcharge indices.

Operating Expenses

Operating expenses, and operating expenses excluding the year over year impact of transformation strategy costs, decreased in the first quarter of 2020. These decreases were the result of effective management of network capacity and cost in response to lower volumes within our air, ground and local pickup and delivery networks, combined with lower fuel prices and favorable currency exchange rate movements.

In addition to variability in usage and market prices, the manner in which we purchase fuel also influences the net impact of fuel costs on our results. The majority of our contracts for fuel purchases utilize index-based pricing formulas plus or minus a fixed locational/supplier differential. While many of the indices are aligned, each index may fluctuate at a different pace, driving variability in the prices paid for fuel. Because of this, our operating results may be affected should the market price of fuel suddenly change by a significant amount or change by amounts that do not result in an adjustment in our fuel surcharges, which can significantly affect our earnings either positively or negatively in the short-term.

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

The costs of operating our integrated international air and ground network decreased \$32 million in the first quarter of 2020. This was driven by a 2.7% decrease in aircraft block hours resulting from lower package volume, together with lower fuel prices. Pickup and delivery costs increased \$5 million due to shifts in customer and product mix. The remaining decrease in operating expenses in the first quarter was largely attributable to changes in other employee benefits costs and favorable currency exchange rate movements.

Operating Profit and Margin

As a result of the factors described above, operating profit increased \$23 million in the first quarter of 2020, with operating margin increasing 100 basis points to 16.3%. Excluding the year over year impact of transformation strategy costs, adjusted operating profit decreased for the first quarter of 2020, with adjusted operating margin down 120 basis points to 16.5%.

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

Supply Chain & Freight Operations

| | Three Months Ended March 31, | | Change | |
|---|------------------------------|----------|---------|----------|
| | 2020 | 2019 | \$ | % |
| Freight LTL Statistics: | | | | |
| Revenue (in millions) | \$ 637 | \$ 635 | \$ 2 | 0.3 % |
| Revenue Per Hundredweight | \$ 26.50 | \$ 26.10 | \$ 0.40 | 1.5 % |
| Shipments (in thousands) | 2,225 | 2,183 | | 1.9 % |
| Shipments Per Day (in thousands) | 34.8 | 34.7 | | 0.3 % |
| Gross Weight Hauled (in millions of lbs) | 2,404 | 2,433 | | (1.2) % |
| Weight Per Shipment (in lbs) | 1,081 | 1,115 | | (3.0) % |
| Operating Days in Period | 64 | 63 | | |
| Revenue (in millions): | | | | |
| Forwarding | \$ 1,373 | \$ 1,416 | \$ (43) | (3.0) % |
| Logistics | 845 | 832 | 13 | 1.6 % |
| Freight | 766 | 773 | (7) | (0.9) % |
| Other | 212 | 200 | 12 | 6.0 % |
| Total Revenue | \$ 3,196 | \$ 3,221 | \$ (25) | (0.8) % |
| Operating Expenses (in millions): | | | | |
| Operating Expenses | \$ 3,039 | \$ 3,021 | \$ 18 | 0.6 % |
| Transformation Strategy Costs | (1) | (11) | 10 | (90.9) % |
| Adjusted Operating Expenses: | \$ 3,038 | \$ 3,010 | \$ 28 | 0.9 % |
| Operating Profit (in millions) and Operating Margin: | | | | |
| Operating Profit | \$ 157 | \$ 200 | \$ (43) | (21.5) % |
| Adjusted Operating Profit | \$ 158 | \$ 211 | \$ (53) | (25.1) % |
| Operating Margin | 4.9 % | 6.2 % | | |
| Adjusted Operating Margin | 4.9 % | 6.6 % | | |
| Currency Benefit / (Cost) – (in millions)*: | | | | |
| Revenue | | | \$ (48) | |
| Operating Expenses | | | 47 | |
| Operating Profit | | | \$ (1) | |

* Amount represents the change in currency translation compared to the prior year.

| | Three Months Ended March 31, | | Change | |
|---|------------------------------|-------|---------|-----------|
| | 2020 | 2019 | \$ | % |
| Transformation Strategy Costs (in millions): | | | | |
| Forwarding | \$ 1 | \$ 5 | \$ (4) | (80.0) % |
| Logistics | — | 6 | (6) | (100.0) % |
| Total Transformation Strategy Costs | \$ 1 | \$ 11 | \$ (10) | (90.9) % |

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

Revenue

Total revenue for the Supply Chain & Freight segment decreased \$25 million in the first quarter of 2020 compared with 2019.

Forwarding revenue decreased primarily due to an overall decline in market demand that was driven by continuing trade uncertainties and the COVID-19 pandemic. This led to lower tonnage and volume in our North American air freight and ocean freight forwarding businesses, as well as declines in rates charged to our customers. In addition, market pricing pressure in the truckload brokerage market contributed to the decline in revenue. These decreases were partially offset by an increase in revenue in our international air freight forwarding business. Volume on Asia-outbound lanes began to recover in March following declines in the first two months of the quarter that were driven by shutdowns initiated in response to COVID-19.

Logistics revenue increased due to volume growth in the healthcare sector, partly resulting from increased demand for healthcare logistics and distribution solutions in response to COVID-19. In addition, our mail services business experienced revenue growth due to a favorable shift in product mix. Revenue from most other sectors declined as the economic impacts of the pandemic spread to Europe and North America toward the end of the quarter.

UPS Freight revenue decreased as a result of volume and revenue declines in our truckload product. These decreases were partially offset by an increase in LTL revenue per hundredweight and average daily LTL shipments. The increase in LTL revenue per hundredweight was largely due to base rate increases that took effect in March 2020. While the impact of COVID-19 resulted in volume declines for our GFP product, revenue from this product remained flat year over year due to overall rate increases.

Operating Expenses

Total operating expenses for the Supply Chain & Freight segment, and operating expenses excluding the year over year impact of transformation strategy costs, increased in the first quarter of 2020.

Forwarding operating expenses decreased \$5 million. Purchased transportation expense increased, as volume increases in our international air freight forwarding and truckload brokerage businesses outpaced the declines in tonnage and volume in our North American air freight and ocean freight forwarding businesses. This increase was more than offset by cost management initiatives.

Logistics operating expenses increased \$2 million, primarily due to increases in purchased transportation expense that were driven by increased rates for mail services and volume growth in the healthcare sector.

UPS Freight operating expenses increased \$14 million, largely due to increases in reserves for self-insured workers' compensation and automobile liability claims, an increase in cost per LTL shipment driven by higher pickup and delivery expense and an additional \$3 million in allocated cost for the GFP product.

Operating Profit and Margin

As a result of the factors described above, operating profit for the Supply Chain & Freight segment decreased \$43 million in the first quarter of 2020 compared with 2019. Excluding the year over year impact of transformation strategy costs, adjusted operating profit decreased \$53 million.

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

Consolidated Operating Expenses

| | Three Months Ended March 31, | | Change | |
|--|------------------------------|-----------|----------|----------|
| | 2020 | 2019 | \$ | % |
| Operating Expenses (in millions): | | | | |
| Compensation and benefits | \$ 10,086 | \$ 9,317 | \$ 769 | 8.3 % |
| Transformation Strategy Costs | (12) | (106) | 94 | (88.7) % |
| Adjusted Compensation and benefits | 10,074 | 9,211 | 863 | 9.4 % |
| Repairs and maintenance | 563 | 434 | 129 | 29.7 % |
| Depreciation and amortization | 648 | 568 | 80 | 14.1 % |
| Purchased transportation | 2,931 | 2,966 | (35) | (1.2) % |
| Fuel | 761 | 770 | (9) | (1.2) % |
| Other occupancy | 383 | 371 | 12 | 3.2 % |
| Other expenses | 1,591 | 1,340 | 251 | 18.7 % |
| Total Other expenses | 6,877 | 6,449 | 428 | 6.6 % |
| Other Transformation Strategy Costs | (33) | (17) | (16) | 94.1 % |
| Adjusted Total Other expenses | 6,844 | 6,432 | 412 | 6.4 % |
| Total Operating Expenses | \$ 16,963 | \$ 15,766 | \$ 1,197 | 7.6 % |
| Adjusted Total Operating Expenses | \$ 16,918 | \$ 15,643 | \$ 1,275 | 8.2 % |
| Currency (Benefit) / Cost - (in millions)* | | | \$ (88) | |

* Amount represents the change in currency translation compared to the prior year.

| | Three Months Ended March 31, | | Change | |
|---|------------------------------|--------|---------|----------|
| | 2020 | 2019 | \$ | % |
| Transformation Strategy Costs (in millions): | | | | |
| Compensation | \$ 8 | \$ — | \$ 8 | N/M |
| Benefits | 4 | 106 | (102) | (96.2) % |
| Other occupancy | 2 | — | 2 | N/M |
| Other expenses | 31 | 17 | 14 | 82.4 % |
| Total Transformation Strategy Costs | \$ 45 | \$ 123 | \$ (78) | (63.4) % |

Compensation and Benefits

Total compensation and benefits, and total compensation and benefits excluding the year over year impact of transformation strategy costs, increased in the first quarter of 2020.

Total compensation costs increased \$353 million or 6.4%. Excluding the year over year impact of transformation strategy costs, adjusted compensation costs increased \$345 million largely due to higher U.S. Domestic direct labor costs. These costs increased as a result of additional headcount, driven by U.S. Domestic average daily volume growth that resulted in an increase in average daily union hours of 8.6%. Contractual union wage increases also contributed to the increase in compensation costs for hourly employees.

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

Benefits expense increased \$416 million. Excluding the year over year impact of transformation strategy costs, adjusted benefits costs increased \$518 million due to the following:

- Health and welfare costs increased \$165 million, driven by increased contributions to multiemployer plans due to an overall increase in the size of the workforce, contractual rate increases and changes in eligibility for certain union employees.
- Pension and postretirement benefits increased \$158 million due to higher service cost for company-sponsored plans, primarily driven by a reduction in discount rates, increased contributions to multiemployer plans due to contractually-mandated contribution increases and an overall increase in the size of the workforce.
- Vacation, excused absence, payroll taxes and other expenses increased \$85 million, primarily driven by salary increases and growth in the overall size of the workforce.
- Workers' compensation expense increased \$110 million driven by an increase in the overall size of the workforce, wage and medical inflation and unfavorable claims trends. We evaluate the total potential range of actuarial outcomes when estimating losses that will ultimately be incurred. See note 1 to the audited, consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2019, for a further description of this policy.

Repairs and Maintenance

The increase in repairs and maintenance expense was driven by additional aircraft engine maintenance events, as well as increased routine repairs to buildings and facilities and maintenance of our other transportation equipment.

Depreciation and Amortization

Depreciation and amortization expense increased as a result of the additional investments in facility automation and capacity expansion projects, increases in the size of our vehicle and aircraft fleets and investments in internally developed software.

Purchased Transportation

The overall decrease in purchased transportation expense charged to us by third-party carriers was primarily driven by the following:

- Forwarding and Logistics expense increased \$15 million, primarily due to increased volume in our truckload brokerage business, as well as increases in healthcare logistics and international air freight forwarding. This was partially offset by a reduction in ocean freight volume.
- International Package expense decreased \$24 million primarily due to favorable impacts from currency exchange rate movements.
- U.S. Domestic Package expense increased \$15 million primarily due to network enhancements and carrier rate increases.
- UPS Freight expense decreased \$1 million primarily due to lower fuel surcharges passed on to us by outside carriers.
- Other purchased transportation expense decreased \$40 million due to changes in the number of leased and chartered aircraft.

Fuel

The decrease in fuel expense was driven by lower jet fuel, diesel and gasoline prices, as well as alternative fuel tax credits arising from legislation passed in the fourth quarter of 2019. These decreases were partially offset by higher consumption due to increases in aircraft block hours and miles driven as a result of increased U.S. Domestic package volume.

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

Other Occupancy

Other occupancy expense, and other occupancy expense excluding the year over year impact of transformation strategy costs, increased primarily due to additional operating facilities coming into service. This increase was partially offset by lower weather-related expenses, such as snow removal.

Other Expenses

Other expenses, and other expenses excluding the year over year impact of transformation strategy costs, increased. The increase was attributable to various items, including year over year changes to reserves for self-insured automobile liability claims of \$109 million, an additional \$32 million of credit loss expense primarily driven by forecast losses resulting from the economic impacts of the COVID-19 pandemic, as well as advertising, employee-related expenses and technology equipment and software licenses.

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

Other Income and (Expense)

The following table sets forth investment income and other and interest expense for the three months ended March 31, 2020 and 2019 (in millions):

| | Three Months Ended March 31, | | Change | |
|----------------------------------|-------------------------------------|--------------|---------------|----------|
| | 2020 | 2019 | \$ | % |
| Investment Income and Other | \$ 345 | \$ 215 | \$ 130 | 60.5 % |
| Interest Expense | (167) | (169) | 2 | (1.2)% |
| Total Other Income and (Expense) | <u>\$ 178</u> | <u>\$ 46</u> | <u>\$ 132</u> | N/A |

Investment Income and Other

The increase in investment income and other for the first quarter of 2020 was primarily due to an increase in other pension income, which is comprised of expected returns on pension assets net of interest cost on projected benefit obligations. Expected returns on pension assets increased as a result of a higher asset base due to positive asset returns in 2019 and discretionary contributions. Pension interest cost decreased due to the impact of lower year end discount rates that was partially offset by ongoing plan growth and an increase in projected benefit obligations as a result of the year end measurement of our plans. Investment income decreased due to lower yields on invested assets.

Interest Expense

The reduction in interest expense for the first quarter of 2020 was primarily due to lower effective interest rates on outstanding floating rate debt and commercial paper balances, partially offset by additional interest expense from debt issuances since the first quarter of 2019.

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

Income Tax Expense

The following table sets forth income tax expense and our effective tax rate for the three months ended March 31, 2020 and 2019 (in millions):

| | Three Months Ended March 31, | | Change | |
|-------------------------------|-------------------------------------|-------------|---------------|----------|
| | 2020 | 2019 | \$ | % |
| Income Tax Expense | \$ 285 | \$ 329 | \$ (44) | (13.4)% |
| Income Tax Impact of: | | | | |
| Transformation Strategy Costs | 10 | 30 | (20) | (66.7)% |
| Adjusted Income Tax Expense | \$ 295 | \$ 359 | \$ (64) | (17.8)% |
| Effective Tax Rate | 22.8 % | 22.8 % | | |
| Adjusted Effective Tax Rate | 22.8 % | 23.0 % | | |

For additional information on income tax expense and our effective tax rate, see note 16 to the unaudited, consolidated financial statements included in this report.

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

Liquidity and Capital Resources

As of March 31, 2020, we had \$9.5 billion in cash, cash equivalents and marketable securities. We believe that these positions, expected cash from operations, access to commercial paper programs and capital markets financing and other available liquidity options will be adequate to fund our operating requirements, planned capital expenditures and pension contributions, transformation strategy costs, debt obligations and planned shareowner returns. We regularly evaluate opportunities to optimize our capital structure, including through issuances of debt to refinance existing debt and to fund ongoing needs.

As described below, as a result of the economic uncertainty created by the COVID-19 pandemic, we intend to defer certain components of our previously announced capital expenditure program beyond 2020, and have suspended the repurchase of shares for the remainder of 2020.

Cash Flows From Operating Activities

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

| | Three Months Ended March 31, | |
|---|-------------------------------------|-----------------|
| | 2020 | 2019 |
| Net income | \$ 965 | \$ 1,111 |
| Non-cash operating activities ^(a) | 1,282 | 1,108 |
| Pension and postretirement benefit plan contributions (company-sponsored plans) | (222) | (214) |
| Hedge margin receivables and payables | 211 | 57 |
| Income tax receivables and payables | 102 | 147 |
| Changes in working capital and other non-current assets and liabilities | 203 | 75 |
| Other operating activities | 9 | (7) |
| Net cash from operating activities | <u>\$ 2,550</u> | <u>\$ 2,277</u> |

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

Net cash from operating activities increased \$273 million in the first quarter of 2020 as compared to 2019. The following factors contributed to the change in net cash from operating activities:

- We made contributions to our company-sponsored pension and U.S. postretirement medical benefit plans totaling \$222 million during the first three months of 2020 as compared to \$214 million in 2019.
- The net hedge margin collateral received from our derivative counterparties increased by \$154 million in the first three months of 2020, due to the change in net fair value of derivative contracts used in our currency and interest rate hedging programs.
- Cash received in respect of income taxes decreased in the first three months of 2020, primarily due to the timing of income tax payments.
- In addition to the transactions described above, operating cash flows were favorably impacted by changes in our working capital, driven by incentive compensation plan payouts and other payroll-related items, as well as the timing of interest payments on outstanding debt. We experienced impacts in our collections activities toward the end of the quarter as the effects of shutdowns in response to the COVID-19 pandemic disrupted business activity in the U.S. and internationally.

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

As of March 31, 2020, our total worldwide holdings of cash, cash equivalents and marketable securities were \$9.5 billion, of which approximately \$2.6 billion was held by foreign subsidiaries. The amount of cash, cash equivalents and marketable securities held by our U.S. and foreign subsidiaries fluctuates throughout the year due to a variety of factors, including the timing of cash receipts and disbursements in the normal course of business. Cash provided by operating activities in the U.S. continues to be our primary source of funds to finance domestic operating needs, capital expenditures, and shareowner returns, including any share repurchases and dividend payments. All cash, cash equivalents and marketable securities held by foreign subsidiaries are generally available for distribution to the U.S. without any U.S. federal income taxes. Any such distributions may be subject to foreign withholding and U.S. state taxes. When amounts earned by foreign subsidiaries are expected to be indefinitely reinvested, no accrual for taxes is provided.

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security (CARES) Act was signed into law. The CARES Act includes, among other things, provisions relating to deferral of the employer portion of certain payroll taxes, temporary suspension of federal excise taxes on the transportation of property by air and on commercial purchases of jet aviation fuel and deferral of federal income tax payments.

We anticipate that the various provisions of the CARES Act will provide a temporary cash flow benefit in the current year of approximately \$1.0 billion.

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

Cash Flows From Investing Activities

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

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------------|
| | 2020 | 2019 |
| Net cash used in investing activities | \$ (934) | \$ (1,416) |
| Capital Expenditures: | | |
| Buildings, facilities and plant equipment | \$ (519) | \$ (800) |
| Aircraft and parts | (179) | (335) |
| Vehicles | (62) | (224) |
| Information technology | (173) | (155) |
| | <u>\$ (933)</u> | <u>\$ (1,514)</u> |
| Capital Expenditures as a % of revenue | 5.2 % | 8.8 % |
| Other Investing Activities: | | |
| Proceeds from disposals of property, plant and equipment | \$ 1 | \$ 4 |
| Net change in finance receivables | \$ 3 | \$ 10 |
| Net (purchases), sales and maturities of marketable securities | \$ — | \$ 101 |
| Cash paid for business acquisitions, net of cash and cash equivalents acquired | \$ — | \$ (1) |
| Other investing activities | \$ (5) | \$ (16) |

We have commitments for the purchase of aircraft, vehicles, equipment and real estate to provide for the replacement of existing capacity and anticipated future growth. Future capital spending for anticipated growth and replacement assets will depend on a variety of factors, including economic and industry conditions. In 2017, we began a multi-year investment program in our smart global logistics network which impacts all asset categories, with the largest investments in buildings, facilities and plant equipment. As a result of current economic uncertainties, we have reduced our forecast capital expenditures by \$1.0 billion for 2020, by deferring certain facility projects and vehicle purchases to future years. We currently anticipate that our capital expenditures will be approximately \$5.5 to \$6.0 billion in 2020.

Capital expenditures on buildings, facilities and plant equipment decreased in the first three months of 2020 as compared to 2019 in our U.S. and international package businesses, largely due to the timing of payments for facility automation and capacity expansion projects. Capital spending on aircraft decreased due to reductions in contract deposits on open aircraft orders and final payments associated with the delivery of aircraft. Capital spending on vehicles decreased in the first three months of 2020, largely due to the timing of vehicle replacements and changes in vendor payment terms.

The net change in finance receivables was primarily due to reductions in our finance portfolios. Purchases and sales of marketable securities are largely determined by liquidity needs and the periodic rebalancing of investment types, and will fluctuate from period to period.

There was no cash paid for business acquisitions in the first three months of 2020. Cash paid for business acquisitions in the first three months of 2019 related to our acquisition of area franchise rights for The UPS Store. Other investing activities are impacted by changes in our non-current investments and various other items.

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

Cash Flows From Financing Activities

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

| | Three Months Ended March 31, | |
|---|-------------------------------------|-------------|
| | 2020 | 2019 |
| Net cash from (used in) financing activities | \$ 2,167 | \$ (695) |
| Share Repurchases: | | |
| Cash expended for shares repurchased | \$ (220) | \$ (246) |
| Number of shares repurchased | (2.1) | (2.4) |
| Shares outstanding at period end | 861 | 860 |
| Percent increase (decrease) in shares outstanding | 0.5 % | 0.2 % |
| Dividends: | | |
| Dividends declared per share | \$ 1.01 | \$ 0.96 |
| Cash expended for dividend payments | \$ (840) | \$ (799) |
| Borrowings: | | |
| Net borrowings (repayments) of debt principal | \$ 3,475 | \$ 485 |
| Other Financing Activities: | | |
| Cash received for common stock issuances | \$ 70 | \$ 47 |
| Other financing activities | \$ (318) | \$ (182) |
| Capitalization: | | |
| Total debt outstanding at period end | \$ 28,601 | \$ 23,166 |
| Total shareowners' equity at period end | 3,313 | 3,485 |
| Total capitalization | \$ 31,914 | \$ 26,651 |
| Debt to Total Capitalization % | 89.6 % | 86.9 % |

We repurchased a total of 2.1 million shares of class A and class B common stock for \$217 million in the first three months of 2020 and 2.4 million shares for \$251 million in the first three months of 2019 (\$220 and \$246 million in repurchases for 2020 and 2019, respectively, are reported on the statement of cash flows due to timing of settlements). We have suspended our stock repurchase program for the remainder of 2020. For additional information on our share repurchase activities, see note 12 to the unaudited, consolidated financial statements included in this report.

The declaration of dividends is subject to the discretion of the Board and will depend on various factors, including our net income, financial condition, cash requirements, future prospects and other relevant factors. We increased our quarterly cash dividend payment to \$1.01 per share in 2020, compared with a \$0.96 quarterly dividend rate in 2019. We expect to continue paying regular cash dividends.

Issuances of debt in the first three months of 2020 consisted primarily of fixed-rate senior notes of varying maturities totaling \$3.5 billion, as well as borrowings under our commercial paper program. These issuances more than satisfy our debt repayment obligations for 2020. Repayments of debt during the first quarter included paydowns of commercial paper and scheduled principal payments on our finance lease obligations. Issuances of debt in the first three months of 2019 consisted primarily of fixed-rate senior notes totaling \$1.5 billion, and repayments consisted of paydowns of commercial paper. 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.

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

The amount of commercial paper outstanding fluctuates throughout the year based on daily liquidity needs. The following is a summary of our commercial paper program (in millions):

| | Functional currency outstanding balance at quarter-end | Outstanding balance at quarter-end (\$) | Average balance outstanding | Average balance outstanding (\$) | Average interest rate |
|-------------|---|--|--|---|------------------------------|
| 2020 | | | | | |
| USD | \$ 2,349 | \$ 2,349 | \$ 1,973 | \$ 1,973 | 1.56 % |
| EUR | € 818 | \$ 896 | € 991 | \$ 1,093 | (0.42)% |
| Total | | <u>\$ 3,245</u> | | | |

Cash outflows for other financing activities were impacted by several factors. Net cash outflows from the premium payments and settlements of capped call options for the purchase of UPS class B shares were \$0 and \$5 million during the first three months of 2020 and 2019, respectively. Cash outflows related to the repurchase of shares to satisfy tax withholding obligations on vested employee stock awards were \$310 and \$177 million during the first three months of 2020 and 2019, respectively. This increase was driven by changes in the vesting schedule for certain of our awards.

Sources of Credit

See note 9 to the unaudited, consolidated financial statements for a discussion of our available credit and the financial covenants that we are subject to as part of our credit agreements.

Guarantees and Other Off-Balance Sheet Arrangements

Except as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2019, we do not have guarantees or other off-balance sheet financing arrangements, including variable interest entities, which we believe could have a material impact on our financial condition or liquidity.

Legal Proceedings and Contingencies

See note 7 and note 11 to the unaudited, consolidated financial statements for a discussion of judicial proceedings and other matters arising from the conduct of our business activities, and note 16 for a discussion of income tax related matters.

Collective Bargaining Agreements

See note 7 to the unaudited, consolidated financial statements for a discussion of the status of our collective bargaining agreements.

Multiemployer Benefit Plans

See note 7 to the unaudited, consolidated financial statements for a discussion of our participation in multiemployer benefit plans.

Recent Accounting Pronouncements

Adoption of New Accounting Standards

See note 2 to the unaudited, consolidated financial statements for a discussion of recently adopted accounting standards.

Accounting Standards Issued But Not Yet Effective

See note 2 to the unaudited, consolidated financial statements for a discussion of accounting standards issued, but not yet effective.

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

Rate Adjustments

In February 2020, we announced the following changes that took effect on March 2, 2020:

- Fuel surcharge increases for U.S. Ground, Air, Import and Export services.
- UPS Freight general rate increases of 5.4%. This applies to non-contractual less-than-truckload shipments rated on the current UPS Freight 525, 560 and 570 tariffs.
- All UPS Freight published fuel surcharges increased by 0.5 points.

On March 20, 2020, we announced a temporary peak surcharge for UPS Worldwide Express, UPS Worldwide Express Freight and UPS Expedited shipments originating from China Mainland or Hong Kong SAR to North America and Europe. This surcharge became effective April 5, 2020.

On April 7, 2020, we announced an increase to the temporary peak surcharge that took effect on April 5, 2020 and additional peak surcharges for international shipments with other origins and/or destinations. These changes became effective April 12, 2020.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk from changes in certain commodity prices, foreign currency exchange rates, interest rates and equity prices. All of these market risks arise in the normal course of business, as we do not engage in speculative trading activities. In order to manage the risk arising from these exposures, we utilize a variety of commodity, foreign exchange and interest rate forward contracts, options and swaps. A discussion of our accounting policies for derivative instruments and further disclosures are provided in note 15 to the unaudited, consolidated financial statements.

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

| | March 31, 2020 | December 31, 2019 |
|---------------------------|----------------|-------------------|
| Currency Derivatives | \$ 658 | \$ 374 |
| Interest Rate Derivatives | 50 | 21 |
| | <u>\$ 708</u> | <u>\$ 395</u> |

As of March 31, 2020 and December 31, 2019, we had no outstanding commodity hedge positions.

Our market risks, hedging strategies and financial instrument positions at March 31, 2020 have not materially changed from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2019. In 2020, we entered into several foreign exchange forward contracts on the Euro, British Pound Sterling, Canadian Dollar and Hong Kong Dollar, and had forward contracts expire. The remaining fair value changes between December 31, 2019 and March 31, 2020 in the preceding table are primarily due to interest rate and foreign currency exchange rate fluctuations between those dates.

The foreign exchange 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 and by monitoring counterparty credit risk to prevent concentrations of credit risk with any single counterparty.

We have agreements with all of our active counterparties (covering the majority of our derivative positions) containing early termination rights and/or zero threshold bilateral collateral provisions whereby cash is required based on the net fair value of derivatives associated with those counterparties. Events such as a credit rating downgrade (depending on the ultimate rating level) could also allow us to take additional protective measures such as the early termination of trades. Under these agreements, we held cash collateral of \$706 million and were not required to post any cash collateral with our counterparties as of March 31, 2020.

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

The information concerning market risk in Item 7A under the caption “Quantitative and Qualitative Disclosures about Market Risk” of our Annual Report on Form 10-K for the year ended December 31, 2019 is hereby incorporated by reference.

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 Principal Executive Officer and Principal 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) under the Exchange Act). Based upon, and as of the date of, the evaluation, our Principal Executive Officer and Principal 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, including the Principal Executive Officer and Principal Financial Officer, as appropriate to allow their timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the quarter ended March 31, 2020 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. We have not experienced any material impact to our internal controls over financial reporting despite the fact that more of our employees are working remotely due to the COVID-19 pandemic. We are continually monitoring and assessing the effects of the COVID-19 situation on our internal controls to minimize the impact on their design and operating effectiveness.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

For a discussion of material legal proceedings affecting us and our subsidiaries, see note 11 to the unaudited, consolidated financial statements included in this report.

Item 1A. *Risk Factors*

The occurrence of any of the significant risk factors described in Part 1, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2019 could materially affect us, including impacting our business, financial condition, results of operations, stock price or credit rating, as well as our reputation. The following represents an additional material risk from those factors disclosed in our 2019 Annual Report on Form 10-K that is adversely affecting our operations and financial performance, and is expected to continue to adversely affect our operations and financial performance in the future, possibly materially. These risks are not the only ones we face. We could also be materially adversely affected by other events, factors or uncertainties that are unknown to us, or that we do not currently consider to be significant.

The outbreak and rapid spread of the novel strain of coronavirus COVID-19 is having an adverse impact on our operations and financial performance, as well as on the operations, financial performance and liquidity of many of our customers. We are unable to predict the full extent to which the coronavirus will continue to adversely impact us.

The COVID-19 pandemic has resulted in, and is expected to continue to result in, a substantial curtailment of business activities (including the decrease in demand for a broad variety of goods and services), weakened economic conditions, supply chain disruptions, significant economic uncertainty and volatility in the financial markets, both in the United States and abroad. The pandemic is adversely impacting, and is expected to continue to adversely impact, our operations and financial performance, and has had a material adverse impact on the operations, financial performance and liquidity of many of our customers. For example, in the first quarter of 2020 some of our customers slowed or stopped production, and we experienced a significant shift in customer and product mix, and significant supply chain interruptions.

Because the severity, magnitude and duration of the COVID-19 pandemic and its economic consequences are uncertain, rapidly changing and difficult to predict, the impact on our operations, financial condition and liquidity remains uncertain and difficult to predict. The ultimate impact of the pandemic will depend on evolving factors, many of which are not within our control, and to which we may not be able to effectively respond. These risks include, but are not limited to: a significant reduction in revenue due to curtailment of business from our customers; a reduction in our operating margins due to long-term changes in the mix of our products and services; other effects from governmental, business and individuals' actions that have been and continue to be taken in response to the pandemic (including restrictions on travel and transportation and workforce pressures); reductions in operating effectiveness due to employees working remotely; unavailability of personnel; the delay or cancellation of capital projects and related delays in, or loss of, expected benefits therefrom; limited access to liquidity; increased volatility and pricing in the capital and commercial paper markets; further disruption of our global supply chains; a requirement that we recognize an impairment in the fair value of our assets; an increase in our pension funding obligations; and the effect of the pandemic on the credit-worthiness of our customers. Further, the COVID-19 pandemic, and the volatile regional and global economic conditions stemming from it, could also precipitate or aggravate risk factors that we identify in our 2019 Annual Report on Form 10-K or affect our operations and financial performance in a manner that is not presently known to us or that we currently do not consider to present significant risks. The occurrence or continuation of any of the foregoing could have a material adverse effect on us.

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

(c) A summary of repurchases of our class A and class B common stock during the first quarter of 2020 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 |
|----------------------------------|--|-------------------------------------|---|---|
| January 1 – January 31, 2020 | 0.7 | \$ 115.74 | 0.7 | \$ 2,254 |
| February 1 – February 29, 2020 | 0.8 | 101.81 | 0.8 | 2,175 |
| March 1 – March 31, 2020 | 0.6 | 91.87 | 0.6 | 2,117 |
| Total January 1 – March 31, 2020 | 2.1 | \$ 103.14 | 2.1 | |

(1) Includes shares repurchased through our publicly announced share repurchase programs and shares tendered to pay the exercise price and tax withholding on employee stock options.

In May 2016, the Board of Directors approved a share repurchase authorization of \$8.0 billion for shares of class A and class B common stock. In the first quarter of 2020, we repurchased approximately \$217 million of shares. Due to ongoing economic uncertainty resulting from the COVID-19 pandemic, we have suspended our share repurchase program for the remainder of 2020.

For additional information on our share repurchase activities, see note 12 to the unaudited, consolidated financial statements included in this report.

Exhibit

- 3.1 — [Restated Certificate of Incorporation of United Parcel Service, Inc. \(incorporated by reference to Exhibit 3.3 to Form 8-K filed on May 12, 2010\).](#)
- 3.2 — [Amended and Restated Bylaws of United Parcel Service, Inc. as of February 14, 2013 \(incorporated by reference to Exhibit 3.1 to Form 8-K, filed on February 19, 2013\).](#)
- 4.1 — [Form of 3.900% Senior Notes due 2025 \(incorporated by reference to Exhibit 4.1 to Form 8-K, filed on March 25, 2020\).](#)
- 4.2 — [Form of 4.450% Senior Notes due 2030 \(incorporated by reference to Exhibit 4.2 to Form 8-K, filed on March 25, 2020\).](#)
- 4.3 — [Form of 5.200% Senior Notes due 2040 \(incorporated by reference to Exhibit 4.3 to Form 8-K, filed on March 25, 2020\).](#)
- 4.4 — [Form of 5.300% Senior Notes due 2050 \(incorporated by reference to Exhibit 4.4 to Form 8-K, filed on March 25, 2020\)](#)
- 10.1 — [Employment offer letter agreement between UPS and Carol B. Tomé, dated March 11, 2020 \(incorporated by reference to Exhibit 10.1 to Form 8-K filed on March 12, 2020\).*](#)
- 10.2 — [Protective Covenant Agreement between UPS and Carol Tomé, dated March 11, 2020 \(incorporated by reference to Exhibit 10.2 to Form 8-K, filed on March 12, 2020\).*](#)
- 10.3 — [Transition Agreement between UPS and David P. Abney, dated March 11, 2020 \(incorporated by reference to Exhibit 10.3 to Form 8-K, filed on March 12, 2020\).*](#)
- 10.4 — [Release and Protective Covenant Agreement between UPS and Richard N. Peretz, dated March 26, 2020 \(incorporated by reference to Exhibit 10.1 to Form 8-K, on March 27, 2020\).*](#)
- 31.1 — [Certification of the Principal 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 Principal 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 Principal 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 Principal 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 unaudited financial information from this Quarterly Report on Form 10-Q for the quarter ended March 31, 2020, are formatted in iXBRL (Inline Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Statements of Consolidated Income, (iii) the Statements of Consolidated Comprehensive Income (Loss), (iv) the Statements of Consolidated Cash Flows, and (v) the Notes to the Consolidated Financial Statements.
- 104 — Cover Page Interactive Data File - The cover page from this Quarterly Report on Form 10-Q for the quarter ended March 31, 2020 is formatted in iXBRL.

* Management contract or compensatory plan or arrangement.

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: May 8, 2020

By: _____ /s/ BRIAN NEWMAN
Brian Newman
Senior Vice President, Chief Financial Officer and Treasurer

(Principal Financial Officer)

CERTIFICATE OF PRINCIPAL EXECUTIVE OFFICER

I, David P. Abney, certify that:

1. I have reviewed this quarterly report on Form 10-Q of United Parcel Service, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ DAVID P. ABNEY

David P. Abney

Chairman and Chief Executive Officer

(Principal Executive Officer)

May 8, 2020

CERTIFICATE OF PRINCIPAL FINANCIAL OFFICER

I, Brian O. Newman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of United Parcel Service, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ BRIAN O. NEWMAN

Brian O. Newman
Senior Vice President, Chief Financial Officer and Treasurer
(Principal Financial Officer)

May 8, 2020

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with the Quarterly Report on Form 10-Q of United Parcel Service, Inc. (the "Corporation") for the period ended March 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, the Chairman and Chief Executive Officer of the Corporation, certifies that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

/s/ DAVID P. ABNEY

David P. Abney

Chairman and Chief Executive Officer
(Principal Executive Officer)

May 8, 2020

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906 OF THE
SARBANES-OXLEY ACT OF 2002**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and in connection with the Quarterly Report on Form 10-Q of United Parcel Service, Inc. (the "Corporation") for the period ended March 31, 2020, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, the Senior Vice President of the Corporation, certifies that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Corporation.

/s/ BRIAN O. NEWMAN

Brian O. Newman
Senior Vice President, Chief Financial Officer and Treasurer

(Principal Financial Officer)

May 8, 2020