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UNITED PARCEL SERVICE INC

Form 10-Q

October 30, 2018

false--12-31Q320182018-09-3010-Q0001090727Large Accelerated FilerUNITED PARCEL SERVICE  
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ups:Segments iso4217:EUR ups:Employees

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## United States

# Securities and Exchange Commission

Washington, D.C. 20549

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## Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018 or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-15451

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## United Parcel Service, Inc.

(Exact name of registrant as specified in its charter)

Delaware	58-2480149
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

55 Glenlake Parkway, NE Atlanta, Georgia 30328

(Address of Principal Executive Offices) (Zip Code)

(404) 828-6000

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit 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  Accelerated filer  Non-accelerated filer  Smaller reporting company  Emerging growth company

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 164,014,289 Class A shares, and 695,211,879 Class B shares, with a par value of \$0.01 per share, outstanding at October 24, 2018.

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**PART I. FINANCIAL INFORMATION**

**Cautionary Statement About Forward-Looking Statements**

This report includes and refers to certain “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 thereof and similar terms are intended to be forward-looking statements. Forward-looking statements are made subject to safe harbor protections of the federal securities laws pursuant to Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

Our disclosure and analysis in this report, in our Annual Report on Form 10-K for the year ended December 31, 2017 and in our other filings with the Securities and Exchange Commission contain forward-looking statements regarding our intent, belief and current expectations about our strategic direction, prospects and future results. From time to time, we also provide forward-looking statements in other materials we release as well as oral forward-looking statements. Such statements give our current expectations or forecasts of future events; they do not relate strictly to historical or current facts. Management believes that these forward-looking statements are reasonable as and when made. However, caution should be taken not to place undue reliance on any such forward-looking statements because such statements speak only as of the date when made.

Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or anticipated results. These risks and uncertainties include, but are not limited to: general economic conditions, both in the U.S. and internationally; significant competition on a local, regional, national, and international basis; changes in our relationships with our significant customers; the existing complex and stringent regulation in the U.S. and internationally (including tax laws and regulations), changes to which can impact our business; 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; negotiation and ratification of labor contracts; strikes, work stoppages and slowdowns by our employees; the effects of changing prices of energy, including gasoline, diesel and jet fuel, and interruptions in supplies of these commodities; changes in exchange rates or interest rates; our ability to maintain the image of our brand; breaches in data security; disruptions to the Internet or our technology infrastructure; interruption of our business from natural or man-made disasters including terrorism; 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 both in the U.S. and 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 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, 2017 and in subsequent reports filed with the Securities and Exchange Commission. You should consider the limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of predictions contained in such forward-looking statements. We do not undertake any obligation to update forward-looking statements to reflect events, circumstances, changes in expectations, or the occurrence of unanticipated events after the date of those statements, except as required by law.

Table of Contents**Item 1. Financial Statements****UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****September 30, 2018 (unaudited) and December 31, 2017 (In millions)**

	September 30, 2018	December 31, 2017
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 4,097	\$ 3,320
Marketable securities	744	749
Accounts receivable, net	7,494	8,773
Current income taxes receivable	320	1,573
Other current assets	1,336	1,303
Total Current Assets	13,991	15,718
Property, Plant and Equipment, Net	25,379	22,118
Goodwill	3,825	3,872
Intangible Assets, Net	2,070	1,964
Non-Current Investments and Restricted Cash	307	483
Deferred Income Tax Assets	193	266
Other Non-Current Assets	924	1,153
Total Assets	\$ 46,689	\$ 45,574
<b>LIABILITIES AND SHAREOWNERS' EQUITY</b>		
Current Liabilities:		
Current maturities of long-term debt and commercial paper	\$ 3,200	\$ 4,011
Accounts payable	3,689	3,934
Accrued wages and withholdings	2,748	2,608
Self-insurance reserves	697	705
Accrued group welfare and retirement plan contributions	679	677
Other current liabilities	1,209	951
Total Current Liabilities	12,222	12,886
Long-Term Debt	20,101	20,278
Pension and Postretirement Benefit Obligations	7,012	7,061
Deferred Income Tax Liabilities	1,069	756
Self-Insurance Reserves	1,644	1,765
Other Non-Current Liabilities	1,515	1,804
Shareowners' Equity:		
Class A common stock (165 and 173 shares issued in 2018 and 2017, respectively)	2	2
Class B common stock (695 and 687 shares issued in 2018 and 2017, respectively)	7	7
Additional paid-in capital	—	—
Retained earnings	8,377	5,852
Accumulated other comprehensive loss	(5,288)	(4,867)
Deferred compensation obligations	32	37
Less: Treasury stock (1 share in 2018 and 2017)	(32)	(37)
Total Equity for Controlling Interests	3,098	994
Noncontrolling interests	28	30
Total Shareowners' Equity	3,126	1,024
Total Liabilities and Shareowners' Equity	\$ 46,689	\$ 45,574

See notes to unaudited consolidated financial statements.



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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Revenue	\$17,444	\$16,173	\$52,013	\$47,610
Operating Expenses:				
Compensation and benefits	9,015	8,437	27,084	25,032
Repairs and maintenance	437	399	1,294	1,181
Depreciation and amortization	524	572	1,662	1,688
Purchased transportation	3,216	2,832	9,570	7,991
Fuel	867	636	2,469	1,873
Other occupancy	321	282	1,003	845
Other expenses	1,337	1,203	3,911	3,534
Total Operating Expenses	15,717	14,361	46,993	42,144
Operating Profit	1,727	1,812	5,020	5,466
Other Income and (Expense):				
Investment income and other	317	236	913	624
Interest expense	(155 )	(111 )	(457 )	(324 )
Total Other Income and (Expense)	162	125	456	300
Income Before Income Taxes	1,889	1,937	5,476	5,766
Income Tax Expense	381	678	1,138	1,957
Net Income	\$1,508	\$1,259	\$4,338	\$3,809
Basic Earnings Per Share	\$1.74	\$1.45	\$5.01	\$4.37
Diluted Earnings Per Share	\$1.73	\$1.44	\$4.99	\$4.35

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net Income	\$1,508	\$1,259	\$4,338	\$3,809
Change in foreign currency translation adjustment, net of tax	(28 )	32	(112 )	86
Change in unrealized gain (loss) on marketable securities, net of tax	(1 )	—	(4 )	1
Change in unrealized gain (loss) on cash flow hedges, net of tax	49	(86 )	315	(278 )
Change in unrecognized pension and postretirement benefit costs, net of tax	38	32	115	450
Comprehensive Income	\$1,566	\$1,237	\$4,652	\$4,068

See notes to unaudited consolidated financial statements.

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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash Flows From Operating Activities:</b>		
Net income	\$4,338	\$3,809
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	1,662	1,688
Pension and postretirement benefit expense	461	651
Pension and postretirement benefit contributions	(137 )	(2,585 )
Self-insurance reserves	(127 )	(17 )
Deferred tax (benefit) expense	218	298
Stock compensation expense	507	463
Other (gains) losses	243	(21 )
Changes in assets and liabilities, net of effects of business acquisitions:		
Accounts receivable	1,096	818
Other assets	1,299	151
Accounts payable	(391 )	(398 )
Accrued wages and withholdings	200	134
Other liabilities	35	(582 )
Other operating activities	18	9
Net cash from operating activities	9,422	4,418
<b>Cash Flows From Investing Activities:</b>		
Capital expenditures	(4,490 )	(3,708 )
Proceeds from disposals of property, plant and equipment	45	18
Purchases of marketable securities	(634 )	(1,465 )
Sales and maturities of marketable securities	612	1,582
Net (increase) decrease in finance receivables	(7 )	(1 )
Cash paid for business acquisitions, net of cash and cash equivalents acquired	(2 )	(61 )
Other investing activities	(23 )	20
Net cash used in investing activities	(4,499 )	(3,615 )
<b>Cash Flows From Financing Activities:</b>		
Net change in short-term debt	(77 )	(354 )
Proceeds from long-term borrowings	1,052	5,328
Repayments of long-term borrowings	(2,122 )	(2,450 )
Purchases of common stock	(770 )	(1,346 )
Issuances of common stock	176	177
Dividends	(2,260 )	(2,085 )
Other financing activities	(259 )	(184 )
Net cash used in financing activities	(4,260 )	(914 )
<b>Effect of Exchange Rate Changes on Cash, Cash Equivalents and Restricted Cash</b>	(57 )	56
<b>Net Increase (Decrease) in Cash, Cash Equivalents and Restricted Cash</b>	606	(55 )
<b>Cash, Cash Equivalents and Restricted Cash:</b>		
Beginning of period	3,769	3,921
End of period	\$4,375	\$3,866

See notes to unaudited consolidated financial statements.



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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**NOTE 1. BASIS OF PRESENTATION 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 ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly our financial position as of September 30, 2018, our results of operations for the three and nine months ended September 30, 2018 and 2017, and cash flows for the nine months ended September 30, 2018 and 2017. The results reported in these consolidated financial statements should not be regarded as necessarily indicative of results that may be expected for any other period or the entire year. The interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017.

For interim 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.

Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications had no material impact on our financial position or results of operations.

*Fair Value of Financial Instruments*

The carrying amounts of our cash and cash equivalents, accounts receivable, finance receivables and accounts payable approximate fair value as of September 30, 2018. 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 14. 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.

*Property, Plant and Equipment*

Property, plant and equipment are carried at cost. We evaluate the useful lives of our property, plant and equipment based on our usage, maintenance and replacement policies, and taking into account physical and economic factors that may affect the useful lives of the assets. As part of our ongoing investment in transformation, beginning in the third quarter of 2018, we revised our estimates of useful lives for building improvements and vehicles based on our current assessment of these factors. In general, the change in estimate had the effect of lengthening the useful lives of vehicles and building improvements. Depreciation and amortization are provided by the straight-line method over the estimated useful lives of the assets, which are as follows: Vehicles-6 to 15 years; Aircraft-12 to 30 years; Buildings-20 to 40 years; Leasehold Improvements-lesser of asset useful life or lease term; Plant Equipment-3 to 20 years; Technology Equipment-3 to 5 years. The costs of major airframe and engine overhauls, as well as routine maintenance and repairs, are charged to expense as incurred.

This change in estimate was applied prospectively effective for the third quarter of 2018. See "Consolidated Operating Expenses" of Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for the discussion of the impact to "Depreciation and amortization."

*Accounting Estimates*

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

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS***Adoption of New Accounting Standards*

In May 2014, the Financial Accounting Standards Board ("FASB") issued an accounting standards update ("ASU") that changes the revenue recognition for companies that enter into contracts with customers to transfer goods or services ("*Revenue from Contracts with Customers*"). The standard is a comprehensive new revenue recognition model that requires revenue to be recognized in a manner depicting the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. The FASB has also issued a number of updates to this standard. Effective January 1, 2018, we adopted the requirements of this ASU using the full retrospective method. See note 3 for required disclosures pertaining to the new ASU.

In November 2016, the FASB issued an ASU that is intended to reduce diversity in practice by adding or clarifying guidance on classification and presentation of changes in restricted cash on the statement of cash flows ("*Restricted Cash*"). Effective January 1, 2018, we adopted the requirements of this ASU retrospectively. As a result of this update, restricted cash is included within cash and cash equivalents on our statements of consolidated cash flows.

In March 2017, the FASB issued an ASU to improve the presentation of net periodic pension cost and net periodic postretirement benefit cost ("*Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*"). The update requires employers to report the current service cost component in the same line item as other compensation costs arising from services rendered by employees during the period. The other components of net benefit cost are required to be presented separately from service cost and outside of income from operations. Effective January 1, 2018, we adopted the requirements of this ASU retrospectively, as required. As a result of this update, the net amount of interest cost, prior service cost and expected return on plan assets is now presented as other income.

We have recast our consolidated financial statements from amounts previously reported due to the adoption of new revenue recognition, pension and restricted cash standards. Impacted consolidated balance sheet line items, which reflect the adoption of the new ASUs, are as follows (in millions):

	December 31, 2017				
	As previously reported	Adjustments (a)	Adjustments (b)	Adjustments (c)	As Recast
<b>Assets:</b>					
Other current assets	\$ 1,133	\$ 170	\$	—\$	—\$1,303
Total current assets	15,548	170	—	—	15,718
Deferred income tax assets	265	1	—	—	266
Total Assets	\$45,403	\$ 171	\$	—\$	—\$45,574
<b>Liabilities:</b>					
Accounts payable	\$3,872	\$ 62	\$	—\$	—\$3,934
Accrued wages and withholdings	2,521	87	—	—	2,608
Other current liabilities <sup>(1)</sup>	905	29	—	—	934
Total current liabilities	12,708	178	—	—	12,886
Deferred income tax liabilities	757	(1 )	—	—	756
<b>Shareowners' Equity:</b>					
Retained earnings	5,858	(6 )	—	—	5,852
Total Shareowners' Equity	1,030	(6 )	—	—	1,024
Total Liabilities and Shareowners' Equity	\$45,403	\$ 171	\$	—\$	—\$45,574

(1) The caption "Other current liabilities" was presented separately from "Hedge margin liabilities" of \$17 million in the Form 10-K at December 31, 2017. These captions have been collapsed in the consolidated balance sheets as of September 30, 2018 and December 31, 2017 included within this Form 10-Q.

(a) Recast to reflect the adoption of *Revenue from Contracts with Customers*.

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- (b) Recast to reflect the adoption of *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*.
- (c) Recast to reflect the adoption of *Restricted Cash*.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

The unaudited consolidated statement of operations, which reflects the adoption of the new ASUs, is as follows (in millions):

	Three months ended September 30, 2017				
	As Previously Reported	Adjustments (a)	Adjustments (b)	Adjustments (c)	As Recast
Revenue	\$15,978	\$ 195	\$ —	\$ —	—\$16,173
Operating Expenses:					
Compensation and benefits	8,221	—	216	—	8,437
Repairs and maintenance	398	1	—	—	399
Depreciation and amortization	572	—	—	—	572
Purchased transportation	2,652	180	—	—	2,832
Fuel	636	—	—	—	636
Other occupancy	282	—	—	—	282
Other expenses	1,182	21	—	—	1,203
Total Operating Expenses	13,943	202	216	—	14,361
Operating Profit	2,035	(7 )	(216 )	—	1,812
Other Income and (Expense):					
Investment income and other	20	—	216	—	236
Interest expense	(111 )	—	—	—	(111 )
Total Other Income and (Expense)	(91 )	—	216	—	125
Income Before Income Taxes	1,944	(7 )	—	—	1,937
Income Tax Expense (Benefit)	680	(2 )	—	—	678
Net Income	\$1,264	\$ (5 )	\$ —	\$ —	—\$1,259
Basic Earnings Per Share	\$1.45	\$ —	\$ —	\$ —	—\$1.45
Diluted Earnings Per Share	\$1.45	\$ (0.01 )	\$ —	\$ —	—\$1.44

(a) Recast to reflect the adoption of *Revenue from Contracts with Customers*.

(b) Recast to reflect the adoption of *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*.

(c) Recast to reflect the adoption of *Restricted Cash*.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

	Nine months ended September 30, 2017				
	As Previously Reported	Adjustments (a)	Adjustments (b)	Adjustments (c)	As Recast
Revenue	\$47,043	\$ 567	\$ —	\$	—\$47,610
Operating Expenses:					
Compensation and benefits	24,457	—	575	—	25,032
Repairs and maintenance	1,180	1	—	—	1,181
Depreciation and amortization	1,688	—	—	—	1,688
Purchased transportation	7,461	530	—	—	7,991
Fuel	1,873	—	—	—	1,873
Other occupancy	845	—	—	—	845
Other expenses	3,504	30	—	—	3,534
Total Operating Expenses	41,008	561	575	—	42,144
Operating Profit	6,035	6	(575 )	—	5,466
Other Income and (Expense):					
Investment income and other	49	—	575	—	624
Interest expense	(324 )	—	—	—	(324 )
Total Other Income and (Expense)	(275 )	—	575	—	300
Income Before Income Taxes	5,760	6	—	—	5,766
Income Tax Expense (Benefit)	1,954	3	—	—	1,957
Net Income	\$3,806	\$ 3	\$ —	\$	—\$3,809
Basic Earnings Per Share	\$4.36	\$ 0.01	\$ —	\$	—\$4.37
Diluted Earnings Per Share	\$4.35	\$ —	\$ —	\$	—\$4.35

(a) Recast to reflect the adoption of *Revenue from Contracts with Customers*.

(b) Recast to reflect the adoption of *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*.

(c) Recast to reflect the adoption of *Restricted Cash*.

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

The unaudited impacted consolidated statement of cash flows line items, which reflect the adoption of the new ASUs, are as follows (in millions):

	Nine Months Ended September 30, 2017				
	As Previously Reported	Adjustments (a)	Adjustments (b)	Adjustments (c)	As Recast
Net Income	\$3,806	\$ 3	\$ —	\$ —	\$3,809
Adjustments to reconcile net income to net cash from operating activities:					
Deferred tax (benefit) expense	295	3	—	—	298
Other assets	185	(34 )	—	—	151
Accounts payable	(411 )	13	—	—	(398 )
Accrued wages and withholdings	117	17	—	—	134
Other liabilities	(580 )	(2 )	—	—	(582 )
Cash flows from operating activities	4,418	—	—	—	4,418
Purchase of marketable securities	(1,468 )	—	—	3	(1,465 )
Net cash used in investing activities	(3,618 )	—	—	3	(3,615 )
Net decrease in cash, cash equivalents and restricted cash	(58 )	—	—	3	(55 )
Cash, cash equivalents and restricted cash at the beginning of period	3,476	—	—	445	3,921
Cash, cash equivalents and restricted cash at the end of period	\$3,418	\$ —	\$ —	\$ 448	\$3,866

(a) Recast to reflect the adoption of *Revenue from Contracts with Customers*.

(b) Recast to reflect the adoption of *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*.

(c) Recast to reflect the adoption of *Restricted Cash*.

In February 2018, the FASB issued an ASU that allows a reclassification from accumulated other comprehensive income ("AOCI") to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (the "Tax Act"). Effective January 1, 2018, we early adopted this ASU and elected to reclassify the income tax effects of the Tax Act from AOCI to retained earnings. This resulted in a \$735 million increase to retained earnings and a \$735 million decrease to AOCI. Our current accounting policy for releasing income tax effects from other comprehensive income is based on a portfolio approach.

Other accounting pronouncements adopted during the periods covered by the 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 August 2017, the FASB issued an ASU to enhance recognition of the economic results of hedging activities in the financial statements. In addition, this update makes certain targeted improvements to simplify the application of hedge accounting guidance and increase transparency regarding the scope and results of hedging activities. The guidance will generally be applied prospectively and becomes effective for us in the first quarter of 2019, but early adoption is permitted. We continue to evaluate this update to determine the full impact of its adoption but do not expect this ASU to have a material impact on our consolidated financial position, results of operations or cash flows.

In March 2017, the FASB issued an ASU to require the premium on callable debt securities to be amortized to the earliest call date. The amortization period for callable debt securities purchased at a discount would not be impacted by the proposed update. Under U.S. GAAP, premiums on callable debt securities are generally amortized over the contractual life of the security. Only in cases when an entity has a large number of similar securities is it allowed to consider estimates of principal prepayments. Amortization of the premium over the contractual life of the instrument can result in losses being recorded for the unamortized premium if the issuer exercises the call feature prior to maturity. The standard will be effective for us in the first quarter of 2019, but early adoption is permitted. We continue to evaluate this update to determine the full impact of its adoption but do not expect this ASU to have a material

impact on our consolidated financial position, results of operations or cash flows.

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

In January 2017, the FASB issued an ASU to simplify the accounting for goodwill impairment. The update removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The standard will be effective for us in the first quarter of 2020, but early adoption is permitted. We continue to evaluate this update to determine the full impact of its adoption but do not expect this ASU to have a material impact on our consolidated financial position, results of operations or cash flows.

In February 2016, the FASB issued an ASU that requires lessees to recognize a right-of-use asset and lease liability on their balance sheet for all leases with terms beyond twelve months. Although the distinction between operating and finance leases will continue to exist under the new standard, the recognition and measurement of expenses and cash flows will not change significantly from the current treatment. The ASU requires a transition adoption election using either 1) a modified retrospective approach with periods prior to the adoption date being recast or 2) a prospective adoption approach with a cumulative-effect adjustment recognized to the opening balance of retained earnings on the adoption date with prior periods not restated. We anticipate adopting this standard on January 1, 2019 using the prospective adoption approach. We have reviewed and selected a new lease accounting system and are currently accumulating and processing lease data into the system. We are nearing completion of our efforts to compile a complete inventory of arrangements containing a lease and accumulating the lease data necessary to apply this update. We are currently assessing the impact of other arrangements for embedded leases. We plan to apply practical expedients provided in the update that allow, among other things, not to reassess contracts that commenced prior to the adoption. We also anticipate electing a policy not to recognize right of use assets and lease liabilities related to short-term leases. We continue to evaluate this update and subsequent amendments to the original update to determine the full impact of its adoption on our consolidated financial position, results of operations, cash flows and related disclosures, as well as the impact of adoption on policies, practices and systems. In addition, we are currently analyzing our internal control framework to determine if controls should be added or modified as a result of adopting this standard. Based on the preliminary evaluation of our lease portfolio, we believe the largest impact will be accounting for leases for real estate, as we have a large portfolio of leased properties that are currently accounted for as operating leases. As of December 31, 2017, we had \$1.637 billion of future minimum operating lease commitments that are not currently recognized on our consolidated balance sheets. We expect material changes to our consolidated balance sheets as a result of the new standard and will apply these changes prospectively.

Other accounting pronouncements issued, but not effective until after September 30, 2018, are not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

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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 (referred to hereafter as “transportation services”), whether carried out by or arranged by UPS, both domestically and internationally, which generally occurs over a short period of time. Additionally, we provide value-added logistics services to customers through our global network of company-owned and leased distribution centers and field stocking locations, both domestically and internationally.

*Disaggregation of Revenue*

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
<b>Revenue:</b>				
Next Day Air	\$1,896	\$1,769	\$5,510	\$5,186
Deferred	1,066	1,001	3,215	2,991
Ground	7,475	6,881	22,293	20,751
U.S. Domestic Package	10,437	9,651	31,018	28,928
Domestic	678	673	2,094	1,909
Export	2,654	2,568	8,073	7,331
Cargo & Other	146	135	446	381
International Package	3,478	3,376	10,613	9,621
Forwarding	1,672	1,434	4,936	4,047
Logistics	790	736	2,356	2,194
Freight	867	778	2,497	2,240
Other	200	198	593	580
Supply Chain & Freight	3,529	3,146	10,382	9,061
Consolidated revenue	\$17,444	\$16,173	\$52,013	\$47,610

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. See note 2 for the adoption of new accounting standards.

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**  
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*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 U.S. GAAP. To determine the proper revenue recognition method for contracts, we evaluate whether two or more contracts should be combined and accounted for as one 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. For most of our contracts, the customer contracts with us to provide distinct services within a contract, 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 in an amount 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.

In certain business units, such as Logistics, we sell customized, customer-specific solutions in which we provide a significant service of integrating 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 reperform 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 awarded 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 will be accounted for prospectively as the remaining performance obligations are distinct.

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**  
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*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 revenue contracts with customers.

*Principal vs. Agent Considerations*

In our transportation businesses, we utilize independent contractors and third-party carriers in the performance of some transportation services. U.S. GAAP requires us to evaluate 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) using a control model. 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. This required a change in reporting for certain of our Supply Chain & Freight businesses where previously revenue was reported net of associated purchased transportation costs. Revenue and the associated purchased transportation costs are now 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 they are incurred, which requires us to make our best estimate of the probable losses inherent in our customer receivables at each balance sheet date. These estimates require consideration of historical loss experience, adjusted for current conditions, trends in customer payment frequency, and judgments about the probable effects of relevant observable data, including present economic conditions and the financial health of specific customers and market sectors. Our risk management process includes standards and policies for reviewing major account exposures and concentrations of risk. Our total provision for doubtful accounts charged to expense before recoveries during the quarters ended September 30, 2018 and 2017 was \$35 and \$29 million, respectively, and \$76 and \$92 million during the nine months ended September 30, 2018 and 2017, 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 \$254 and \$170 million at September 30, 2018 and December 31, 2017, respectively, net of deferred revenue related to in-transit packages of \$233 and \$174 million at September 30,

2018 and December 31, 2017, respectively. Contract assets are included within "Other current assets" in the consolidated balance sheets. Short-term contract liabilities related to advanced payments from customers were \$6 and \$31 million at September 30, 2018 and December 31, 2017, respectively. Short-term contract liabilities are included within "Other current liabilities" in the consolidated balance sheets. Long-term contract liabilities related to advanced payments from customers were \$26 million at September 30, 2018 and \$0 at December 31, 2017, respectively. Long-term contract liabilities are included within "Other Non-Current liabilities" in the consolidated balance sheets.

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 4. STOCK-BASED COMPENSATION**

We issue employee share-based awards under the UPS Incentive Compensation Plan, which permits 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")*

During the first quarter of 2018, we granted Restricted Units under MIP to certain eligible management employees. Restricted Units granted under MIP generally vest over a five-year period with approximately 20% of the award vesting on January 15th of each of the years following the grant date (except in the case of death or disability, in which case immediate vesting occurs). The entire grant is expensed on a straight-line basis (less estimated forfeitures) ratably 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 MIP, we determined the award measurement dates to be February 7, 2018 (for U.S.-based employees other than management committee employees), March 1, 2018 (for management committee employees) and March 26, 2018 (for international-based employees); therefore, the Restricted Units awarded were valued for stock compensation expense purposes using the closing New York Stock Exchange price of \$111.91, \$106.43 and \$103.70 on those dates, respectively.

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

We award Restricted Units under the LTIP to certain eligible management employees. The 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. These Restricted Units generally vest at the end of a three-year period (except in the case of death, disability or retirement, in which case immediate vesting occurs on a prorated basis). The number of Restricted Units earned will be based on the percentage achievement of the performance targets established on the grant date.

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.

Based on the date that the eligible management population and performance targets were approved for the 2018 LTIP Award, we determined the award measurement date to be May 9, 2018; 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 New York Stock Exchange price of \$111.40 on that date.

During the third quarter of 2018, the UPS Compensation Committee approved awards for new executives. These awards will vest over the same period as the 2018 LTIP Award. Based on the date that the Compensation Committee approved these awards, we determined the award measurement date to be August 8, 2018; therefore, the target Restricted Units awarded for the ROIC and growth in currency-constant consolidated revenue portions of the awards

were valued for stock compensation expense using the closing New York Stock Exchange price of \$120.58 on that date.

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The weighted-average assumptions used and the calculated weighted-average fair values of the RTSR portion of the LTIP awards granted in the third quarter of 2018, the second quarter of 2018 and 2017 are as follows:

	Q3 2018	Q2 2018	2017	
Risk-free interest rate	2.70	% 2.61	% 1.46	%
Expected volatility	16.91	% 16.51	% 16.59	%
Weighted-average fair value of units granted	\$ 156.55	\$ 137.53	\$ 119.29	
Share payout	129.83	% 123.46	% 113.55	%

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

*Non-Qualified Stock Options*

During the first quarter of 2018, we granted 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 date of the grant (except in the case of death or disability, in which case immediate vesting occurs). The options granted expire 10 years after the date of the grant. In the first quarter of 2018, we granted 0.3 and 0.01 million stock options at a grant price of \$106.43 and \$104.45, respectively, which is based on the closing New York Stock Exchange price on March 1, 2018 and March 22, 2018, respectively. In the first quarter of 2017, we granted 0.3 million stock options at a grant price of \$106.87, which is based on the closing New York Stock Exchange price on March 1, 2017.

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 2018 and 2017 are as follows:

	2018	2017	
Expected dividend yield	2.93	% 2.89	%
Risk-free interest rate	2.84	% 2.15	%
Expected life (in years)	7.5	7.5	
Expected volatility	16.72	% 17.81	%
Weighted-average fair value of options granted	\$ 15.23	\$ 14.70	

Compensation expense for share-based awards recognized in "Compensation and benefits" on the statements of consolidated income for the three months ended September 30, 2018 and 2017 was \$129 and \$118 million, respectively. Compensation expense for share-based awards recognized in "Compensation and benefits" on the statements of consolidated income for the nine months ended September 30, 2018 and 2017 was \$507 and \$463 million, respectively.

Table of Contents**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 September 30, 2018 and December 31, 2017 (in millions):

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
<b>September 30, 2018:</b>				
<i>Current trading marketable securities:</i>				
Corporate debt securities	\$75	\$ —	\$ —	\$ 75
Equity securities	2	—	—	2
Total trading marketable securities	77	—	—	77
<i>Current available-for-sale securities:</i>				
U.S. government and agency debt securities	297	—	(5 )	292
Mortgage and asset-backed debt securities	85	—	(1 )	84
Corporate debt securities	277	—	(2 )	275
Non-U.S. government debt securities	16	—	—	16
Total available-for-sale marketable securities	675	—	(8 )	667
Total current marketable securities	\$752	\$ —	\$ (8 )	\$ 744

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
<b>December 31, 2017:</b>				
<i>Current trading marketable securities:</i>				
Corporate debt securities	\$75	\$ —	\$ —	\$ 75
Carbon credit investments <sup>(1)</sup>	77	16	—	93
Total trading marketable securities	152	16	—	168
<i>Current available-for-sale securities:</i>				
U.S. government and agency debt securities	286	—	(3 )	283
Mortgage and asset-backed debt securities	86	—	—	86
Corporate debt securities	201	1	(1 )	201
Equity securities	2	—	—	2
Non-U.S. government debt securities	9	—	—	9
Total available-for-sale marketable securities	584	1	(4 )	581
Total current marketable securities	\$736	\$ 17	\$ (4 )	\$ 749

<sup>(1)</sup> These investments are hedged with forward contracts that are not designated in hedging relationships. See Note 14 for offsetting statement of consolidated income impact.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS***Investment Other-Than-Temporary Impairments*

We have concluded that no material other-than-temporary impairment losses existed as of September 30, 2018. In making this determination, we considered the financial condition and prospects of the issuer, the magnitude of the losses compared with the investments' cost, the probability that we will be unable to collect all amounts due according to the contractual terms of the security, the credit rating of the security and our ability and intent to hold these investments until the anticipated recovery in market value occurs.

*Maturity Information*

The amortized cost and estimated fair value of marketable securities at September 30, 2018, by contractual maturity, are shown below (in millions). Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

	Cost	Estimated Fair Value
Due in one year or less	\$230	\$ 228
Due after one year through three years	424	420
Due after three years through five years	21	21
Due after five years	75	73
	750	742
Equity securities	2	2
	\$752	\$ 744

*Non-Current Investments and Restricted Cash*

Non-current investments and restricted cash is primarily associated with our self-insurance programs. We entered into an escrow agreement with an insurance carrier to guarantee our self-insurance obligations. This agreement requires us to provide collateral to the insurance carrier, which is invested in various marketable securities and cash equivalents. Collateral provided is reflected in "Cash, Cash Equivalents and Restricted Cash" in the statements of consolidated cash flows. At September 30, 2018 and December 31, 2017, we had \$278 and \$449 million in self-insurance investments and restricted cash, respectively.

We held a \$19 million investment in a variable life insurance policy to fund benefits for the UPS Excess Coordinating Benefit Plan at September 30, 2018 and December 31, 2017. The quarterly change in investment fair value is recognized in "Investment income and other" on the statements of consolidated income. Additionally, we held escrowed cash related to the acquisition and disposition of certain assets, primarily real estate, of \$9 and \$15 million as of September 30, 2018 and December 31, 2017, respectively.

The amounts described above are classified as "Non-Current Investments and Restricted Cash" in the consolidated balance sheets.

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):

	September 30, 2018	December 31, 2017	September 30, 2017
Cash and cash equivalents	\$ 4,097	\$ 3,320	\$ 3,418
Restricted cash	278	449	448
Total cash, cash equivalents and restricted cash	\$ 4,375	\$ 3,769	\$ 3,866

*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.



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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

We maintain holdings in certain investment partnerships that are measured at fair value utilizing Level 3 inputs (classified as “Other non-current investments” in the tables below, and as “Other Non-Current Assets” in the consolidated balance sheets). These partnership holdings do not have quoted prices, nor can they be valued using inputs based on observable market data. These investments are valued internally using a discounted cash flow model with two significant inputs: (1) the after-tax cash flow projections for each partnership, and (2) a risk-adjusted discount rate consistent with the duration of the expected cash flows for each partnership. The weighted-average discount rates used to value these investments were 8.14% and 7.56% as of September 30, 2018 and December 31, 2017, respectively. These inputs, and the resulting fair values, are updated on a quarterly basis. The level 3 instruments measured on a recurring basis totaled \$2 and \$6 million as of September 30, 2018 and December 31, 2017, respectively. The following table presents information about our investments measured at fair value on a recurring basis as of September 30, 2018 and December 31, 2017, 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
<b>September 30, 2018:</b>				
Marketable Securities:				
U.S. government and agency debt securities	\$ 292	\$ —	\$ —	\$ 292
Mortgage and asset-backed debt securities	—	84	—	84
Corporate debt securities	—	350	—	350
Equity securities	—	2	—	2
Non-U.S. government debt securities	—	16	—	16
Total marketable securities	292	452	—	744
Other non-current investments	19	—	2	21
Total	\$ 311	\$ 452	\$ 2	\$ 765
<b>December 31, 2017:</b>				
Marketable Securities:				
U.S. government and agency debt securities	\$283	\$—	\$—	\$283
Mortgage and asset-backed debt securities	86	—	86	
Corporate debt securities	—	276	—	276
Equity securities	—	2	—	2
Non-U.S. government debt securities	—	9	—	9
Carbon credit investments	93	—	—	93
Total marketable securities	376	373	—	749
Other non-current investments	19	—	6	25
Total	\$395	\$373	\$6	\$774

There were no transfers of investments between Level 1 and Level 2 during the three or nine months ended September 30, 2018 or 2017.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 6. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment as of September 30, 2018 and December 31, 2017 consists of the following (in millions):

	2018	2017
Vehicles	\$9,500	\$9,365
Aircraft	17,245	16,248
Land	1,783	1,582
Buildings	4,615	4,035
Building and leasehold improvements	4,095	3,934
Plant equipment	10,054	9,387
Technology equipment	2,062	1,907
Equipment under operating leases	—	29
Construction-in-progress	3,692	2,239
	53,046	48,726
Less: Accumulated depreciation and amortization	(27,667 )	(26,608 )
	\$25,379	\$22,118

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 or nine months ended September 30, 2018 or 2017.

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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 and nine months ended September 30, 2018 and 2017 (in millions):

	U.S. Pension Benefits		U.S. Postretirement Medical Benefits		International Pension Benefits	
	2018	2017	2018	2017	2018	2017
<b>Three Months Ended September 30:</b>						
Service cost	\$415	\$382	\$ 7	\$ 7	\$ 15	\$ 15
Interest cost	450	445	26	28	11	10
Expected return on assets	(800 )	(730 )	(2 )	(2 )	(19 )	(17 )
Amortization of prior service cost	48	48	2	1	—	1
Net periodic benefit cost	\$113	\$145	\$ 33	\$ 34	\$ 7	\$ 9

	U.S. Pension Benefits		U.S. Postretirement Medical Benefits		International Pension Benefits	
	2018	2017	2018	2017	2018	2017
<b>Nine Months Ended September 30:</b>						
Service cost	\$1,246	\$1,161	\$ 21	\$ 21	\$ 47	\$ 44
Interest cost	1,349	1,369	78	84	34	30
Expected return on assets	(2,401 )	(2,154 )	(6 )	(5 )	(58 )	(49 )
Amortization of prior service cost	145	144	6	5	—	1
Net periodic benefit cost	\$339	\$520	\$ 99	\$ 105	\$ 23	\$ 26

During the first nine months of 2018, we contributed \$74 and \$63 million to our company-sponsored pension and U.S. postretirement medical benefit plans, respectively. We currently expect to contribute \$24 and \$16 million over the remainder of the year to the pension and U.S. postretirement medical benefit plans, respectively. 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.

*Plan Amendments and Curtailments*

In the quarter ended June 30, 2017, we amended the UPS Retirement Plan and the UPS Excess Coordinating Benefit Plan to cease accruals of additional benefits for future service and compensation for non-union participants effective January 1, 2023. We remeasured plan assets and pension benefit obligations for the affected pension plans as of June 30, 2017, resulting in a net actuarial gain of \$569 million. This reflected a curtailment gain of \$1.525 billion resulting from the benefit plan changes that was partially offset by net actuarial losses of \$956 million, driven by a reduction of approximately 32 basis points in the discount rate compared to December 31, 2016, offset by actual assets returns approximately 275 basis points above our expected return as of the remeasurement date. The net curtailment gain reduced the actuarial loss recorded in "Accumulated other comprehensive loss" in the equity section of the consolidated balance sheets. As actuarial losses were within the corridor (defined as 10% of the greater of the fair value of plan assets and the plan's projected benefit obligation), there was no impact to the statements of consolidated income as a result of this remeasurement.

Effective June 23, 2017, the Company amended the UPS 401(k) Savings Plan so that non-union employees who currently participate in the UPS Retirement Plan will, in addition to current benefits under the UPS 401(k) Savings Plan, earn a UPS Retirement Contribution beginning January 1, 2023. UPS will contribute 5% to 8% of eligible compensation to the UPS 401(k) Savings Plan based on years of vesting service. The amendment also provides for transition contributions for certain participants. There was no impact to the statements of consolidated income for the three and nine months ended September 30, 2018 and for the three months ended September 30, 2017 as a result of the

above changes.

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

*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 September 30, 2018 and December 31, 2017 we had \$854 and \$859 million, respectively, recorded in "Other non-current liabilities" as well as \$7 and \$8 million as of September 30, 2018 and December 31, 2017, respectively, 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 44 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 September 30, 2018 and December 31, 2017 was \$836 and \$921 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 plan 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.

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") under the MPRA. The CSPF plan proposed to reduce retirement benefits to the CSPF participants, including the UPS Transfer Group. We challenged the proposed benefit reduction plan because the CSPF failed to comply with its contractual obligation to obtain our consent to reduce benefits to the UPS Transfer Group under the terms of our withdrawal agreement with the CSPF and because we believed that it did not comply with the law. On May 6, 2016, Treasury rejected the proposed plan submitted by the CSPF, stating that it failed to satisfy a number of requirements set forth in the MPRA.

The CSPF has asserted that it will become insolvent in 2025, which could lead to the reduction of retirement benefits. Although there are numerous factors that could affect the CSPF's funded status, if the CSPF were to become insolvent as it has asserted, UPS may be required to provide coordinating benefits, thereby increasing the current projected benefit obligation of the UPS/IBT Plan by approximately \$4 billion. The CSPF has said that it believes a legislative solution to its funding status is necessary, and we expect that the CSPF will continue to explore options to avoid insolvency.

The potential obligation to pay coordinating benefits from the UPS/IBT Plan is subject to a number of significant uncertainties, including actions that may be taken by the CSPF, the federal government or others. These actions include whether the CSPF will submit a revised pension benefit reduction plan or otherwise seek federal government assistance, the extent to which benefits are paid by the Pension Benefit Guaranty Corporation and our ability to successfully defend our legal positions, as well as the effect of discount rates and various other actuarial assumptions. We account for this potential obligation under Accounting Standards Codification Topic 715- Compensation-Retirement Benefits ("ASC 715"). Under ASC 715 we are required 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 a result, our best estimate as

of December 31, 2017, the most recent measurement date, did not consider this possibility. However, 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.

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

Absent an ability to anticipate changes in law in estimating pension liabilities, our best estimate of the next most likely outcome to address the CSPF's potential insolvency is that the CSPF will submit another benefit reduction plan under the MPRA to forestall insolvency. We believe that it is reasonably possible that such a MPRA filing would include a proposal to reduce benefits to the UPS Transfer Group. If the CSPF seeks to impermissibly reduce benefits to the UPS Transfer Group under a MPRA filing, we would have a strong legal position to prevent that from occurring given that, under our existing agreement with the CSPF, these benefits cannot be reduced without our consent and such a reduction, without first exhausting reductions to other groups in the CSPF, would be contrary to law. Our best estimate as of December 31, 2017, the most recent measurement date, was that there was no additional liability to be recognized for coordinating benefits of the UPS/IBT Plan. However, based on the passage of time and possible changes in other actuarial assumptions, it is reasonably possible that, at the next measurement date, our projected benefit obligation could materially increase as uncertainties are resolved. The amount, if any, of an increase in our projected benefit obligation at our next measurement date will be dependent on the economic and plan conditions that exist as of that date. We will continue to assess the impact of these uncertainties on the projected benefit obligation of the UPS/IBT Plan in accordance with ASC 715.

*Collective Bargaining Agreements*

As of December 31, 2017, we had approximately 280,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the Teamsters. Although these agreements were set to expire July 31, 2018, we reached tentative agreements with the Teamsters on two new five-year contracts in the U.S. Domestic Package and UPS Freight business units on June 21, 2018 and on July 12, 2018, respectively. See Teamsters updated within note 17.

We have approximately 2,700 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association ("IPA"), which becomes amendable on September 1, 2021. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which became amendable November 1, 2013. We remain in negotiations with respect to this agreement. In addition, approximately 3,100 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") that will become amendable on July 31, 2019.

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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 September 30, 2018 and December 31, 2017 (in millions):

	U.S. Domestic Package	International Package	Supply Chain & Freight	Consolidated
<b>December 31, 2017:</b>	\$ 715	\$ 435	\$ 2,722	\$ 3,872
Acquired	—	—	—	—
Currency / Other	—	(19 )	(28 )	(47 )
<b>September 30, 2018:</b>	\$ 715	\$ 416	\$ 2,694	\$ 3,825

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.

*Goodwill Impairment*

We completed our annual goodwill impairment valuation for all reporting units and indefinite-lived intangible assets as of July 1, 2018, and determined that goodwill is not impaired. There were no triggering events identified during the third quarter of 2018. We will continue to monitor each reporting unit for triggering events that might require an update to our annual impairment evaluation between the annual assessment date and December 31, 2018.

The following is a summary of intangible assets as of September 30, 2018 and December 31, 2017 (in millions):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
<b>September 30, 2018:</b>			
Capitalized software	\$ 3,631	\$(2,454 )	\$ 1,177
Licenses	114	(29 )	85
Franchise rights	145	(102 )	43
Customer relationships	740	(200 )	540
Trade name	200	—	200
Trademarks, patents and other	54	(29 )	25
Total Intangible Assets, Net	\$ 4,884	\$(2,814 )	\$ 2,070
<b>December 31, 2017:</b>			
Capitalized software	\$ 3,273	\$(2,310 )	\$ 963
Licenses	114	(10 )	104
Franchise rights	144	(97 )	47
Customer relationships	776	(160 )	616
Trade name	200	—	200
Trademarks, patents and other	71	(37 )	34
Total Intangible Assets, Net	\$ 4,578	\$(2,614 )	\$ 1,964

As of September 30, 2018, we had a trade name with a carrying value of \$200 million and licenses with a carrying value of \$5 million, which are deemed to be indefinite-lived intangible assets and are included in the table above. Impairment tests for the finite-lived intangible assets are only performed when a triggering event occurs that may indicate that the carrying value of the intangible may not be recoverable. There was a \$12 million impairment of a finite-lived asset in the second quarter of 2018.



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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 9. DEBT AND FINANCING ARRANGEMENTS**

The carrying value of our outstanding debt as of September 30, 2018 and December 31, 2017 consists of the following (in millions):

	Principal Amount	Maturity	Carrying Value	
			2018	2017
Commercial paper	\$2,815	2018 - 2019	\$2,815	\$3,203
Fixed-rate senior notes:				
5.500% senior notes	750	2018	—	751
5.125% senior notes	1,000	2019	1,004	1,019
3.125% senior notes	1,500	2021	1,509	1,549
2.050% senior notes	700	2021	697	696
2.450% senior notes	1,000	2022	952	979
2.350% senior notes	600	2022	597	597
2.500% senior note	1,000	2023	994	992
2.800% senior note	500	2024	496	495
2.400% senior note	500	2026	497	497
3.050% senior note	1,000	2027	991	990
6.200% senior notes	1,500	2038	1,482	1,482
4.875% senior notes	500	2040	490	489
3.625% senior notes	375	2042	368	368
3.400% senior notes	500	2046	491	491
3.750 % senior notes	1,150	2047	1,136	1,135
Floating-rate senior notes:				
Floating-rate senior notes	350	2021	348	348
Floating-rate senior notes	400	2022	399	398
Floating-rate senior notes	500	2023	499	496
Floating-rate senior notes	1,043	2049-2067	1,030	1,032
8.375% Debentures:				
8.375% debentures	424	2020	434	447
8.375% debentures	276	2030	281	282
Pound Sterling notes:				
5.500% notes	87	2031	86	84
5.125% notes	593	2050	561	586
Euro senior notes:				
0.375% notes	811	2023	805	832
1.625% notes	811	2025	806	833
1.000% notes	579	2028	575	595
1.500% notes	579	2032	575	594
Floating-rate senior notes	579	2020	578	598
Canadian senior notes:				
2.125% notes	575	2024	572	593
Capital lease obligations	900	2018-3005	900	500
Facility notes and bonds	320	2029-2045	320	319
Other debt	13	2018-2022	13	19
Total debt	\$24,230		23,301	24,289
Less: Current maturities			(3,200 )	(4,011 )
Long-term debt			\$20,101	\$20,278

*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

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

of September 30, 2018: \$2.267 billion with an average interest rate of 2.01% and €473 million (\$548 million) with an average interest rate of -0.37%. As of September 30, 2018, we have classified the entire commercial paper balance as a current liability on our consolidated balance sheets.

*Debt Classification*

We have classified our 5.125% senior notes due April 2019 with a principal balance of \$1.0 billion as long-term debt based on our intent and ability to refinance the debt as of September 30, 2018. 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 Repayments*

On January 15, 2018, our \$750 million 5.500% senior notes matured and were repaid in full.

*Sources of Credit*

We maintain two credit agreements with a consortium of banks. One of these agreements provides revolving credit facilities of \$4.5 billion, and expires on March 22, 2019. Generally, amounts outstanding under this facility bear interest at a periodic fixed rate equal to LIBOR for the applicable interest period and currency denomination, plus an applicable margin. Alternatively, a fluctuating rate of interest equal to the highest of (1) JPMorgan Chase Bank's publicly announced prime rate; (2) the Federal Funds effective rate plus 0.50%; and (3) LIBOR for a one month interest period plus 1.00%, plus an applicable margin, may be used at our discretion. In each case, the applicable margin for advances bearing interest based on LIBOR is a percentage determined by quotations from Markit Group Ltd. for our 1-year credit default swap spread, subject to a minimum rate of 0.10% and a maximum rate of 0.75%. The applicable margin for advances bearing interest based on the prime rate is 1.00% below the applicable margin for LIBOR advances (but not lower than 0.00%). We are also able to request advances under this facility based on competitive bids for the applicable interest rate. There were no amounts outstanding under this facility as of September 30, 2018.

The second agreement provides revolving credit facilities of \$3.0 billion, and expires on March 24, 2022. Generally, amounts outstanding under this facility bear interest at a periodic fixed rate equal to LIBOR for the applicable interest period and currency denomination, plus an applicable margin. Alternatively, a fluctuating rate of interest equal to the highest of (1) JPMorgan Chase Bank's publicly announced prime rate; (2) the Federal Funds effective rate plus 0.50%; and (3) LIBOR for a one month interest period plus 1.00%, plus an applicable margin, may be used at our discretion. In each case, the applicable margin for advances bearing interest based on LIBOR is a percentage determined by quotations from Markit Group Ltd. for our 1-year credit default swap spread, 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 0.00%). We are also able to request advances under this facility based on competitive bids. There were no amounts outstanding under this facility as of September 30, 2018.

*Debt Covenants*

Our existing debt instruments and credit facilities subject us to certain financial covenants. As of September 30, 2018 and for all prior periods presented, we were in compliance with all applicable 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 September 30, 2018, 10% of net tangible assets was equivalent to \$2.857 billion; however, we have no covered sale-leaseback transactions or secured indebtedness outstanding. We do not expect these covenants to have a material impact on our financial condition or liquidity.

*Fair Value of Debt*

Based on the borrowing rates currently available to the Company for debt with similar terms and maturities, the fair value of long-term debt, including current maturities, was approximately \$23.857 and \$25.206 billion as of

September 30, 2018 and December 31, 2017, 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.

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

**NOTE 10. LEGAL PROCEEDINGS AND CONTINGENCIES**

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

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

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

*Judicial Proceedings*

We are a defendant in a number of lawsuits filed in state and federal courts containing various class action allegations under state wage-and-hour laws. At this time, we do not believe that any loss associated with these matters would have a material adverse effect on our financial condition, results of operations or liquidity.

UPS and our subsidiary The UPS Store, Inc. were defendants in *Morgate v. The UPS Store, Inc. et al.*, an action in the Los Angeles Superior Court brought on behalf of a certified class of all franchisees who chose to rebrand their Mail Boxes Etc. franchises to The UPS Store in March 2003. Plaintiff alleged that UPS and The UPS Store, Inc. misrepresented and omitted facts to the class about the market tests that were conducted before offering the class the choice of whether to rebrand to The UPS Store. In May 2018, we reached an agreement to resolve the case for an immaterial amount, subject to court approval. Court approval was received and the case was resolved in the third quarter of 2018.

We are a defendant in *Ryan Wright and Julia Zislin v. United Parcel Service Canada Ltd.*, an action brought on behalf of a certified class of customers in the Superior Court of Justice in Ontario, Canada. Plaintiffs filed suit in February 2007, alleging inadequate disclosure concerning the existence and cost of brokerage services provided by us under applicable provincial consumer protection legislation and infringement of interest restriction provisions under the Criminal Code of Canada. Partial summary judgment was granted to us and the plaintiffs by the Ontario motions court in August 2011, when it dismissed plaintiffs' complaint under the Criminal Code and granted plaintiffs' complaint of inadequate disclosure. We appealed the Court's decision pertaining to inadequate disclosure in September 2011. In June 2018, we reached an agreement to resolve the case for an immaterial amount, subject to court approval. Court approval was received and the case was resolved in the third quarter of 2018.

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 \$9.4 million and penalties of \$237.6 million. An accrual of \$9.4 million with respect to the damages awarded by the court is included on our consolidated balance sheets at September 30, 2018. 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 remain to be determined in future legal proceedings. Consequently, we are unable to reasonably estimate a likely amount of loss within that range. We strongly disagree with the District Court's analysis and conclusions, and have appealed to the United States Court of Appeals for the Second Circuit. The briefing is now complete and we are awaiting the scheduling of oral arguments.



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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

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

In 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 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 €19.2 million. UPS has 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 the amount of loss, if any, that may result from this matter including: (1) we are vigorously defending ourselves and believe that we have a number of meritorious legal defenses; and (2) there are unresolved questions of law and fact that could be important to the ultimate resolution of this matter. Accordingly, at this time we are not able to estimate a possible loss or range of loss that may result from this matter or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

In February 2018 the Turkish Competition Authority ("Authority") opened an investigation into nine companies (including UPS) in the small package industry 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. The investigation is in its early stages. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from this matter including: (1) we are vigorously defending ourselves and believe that we have a number of meritorious legal defenses; and (2) there are unresolved questions of law and fact that could be important to the ultimate resolution of this matter. Accordingly, at this time we are not able to estimate a possible loss or range of loss that may result from this matter or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of 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.

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 11. SHAREOWNERS' EQUITY***Capital Stock, Additional Paid-In Capital and Retained Earnings*

We maintain two classes of common stock, which are distinguished from each other primarily by their respective voting rights. Class A shares are entitled to 10 votes per share, whereas class B shares are entitled to one vote per share. Class A shares are primarily held by UPS employees and retirees, and these shares are fully convertible on a one-to-one basis into class B shares at any time. Class B shares are publicly traded on the New York Stock Exchange under the symbol "UPS". Class A and B shares both have a \$0.01 par value, and as of September 30, 2018, there were 4.6 billion class A shares and 5.6 billion class B shares authorized to be issued. Additionally, there are 200 million preferred shares, with a \$0.01 par value, authorized to be issued. As of September 30, 2018, no preferred shares had been issued.

The following is a rollforward of our common stock, additional paid-in capital and retained earnings accounts for the nine months ended September 30, 2018 and 2017 (in millions, except per share amounts):

	2018		2017	
	Shares	Dollars	Shares	Dollars
<b>Class A Common Stock</b>				
Balance at beginning of period	173	\$2	180	\$2
Common stock purchases	(3 )	—	(3 )	—
Stock award plans	4	—	4	—
Common stock issuances	3	—	2	—
Conversions of class A to class B common stock	(12 )	—	(7 )	—
Class A shares issued at end of period	165	\$2	176	\$2
<b>Class B Common Stock</b>				
Balance at beginning of period	687	\$7	689	\$7
Common stock purchases	(4 )	—	(9 )	—
Conversions of class A to class B common stock	12	—	7	—
Class B shares issued at end of period	695	\$7	687	\$7
<b>Additional Paid-In Capital</b>				
Balance at beginning of period		\$—		\$—
Stock award plans		307		283
Common stock purchases		(632 )		(604 )
Common stock issuances		312		268
Option premiums received (paid)		13		53
Balance at end of period		\$—		\$—
<b>Retained Earnings</b>				
Balance at beginning of period		\$5,852		\$4,880
Net income attributable to common shareowners		4,338		3,809
Dividends (\$2.73 and \$2.49 per share)		(2,408 )		(2,213 )
Common stock purchases		(124 )		(748 )
Reclassification from AOCI pursuant to the early adoption of ASU 2018-02		735		—
Other		(16 )		—
Balance at end of period		\$8,377		\$5,728

We repurchased 6.6 million shares of class A and class B common stock for \$756 million during the nine months ended September 30, 2018, and 12.3 million shares for \$1.352 billion during the nine months ended September 30, 2017. In May 2016, the Board of Directors approved a share repurchase authorization of \$8.0 billion, which has no expiration date. As of September 30, 2018, we had \$3.583 billion of this share repurchase authorization available.



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

From time to time, we enter into share repurchase programs with large financial institutions to assist in our buyback of company stock. These programs allow us to repurchase our shares at a price below the weighted average UPS share price for a given period. During the third quarter of 2018, 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 received net premiums of \$13 million during the first nine months of 2018 and \$53 million during the first nine months of 2017, related to entering into and settling capped call options for the purchase of class B shares. As of September 30, 2018, we had outstanding options for the purchase of 0.4 million shares with a weighted average strike price of \$98.16 per share that will settle during 2018.

*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. Additionally, effective January 1, 2018, we early adopted an ASU that allows a reclassification from AOCI to retained earnings for stranded tax effects resulting from the Tax Act (see note 2 for further information). The activity in AOCI for the nine months ended September 30, 2018 and 2017 is as follows (in millions):

	2018	2017
<b>Foreign currency translation gain (loss), net of tax:</b>		
Balance at beginning of period	\$(930 )	\$(1,016 )
Translation adjustment (net of tax effect of \$26 and \$(146))	(112 )	86 )
Reclassification to retained earnings pursuant to the early adoption of ASU 2018-02	(47 )	— )
Balance at end of period	(1,089 )	(930 )
<b>Unrealized gain (loss) on marketable securities, net of tax:</b>		
Balance at beginning of period	(2 )	(1 )
Current period changes in fair value (net of tax effect of \$(2) and \$1)	(6 )	2 )
Reclassification to earnings (net of tax effect of \$1 and \$0)	2 )	(1 )
Balance at end of period	(6 )	— )
<b>Unrealized gain (loss) on cash flow hedges, net of tax:</b>		
Balance at beginning of period	(366 )	(45 )
Current period changes in fair value (net of tax effect of \$81 and \$(162))	254 )	(269 )
Reclassification to retained earnings pursuant to the early adoption of ASU 2018-02	(79 )	— )
Reclassification to earnings (net of tax effect of \$19 and \$(6))	61 )	(9 )
Balance at end of period	(130 )	(323 )
<b>Unrecognized pension and postretirement benefit costs, net of tax:</b>		
Balance at beginning of period	(3,569 )	(3,421 )
Remeasurement of plan assets and liabilities (net of tax effect of \$0 and \$214) <sup>(1)</sup>	— )	356 )
Reclassification to retained earnings pursuant to the early adoption of ASU 2018-02	(609 )	— )
Reclassification to earnings (net of tax effect of \$36 and \$56)	115 )	94 )
Balance at end of period	(4,063 )	(2,971 )
Accumulated other comprehensive income (loss) at end of period	\$(5,288 )	\$(4,224 )

<sup>(1)</sup> See note 7 for further information about plan curtailments resulting in remeasurement of plan assets and liabilities.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

Detail of the gains (losses) reclassified from AOCI to the statements of consolidated income for the three and nine months ended September 30, 2018 and 2017 is as follows (in millions):

**Three Months Ended September 30:**

	Amount Reclassified from AOCI		Affected Line Item in the Income Statement
	2018	2017	
<b>Unrealized gain (loss) on marketable securities:</b>			
Realized loss on sale of securities	\$(1 )	\$1	Investment income and other
Income tax (expense) benefit	—	—	Income tax expense
Impact on net income	(1 )	1	Net income
<b>Unrealized gain (loss) on cash flow hedges:</b>			
Interest rate contracts	(6 )	(6 )	Interest expense
Foreign exchange contracts	—	3	Revenue
Income tax (expense) benefit	1	1	Income tax expense
Impact on net income	(5 )	(2 )	Net income
<b>Unrecognized pension and postretirement benefit costs:</b>			
Prior service costs	(50 )	(50 )	Investment income and other
Income tax (expense) benefit	12	19	Income tax expense
Impact on net income	(38 )	(31 )	Net income
Total amount reclassified for the period	\$(44 )	\$(32 )	Net income

**Nine Months Ended September 30:**

	Amount Reclassified from AOCI		Affected Line Item in the Income Statement
	2018	2017	
<b>Unrealized gain (loss) on marketable securities:</b>			
Realized loss on sale of securities	(3 )	1	Investment income and other
Income tax (expense) benefit	1	—	Income tax expense
Impact on net income	(2 )	1	Net income
<b>Unrealized gain (loss) on cash flow hedges:</b>			
Interest rate contracts	(18 )	(20 )	Interest expense
Foreign exchange contracts	(62 )	35	Revenue
Income tax (expense) benefit	19	(6 )	Income tax expense
Impact on net income	(61 )	9	Net income
<b>Unrecognized pension and postretirement benefit costs:</b>			
Prior service costs	(151 )	(150 )	Investment income and other
Income tax (expense) benefit	36	56	Income tax expense
Impact on net income	(115 )	(94 )	Net income
Total amount reclassified for the period	\$(178 )	\$(84 )	Net income



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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS***Deferred Compensation Obligations and Treasury Stock*

Activity in the deferred compensation program for the nine months ended September 30, 2018 and 2017 is as follows (in millions):

	2018	2017
	Share Dollars	Share Dollars
<b>Deferred Compensation Obligations:</b>		
Balance at beginning of period	\$37	\$45
Reinvested dividends	2	2
Benefit payments	(7 )	(10 )
Balance at end of period	\$32	\$37
<b>Treasury Stock:</b>		
Balance at beginning of period	(1) \$(37)	(1) \$(45)
Reinvested dividends	— (2 )	— (2 )
Benefit payments	— 7	— 10
Balance at end of period	(1) \$(32)	(1) \$(37)

*Noncontrolling Interests:*

We have noncontrolling interests in certain consolidated subsidiaries in our International Package and Supply Chain & Freight segments. Noncontrolling interests decreased \$2 million and increased \$6 million for the nine months ended September 30, 2018 and 2017, respectively.

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 12. SEGMENT INFORMATION**

We report our operations in three segments: U.S. Domestic Package operations, International Package operations and Supply Chain & Freight operations. Package operations represent our most significant business and are broken down into regional operations around the world. Regional operations managers are responsible for both domestic and export 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 our 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 consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2017 and updated in note 2 and note 3 for newly adopted accounting standards. Certain expenses are allocated between the segments using activity-based costing methods.

Segment information for the three and nine months ended September 30, 2018 and 2017 is as follows (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
<b>Revenue:</b>				
U.S. Domestic Package	\$10,437	\$9,651	\$31,018	\$28,928
International Package	3,478	3,376	10,613	9,621
Supply Chain & Freight	3,529	3,146	10,382	9,061
Consolidated	\$17,444	\$16,173	\$52,013	\$47,610
<b>Operating Profit:</b>				
U.S. Domestic Package	\$949	\$1,011	\$2,644	\$3,216
International Package	536	606	1,748	1,694
Supply Chain & Freight	242	195	628	556
Consolidated	\$1,727	\$1,812	\$5,020	\$5,466

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 13. 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 and nine months ended September 30, 2018 and 2017 (in millions, except per share amounts):

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2017	
<b>Numerator:</b>				
Net income attributable to common shareowners	\$1,508	\$1,259	\$4,338	\$3,809
<b>Denominator:</b>				
Weighted average shares	860	864	861	867
Deferred compensation obligations	1	1	1	1
Vested portion of restricted units	4	4	4	4
<b>Denominator for basic earnings per share</b>	<b>865</b>	<b>869</b>	<b>866</b>	<b>872</b>
<b>Effect of dilutive securities:</b>				
Restricted units	5	4	4	3
Stock options	—	1	—	1
<b>Denominator for diluted earnings per share</b>	<b>870</b>	<b>874</b>	<b>870</b>	<b>876</b>
<b>Basic earnings per share</b>	<b>\$1.74</b>	<b>\$1.45</b>	<b>\$5.01</b>	<b>\$4.37</b>
<b>Diluted earnings per share</b>	<b>\$1.73</b>	<b>\$1.44</b>	<b>\$4.99</b>	<b>\$4.35</b>

There were no antidilutive shares for the three months ended September 30, 2018 or 2017. Diluted earnings per share for the nine months ended September 30, 2018 and 2017 excluded the effect of 0.1 million and 0.2 million shares of common stock, respectively, that may be issued upon the exercise of employee stock options, because such effect would be antidilutive.

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

**NOTE 14. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT**

*Risk Management Policies*

Changes in fuel prices, interest rates and foreign 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 for those instruments generally would be offset by increases in the value of those hedged transactions. We do not hold or issue derivative financial instruments for trading or speculative purposes.

*Credit Risk Management*

The forward contracts, swaps and options discussed below contain an element of risk that the counterparties may be unable to meet the terms of the agreements; however, we 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 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.

At September 30, 2018 and December 31, 2017, we held cash collateral of \$59 and \$17 million, respectively, under these agreements; this collateral is included in "Cash and cash equivalents" on the consolidated balance sheets and its use by UPS is not restricted. At September 30, 2018 and December 31, 2017, \$45 and \$174 million, respectively, of 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.

The aggregate fair value of instruments not covered by the zero threshold bilateral collateral provisions were in a net liability position of \$0 and \$16 million at September 30, 2018 and December 31, 2017, respectively.

*Accounting Policy for Derivative Instruments*

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

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

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

consolidated income during the current period, as well as the offsetting gain or loss on the hedged item.

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

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

*Types of Hedges*

*Commodity Risk Management*

Currently, the fuel surcharges that we apply to our domestic and international package and LTL services are the primary means of reducing the risk of adverse fuel price changes on our business. 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.

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. Any ineffective portion of net investment hedging is recognized as a component of investment income and other. Balances in the cumulative translation adjustment accounts remain until the sale or complete liquidation of the foreign entity.

*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 the 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.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS***Outstanding Positions*

As of September 30, 2018 and December 31, 2017, the notional amounts of our outstanding derivative positions were as follows (in millions):

	September 30, 2018	December 31, 2017
<b>Currency hedges:</b>		
Euro	EUR 4,848	EUR 4,942
British Pound Sterling	GBP 1,713	GBP 1,736
Canadian Dollar	CAD 1,433	CAD 1,259
Mexican Peso	MXN —	MXN 169
Singapore Dollar	SGD 41	SGD 11

**Interest rate hedges:**

Fixed to Floating Interest Rate Swaps	USD 4,674	USD 5,424
Floating to Fixed Interest Rate Swaps	USD 778	USD 778

**Investment market price hedges:**

Marketable Securities	EUR —	EUR 64
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As of September 30, 2018 or December 31, 2017, we had no outstanding commodity hedge positions.

*Balance Sheet Recognition and Fair Value Measurements*

The following table indicates the location on 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). The table is segregated between those derivative instruments that qualify and are designated as hedging instruments and those that are not, as well as by type of contract and whether the derivative is in an asset or liability position.

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

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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	
			September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
<b>Derivatives designated as hedges:</b>						
Foreign exchange contracts	Other current assets	Level 2	\$ 63	\$ 2	\$ 39	\$ —
Interest rate contracts	Other current assets	Level 2	4	1	4	1
Foreign exchange contracts	Other non-current assets	Level 2	96	1	66	—
Interest rate contracts	Other non-current assets	Level 2	9	59	2	43
<b>Derivatives not designated as hedges:</b>						
Foreign exchange contracts	Other current assets	Level 2	3	18	3	17
Foreign exchange contracts	Other non-current assets	Level 2	1	—	—	—
Interest rate contracts	Other non-current assets	Level 2	20	26	20	26
Total Asset Derivatives			\$ 196	\$ 107	\$ 134	\$ 87

  

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	
			September 30, 2018	December 31, 2017	September 30, 2018	December 31, 2017
<b>Derivatives designated as hedges:</b>						
Foreign exchange contracts	Other current liabilities	Level 2	\$ 30	\$ 93	\$ 6	\$ 91
Foreign exchange contracts	Other non-current liabilities	Level 2	39	194	9	193
Interest rate contracts	Other non-current liabilities	Level 2	65	28	58	12
<b>Derivatives not designated as hedges:</b>						
Foreign exchange contracts	Other current liabilities	Level 2	1	1	1	—
Investment market price contracts	Other current liabilities	Level 2	—	16	—	16
Foreign exchange contracts	Other non-current liabilities	Level 2	1	—	—	—
Total Liability Derivatives			\$ 136	\$ 332	\$ 74	\$ 312

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.

*Income Statement and AOCI Recognition*

The following table indicates the amount of gains and losses that have been recognized in AOCI for the three and nine months ended September 30, 2018 and 2017 for those derivatives designated as cash flow hedges (in millions):

**Three Months Ended September 30:**

Derivative Instruments in Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in AOCI on Derivative (Effective Portion)	
	2018	2017
	Interest rate contracts	\$1
Foreign exchange contracts	57	(141)
Total	\$58	\$(141)

**Nine Months Ended September 30:**

Derivative Instruments in Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in AOCI on Derivative (Effective Portion)	
	2018	2017
Interest rate contracts	\$3	\$—
Foreign exchange contracts	332	(431 )
Total	\$335	\$(431 )

As of September 30, 2018, there are \$3 million of pre-tax losses related to cash flow hedges that are currently deferred in AOCI that are expected to be reclassified to income over the 12 month period ending September 30, 2019. The actual amounts that will be reclassified to income over the next 12 months will vary from this amount as a result of changes in market conditions. The maximum term over which we are hedging exposures to the variability of cash flow is approximately 14 years.

The amount of ineffectiveness recognized in income on derivative instruments designated in cash flow hedging relationships was immaterial for the three and nine months ended September 30, 2018 and 2017.

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The following table indicates the amount of gains and losses that have been recognized in AOCI within foreign currency translation adjustment for the three and nine months ended September 30, 2018 and 2017 for those instruments designated as net investment hedges (in millions):

**Three Months Ended September 30:**

Non-derivative Instruments in Net Investment Hedging Relationships	Amount of Gain (Loss) Recognized in AOCI on Debt (Effective Portion)	
	2018	2017
Foreign denominated debt	\$ 10	\$(142)
Total	\$ 10	\$(142)

**Nine Months Ended September 30:**

Non-derivative Instruments in Net Investment Hedging Relationships	Amount of Gain (Loss) Recognized in AOCI on Debt (Effective Portion)	
	2018	2017
Foreign denominated debt	\$ 148	(389)
Total	\$ 148	\$(389)

The amount of ineffectiveness recognized in income on non-derivative instruments designated in net investment hedging relationships was immaterial for the three and nine months ended September 30, 2018 and 2017.

The following table indicates the amount and location in the statements of consolidated income in which derivative gains and losses, as well as the associated gains and losses on the underlying exposure, have been recognized for those derivatives designated as fair value hedges for the three and nine months ended September 30, 2018 and 2017 (in millions):

Derivative Instruments in Fair Value Hedging Relationships	Location of Gain (Loss) Recognized in Income	Derivative Amount of Gain (Loss) Recognized in Income		Hedged Items in Fair Value Hedging Relationships	Location of Gain (Loss) Recognized In Income	Hedged Items Amount of Gain (Loss) Recognized in Income	
		2018	2017			2018	2017
<b>Three Months Ended September 30:</b>							
Interest rate contracts	Interest Expense	\$(13)	\$(18)	Fixed-Rate Debt	Interest Expense	\$ 13	\$ 18
<b>Nine Months Ended September 30:</b>							
Interest rate contracts	Interest Expense	\$(86)	\$(41)	Fixed-Rate Debt	Interest Expense	\$ 86	\$ 41

Additionally, we maintain some interest rate swaps, foreign exchange forwards and investment market price forward contracts that are not designated as hedges. These interest rate swap contracts are intended to provide an economic hedge of portions of our outstanding debt. These 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. These 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.

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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 and nine months ended September 30, 2018 and 2017 (in millions):

Derivative Instruments Not Designated in Hedging Relationships	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income	
		2018	2017
<b>Three Months Ended September 30:</b>			
Interest rate contracts	Interest expense	\$ (3 )	\$ (2 )
Foreign exchange contracts	Investment income and other	(14 )	14
Investment market price contracts	Investment income and other	—	(45 )
Total		\$ (17 )	\$ (33 )
<b>Nine Months Ended September 30:</b>			
Interest rate contracts	Interest expense	\$ (7 )	\$ (6 )
Foreign exchange contracts	Investment income and other	(73 )	\$ 34
Investment market price contracts	Investment income and other	16	(37 )
Total		\$ (64 )	\$ (9 )

Table of Contents**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES****NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS****NOTE 15. INCOME TAXES**

Our effective tax rate decreased to 20.2% in the third quarter of 2018 from 35.0% in the same period of 2017 (20.8% year-to-date in 2018 compared to 33.9% in the same period of 2017). The decrease in our effective tax rate was primarily due to the impact of the Tax Act, discussed further below, which reduced the U.S. federal corporate income tax rate from 35% to 21% effective January 1, 2018. In addition, the recognition of excess tax benefits related to share-based compensation in income tax reduced our effective rate by 0.8% year-to-date in 2018 compared to 1.1% in the same period of 2017 (there was not a significant impact in the third quarter of 2018 or 2017). Other factors that impacted our effective tax rate in the third quarter and year-to-date periods of 2018 compared with the same periods of 2017 include favorable resolutions of uncertain tax positions, favorable U.S. state and local tax law changes, favorable tax provisions enacted in the Bipartisan Budget Act of 2018 and discrete tax credits associated with the filing of our 2017 U.S. federal income tax return.

As discussed in note 16, we recognized pre-tax transformation strategy costs of \$97 million in the third quarter of 2018 (\$360 million year-to-date). As a result, we recorded an additional income tax benefit of \$24 million (\$87 million year-to-date). This benefit was generated at a higher average tax rate than the 2018 U.S. federal statutory rate primarily due to the effect of U.S. state and local taxes and foreign taxes.

As discussed in our Annual Report on Form 10-K for the year ended December 31, 2017, 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 statute of limitations or other unforeseen circumstances.

*Tax Cuts and Jobs Act*

On December 22, 2017, the United States enacted into law the Tax Act. The Tax Act makes broad and complex changes to the U.S. tax code, including a permanent corporate rate reduction to 21% and a transition to a territorial international system effective in 2018. The Tax Act also includes provisions that affected 2017, including: (1) requiring a one-time transition tax on certain unrepatriated earnings of foreign subsidiaries ("Transition Tax") that is payable over eight years; (2) requiring a remeasurement of all U.S. deferred tax assets and liabilities to the newly enacted corporate tax rate of 21%; and (3) providing for additional first-year depreciation that allows full expensing of qualified property placed into service after September 27, 2017.

In late December 2017, the SEC staff issued Staff Accounting Bulletin ("SAB") 118, which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the related accounting under U.S. GAAP. If a company's accounting for certain income tax effects of the Tax Act is incomplete, but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements. Accordingly, we recorded provisional estimates in the year ended December 31, 2017 related to our Transition Tax liability, our change in indefinite reinvestment assertion for certain foreign subsidiaries and the remeasurement of our U.S. net deferred tax liabilities.

To calculate the amount of Transition Tax, we must determine, in addition to other factors, the amount of post-1986 earnings and profits ("E&P") of the foreign subsidiaries as well as the amount of non-U.S. income taxes paid on such earnings. We were able to make a reasonable estimate of the Transition Tax and recorded a provisional liability of \$310 million in the year ended December 31, 2017; however, there are certain factors that could impact our provisional estimate.

First, several of our foreign subsidiaries have a fiscal year-end other than December 31, and E&P for these subsidiaries cannot be precisely calculated until their fiscal years conclude during 2018. Second, we continue to gather

additional information needed to precisely estimate the impact of the Transition Tax on our U.S. state and local tax liabilities given the complexity of the relevant state laws. Finally, we expect additional regulatory guidance and technical clarifications from the U.S. Department of the Treasury and Internal Revenue Service that could change our provisional estimate of the Transition Tax.

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As the U.S. has moved to a territorial system, we have changed our indefinite reinvestment assertion with respect to the earnings of certain foreign subsidiaries. As a result, we recorded a provisional deferred tax liability and corresponding increase to deferred tax expense of \$24 million in the year ended December 31, 2017. There are certain factors, discussed above with regard to the Transition Tax, which could also impact our provisional estimate for the change in indefinite reinvestment assertion. For all other foreign subsidiaries, we continue to assert that these earnings are indefinitely reinvested. We will continue to evaluate our indefinite reinvestment assertion for all foreign subsidiaries in light of the Tax Act and our provisional estimate is subject to change.

For our net U.S. deferred tax liabilities, we recorded a provisional decrease of \$606 million with a corresponding reduction to deferred tax expense of \$606 million for the year ended December 31, 2017. While we are able to make a reasonable estimate of the impact of the reduction in corporate rate, it may be affected by other analysis related to the Tax Act, including, but not limited to, completing the analysis of our 2017 capital expenditures that qualify for full expensing and the state tax effect of adjustments made to federal temporary differences.

During the third quarter of 2018, guidance was issued clarifying certain provisions of the Tax Act, and we filed our 2017 U.S. federal income tax return. We have not identified or made any adjustments to our provisional estimates through the third quarter of 2018. During the fourth quarter, we expect the issuance of additional regulatory guidance on certain provisions of the Tax Act, and we will file our 2017 U.S. state and local and certain foreign tax returns. We expect to complete our accounting for our provisional estimates during the fourth quarter, which is within the prescribed measurement period.

**NOTE 16. TRANSFORMATION STRATEGY**

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

During the quarter ended September 30, 2018, we recorded a pre-tax charge of \$97 million (\$360 million year-to-date) that reflects costs and other benefits of \$70 million for the quarter (\$262 million year-to-date) included within "Compensation and benefits" on the statements of consolidated income, and other costs of \$27 million (\$98 million year-to-date) recorded to total other expenses. The after-tax transformation strategy costs totaled \$73 million in the third quarter of 2018 (\$273 million year-to-date). The income tax effects of the transformation strategy costs are calculated by multiplying the amount of the adjustments by the statutory tax rates applicable in each tax jurisdiction. There were no comparable costs for the first nine months of 2017.



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**NOTE 17. SUBSEQUENT EVENTS**

*Collective Bargaining Agreement Status*

On October 5, 2018, the Teamsters declared that the tentative national master agreement for the U.S. Domestic Package business unit was considered ratified, and will be implemented as soon as five remaining local and supplemental agreements are renegotiated and ratified. We remain in the process of negotiating and ratifying these local and supplemental agreements which, when ratified, will be retroactive to August 1, 2018. The UPS Freight business unit national master agreement was not ratified, and we remain in negotiations with respect to this agreement.

We cannot provide any assurances as to our ability to successfully negotiate and enter into any new agreements, or the timing thereof, or the impact that any of these matters may have on our business, financial position, results of operations or liquidity.

*Acquisition of Noncontrolling Interests*

On October 24, 2018 we acquired the noncontrolling interest in our express services joint venture in India. We previously held a majority position in this joint venture, which exclusively serves our international express small package shipping business in India. The acquisition was not material to our results of operations or financial position.

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

During the third quarter of 2018, our business units produced strong revenue growth across all three segments. We realized improvements in revenue per piece as pricing and growth initiatives drove an increase in yields in each of our major products.

On a year-to-date basis, we produced solid operating results in both our International Package and Supply Chain & Freight segments. The U.S. Domestic Package segment realized strong revenue growth, driven by yield improvements across all products and solid volume growth. Operating profit was impacted by planned costs related to our transformation strategy, continuing deployment of Saturday operations, higher pension expenses and the impact of bringing new facility and technology projects on-line. The benefits of our efficiency and growth initiatives in the U.S. will not be fully realized until future periods.

Consolidated revenue increased 7.9% to \$17.444 billion for the third quarter of 2018 when compared to 2017. For the year-to-date period, consolidated revenue increased 9.2% to \$52.013 billion in 2018 from \$47.610 billion in 2017.

Revenue for the third quarter of 2018 increased in all segments and major product categories as demand for our services remained strong. Operating profit was \$1.727 billion for the three months ended September 30, 2018 and \$5.020 billion for the nine months ended September 30, 2018, compared to \$1.812 and \$5.466 billion for the three and nine months ended September 30, 2017, respectively.

Average daily package volume increased 2.7% for the third quarter of 2018 and 3.4% year-to-date. We reported third quarter 2018 net income of \$1.508 billion which increased 19.8% in 2018 compared to 2017 as diluted earnings per share increased 20.1% to \$1.73 in 2018. On a year-to-date basis, net income was \$4.338 billion and increased 13.9% in 2018 compared to 2017 as diluted earnings per share increased 14.7% to \$4.99.

Our consolidated results are presented in the table below:

	Three Months Ended September 30,		Change %	Nine Months Ended September 30,		Change %
	2018	2017		2018	2017	
Revenue (in millions)	\$17,444	\$16,173	7.9 %	\$52,013	\$47,610	9.2 %
Operating Expenses (in millions)	15,717	14,361	9.4 %	46,993	42,144	11.5 %
Operating Profit (in millions)	\$1,727	\$1,812	(4.7 )%	\$5,020	\$5,466	(8.2 )%
Operating Margin	9.9 %	11.2 %		9.7 %	11.5 %	
Average Daily Package Volume (in thousands)	19,506	18,995	2.7 %	19,349	18,706	3.4 %
Average Revenue Per Piece	\$11.20	\$10.77	4.0 %	\$11.14	\$10.68	4.3 %
Net Income (in millions)	\$1,508	\$1,259	19.8 %	\$4,338	\$3,809	13.9 %
Basic Earnings Per Share	\$1.74	\$1.45	20.0 %	\$5.01	\$4.37	14.6 %
Diluted Earnings Per Share	\$1.73	\$1.44	20.1 %	\$4.99	\$4.35	14.7 %

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND  
RESULTS OF OPERATIONS****Items Affecting Comparability**

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

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
<b>Non-GAAP Adjustments</b>	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
<b>Operating Expenses:</b>				
Transformation Strategy Costs	\$97	\$ —	\$ —360	\$ —
<b>Total Adjustments to Operating Expenses</b>	<b>97</b>	<b>—</b>	<b>360</b>	<b>—</b>
Income Tax Benefit from Transformation Strategy Costs	(24 )	—	(87 )	—
<b>Total Adjustments to Net Income</b>	<b>\$73</b>	<b>\$ —</b>	<b>—273</b>	<b>\$ —</b>

Transformation strategy costs described in note 16 to the unaudited consolidated financial statements have been excluded from comparisons of "adjusted" compensation and benefits, other operating expenses, operating profit, operating margin, income tax expense and effective tax rate. The pre-tax transformation strategy costs totaled \$97 million in the third quarter of 2018 (\$360 million year-to-date), and reflects costs and other benefits of \$70 million for the quarter (\$262 million year-to-date) included within "Compensation and benefits" on the statements of consolidated income, and other costs of \$27 million (\$98 million year-to-date) recorded to total other expenses. The after-tax transformation strategy costs totaled \$73 million in the third quarter of 2018 (\$273 million year-to-date). The income tax effects of the transformation strategy costs are calculated by multiplying the amount of the adjustments by the statutory tax rates applicable in each tax jurisdiction.

We believe this adjusted information provides useful comparison of year-to-year ongoing operating performance without considering the short-term impact of transformation strategy costs. We evaluate the performance of our businesses on an adjusted basis.

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**UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES  
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**Results of Operations - Segment Review**

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

We supplement the reporting of our financial information determined under generally accepted accounting principles ("U.S. GAAP") with certain non-GAAP financial measures including, as applicable, "adjusted" compensation and benefits, operating expenses, operating profit, operating margin, other pension income or expense, income tax expense and effective tax rate. We believe that these adjusted financial measures provide meaningful information to assist investors and analysts in understanding our financial results and assessing our prospects for future performance. We believe these adjusted financial measures are important indicators of our recurring results of operations because they exclude items that may not be indicative of, or are unrelated to, our underlying operating results, and provide a useful baseline for analyzing trends in our underlying businesses. Additionally, these adjusted financial measures are used internally by management for the determination of incentive compensation awards, business unit operating performance analysis and business unit resource allocation.

Non-GAAP financial measures should be considered in addition to, and not as an alternative for, our reported results prepared in accordance with U.S. GAAP. Our non-GAAP financial information does not represent a comprehensive basis of accounting. Therefore, our non-GAAP financial information may not be comparable to similarly titled measures reported by other companies.

We supplement the reporting of our revenue, revenue per piece and operating profit with similar 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 businesses on a 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 current period local currency revenue, revenue per piece and operating profit 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.

Certain operating expenses are allocated between our reporting segments based on activity-based costing methods. These activity-based costing methods require us to make estimates that impact the amount of each expense category that is attributed to each segment. Changes in these estimates will directly impact the amount of expense allocated to each segment and therefore the operating profit of each reporting segment. Our allocation methodologies are refined periodically, as necessary, to reflect changes in our business. There were no significant changes in our expense allocation methodologies during 2018 or 2017.

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RESULTS OF OPERATIONS****U.S. Domestic Package Operations**

	Three Months Ended September 30,		Change %	Nine Months Ended September 30,		Change %
	2018	2017		2018	2017	
Average Daily Package Volume (in thousands):						
Next Day Air	1,526	1,471	3.7 %	1,462	1,394	4.9 %
Deferred	1,256	1,240	1.3 %	1,260	1,245	1.2 %
Ground	13,624	13,178	3.4 %	13,529	13,065	3.6 %
Total Avg. Daily Package Volume	16,406	15,889	3.3 %	16,251	15,704	3.5 %
Average Revenue Per Piece:						
Next Day Air	\$19.72	\$19.09	3.3 %	\$19.73	\$19.48	1.3 %
Deferred	13.47	12.81	5.2 %	13.36	12.58	6.2 %
Ground	8.71	8.29	5.1 %	8.63	8.32	3.7 %
Total Avg. Revenue Per Piece	\$10.10	\$9.64	4.8 %	\$9.99	\$9.64	3.6 %
Operating Days in Period						
	63	63		191	191	
Revenue (in millions):						
Next Day Air	\$1,896	\$1,769	7.2 %	\$5,510	\$5,186	6.2 %
Deferred	1,066	1,001	6.5 %	3,215	2,991	7.5 %
Ground	7,475	6,881	8.6 %	22,293	20,751	7.4 %
Total Revenue	\$10,437	\$9,651	8.1 %	\$31,018	\$28,928	7.2 %
Operating Expenses (in millions):						
Operating Expenses	\$9,488	\$8,640	9.8 %	\$28,374	\$25,712	10.4 %
Transformation Strategy Costs	\$(39 )	—	N/A	\$(235 )	—	N/A
Adjusted Operating Expense	\$9,449	\$8,640	9.4 %	\$28,139	\$25,712	9.4 %
Operating Profit (in millions) and Operating Margin:						
Operating Profit	\$949	\$1,011	(6.1)%	\$2,644	\$3,216	(17.8)%
Adjusted Operating Profit	\$988	\$1,011	(2.3)%	\$2,879	\$3,216	(10.5)%
Operating Margin	9.1	% 10.5	%	8.5	% 11.1	%
Adjusted Operating Margin	9.5	% 10.5	%	9.3	% 11.1	%

*Revenue*

The change in overall revenue was impacted by the following factors in 2018 compared with the corresponding period of 2017:

	Volume	Rates / Product Mix	Fuel Surcharge	Total Revenue Change
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**Revenue Change Drivers:**

Third quarter 2018 vs. 2017	3.3 %	2.9 %	1.9 %	8.1 %
Year-to-date 2018 vs. 2017	3.5 %	2.1 %	1.6 %	7.2 %

*Volume*

Our overall volume increased in the third quarter and year-to-date periods of 2018 compared with 2017, largely due to continued growth in overall retail sales, of which e-commerce continues to represent a larger percentage of the total growth. Growth was focused within the retail, healthcare, and manufacturing industry verticals.

Business-to-consumer shipments, which represented approximately 50% of the total U.S. Domestic Package volume for the quarter, grew 6.9% (up 8.1% year-to-date) and drove overall increases in both air and ground shipments.

Business-to-business shipments were relatively flat in the third quarter and year-to-date periods of 2018 compared

with 2017.

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Among our air products, volume increased in the third quarter and year-to-date periods of 2018 for our Next Day Air and Deferred services. Solid air volume growth continued for those products most aligned with business-to-consumer shipping, including our residential Next Day Air, Next Day Air Saver and residential Second Day package products, as consumers continue to demand faster and more economical delivery options. This growth was slightly offset by declines in residential Second Day letter volume due to shifts in customer preferences. Commercial air product volume decreased slightly for both the third quarter and year-to-date periods of 2018 compared to 2017.

The increase in ground volume in the third quarter and year-to-date periods of 2018 was driven by growth in residential Ground and SurePost volume, which benefited from continued e-commerce demand. Business-to-business ground shipments were relatively flat in the third quarter and year-to-date periods of 2018 compared with 2017.

*Rates and Product Mix*

Overall revenue per piece increased 4.8% for the third quarter of 2018 (3.6% year-to-date) compared with the same period of 2017 and was impacted by changes in base rates, the implementation of new surcharges for oversized packages and audit fees, customer and product mix and fuel surcharge rates.

Revenue per piece for ground and air products was positively impacted by a base rate increase on December 24, 2017. UPS Ground rates and UPS Air services rates increased an average net 4.9%. Effective June 4, 2018, we increased the surcharge for Over Maximum Limits, Oversize Pallet Handling, and shipping correction audit fee.

In the first quarter of 2017, we expanded Saturday ground operations to several metropolitan areas in the U.S. As of September 30, 2018, Saturday service is available in approximately 5,300 cities and towns in the United States covering nearly 60% of the population. A Saturday pickup stop charge went into effect on May 1, 2017 and varies depending on the pickup service selected.

Revenue per piece for all products was positively impacted by higher fuel surcharge rates for the third quarter and year-to-date periods of 2018 due to escalating fuel prices and a 0.50% increase in the ground fuel threshold in the third quarter.

Revenue per piece for our Next Day Air services increased in the third quarter and year-to-date periods of 2018 compared with 2017. The increase in Next Day Air revenue per piece was primarily due to an increase in base rates driven by pricing initiatives and an increase in average billable weight per piece, which more than offset an unfavorable shift in product mix.

Revenue per piece for our deferred air services increased in the third quarter and year-to-date periods of 2018 compared with 2017 due to an increase in base rate pricing driven by pricing initiatives and average billable weight per piece offset slightly by an unfavorable shift in product mix.

Ground revenue per piece increased for the third quarter and year-to-date periods of 2018, primarily due to base rate increases driven by our pricing initiatives. These factors were partially offset by changes in product mix, as we experienced faster volume growth in our SurePost product.

*Fuel Surcharges*

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

	Three Months			Nine Months		
	Ended	Change	Ended	Change	Ended	Change
	September 30,		September 30,		September 30,	
	2018	2017	% Point	2018	2017	% Point
Next Day Air / Deferred	8.0%	5.0%	3.0 %	7.6%	4.8%	2.8 %
Ground	7.3%	5.4%	1.9 %	6.8%	5.4%	1.4 %



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Effective February 6, 2017, the U.S. fuel surcharge rates are reset weekly instead of monthly. In addition, the price indices have moved from a two month to a two week lag. Effective April 2, 2018, UPS created separate fuel surcharges for Domestic Air shipments and International Air export shipments. These surcharges are based on the U.S. Gulf Coast Jet Fuel price and are adjusted weekly. Additionally, effective June 11, 2018, the ground fuel surcharge increased by 0.50% for all thresholds. These surcharges will continue to be based on the national U.S. Average On Highway Diesel Fuel price and adjusted weekly.

Total domestic fuel surcharge revenue increased by \$188 million in the third quarter of 2018 as a result of higher fuel surcharge rates caused by increasing jet and diesel fuel prices, the implementation of increases in the surcharge indices, as well as the overall increase in package volume during the quarter. In addition to the factors above, fuel surcharge revenue was positively impacted by the changes to the fuel surcharge calculation, as the rates and price indices are updated more frequently to better align with prevailing market rates. On a year-to-date basis, fuel surcharge revenue increased by \$458 million.

*Operating Expenses*

Operating expenses for the segment increased \$848 million in the third quarter of 2018 compared with the same period of 2017, which included \$39 million of transformation strategy costs. Excluding the impact of transformation strategy costs, operating expenses for the segment increased \$809 million in third quarter of 2018, primarily due to pickup and delivery costs (up \$344 million), the costs of operating our domestic integrated air and ground network (up \$412 million) and the costs of package sorting (up \$146 million), offset by a reduction in indirect operating costs (down \$93 million) for the quarter. Higher pension expense and expansion of our technology-enabled network increased expenses in the third quarter of 2018.

The growth in pickup and delivery and network costs was impacted by several factors:

We incurred higher employee compensation and benefit costs largely resulting from volume growth, which impacted an increase in average daily union labor hours (up 5.7%), scheduled union pay rate and benefit increases and growth in the overall size of the workforce due to facility expansions. Labor hour increases were also related to the significant expansion in Saturday operations. In addition, pension expense increased due to lower year end discount rates used to measure the pension benefit obligation, driving higher service costs.

We incurred higher fuel expense in the third quarter of 2018 primarily due to higher fuel prices, expansion of our air network and increased volume which resulted in higher fuel usage (an increase in package delivery miles driven of 4.0% and an increase in aircraft block hours of 9.1%).

We incurred higher costs associated with outside contract carriers primarily due to volume growth and higher fuel surcharges passed to us by carriers and general rate increases.

On a year-to-date basis, operating expenses for the segment increased \$2.662 billion which included \$235 million of transformation strategy costs. Excluding the impact of transformation strategy costs, operating expenses for the segment increased \$2.427 billion for the year-to-date periods of 2018, largely due to pickup and delivery costs (up \$954 million), network costs (up \$1.217 billion), the cost of package sorting (up \$429 million), offset by a reduction in indirect operating costs (down \$173 million). These expenses were primarily due to higher volume, increased employee compensation costs, fuel prices and a 13.5% increase in average daily block hours.

Total cost per piece increased 6.3% for the third quarter of 2018 compared with the same period of 2017 (6.6% year-to-date), which includes transformation strategy costs of \$39 million for the third quarter of 2018 (\$235 million year-to-date). The cost per piece increase was primarily driven by costs related to the improvement of our smart global logistics network, including additional aircraft leases to improve our air service reliability, costs related to the implementation of Saturday operations in additional markets and higher pension expense. Costs were also negatively

impacted by rising fuel prices offset by changes in depreciation.

*Operating Profit and Margin*

Operating profit decreased \$62 million for the third quarter of 2018 compared with 2017 (down \$572 million year-to-date) with operating margins decreasing 140 basis points to 9.1% (down 260 basis points to 8.5% year-to-date). Excluding the impact of transformation strategy costs, operating profit decreased \$23 million for the third quarter and \$337 million year-to-date with operating margins decreasing 100 basis points and 180 basis points, respectively. While net fuel and depreciation had a positive impact on operating profit, higher purchased transportation costs due to volume growth and an increase in employee benefit costs driven by lower pension discount rates weighed on profits. Additionally, operating profit was negatively impacted by costs related to continued investments in our smart global logistics network, including implementation of Saturday operations in additional markets. The benefits of these projects will not be fully realized until future periods.

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	Three Months Ended September 30,		Change %	Nine Months Ended September 30,		Change %
	2018	2017		2018	2017	
Average Daily Package Volume (in thousands):						
Domestic	1,663	1,706	(2.5 )%	1,662	1,669	(0.4 )%
Export	1,437	1,401	2.6 %	1,436	1,333	7.7 %
Total Avg. Daily Package Volume	3,100	3,107	(0.2 )%	3,098	3,002	3.2 %
Average Revenue Per Piece:						
Domestic	\$6.47	\$6.26	3.4 %	\$6.60	\$5.99	10.2 %
Export	29.32	29.09	0.8 %	29.43	28.79	2.2 %
Total Avg. Revenue Per Piece	\$17.06	\$16.56	3.0 %	\$17.18	\$16.11	6.6 %
Operating Days in Period	63	63		191	191	
Revenue (in millions):						
Domestic	\$678	\$673	0.7 %	\$2,094	\$1,909	9.7 %
Export	2,654	2,568	3.3 %	8,073	7,331	10.1 %
Cargo and Other	146	135	8.1 %	446	381	17.1 %
Total Revenue	\$3,478	\$3,376	3.0 %	\$10,613	\$9,621	10.3 %
Operating Expenses (in millions):						
Operating Expenses	\$2,942	\$2,770	6.2 %	\$8,865	\$7,927	11.8 %
Transformation Strategy Costs	(40 )	—		(76 )	—	
Adjusted Operating Expenses	\$2,902	\$2,770	4.8 %	\$8,789	\$7,927	10.9 %
Operating Profit (in millions) and Operating Margin:						
Operating Profit	\$536	\$606	(11.6)%	\$1,748	\$1,694	3.2 %
Adjusted Operating Profit	\$576	\$606	(5.0 )%	\$1,824	\$1,694	7.7 %
Operating Margin	15.4 %	18.0 %		16.5 %	17.6 %	
Adjusted Operating Margin	16.6 %	18.0 %		17.2 %	17.6 %	
Currency Benefit / (Cost) – (in millions)*:						
Revenue				\$(67)		\$239
Operating Expenses				39		(223 )
Operating Profit				\$(28)		\$16

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

**Revenue**

The change in overall revenue was impacted by the following factors in 2018 compared with the corresponding period of 2017:

	Volume	Rates / Product Mix	Fuel Surcharge	Currency	Total Revenue Change
<b>Revenue Change Drivers:</b>					
Third quarter 2018 vs. 2017	(0.2)%	2.2 %	3.0 %	(2.0)%	3.0 %
Year-to-date 2018 vs. 2017	3.2 %	1.7 %	2.9 %	2.5 %	10.3 %

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*Volume*

Our overall average daily volume decreased slightly in the third quarter of 2018 compared with 2017, but increased in the comparable year-to-date periods. Average daily volume for export products grew in the third quarter of 2018 as compared with 2017, while average daily volume for domestic products decreased due to revenue management initiatives. The decrease was due to lower demand across a number of sectors including diversified vehicles and parts, government and professional services, partially offset by higher demand in retail, high tech, industrial manufacturing and healthcare. Business-to-consumer shipments remained relatively flat for both the quarter and year-to-date. Export volume in the third quarter of 2018 as well as year-to-date grew across most major trade lanes, with overall growth in all regions. Asian export volume showed growth in most regions, particularly Asia-to-Americas, Asia-to-U.S. and intra-Asia trade lanes. European export volume showed growth in the Europe-to-U.S. and intra-Europe trade lanes. Americas export volume showed growth in Americas-to-U.S trade lane. Export volume from the U.S. grew in all trade lanes, particularly with the Europe and Asia Pacific regions. Export volume growth was strong across most major products, with a continued shift towards our premium express products, such as Worldwide Express and Transborder Express services.

Domestic volume growth decreased slightly both for the third quarter and year-to-date periods of 2018 compared with 2017, driven by declines in domestic standard products in the Euro zone.

*Rates and Product Mix*

On December 24, 2017 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 increased 3.0% in the third quarter of 2018 (6.6 % year-to-date) compared to 2017. Total average revenue per piece was impacted by an increase in fuel surcharge revenue in both the quarter and year-to-date periods. The increase was partially offset by a 210 basis point decrease from currency in the third quarter. In the year-to-date period, average revenue per piece was impacted by a 240 basis point increase from currency as well as a favorable shift in product mix as the growth in higher yielding premium products continued to exceed the growth in our standard products.

Export revenue per piece increased 0.8% in the third quarter of 2018 (2.2% year-to-date) compared with 2017. Export revenue per piece was impacted by an increase in fuel surcharge revenue from changes in commodity prices, partially offset by shifts in product mix and a 190 basis point decrease from currency for the quarter (160 basis point increase year-to-date).

Domestic revenue per piece increased 3.4% in the third quarter of 2018 (10.2% year-to-date) compared with 2017. The increase was partially offset by a 240 basis point decrease from currency for the quarter (570 basis point increase year-to-date). The remaining increase is due to higher fuel surcharges.

*Fuel Surcharges*

We maintain fuel surcharges on our international air and ground services. The fuel surcharges for international air products originating inside or outside the United States are indexed to the DOE's Gulf Coast spot price for a gallon of kerosene-type jet fuel, while the fuel surcharges for ground products originating outside the United States are indexed to fuel prices in the international region or country where the shipment takes place. Total international fuel surcharge revenue increased \$94 million for the third quarter of 2018 (\$313 million year-to-date) compared with 2017, due to volume increases and higher fuel prices.

*Operating Expenses*

Operating expenses increased by \$172 million in the third quarter of 2018 (\$938 million year-to-date) compared to 2017, including a \$40 million increase in transformation strategy costs (\$76 million increase year-to-date). Excluding

the impact of the transformation strategy costs, operating expenses for the segment increased \$132 million in the third quarter of 2018 (\$862 million year-to-date). These increases are primarily due to increases in the costs of operating our air and ground networks and pickup and delivery costs from increased volumes year-to-date and higher fuel prices, partially offset by currency exchange rate movements.

The costs of operating our international integrated air and ground network increased \$144 million for the third quarter of 2018 (\$435 million year-to-date) compared with 2017. The increase in network costs was primarily driven by higher fuel prices which were partially offset by a 2.3% decrease in aircraft block hours in the third quarter of 2018 (1.0% increase year-to-date). Additionally, pickup and delivery costs increased \$20 million in the third quarter of 2018 (\$287 million year-to-date) compared with 2017, largely due to higher fuel prices.

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The remaining change in operating expenses in the third quarter of 2018 and year-to-date compared with 2017 was largely due to an increase in the costs of package sorting. Indirect operating costs declined for the third quarter of 2018, and increased year-to-date.

*Operating Profit and Margin*

Operating profit decreased \$70 million in the third quarter of 2018 compared with 2017 (\$54 million increase year-to-date), with operating margin decreasing 260 basis points to 15.4% (down 110 basis points to 16.5% year-to-date). Without the impact of transformation strategy costs, operating profit decreased \$30 million for the third quarter of 2018 (\$130 million increase year-to-date) compared with 2017, with operating margin decreasing 140 basis points and 40 basis points, respectively. Comparisons for the third quarter reflect negative impacts of currency fluctuations and the unique market conditions that existed last year in Europe.

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	Three Months Ended September 30,		Change %	Nine Months Ended September 30,		Change %
	2018	2017		2018	2017	
Freight LTL Statistics:						
Revenue (in millions)	\$735	\$673	9.2 %	\$2,122	\$1,943	9.2 %
Revenue Per Hundredweight	\$25.70	\$24.46	5.1 %	\$25.29	\$23.89	5.9 %
Shipments (in thousands)	2,603	2,590	0.5 %	7,710	7,738	(0.2)%
Shipments Per Day (in thousands)	41.3	41.1	0.5 %	40.4	40.5	(0.2)%
Gross Weight Hauled (in millions of lbs)	2,860	2,751	4.0 %	8,391	8,132	3.2 %
Weight Per Shipment (in lbs)	1,098	1,062	3.4 %	1,088	1,051	3.5 %
Operating Days in Period	63	63		191	191	
Revenue (in millions):						
Forwarding	\$1,672	\$1,434	16.6 %	\$4,936	\$4,047	22.0 %
Logistics	790	736	7.3 %	2,356	2,194	7.4 %
Freight	867	778	11.4 %	2,497	2,240	11.5 %
Other	200	198	1.0 %	593	580	2.2 %
Total Revenue	\$3,529	\$3,146	12.2 %	\$10,382	\$9,061	14.6 %
Operating Expenses (in millions):						
Operating Expenses	\$3,287	\$2,951	11.4 %	\$9,754	\$8,505	14.7 %
Transformation Strategy Costs	(18 )	—		(49 )	—	
Adjusted Operating Expenses:	\$3,269	\$2,951	10.8 %	\$9,705	\$8,505	14.1 %
Operating Profit (in millions) and Operating Margin:						
Operating Profit	\$242	\$195	24.1 %	\$628	\$556	12.9 %
Adjusted Operating Profit	\$260	\$195	33.3 %	\$677	\$556	21.8 %
Operating Margin	6.9 %	6.2 %		6.0 %	6.1 %	
Adjusted Operating Margin	7.4 %	6.2 %		6.5 %	6.1 %	
Currency Benefit / (Cost) – (in millions)*:						
Revenue				\$(17)		\$63
Operating Expenses				13		(68 )
Operating Profit				\$(4 )		\$(5 )

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

**Revenue**

Total revenue for the Supply Chain & Freight segment increased \$383 million for the third quarter of 2018 (\$1.321 billion year-to-date) compared to 2017.

Forwarding revenue increased \$238 million in the third quarter of 2018 (\$889 million year-to-date) compared with 2017, primarily due to increased truckload brokerage freight volume as well as tonnage increases and sell price improvements in our international air freight forwarding business. Revenue in our truckload brokerage business was driven by robust demand and tight capacity. The increases in our international air freight forwarding business were driven by rising demand and pricing improvements, with the Asia-to-U.S. lane experiencing particularly strong growth.

Logistics revenues increased by \$54 million in the third quarter of 2018 (\$162 million year-to-date) compared with 2017, as we experienced growth in the retail, healthcare and manufacturing sectors.



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UPS Freight revenue increased \$89 million in the third quarter of 2018 (\$257 million year-to-date) driven by increases in average weight per shipment from improved customer mix due to middle market growth. LTL revenue per hundredweight increased 5.1% during the third quarter (5.9% year-to-date) as LTL base rate increases for certain shipments in the U.S., Canada and Mexico, averaging 5.9%, took effect March 26, 2018. Fuel surcharge revenue also increased \$26 million in the third quarter (\$75 million year-to-date), due to changes in overall LTL shipment volume and diesel fuel prices.

*Operating Expenses*

Total operating expenses for the Supply Chain & Freight segment increased \$336 million in the third quarter of 2018 (\$1.249 billion year-to-date) compared to 2017. Excluding the \$18 million (\$49 million year-to-date) impact related to transformation strategy costs, operating expenses increased \$318 million in the third quarter of 2018 (\$1.200 billion year-to-date).

Forwarding operating expenses increased \$204 million for the third quarter of 2018 (\$848 million year-to-date) compared with 2017. Prior year operating expenses for the 2017 year-to-date period included a \$20 million favorable legal settlement. Excluding costs related to our transformation strategy, forwarding operating expenses increased \$193 million for the third quarter of 2018 (\$832 million year-to-date) compared with 2017, largely due to increased purchased transportation. Purchased transportation expense increased \$183 million in the third quarter of 2018 (\$727 million year-to-date) compared to 2017 primarily due to increased truckload brokerage freight volume and the resulting costs passed to us from outside transportation providers. Increased tonnage and third-party air carrier procurement rates in our international air freight forwarding business also contributed to the increase in purchased transportation expenses.

Logistics operating expenses increased \$51 million for the third quarter of 2018 (\$153 million year-to-date) compared with 2017. Excluding costs related to our transformation strategy, logistics operating expenses increased \$45 million for the third quarter of 2018 (\$131 million year-to-date) compared with 2017. The increases were driven by purchased transportation expense, costs associated with retail facility expansions and strategic information technology investments.

UPS Freight operating expenses increased \$80 million for the third quarter of 2018 (\$252 million year-to-date) compared with 2017. Excluding costs related to our transformation strategy, UPS Freight operating expenses increased \$246 million year-to-date compared to 2017. The operating expenses increased largely due to costs associated with operating our linehaul network (\$35 million over the prior year and \$96 million year-to-date) and increases in pickup and delivery costs (\$27 million over the prior year and \$72 million year-to-date). The linehaul network and pickup and delivery costs were driven by higher fuel prices and expense for outside transportation carriers, including fuel surcharges passed on to us by outside carriers.

*Operating Profit and Margin*

Total operating profit for the Supply Chain & Freight segment increased \$47 million in the third quarter of 2018 (\$72 million year-to-date) compared with 2017, which includes an \$18 million impact related to transformation strategy costs (\$49 million year-to-date). Excluding the \$18 million (\$49 million year-to-date) impact of transformation strategy costs, operating profit for the third quarter increased \$65 million (\$121 million year-to-date).

Operating results for the Forwarding unit increased mainly due to tonnage increases and pricing improvements. Additionally, our truckload brokerage business grew due to robust demand and tight capacity. Operating profit for the Logistics unit improved due to increased demand in retail, healthcare and manufacturing sectors. Higher operating profits in UPS Freight primarily resulted from growth in LTL products.

The prior year-to-date operating profit was impacted by a \$20 million favorable legal settlement with no comparable settlement in 2018.



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	Three Months Ended September 30,		Change %	Nine Months Ended September 30,		Change %		
	2018	2017		2018	2017			
<b>Operating Expenses (in millions):</b>								
Compensation and Benefits	\$9,015	\$8,437	6.9	%	\$27,084	\$25,032	8.2	%
Transformation Strategy Costs	(70)	—			(262)	—		
Adjusted Compensation and Benefits	8,945	8,437	6.0	%	26,822	25,032	7.2	%
Repairs and Maintenance	437	399	9.5	%	1,294	1,181	9.6	%
Depreciation and Amortization	524	572	(8.4)	%	1,662	1,688	(1.5)	%
Purchased Transportation	3,216	2,832	13.6	%	9,570	7,991	19.8	%
Fuel	867	636	36.3	%	2,469	1,873	31.8	%
Other Occupancy	321	282	13.8	%	1,003	845	18.7	%
Other Expenses	1,337	1,203	11.1	%	3,911	3,534	10.7	%
Total Other Expenses	6,702	5,924	13.1	%	19,909	17,112	16.3	%
Other Transformation Strategy Costs	(27)	—			(98)	—		
Adjusted Total Other Expenses	6,675	5,924	12.7	%	19,811	17,112	15.8	%
Total Operating Expenses	\$15,717	\$14,361	9.4	%	\$46,993	\$42,144	11.5	%
Adjusted Total Operating Expenses	\$15,620	\$14,361	8.8	%	\$46,633	\$42,144	10.7	%

Currency (Benefit) / Cost - (in millions)\* \$(52) \$291

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

***Compensation and Benefits***

Total compensation and benefits increased \$578 million for the third quarter of 2018 (\$2.052 billion year-to-date) compared with 2017. Excluding the impact of transformation strategy and other benefits of \$70 million for the third quarter of 2018 (\$262 million year-to-date) discussed in note 16 to the unaudited consolidated financial statements, compensation and benefits costs increased \$508 million for the third quarter of 2018 (\$1.790 billion year-to-date). Employee payroll costs increased \$310 million for the third quarter of 2018 (\$1.115 billion year-to-date) compared with 2017, largely due to higher U.S. domestic hourly and management compensation costs. Total compensation costs increased 6.1% for the third quarter of 2018 (7.4% year-to-date). U.S. Domestic compensation costs for hourly employees increased largely due to higher volume growth, which drove an increase in headcount and a 5.7% increase in average daily union labor hours (6.7% increase year-to-date), in addition to contractual union wage increases. Compensation costs for management employees increased primarily due to merit salary increases and growth in the overall size of the workforce. Overall compensation costs increased due to continued expansion of Saturday operations and the opening of new facilities.

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Benefits expense increased \$268 million for the third quarter of 2018 (\$937 million year-to-date) compared with 2017. Excluding the impact of transformation strategy and other benefits of \$70 million for the third quarter of 2018 (\$262 million year-to-date) discussed in note 16 to the unaudited consolidated financial statements, benefits costs increased \$198 million for the third quarter of 2018 (\$675 million year-to-date) primarily due to the following factors:

Health and welfare costs increased \$57 million for the third quarter (\$210 million year-to-date), largely due to increased contributions to multiemployer plans resulting from contractual contribution rate increases and an overall increase in the size of the workforce.

Pension and retirement benefits expense increased \$80 million for the third quarter (\$237 million year-to-date), primarily due to contractually mandated contribution rate increases to multiemployer pension plans and lower pension discount rates at year-end, driving an increase in service costs. These increases were partially offset by lower Pension Benefit Guaranty Corporation premiums due to prior voluntary pension contributions, as well as the amendment of the UPS Retirement Plan in the prior year.

Vacation, holiday, bonus, excused absence, payroll tax and other expenses increased \$74 million for the third quarter (\$233 million year-to-date), primarily driven by salary increases and growth in the overall size of the workforce.

Workers' compensation expense decreased \$13 million for the third quarter (decreased \$5 million year-to-date).

Insurance reserves are established based on actuarial estimates of the loss that we will ultimately incur on reported workers' compensation claims, as well as estimates of claims that have been incurred but not reported, and take into account a number of factors including our history of claim losses, payroll growth and the impact of safety improvement initiatives.

*Repairs and Maintenance*

The \$38 million increase in repairs and maintenance expense for the third quarter of 2018 (\$113 million year-to-date) compared with 2017 was primarily due to routine repairs to buildings and facilities and maintenance of our transportation equipment and aircraft.

*Depreciation and Amortization*

Depreciation and amortization expense decreased \$48 million in the third quarter of 2018 (\$26 million year-to-date) compared with 2017 due to increases in the estimated useful lives of our vehicle fleet and building improvements of \$92 million and certain large facilities being fully depreciated of \$17 million, offset by increased depreciation of projects coming online. We evaluate the useful lives of our property, plant and equipment based on our usage, maintenance and replacement policies, and taking into account physical and economic factors that may affect the useful lives of the assets. As part of our ongoing investment in transformation, beginning in the third quarter of 2018, we revised our estimates of useful lives for building improvements and vehicles based on our current assessment of these factors. In general, the change in estimate had the effect of lengthening the useful lives of vehicles and building improvements. Refer to note 1 in the unaudited consolidated financial statements for description of our policy.

*Purchased Transportation*

The \$384 million increase in purchased transportation expense charged to us by third-party air, rail, ocean and truck carriers for the third quarter of 2018 (\$1.579 billion year-to-date) compared with 2017 was primarily driven by the following factors:

Forwarding and logistics expense increased \$204 million in the third quarter of 2018 (\$808 million year-to-date) compared to 2017, primarily due to increased truckload brokerage freight loads per day and increased tonnage and rates in our international air freight forwarding businesses. The increase for the third quarter and year-to-date periods of 2018 is also due to higher fuel surcharges passed on to us by outside carriers.

- International Package expense increased \$12 million in the third quarter of 2018 (\$185 million year-to-date) compared to 2017, primarily due to the increased usage of third-party carriers and an unfavorable impact from

currency exchange rate movements. Additionally, increased fuel surcharges passed on to us by outside carriers increased during the third quarter and year-to-date periods of 2018.

U.S. Domestic Package expense increased \$68 million for the third quarter of 2018 (\$284 million year-to-date) compared to 2017, primarily due to increased volume, as well as higher rates and fuel surcharges passed to us from outside contract carriers and rail carriers.

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UPS Freight expense increased \$49 million in the third quarter of 2018 (\$145 million year-to-date) compared to 2017, primarily due to increases in our ground freight pricing product, higher rates, longer shipments and higher fuel surcharges passed to us from outside transportation providers.

We incurred additional purchased transportation expense of \$51 million in the third quarter of 2018 (\$157 million year-to-date) compared to 2017 related to leasing additional aircraft to handle increases in air volume and related higher jet fuel surcharges.

*Fuel*

The \$231 million increase in fuel expense for the third quarter of 2018 (\$596 million year-to-date) compared with 2017 was primarily due to higher jet fuel, diesel and unleaded gasoline prices, which increased fuel expense by \$204 million (\$517 million year-to-date). Additionally, increased fuel consumption, primarily due to increases in total aircraft block hours and U.S. Domestic delivery miles driven, increased expense by \$22 million in the third quarter of 2018 (\$107 million year-to-date). These increases were partially offset by increased fuel efficiency and increased fuel tax credits from the usage of alternative fuels.

*Other Occupancy*

Other occupancy expense increased \$39 million in the third quarter of 2018 (\$158 million year-to-date) compared to 2017, primarily due to an increase in real estate and other property taxes, utility costs and rent related to the expansion of new facilities.

*Other Expenses*

The \$134 million increase in other expenses in the third quarter of 2018 (\$377 million year-to-date) compared with 2017 was primarily attributable to increases in transportation equipment rental, outside professional service costs, auto liability insurance, security protection, non-income based state and local taxes and data processing. Additionally, costs of \$27 and \$86 million related to our transformation strategy contributed to the increase in the third quarter and year-to-date periods of 2018, respectively, when compared to 2017.

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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 and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change %	2018	2017	Change %
(in millions)						
Investment income and other	\$317	\$236	34.3%	\$913	\$624	46.3%
Interest expense	\$(155)	\$(111)	39.6%	\$(457)	\$(324)	41.0%

*Investment Income and Other*

The increase in investment income and other for the third quarter and year-to-date periods of 2018 as compared to 2017 is primarily due to increases in pension income which is comprised of expected investment returns on pension assets net of interest cost on projected benefit obligations. Expected returns on plan assets increased as a result of higher discretionary contributions and higher actual returns on plan assets in 2017. Additionally, pension interest cost decreased as a result of lower year-end discount rates and the 2017 amendment of the UPS Retirement Plan described in note 7 to the unaudited consolidated financial statements.

*Interest Expense*

Interest expense increased in the third quarter and year-to-date periods of 2018, as compared to 2017, primarily due to an increase in long-term debt balances and higher effective interest rates, partially offset by higher capitalized interest related to several large construction projects.

**Income Tax Expense**

The following table sets forth income tax expense and our effective tax rate for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2018	2017	Change %	2018	2017	Change %
(in millions)						
Income Tax Expense	\$381	\$678	(43.8)%	\$1,138	\$1,957	(41.8)%
Income Tax Impact of:						
Transformation Strategy Costs	24	—		87	—	
Adjusted Income Tax Expense	\$405	\$678	(40.3)%	\$1,225	\$1,957	(37.4)%
Effective Tax Rate	20.2 %	35.0 %		20.8 %	33.9 %	
Adjusted Effective Tax Rate	20.4 %	35.0 %		21.0 %	33.9 %	

Our effective tax rate decreased to 20.2% in the third quarter of 2018 from 35.0% in the same period of 2017 (20.8% year-to-date in 2018 compared to 33.9% in the same period of 2017). The decrease in our effective tax rate was primarily due to the impact of the Tax Act which reduced the U.S. federal corporate income tax rate from 35% to 21% effective January 1, 2018. In addition, the recognition of excess tax benefits related to share-based compensation in income tax reduced our effective rate by 0.8% year-to-date in 2018 compared to 1.1% in the same period of 2017 (there was not a significant impact in the third quarter of 2018 or 2017). See note 15 to the unaudited consolidated financial statements for additional information. Other factors that impacted our effective tax rate in the third quarter and year-to-date periods of 2018 compared with the same periods of 2017 include favorable resolutions of uncertain

tax positions, favorable U.S. state and local tax law changes, favorable tax provisions enacted in the Bipartisan Budget Act of 2018 and discrete tax credits associated with the filing of our 2017 U.S. federal income tax return.

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

As discussed in note 16 to the unaudited consolidated financial statements, we recorded pre-tax transformation strategy costs of \$97 million in the third quarter of 2018 (\$360 million year-to-date). As a result, we recorded an additional income tax benefit of \$24 million (\$87 million year-to-date). This benefit was generated at a higher average tax rate than the 2018 U.S. federal statutory rate primarily due to the effect of the U.S. state and local taxes and foreign taxes.

**Liquidity and Capital Resources**

As of September 30, 2018, we had \$4.841 billion in cash, cash equivalents and marketable securities. We believe that our current cash position, access to capital markets and cash flows generated from operations should be adequate not only for operating requirements but also to enable us to complete our capital expenditure programs, transformation strategy and to fund dividend payments, share repurchases and long-term debt payments through the next several years. We regularly evaluate opportunities to optimize our capital structure, including through issuances of debt to refinance existing debt and to fund ongoing cash needs.

***Cash Flows From Operating Activities***

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

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2018</b>	<b>2017</b>
Net income	\$4,338	\$3,809
Non-cash operating activities <sup>(a)</sup>	2,964	3,062
Pension and postretirement benefit contributions (UPS-sponsored plans)	(137 )	(2,585 )
Hedge margin receivables and payables	171	(632 )
Income tax receivables and payables	1,129	152
Changes in working capital and other non-current assets and liabilities	939	604
Other operating activities	18	9
Net cash from operating activities	\$9,422	\$4,419

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

Net cash from operating activities increased \$5.004 billion through the third quarter of 2018 compared to 2017, largely due to lower pension and postretirement benefit contributions, changes in hedge margin payables and receivables, increased net cash receipts from income taxes and improvements in working capital.

We made contributions to our company-sponsored pension and U.S. postretirement medical benefit plans totaling \$137 million during the nine months of 2018 compared to \$2.585 billion in 2017. The net hedge margin collateral received from our derivative counterparties increased by \$803 million in the first nine months of 2018 relative to 2017, due to the change in net fair value of our derivative contracts used in our currency and interest rate hedging programs. The net cash receipts from income taxes increased in the first nine months of 2018 compared to 2017, primarily due to the timing of a \$5.0 billion pension contribution made in December 2017 which resulted in a tax refund in the first quarter of 2018. Apart from the transactions described above, operating cash flow was impacted by improvements in our working capital position.

As of September 30, 2018, our worldwide holdings of cash, cash equivalents and marketable securities was \$4.841 billion, of which \$2.656 billion was held by non-U.S. subsidiaries. The amount of cash, cash equivalents and marketable securities held by our U.S. and non-U.S. 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 U.S. operating needs, capital expenditures, share repurchases and dividend payments to shareowners. 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.

Table of Contents**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):

	Nine Months Ended September 30,	
	2018	2017
Net cash used in investing activities	\$(4,499)	\$(3,615)
<b>Capital Expenditures:</b>		
Buildings, facilities and plant equipment	\$(2,287)	\$(2,024)
Aircraft and parts	(1,037 )	(590 )
Vehicles	(619 )	(685 )
Information technology	(547 )	(409 )
Total Capital Expenditures	\$(4,490)	\$(3,708)
Capital Expenditures as a % of Revenue	(8.6 )%	(7.8 )%

**Other Investing Activities:**

Proceeds from disposals of property, plant and equipment	\$45	\$18
Net (increase) decrease in finance receivables	\$(7 )	\$(1 )
Net (purchases), sales and maturities of marketable securities	\$(22 )	\$117
Cash paid for business acquisitions, net of cash and cash equivalents acquired	\$(2 )	\$(61 )
Other investing activities	\$(23 )	\$20

We have commitments for the purchase of aircraft, vehicles, equipment and real estate to provide for anticipated future growth and the replacement of existing capacity. We generally fund our capital expenditures with our cash from operations. Future capital spending for anticipated growth and replacement assets will depend on a variety of factors, including economic and industry conditions. We anticipate that our total capital expenditures for 2018 will be approximately \$6.5 to \$7.0 billion.

Capital spending on buildings, facilities and plant equipment increased in the first nine months of 2018 in our U.S. and international package businesses, largely due to several facility automation and capacity expansion projects. Compared to 2017, capital spending on aircraft increased due to contract deposits on open aircraft orders as well as final payments associated with the delivery of aircraft. Capital spending on information technology increased in the first nine months of 2018 due to further development of technology enabled enhancements and capitalized software projects. Capital spending on vehicles decreased in the first nine months of 2018, relative to 2017, largely due to the timing of vehicle replacements.

The proceeds from the disposal of property, plant and equipment increased in 2018 compared to 2017, largely due to the disposal of owned equipment under operating leases. 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.

Cash paid for business acquisitions in 2018 was related to our acquisition of area franchise rights related to The UPS Store. The cash paid for business acquisitions during the first nine months of 2017 was related to the purchases of Freightex and Nightline. Other investing activities are impacted by changes in our non-current investments, capital contributions into certain investment partnerships and various other items.



Table of Contents**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 are as follows (amounts in millions, except per share data):

	Nine Months Ended September 30,	
	2018	2017
Net cash used in financing activities	\$(4,260 )	\$(914 )
<b>Share Repurchases:</b>		
Cash expended for shares repurchased	\$(770 )	\$(1,346 )
Number of shares repurchased	(6.6 )	(12.3 )
Shares outstanding at period end	859	862
Percent increase (decrease) in shares outstanding	0.0	% (0.7 )%
<b>Dividends:</b>		
Dividends declared per share	\$2.73	\$2.49
Cash expended for dividend payments	\$(2,260 )	\$(2,085 )
<b>Borrowings:</b>		
Net borrowings (repayments) of debt principal	\$(1,147 )	\$2,524
<b>Other Financing Activities:</b>		
Cash received for common stock issuances	\$176	\$177
Other financing activities	\$(259 )	\$(184 )
<b>Capitalization:</b>		
Total debt outstanding at period end	\$23,301	\$18,910
Total shareowners' equity at period end	3,126	1,543
Total capitalization	\$26,427	\$20,453
Debt to Total Capitalization %	88.2	% 92.5 %

We repurchased a total of 6.6 million shares of class A and class B common stock for \$756 million in the first nine months of 2018, and 12.3 million shares for \$1.352 billion in the first nine months of 2017 (\$770 million and \$1.346 billion in repurchases for 2018 and 2017, respectively, are reported on the statements of consolidated cash flows due to unsettled repurchases).

In May 2016, the Board of Directors approved a new share repurchase authorization of \$8.0 billion. As of September 30, 2018, we had \$3.583 billion of this share repurchase authorization available.

Share repurchases may take the form of accelerated share repurchases, open market purchases or other such methods as we deem appropriate. The timing of our share repurchases will depend upon market conditions. Unless terminated earlier by the Board, the program will expire when we have purchased all shares authorized for repurchase under the program. We anticipate repurchasing approximately \$1.0 billion of shares in 2018.

The declaration of dividends is subject to the discretion of the Board of Directors and will depend on various factors, including our net income, financial condition, cash requirements, future prospects and other relevant factors. We increased our quarterly cash dividend payment to \$0.91 per share in 2018, compared with the previous \$0.83 quarterly dividend rate in 2017. We expect to continue the practice of paying regular cash dividends.

Issuances of debt in the first nine months of 2018 consisted primarily of commercial paper. Issuances of debt in 2017 consisted of commercial paper, fixed rate senior notes of \$600 million, Canadian dollar denominated fixed rate senior notes of C\$750 million (\$547 million) and floating-rate senior notes of \$547 million. Repayment of debt in 2018 consisted primarily of our \$750 million 5.50% fixed-rate senior notes that matured in January 2018. In the first nine months of 2017 there were no comparable repayments of fixed-rate or floating-rate senior notes. We consider the

overall fixed and floating interest rate mix of our portfolio and the related overall cost of borrowing when planning for future issuances and non-scheduled repayments of debt.

Table of Contents**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
<b>2018</b>				
USD \$ 2,267	\$ 2,267	\$ 2,261	\$ 2,261	1.70 %
EUR € 473	548	€ 277	\$ 330	(0.39)%
Total	\$ 2,815			

The cash outflows in other financing activities were impacted by several factors. Net cash inflows (outflows) from the premium payments and settlements of capped call options for the purchase of UPS class B shares were \$13 and \$53 million during the first nine months of 2018 and 2017, respectively. Cash outflows related to the repurchase of shares to satisfy tax withholding obligations on vested employee stock awards were \$250 and \$236 million during the first nine months of 2018 and 2017, respectively.

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

**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.

**Contractual Commitments**

There have been no material changes to the contractual commitments described in Part II, Item 7 in our Annual Report on Form 10-K for the year ended December 31, 2017 other than as described below.

We have contractual obligations and commitments for the purchase of aircraft, vehicles, technology equipment and building and leasehold improvements. New purchase commitments will provide additional capacity for our air and ground network, hub automation and other expansion projects to meet increased demand. Including these additional obligations, the expected cash outflow to satisfy our total purchase commitments will be as follows (in millions): 2018 (remaining) - \$1,882; 2019 - \$3,424; 2020 - \$1,771; 2021 - \$1,064; 2022 - \$186; and thereafter - \$13.

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

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

**Contingencies**

See note 10 and note 7 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 15 for a discussion of income tax related matters.

**Collective Bargaining Agreements**

*Status of 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.

**Rate Adjustments**

On September 18, 2018, we announced a new peak charge during select weeks in October through December 2018 for packages Over Maximum limits.

On October 1, 2018 we announced peak surcharges for certain U.S. Export and U.S. import packages during select weeks in November and December 2018.

Effective October 15, 2018, the International Air-Import fuel surcharge increased by 0.50%. These surcharges continue to be based on the national Average U.S. Gulf Coast Jet Fuel Price and adjusted weekly.



Table of Contents**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 is provided in note 14 to the unaudited consolidated financial statements.

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

	September 30, 2018	December 31, 2017
Currency Derivatives	\$ 92	\$ (267 )
Interest Rate Derivatives	(32 )	58
Investment Market Price Derivatives	—	(16 )
	\$ 60	\$ (225 )

As of September 30, 2018 or December 31, 2017, we had no outstanding commodity hedge positions.

Our market risks, hedging strategies and financial instrument positions at September 30, 2018 have not materially changed from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017. In 2018, we entered into several foreign exchange forwards on the Euro, British Pound Sterling, Canadian Dollar, Mexican Peso and Singapore Dollar, and had forwards and market price derivatives expire. We had foreign exchange options on the Euro, British Pound Sterling and Canadian Dollar that expired during the first nine months of 2018. The remaining fair value changes between December 31, 2017 and September 30, 2018 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 \$59 million and were required to post \$45 million in cash collateral with our counterparties as of September 30, 2018.

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, 2017 is hereby incorporated by reference in this report.

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**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

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

*Changes in Internal Control over Financial Reporting*

There were no changes in the Company’s internal control over financial reporting during the quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

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

For a discussion of legal proceedings affecting us and our subsidiaries, see note 10 to the unaudited consolidated financial statements included in this report.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors described in Part 1, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2017.

**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 third quarter of 2018 is as follows (in millions, except per share amounts):

	Total Number of Shares Purchased <sup>(1)</sup>	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
July 1 – July 31, 2018	0.8	\$111.65	0.8	\$ 3,752
August 1 – August 31, 2018	0.8	121.29	0.8	3,661
September 1 – September 30, 2018	0.6	121.34	0.6	3,583
Total July 1 – September 30, 2018	2.2	\$117.84	2.2	

(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 new share repurchase authorization of \$8.0 billion. Share repurchases may take the form of accelerated share repurchases, open market purchases or other such methods as we deem appropriate. The timing of our share repurchases will depend upon market conditions. Unless terminated earlier by the Board, the program will expire when we have purchased all shares authorized for repurchase under the program. We anticipate repurchasing approximately \$1.0 billion of shares in 2018.

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**Item 6. Exhibits**

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

- 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).
- 11 Statement regarding Computation of per Share Earnings (incorporated by reference to Note 13 in “Part I, Item 1. Financial Statements” of this Quarterly Report on Form 10-Q).
- †12 Computation of Ratio of Earnings to Fixed Charges.
- †31.1 Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- †31.2 Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- †32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- †32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- The following unaudited financial information from this Quarterly Report on Form 10-Q for the quarter ended September 30, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Statements of Consolidated Income, (iii) the Statements of Consolidated Comprehensive Income, (iv) the Statements of Consolidated Cash Flows, and (v) the Notes to the Consolidated Financial Statements.
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Filed herewith.

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**SIGNATURES**

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

UNITED PARCEL SERVICE, INC.  
(Registrant)

Date: October 30, 2018 By: /s/ RICHARD N. PERETZ

**Richard N. Peretz**  
**Senior Vice President, Chief Financial Officer and Treasurer**  
**(Duly Authorized Officer and**  
**Principal Accounting Officer)**