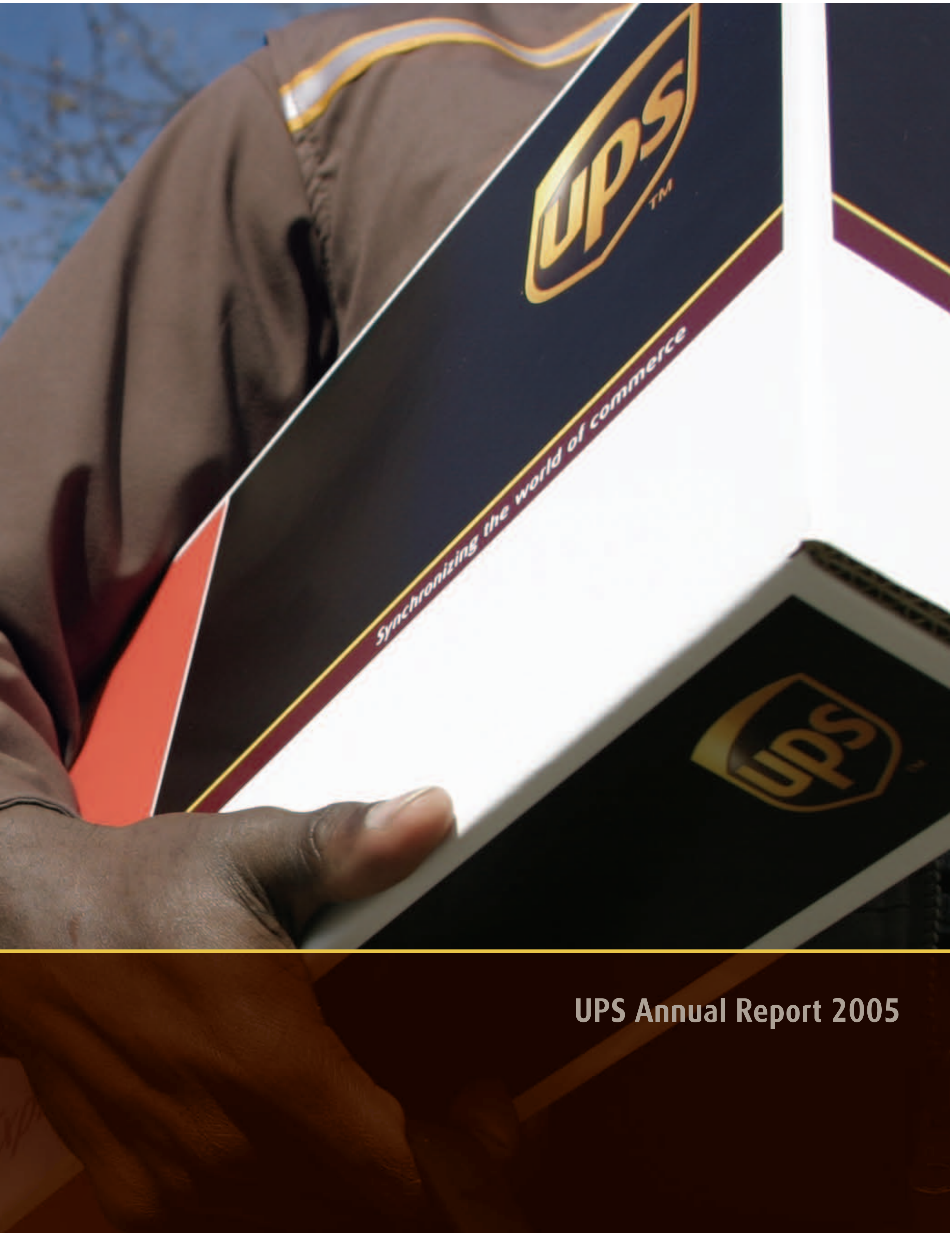


UPS Annual Report 2005

UPS at a Glance

UPS is the world's largest package delivery company and a global leader in supply chain services, operating in over 200 countries and territories.

UPS provides time-definite delivery of a single letter, small package, less-than-truckload (LTL) or truckload freight:

- **via air or ground**
- **anywhere in the world**

UPS supply chain services manage a customer's behind-the-scenes movement of goods anywhere around the world, and — in some cases — even repair those products:

- **shipping via air, sea, ground, and rail**
- **managing international trade**
- **overseeing customs brokerage**
- **filling orders**
- **handling returns**
- **financing business growth**

2005 Highlights

- Record revenue, operating profit and earnings per share.
- Highest volume in UPS history... 3.75 billion packages.
- Free cash flow of $3.6 billion.*
- Significant expansion of the UPS service portfolio — time-definite delivery of air freight and less-than-truckload freight transportation — through acquisitions.
- Strengthened international small package operations in Europe and Asia through acquisitions and the buy out of a joint venture.

* See page 10 for a reconciliation of free cash flow.

Selected Financial Highlights

(in millions, except for per-share amounts)	**2005**	2004	% Change
Revenue	$ 42,581	$ 36,582	16.4
Operating expenses	36,438	31,593	15.3
Net income	3,870	3,333	16.1
Diluted earnings per share	3.47	2.93	18.4
Dividends declared per share	1.32	1.12	17.9
Assets	35,222	33,088	6.4
Long-term debt	3,159	3,261	(3.1)
Shareowners' equity	16,884	16,378	3.1
Capital expenditures	2,187	2,127	2.8
Cash and investments	3,041	5,197	(41.5)

UPS Facts

Founded:
1907

Employees:
407,000

Customers:
7.9 million

Daily small package volume:
14.8 million worldwide

UPS.com:
10 million tracking requests daily

Operating facilities:
3,000 worldwide

Access points:
145,000 worldwide

Aircraft:
268 (Ninth-largest airline in the world)

Package delivery vehicles:
92,000

Freight vehicles:
6,700 tractors; 22,100 trailers

Dear fellow shareowners,

UPS completed 2005 with tremendous momentum and a keen focus on helping our customers succeed in a complex global environment.

Our vision is to bring the world's businesses together through synchronized commerce. We do this by coordinating their distribution systems, supply chains and order management cycles, helping them to compete better in an expanding global economy.

Customers tell us they need to reach new markets, differentiate themselves from competitors, enhance relationships with their own customers, improve cash flow, and focus on what they do best. Increasingly, they rely on UPS and our synchronized solutions to help them achieve these critical business objectives.

As a result, UPS is deeply ingrained in the fabric of global commerce and supply chains. We've become part of the infrastructure of trade — a blending of physical and intellectual assets that both support and drive commerce, whether it's around the block or around the world.

Michael L. Eskew
Chairman and Chief Executive Officer

Diligent execution

A year ago, I laid out four expectations for 2005:

- Preserve the consistency in revenue and earnings growth that we established over the years
- Grow market share in the global small package business
- Increase operating profit in each of our three business units — U.S. domestic, international and supply chain
- Maintain a sustainable approach to running our business

I'm proud to say we achieved all of that and more.

We grew revenue and diluted earnings per share by 16.4 percent and 18.4 percent, respectively.

We delivered a record 3.75 billion small packages in 2005 — or 14.8 million every day.

We grew operating profit in each of our businesses, ending 2005 with total operating profit of $6.1 billion — a 23 percent increase over the previous year's results.

We generated free cash flow of $3.6 billion.*

And we achieved these results through an organization that is as committed as ever to the role of responsible corporate citizenship.

Another outstanding year

Our U.S. domestic small package operation exhibited excellent volume growth during 2005, gaining momentum as the year progressed. Volume gains stemmed from our focus on the middle market customer sector, continued integration of UPS shipping technology into customers' operations, our expanded product portfolio, and accelerated cross-selling of that portfolio.

This business is a significant value generator and has long been the financial engine that provides the resources for our global expansion. With operating profit of $4.5 billion in 2005, our domestic business consistently posts the best operating margins in the industry — 15.7 percent for 2005. Reinvestment of the funds that this business generates supports growth through acquisitions, new product development and service enhancements.

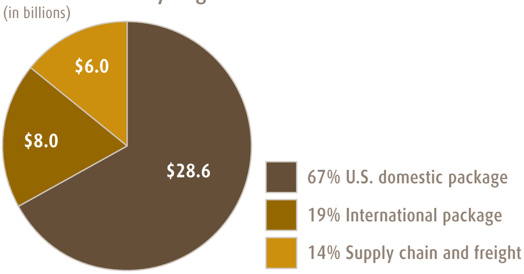
Package Flow Technology, a multi-year re-engineering of our package pickup and delivery process, is a good example of reinvestment to support growth. This technology improves productivity, reduces costs and provides the platform for new consignee-focused services.

Our International segment turned in another exceptional year. Revenue increased 17.2 percent and operating profit was up 30 percent with volume growth in all areas of the world. Operating margin in this business was an outstanding 18.7 percent for the year.

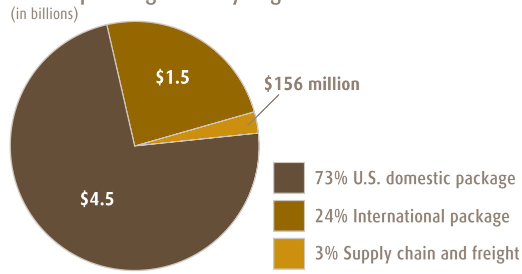
In Europe, UPS has developed a comprehensive, integrated air and ground network — much like that in the United States — which serves our customers' local, regional and international shipping needs. The 2005 acquisition of two strong, local networks in Poland and in the United Kingdom expanded our customer base and brought enhanced services to customers in those areas.

* See page 10 for a reconciliation of free cash flow.

2005 Revenue by Segment
(in billions)



2005 Operating Profit by Segment
(in billions)



In Asia, UPS is pursuing a comprehensive growth strategy, with China as our priority. Acquiring direct control of our express operations in China from our long-time partner made UPS the first global package delivery company to establish large-scale, wholly owned operations there. During 2005, we added new air routes connecting China to other Asian countries, as well as directly to the United States. We also expanded and added facilities to support both our supply chain and air operations in China. In 2007, we plan to open a new air hub in Shanghai.

Asian growth opportunities are not limited to China. By the end of 2006, we expect to serve all key metropolitan areas across Japan with new UPS-branded facilities, service providers and vehicles. We are developing our operations and services in Hong Kong, which is vital to linking China with the lucrative Asia-Europe trade lanes. UPS is the only foreign company that operates a hub in Taiwan, and we have more than 20 strategically placed centers throughout India in locations where the majority of foreign investment occurs.

We expect this part of the world will provide growth opportunities for UPS for years to come.

The supply chain and freight segment more than doubled revenue, with operating profit up 13 percent. These results reflect the full-year impact of the Menlo Worldwide Forwarding acquisition, which closed in late 2004, and the five-month impact from the acquisition of Overnite, which marked UPS's entry into the North American, less-than-truckload freight market.

The Menlo integration will be complete in mid-2006 when we open a new air freight facility in Louisville, KY — our primary heavy air hub — and in five regional air hubs around the United States. We anticipate achieving $50 million to $100 million in savings in 2006 and at least $200 million in 2007 after these facilities become operational.

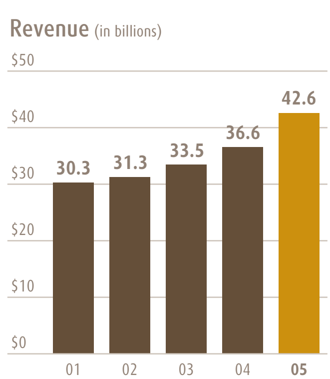
The acquisition of Overnite rounded out our service portfolio. UPS can now offer our customers time-definite, guaranteed delivery of any shipment — from a letter to heavy freight. Overnite's performance since the acquisition has been solid. We anticipate achieving revenue synergies between Overnite and our small package business, once we complete the transition in the second half of 2006.

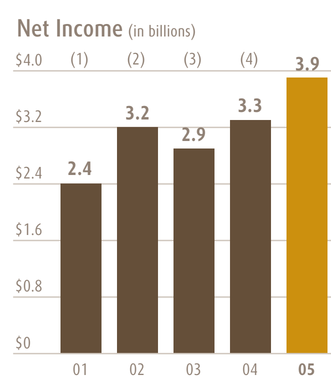
In 2005, we implemented a major change to our management incentive compensation program, which is offered to about 30,000 management employees beginning with the supervisor level. Prior to 2005, bonuses were awarded entirely in shares of common stock on the basis of company profitability. Now they are determined by a multi-metric, performance-based system. This change better aligns incentives with the way we manage the business. The new plan continues to support UPS's ownership culture by providing half the award in the form of Class A shares.

The road ahead

Here's what we expect to accomplish in 2006:

- Grow operating profit in all three of our business segments
- Generate a healthy cash flow once again
- Increase earnings for 2006 between 11 and 16 percent over 2005 results





- Grow our small package business by at least market rates in the United States and faster than market rates in other major regions of the world
- Aggressively expand freight services in specific markets
- Focus our supply chain activities on the high tech, health care and retail sectors where connectivity across all UPS businesses is strong
- Operate a sustainable enterprise that balances the economic, social and environmental consequences of our business practices

Our growth strategy aims to create deeper connections with our customers. When we walk into their offices today, we ask questions like:

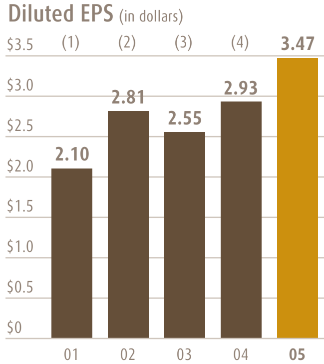
- What do you need?
- What's in your way?
- Where do you go to market?
- Where would you like to go to market?
- What channels would you like to use to get to that market?

We're thinking about their businesses holistically and putting together integrated solutions that help them run their organizations better.

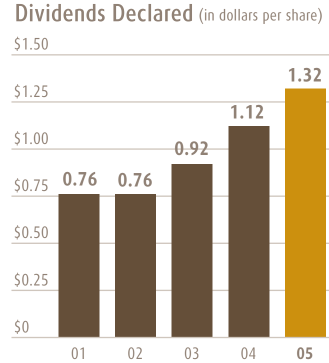
At UPS we believe stronger customer relationships lead to growth, and we operate according to that belief. Our products and services are deeply embedded in the fabric of our customers' businesses. The ultimate purpose… to make our customers more successful. In doing that, we become more successful too.

Michael L. Eskew
Chairman and Chief Executive Officer

Diluted EPS (in dollars)



Dividends Declared (in dollars per share)



(1) Includes an after-tax charge upon adoption of FAS 133 of $26 million or $0.02 per share.

(2) Includes after-tax effects of a gain related to a charge in vacation policy, a restructuring charge, a charge upon adoption of FAS 142, and the settlement of a previously established tax assessment liability. The net effect of these items was to increase net income by $760 million or $0.67 per share.

(3) Includes the after-tax effects of a gain on the sale of Mail Technologies, a gain on the sale of Aviation Technologies, an investment impairment charge, and a gain on the redemption of long-term debt. Also includes credits to income tax expense due to resolution of various tax contingencies, a favorable ruling on the treatment of jet engine maintenance costs, and a lower effective state tax rate. The net effect of these items was to increase net income by $126 million or $0.11 per share.

(4) Includes the after-tax effects of an impairment charge on Boeing 727, 747 and McDonnell Douglas DC-8 aircraft and related parts and engines and a charge to pension expense resulting from the consolidation of data collection systems. Also includes credits to income tax expense related to the resolution of various tax matters, the removal of a portion of the valuation allowance on certain deferred tax assets on net operating loss carry forwards, and an adjustment for identified tax contingency matters. The net effect of these items was to increase net income by $32 million or $0.03 per share.

UPS Products and Services

Creating solutions to help our customers grow their businesses is at the heart of UPS's broad array of products and services. We help our customers become more successful — be it shipping a single package, moving international air and ocean freight, or something more complicated, such as managing distribution or navigating the complexities of international trade.

Shipping services address the urgent and routine, the local and global.

- Express delivery
- Deferred delivery
- Ground service with guaranteed delivery dates
- International express delivery to more than 200 countries and territories

Freight complements the small package services.

- Domestic and international air freight for time-sensitive deliveries
- Less-than-truckload (LTL) and truckload freight
- Ocean freight

Logistics services enhance customers' supply chains.

- Distribution services
- Reverse logistics
- Supplier management

Post-sales support improves customer service.

- Returns and repair management
- Critical parts delivery

Import/export services simplify international trade.

- Customs brokerage
- Compliance, trade and tariff consulting
- International trade management

Visibility services and information technologies help our customers work more efficiently.

- Automated global shipping solutions for any size business
- Package information seamlessly integrated into customers' internal business processes
- Proactive e-mail notifications of shipping events
- Tracking through the Web, wireless devices or third-party applications
- Online payment and visibility of UPS invoices

Business solutions improve cash flow and more.

- Asset-based loans
- Small business lending
- Mail services

Retail access makes for customer convenience.

- The UPS Store® and Mail Boxes Etc.® with more than 5,600 locations worldwide
- 60,000 other retail access points worldwide

UPS is deeply ingrained in the fabric of global commerce.

Dear fellow shareowners,

Ask any executive what the most important business trend is today, and you'll likely get the response — the dramatic increase in global trade. The coordinated, efficient and expedited movement of goods, information and funds across borders is shrinking the world and creating exciting, new business models and economic opportunities.

UPS is a great way to participate in the expanding global economy. Our industry is critical to international trade, our position in this industry is strong, and we have a track record of delivering exceptional financial results.

D. Scott Davis
Chief Financial Officer

An industry with excellent growth dynamics

According to the World Trade Organization (WTO), global trade increased over 13 percent in total for 2003 and 2004. The WTO anticipates expansion continued at about 6.5 percent in 2005, and should be slightly stronger — perhaps 7 percent — in 2006. Clearly, borders have come down, allowing many businesses the opportunity for global sourcing and easier access to new markets.

Global sourcing and markets necessitate new ways of doing business. Longer supply chains require management of multiple transportation modes. To control valuable goods in the supply chain, just-in-time inventory processes are more important than ever. But truly effective supply chain management demands real-time information and network planning to minimize handling and to bypass distribution centers. In addition, high tech, automotive manufacturing, large retailers and other industries are deploying direct-to-consumer models. Product goes from the manufacturer directly to the retail store or even to the home — saving time and money. The result… more frequent, time-definite, information-rich shipments.

And, of course, Internet purchasing drives direct-to-consumer transactions, increasing small package shipments. Consumers demand convenience and choice, and the Internet meets that need. In 2005, for example, online shopping increased 22 percent, extending a seven-year trend of double-digit growth.

Another industry dynamic is the trend toward outsourcing the management of transportation networks and distribution systems. Business leaders recognize the value of focusing on what they do best — product design, services, technology, or marketing. As a result, more than 70 percent of *FORTUNE* 1000 companies outsource some part of their supply chain network. In Asia, business leaders are even more likely than their counterparts in the United States or Europe to outsource their supply chain management needs.

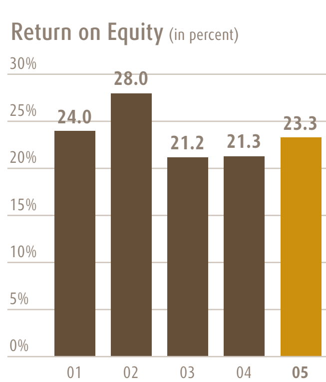
Finally, participation in our industry requires access to a strong physical and information infrastructure across local, regional and global markets. Establishing a worldwide network can require billions of dollars in investment. The ability to make these investments year after year is heavily dependent on a disciplined approach to business. The by-product… an industry focused on investing to create customer and shareowner value.

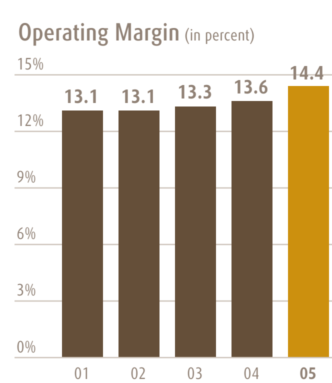
The UPS Advantage

From delivery of an envelope to the movement of heavy freight — locally or internationally, via air or ground, whether commercial or residential — UPS offers comprehensive shipping, tracking, visibility, customs, financial and supply chain management services.

Our integrated global network gives us unsurpassed operational flexibility that ensures the highest levels of customer satisfaction in the industry. This single network supports multiple products with varying time-of-day delivery guarantees. The result… a business model that allows for economies of scope and scale, optimum use of assets and industry-leading margins.

UPS's worldwide network is supported by the most sophisticated information technology in the transportation industry. We have invested $20 billion in I.T. over the past two decades, creating a centralized global infrastructure that sustains business continuity and quality of service at all times. Our customers can





take advantage of our I.T. platform by linking their systems directly into the UPS global network. This seamless integration allows us to provide unique solutions that help customers improve their profitability and access new markets.

All of this is supported by one of the most trusted and recognized brands on the planet — a brand that symbolizes UPS's heritage of reliable service.

Consistent, superior financial performance

UPS has a track record of compelling financial performance. For example, return on equity has been over 20 percent almost every year for the past two decades, our compound annual earnings growth rate is 14 percent for the last decade, and long-term debt to total capitalization was only 15.8 percent in 2005.

Our business generates substantial, positive cash flow that supports reinvestment in the business through new technologies, infrastructure enhancements, new services, and acquisitions. In 2005, UPS generated $3.6 billion in free cash flow.*

This financial strength underscores a commitment to shareowner value. In 2005, UPS spent $2.5 billion to repurchase 33.9 million shares, reducing outstanding shares by 2.6 percent. Over the last five years (2001 through 2005), UPS has distributed over $5.4 billion in dividends. In fact, from February 2003 to February 2006, UPS increased dividends declared 81 percent.

Decades of employee ownership have produced a culture aligned with investor interests — UPS is a company that's run by investors for investors.

This ownership philosophy results in long-term investment decision-making, with a focus on appropriate investment returns.

Our business is straightforward. The balance sheet provides a clear picture of our financial strength. Since we are a service company, we have minimal inventories on hand, and our revenue recognition is easy to understand. These characteristics of our business result in a high level of transparency.

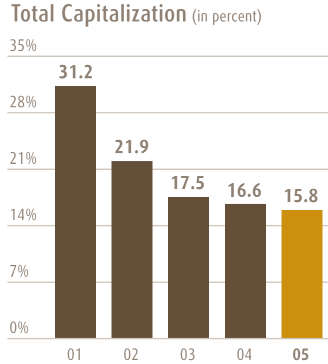
I speak for UPSers the world over when I say we're excited about the prospects afforded us in the transportation industry. Our business both supports and benefits from increased trade. As the world's communities move closer together economically, we believe UPS is an exceptional way to invest in global commerce.

D. Scott Davis
Chief Financial Officer

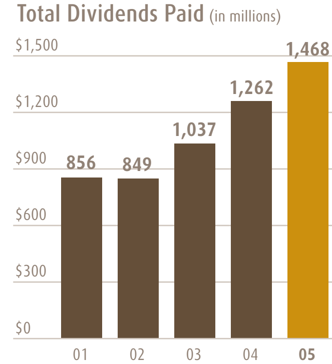
***Reconciliation of 2005 Free Cash Flow** (in millions)

Net cash from operations	$	5,793
Capital expenditures		(2,187)
Proceeds from disposals of PP&E		27
Net change in finance receivables		95
Other investing activities		(174)
Free cash flow	**$**	**3,554**

Long-Term Debt to Total Capitalization (in percent)



Total Dividends Paid (in millions)



UPS Business Philosophy

UPS founder, Jim Casey, established principles and values that are part of the fabric of our business. For almost 100 years, these principles and values have remained constant and have been integral to our success. This legacy of honesty, quality and integrity is fundamental to our ability to attract and retain the best people, gain and keep the trust of our customers, create shareowner value, minimize environmental impacts, support the communities in which we operate, and protect our reputation.

Employees:

We respect and value the individual.

- We encourage a spirit of teamwork.
- We promote from within.
- We help people to develop themselves.
- We place great value on diversity.

Customers:

We believe that enabling our customers to succeed and grow is central to the success of UPS.

- We treat each customer as our only customer.
- We never promise more than we can deliver, and we deliver on every promise.

Shareowners:

We sustain a financially strong company.

- We manage assets wisely.
- We emphasize the "long-term" in strategy development and decision-making.
- We seek to provide long-term competitive returns to our shareowners.

Ownership philosophy:

We encourage ownership of our company by our employees.

- Having a personal stake in the company causes employees to think like owners and work like partners. Employee ownership creates a sense of teamwork, and strengthens and preserves our values.
- It is our goal to have employees share in the success of the company through various plans to reward and encourage participation as shareowners.

Sustainability:

We operate our business by maintaining a balance between economic success, social responsibility and environmental stewardship.

- We believe our economic well-being benefits society by providing good wages, paying taxes, and practicing philanthropy.
- We encourage community involvement and volunteerism by our employees.
- We proactively employ solutions that minimize the impact of our business on the environment.

Our corporate sustainability report can be found at *www.sustainability.ups.com.*

Our Code of Business Conduct is available at *www.shareholder.com/ups.*

UPS Board of Directors

John J. Beystehner
Senior Vice President and Chief Operating Officer, UPS and President, UPS Airlines
Director since 2005

Michael J. Burns
Chairman, President, and Chief Executive Officer, Dana Corporation
Director since 2005

D. Scott Davis
Senior Vice President and Chief Financial Officer, UPS
Director since 2006

Stuart E. Eizenstat
Partner, Covington & Burling LLP
Director since 2005

Michael L. Eskew
Chairman and Chief Executive Officer, UPS
Director since 1998

James P. Kelly
Former Chairman and Chief Executive Officer, UPS
Director since 1991

Ann M. Livermore
Executive Vice President, Hewlett-Packard Company
Director since 1997

Gary E. MacDougal
Former Chairman and Chief Executive Officer, Mark Controls Corporation
Director since 1973

Victor A. Pelson
Senior Advisor, UBS Securities LLC
Director since 1990

John W. Thompson
Chairman and Chief Executive Officer, Symantec Corporation
Director since 2000

Carol B. Tomé
Executive Vice President and Chief Financial Officer, The Home Depot, Inc.
Director since 2003

Ben Verwaayen
Chief Executive, BT Group plc
Director since 2005

D. Scott Davis was appointed to the Board in February 2006. Lea N. Soupata retired from UPS after 36 years of distinguished service, effective January 1, 2006.

Management Committee

David P. Abney
Senior Vice President and President, UPS International

David A. Barnes
Senior Vice President and Chief Information Officer

John J. Beystehner
Senior Vice President and Chief Operating Officer, UPS and President, UPS Airlines

D. Scott Davis
Senior Vice President and Chief Financial Officer

Michael L. Eskew
Chairman and Chief Executive Officer

Allen E. Hill
Senior Vice President, Human Resources and Public Affairs

Kurt P. Kuehn
Senior Vice President, Worldwide Sales and Marketing

Teri P. McClure
Senior Vice President, Legal and Compliance, General Counsel and Corporate Secretary

John J. McDevitt
Senior Vice President, Strategic Integration and Global Transportation

Christine M. Owens
Senior Vice President, Communications and Brand Management

Robert E. Stoffel
Senior Vice President, Supply Chain Group

James F. Winestock
Senior Vice President, U.S. Operations

Effective in January 2006, Allen E. Hill assumed responsibility for Human Resources, having already held responsibility for Public Affairs. Teri P. McClure joined the Management Committee as Senior Vice President, Legal and Compliance.

Senior Operations Management

George W. Brooks Jr.
Southeast Region

Wolfgang Flick
Europe Region

Stephen D. Flowers
Americas Region

Alan Gershenhorn
UPS Supply Chain Solutions

Myron A. Gray
North Central Region

Wayne C. Herring
East Central Region

Robert L. Lekites
UPS Airlines

Gerald R. Mattes
Pacific Region

Stephen R. Miele
Northeast Region

Anthony Poselenzny
West Region

Rocky Romanella
UPS Supply Chain Solutions

Kenneth A. Torok
Asia Pacific Region

Carolyn J. Walsh
Southwest Region

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K
FOR ANNUAL AND TRANSITION REPORTS
PURSUANT TO SECTIONS 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2005

or

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

For the transition period from to

Commission file number 001-15451

United Parcel Service, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**58-2480149**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
55 Glenlake Parkway, N.E. Atlanta, Georgia	**30328**
(Address of Principal Executive Offices)	*(Zip Code)*

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

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

Title of Each Class	Name of Each Exchange on Which Registered
Class B common stock, par value $.01 per share	New York Stock Exchange

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

Class A common stock, par value $.01 per share

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☑ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☑

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☑ Accelerated filer ☐ Non-accelerated filer ☐

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

The aggregate market value of the class B common stock held by non-affiliates of the registrant was approximately $43,231,060,145 as of June 30, 2005. The registrant's class A common stock is not listed on a national securities exchange or traded in an organized over-the-counter market, but each share of the registrant's class A common stock is convertible into one share of the registrant's class B common stock.

As of February 28, 2006, there were 443,660,015 outstanding shares of class A common stock and 648,462,654 outstanding shares of class B common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for its annual meeting of shareowners scheduled for May 4, 2006 are incorporated by reference into Part III of this report.

PART I

Item 1. *Business*

Overview

UPS is the world's largest package delivery company and a global leader in supply chain solutions. We were founded in 1907 as a private messenger and delivery service in Seattle, Washington. Today, we deliver packages each business day for 1.8 million shipping customers to 6.1 million consignees in over 200 countries and territories. In 2005, we delivered an average of more than 14.7 million pieces per day worldwide. In addition, our supply chain solutions capabilities are available to clients in 186 countries and territories.

Total revenue in 2005 was over $42.5 billion. Although our primary business is the time-definite delivery of packages and documents, we have extended our capabilities in recent years to encompass the broader spectrum of services known as supply chain solutions, such as freight forwarding, customs brokerage, fulfillment, returns, financial transactions and even repairs. We are also a leading provider of less-than-truckload ("LTL") transportation services. We have established a global transportation infrastructure and a comprehensive portfolio of services and integrated solutions. We support these services with advanced operational and customer-facing technology. Our supply chain solutions provide visibility into moving inventory across the global supply chain.

We believe the future is bright for this industry.

- Globalization of trade is a worldwide economic reality, which we believe will continue to expand as trade barriers are eliminated and large consumer markets, in particular China and India, experience economic expansion.
- We believe direct-to-consumer shipments will continue to increase as a result of just-in-time inventory management and increased use of the Internet for ordering goods. UPS is enhancing its ability to be a "warehouse in motion" for inventory on the move. The company is also the industry leader in the delivery of goods purchased over the Internet.
- We believe the drive toward outsourcing supply chain management will continue, as customers increasingly view effective management of their supply chains as a strategic advantage rather than a cost center.

Our vision for the future is to synchronize the world of commerce, managing the complexities of our customers' supply chain needs. Our goal is to develop business solutions that create value and competitive advantages for all size customers through product differentiation, market penetration, better customer service and improved cash flow.

Competitive Strengths

Our competitive strengths include:

Global Reach and Scale. We believe that our integrated global ground and air network is the most extensive in the industry. It is the only network that handles all levels of service (express, ground, domestic, international, commercial, residential) through one integrated pickup and delivery service system.

We operate a ground fleet of approximately 98,000 vehicles, ranging from custom-built package cars to large tractors and trailers, and utilize nearly 600 airplanes. In the contiguous U.S., we reach all business and residential addresses. We are the ninth largest airline in the world. Our primary air hub is in Louisville, KY. Regional air hubs are located in Columbia, SC; Dallas, TX; Hartford, CT; Ontario, CA; Philadelphia, PA; and Rockford, IL. Our largest international air hub is in Cologne, Germany, with other regional hubs in Hong Kong, Singapore, Taiwan, Miami, FL and Pampanga, Philippines.

In Europe, where we have operated for nearly 30 years, we maintain a well developed air and ground network, much like that in the U.S. We believe we have the most comprehensive integrated delivery and information services portfolio of any carrier in Europe. In other regions of the world, we rely on both our own and local service providers' capabilities to meet our service commitments.

Through more than two dozen alliances with Asian delivery companies that supplement company-owned operations, we currently serve more than 40 Asia Pacific countries and territories. Two of the fastest growing economies in the world, China and India, are among our most promising opportunities.

We are also the largest air cargo carrier and a leading logistics provider in Latin America and the Caribbean.

Our Canadian operations include both intra-Canada and import/export capabilities. We deliver to all addresses throughout Canada. We are also the only carrier to offer guaranteed 8:00 a.m. next day delivery to most major metropolitan cities in Canada.

Technology. We are a global leader in developing technology that improves our customers' business processes. We have a strong global capability as a mover of electronic information. We currently collect electronic data on 97% of the packages that move through our U.S. system each day – more than any of our competitors.

In 2003 we announced plans to re-engineer our package pick-up and delivery processes. Over several years, beginning in 2003, we expect to invest approximately $600 million to simplify and optimize these processes, which we believe will result in gains in efficiency, reliability and flexibility. Once the new technology is deployed in our package sorting facilities, we anticipate achieving savings through productivity improvements as well as in reduced fuel usage. By the end of 2005 we had deployed this technology for use by almost 61% of our drivers.

Technology powers virtually every service we offer and every operation we perform. Our technology initiatives are driven by our customers' needs. We offer a variety of on-line service options that enable our customers to integrate UPS functionality into their own businesses not only to conveniently send, manage and track their shipments, but to provide their customers with better information services. We provide the infrastructure for an Internet presence that extends to tens of thousands of customers who have integrated UPS tools directly into their own web sites.

E-Commerce Capabilities. We are a leading facilitator of global e-commerce. We enable our customers around the world to thrive in this environment by providing a portfolio of technology solutions that streamlines their shipment processing and integrates critical transportation information into their business applications.

Broad, Flexible Range of Services and Integrated Solutions. Our portfolio of services enables customers to choose the delivery option that is most appropriate for their requirements. Substantially all of our U.S. small package delivery services are guaranteed.

Our express air services are integrated with our vast ground delivery system – one system handling all products. This integrated air and ground network enhances efficiency, improves productivity and asset utilization, and provides us with the flexibility to transport packages using the most reliable and cost-effective transportation mode or combination of modes. Our sophisticated engineering systems allow us to optimize our network efficiency and asset utilization on a daily basis. This unique, integrated global business model creates consistent and superior returns – by far the best in our industry.

Increasingly, our customers benefit from business solutions that integrate many UPS services in addition to package delivery. We offer over 60 supply chain services – such as freight forwarding, customs brokerage, order fulfillment, and returns management – that help improve efficiency of the supply chain management process.

Customer Relationships. We focus on building and maintaining long-term customer relationships. Thousands of customers access us daily through UPS On-Call Pickup℠ for air and ground delivery services. In addition, there are approximately 145,000 domestic and international access points to UPS. These include: nearly 40,000 drop-boxes, more than 1,000 UPS Customer Centers, over 2,200 Alliance partner locations, almost 7,000 independently-owned and national Authorized Shipping Outlets, over 9,600 commercial counters, 5,600 independently owned and operated The UPS Store® and Mail Boxes Etc.® locations worldwide (over 4,400 in the U.S.) – along with 80,000 UPS drivers who can accept packages given to them.

We place significant value on the quality of our customer relationships, and we conduct comprehensive research to monitor customer perceptions. Since 1993, we have conducted telephone interviews with shipping decision-makers virtually every business day to determine their satisfaction with small package carriers and perception of performance on 19 service factors. Results from this survey for 2005 continue to show high levels of customer satisfaction.

Brand Equity. We have built a leading and trusted brand in our industry – a brand that stands for quality service, reliability and product innovation. The distinctive appearance of our vehicles and the friendliness and helpfulness of our drivers are major contributors to our brand equity.

In 2003 we introduced our first new logo in 42 years. The change was more than cosmetic; it signaled our commitment to provide more comprehensive solutions to meet our customers' needs and to be the leader in the broader business arena of synchronized commerce.

Distinctive Culture. We believe that the dedication of our employees results in large part from our distinctive "employee-owner" concept. Our employee stock ownership tradition dates from 1927, when our founders, who believed that employee stock ownership was a vital foundation for successful business, first offered stock to employees. To facilitate employee stock ownership, we maintain several stock-based compensation programs.

Our long-standing policy of "promotion from within" complements our tradition of employee ownership, and this policy makes it generally unnecessary for us to hire managers and executive officers from outside UPS. The vast majority of our management team began their careers as full-time or part-time hourly UPS employees, and has spent their entire careers with us. Our chief executive officer and many of our executive officers have more than 30 years of service with UPS and have accumulated a meaningful ownership stake in our company. Therefore, our executive officers have a strong incentive to effectively manage UPS, which benefits all our shareowners.

Financial Strength. Our balance sheet reflects financial strength that few companies can match. As of December 31, 2005, we had a balance of cash, cash equivalents, marketable securities and short-term investments of approximately $3.0 billion and shareowners' equity of $16.9 billion. Long-term debt was $3.2 billion. We carry long-term debt ratings of AAA/Aaa from Standard & Poor's and Moody's, respectively, reflecting our low use of debt and strong capacity to service our obligations. Our financial strength gives us the resources to achieve global scale and to make investments in technology, transportation equipment and buildings as well as to pursue strategic opportunities which will facilitate our growth.

Growth Strategy

Our growth strategy takes advantage of our competitive strengths while maintaining our focus on meeting or exceeding our customers' requirements. The principal components of our growth strategy are:

Build on Our Leadership Position in Our U.S. Business. We believe that our tradition of reliable package delivery service, our experienced and dedicated employees and our unmatched integrated air and ground network provide us with the advantages of reputation, service quality and economies of scale that differentiate us from our competitors. Our strategy is to increase domestic revenue through cross-selling our existing and new services to our large and diverse customer base, to limit the rate of expense growth and to employ technology-driven efficiencies to increase operating profit.

Continued International Expansion. We have built a strong international presence through significant investments over several decades. The international package delivery market continues to grow at a faster rate than that of the U.S. We will use our worldwide infrastructure and broad product portfolio to grow high-margin premium services and to implement cost, process and technology improvements in our international operations.

Europe is our largest region outside the United States – accounting for half of our international revenue. Both Europe and Asia offer significant opportunities for growth. The expansion of the European Union to include several Eastern European and Baltic countries will create even greater economic cohesion. Growth in Asia will be driven by global demand, leading to improved demographic and economic trends throughout the region, with specific emphasis on China and India.

Provide Comprehensive Supply Chain Solutions. In today's global economy, entire industries have outsourced all or part of their supply chains to streamline and gain efficiencies, to strengthen their balance sheets, to support new business models and to improve service. Companies' global supply chains are growing increasingly complex. This is creating further demand for a global service offering that incorporates transportation, distribution and international trade services with financial and information services. We believe that we are well positioned to capitalize on this growth for the following reasons:

- We manage supply chains for large and small companies in 186 countries and territories, with about 35 million square feet of distribution space and over 1,000 facilities worldwide.
- We focus on supply chain redesign, freight forwarding, international trade services and management-based solutions for our customers rather than solely on more traditional asset-based logistics such as warehouses and vehicle fleets. We have built valuable intellectual capital in specific high growth industries such as healthcare and technology.
- We provide a broad range of transportation solutions to customers worldwide, including air, ocean and ground freight, as well as customs brokerage and trade and materials management. We provide standardized service, IT systems and specialized distribution facilities and services adapted to the unique supply chains of specific industries such as healthcare, technology, and consumer/retail.
- We offer a portfolio of financial services that provides customers with short- and long-term financing, secured lending, working capital, government guaranteed lending, letters of credit, global trade financing, credit cards and equipment leasing.

Leverage Our Leading-Edge Technology and E-Commerce Advantage. Our goal is to provide our customers with easy-to-use, flexible technology offerings that streamline their shipment processing and integrate critical transportation information into their business processes, helping them create supply chain efficiencies, improve their cash flows and better serve their customers. Our leading-edge technology has enabled our e-commerce partners to integrate our shipping functionality and information solutions into their e-commerce product suites.

Pursue Strategic Acquisitions and Global Alliances. Strategic acquisitions and global alliances play a significant role in spurring growth. We look for opportunities that:

- complement our global package business;
- build our global brand;
- enhance our technological capabilities or service offerings;
- lower our costs; or
- expand our geographic presence.

Products and Services

Domestic Package Products and Services. For most of our history, we have been engaged primarily in the delivery of packages traveling by ground transportation. We expanded this service gradually, and today our standard ground service is available to every address in the 48 contiguous United States. With the addition of Hawaii and Alaska, we were the first to reach every address in all 50 states. We handle packages that weigh up to 150 pounds and are up to 165 inches in combined length and girth. We offer same-day pick-up of air and ground packages.

In addition to our standard ground delivery product, *UPS Hundredweight Service®* offers guaranteed, time-definite service to customers sending multiple package shipments having a combined weight of 200 pounds or more, or air shipments totaling 100 pounds or more, addressed to one recipient.

We provide domestic air delivery throughout the United States. *UPS Next Day Air®* offers guaranteed next business day delivery by 10:30 a.m. to 75% of the United States population and delivery by noon to areas covering an additional 15% of the population. We offer Saturday delivery for UPS Next Day Air shipments for an additional fee.

Additional products and services, such as UPS CampusShip, Consignee Billing, Quantum View Manage, Delivery Confirmation and UPS Returns℠, are available to customers who require customized package distribution solutions.

International Package Products and Services. We deliver international shipments to more than 200 countries and territories worldwide, and we provide delivery within one to two business days to the world's major business centers. We offer a complete portfolio of import, export and domestic services. This portfolio includes guaranteed early morning, morning and noon delivery to major cities around the world, as well as scheduled day-definite air and ground services. We offer worldwide customs clearance service for any mode of transportation.

We classify our service as export (packages that cross national borders) and domestic (packages that stay within a single country's boundaries). We have a portfolio of domestic services in 20 major countries throughout the world.

Transborder services, or the movement of packages within the European Union, are proving to be the growth engine in this region. In early 2006, to accommodate growth opportunities across the whole of Europe, we completed the expansion of our automated package sorting hub at the Cologne/Bonn airport in Germany. The expansion doubled the hub's original sorting capacity to 110,000 packages per hour, largely through the deployment of new automation technology.

We continue to invest in infrastructure and technology in Asia. In April 2002, we opened a new intra-Asia hub at Clark Air Force Base in Pampanga, Philippines to enable future growth in the region. This hub allows us to compete more effectively in the Asian express market and improve our Europe/Asia service. In 2005, we announced expansion plans to triple the intra-Asia hub's sorting capacity from 2,500 packages to 7,500 packages per hour. We obtained landing slots on the new runway at Tokyo's Narita Airport, which have enhanced access and connections to the intra-Asia hub.

In 2003, we received from the U.S. Department of Transportation the authority to expand service to and through Hong Kong, including permanent authority to fly from Hong Kong to other cities, specifically to our Cologne hub in Europe. We continue our development efforts in the fast-growing China market. In 2004, the U.S. Department of Transportation authorized us to significantly expand our air operations in that country with the award of 12 new frequencies. The decision tripled UPS's access to China. In April 2005, UPS became the first U.S. airline to launch non-stop service between the U.S. and Guangzhou, which lies strategically in one of

China's fastest growing manufacturing regions. In 2006, we will add another three daily flights to China. Those flights are supporting international express volume into and out of China, which has seen dramatic growth in recent quarters.

We believe that there is long-term potential for us to expand our service offerings in Latin America. To this end, we have realigned our delivery capabilities between key cities in the Mercosur and other trade blocs. Our Americas International Gateway in Miami, Florida is the focal point for trade between Latin America and the U.S. This gateway complements our operations in Florida and Latin America, and represents our commitment to the Americas market.

Mexico and Canada are also important to our international business. We developed the UPS Trade Direct℠ Cross Border service to manage package movements between the U.S. and these countries. This service combines our small package, freight and brokerage capabilities to create an integrated, streamlined and economical door-to-door solution for customers with complex cross-border distribution needs.

The Trade Direct portfolio of ocean and air services integrates our small package and supply chain solutions capabilities to provide additional value to our international customers. In essence, the Trade Direct service consolidates individually labeled packages or pallets into one movement across borders. When the goods arrive in the destination country, packages are deconsolidated and entered into the UPS system for delivery, often eliminating the receiving, sorting and handling necessary in distribution centers. This service significantly cuts the supply chain cycle from point of origin to consignee. It also provides our customers with faster time to market, reduced costs, increased visibility and better management of their global supply chain.

In 2004 we expanded UPS Trade Direct Ocean, a service that transforms ocean container movements into pre-labeled small packages or LTL shipments. As of December 2005, this service was expanded to over 70 international origin ports and five U.S. entry ports. In addition, a faster Trade Direct Air option was also introduced.

Supply Chain & Freight Services. UPS Supply Chain Solutions, which comprises our freight forwarding and logistics businesses, meets customers' supply chain needs by selecting the most appropriate solution from a portfolio of over 60 services. Among these are:

- *Transportation and Freight Forwarding:* air, ocean, rail and ground freight for all size shipments utilizing UPS and other carriers, and multimodal transportation network management.
- *Logistics and Distribution:* supply chain management, distribution center design, planning and management, order fulfillment, inventory management, receiving and shipping, service parts logistics, reverse logistics and cross docking.
- *International Trade Management:* freight forwarding, full-service customs brokerage and international trade consulting.
- *Consulting Services:* strategic supply chain design and re-engineering.

Asset-based lending, global trade finance and export-import lending services are available through UPS Capital℠.

In 2005, we expanded our LTL transportation services with the acquisition of Overnite Corp., which offers a full range of regional, inter-regional and long-haul LTL services in all 50 states, Canada, Puerto Rico, Guam, the Virgin Islands and Mexico. Overnite, which is now known as UPS Freight, provides LTL services through a network of owned and leased service centers and carrier partnerships. UPS Freight transports a variety of products, including fabricated metal products, health care products, chemicals, textiles, machinery, furniture and fixtures, electronics, paper products and general commodities, including consumer goods, packaged food stuffs, industrial equipment and auto parts. UPS Freight also provides our customers with truckload and dedicated truckload transportation solutions (truckload shipments weigh 10,000 pounds or more).

Electronic Services. We provide a variety of UPS on-line solutions that support automated shipping and tracking:

- *UPS WorldShip®* helps shippers streamline their shipping activities by processing shipments, printing address labels, tracking packages and providing management reports, all from a desktop computer. Our technology allows us to connect to a company's order management and fulfillment software, eliminating the need for the company to perform many time consuming tasks, such as re-keying orders.
- *UPS CampusShip®* is a web-based, UPS-hosted distributed shipping solution that allows employees of companies with multiple facilities and decentralized workforces to easily process and ship packages with UPS from their computer desktops. At the same time, the system gives transportation and mailroom decision-makers centralized control over shipping procedures and costs.
- *UPS Internet Shipping* is a quick and convenient way to ship packages using the web without installing additional software.
- *UPS OnLine®* Host Access provides electronic connectivity between UPS and the shipper's host computer system, linking UPS shipping information directly to all parts of the customer's organization.
- *UPS Ready®* encompasses electronic solutions provided by third-party vendors that benefit customers who want to automate their shipping and tracking processes.
- *Quantum View®* is a suite of three visibility services (Quantum View Manage, Quantum View Data and Quantum View Notify) that give businesses and their customers proactive information about the status of their UPS outbound and inbound shipments. The services can be used separately or together, depending on customer needs.
- *UPS Tradeability℠* is a software tool that helps customers navigate the complex process of international shipping by identifying harmonized tariff codes, generating landed cost estimates, and locating up-to-date compliance information.

Our website strategy is to provide our customers with the convenience of shipping functionality tools right on their computer or at one of our shipping outlets. Package tracking, pick-up requests, rate quotes, account opening, wireless registration, drop-off locator, transit times and supply ordering services are all available at the customer's desktop or laptop. The site also displays full domestic and international service information and allows customers to process outbound shipments as well as return labels for their customers.

UPS.com receives more than 145 million hits and processes over 10 million package tracking transactions daily. A growing number of those tracking requests now come from customers in those countries that have wireless access to UPS tracking information. Businesses in a number of countries also can download UPS OnLine Tools℠, to their own websites for direct use by their customers. This allows users to access the information they need without leaving our customers' websites.

Sales and Marketing

The UPS worldwide sales organization includes both our traditional U.S. domestic and international small package delivery business and our Supply Chain & Freight business. This field sales organization consists primarily of locally-based account executives assigned to our individual operating units. For our largest multi-shipping site customers, we manage sales through an organization of regionally-based account managers, reporting directly to our corporate office.

Our sales force also includes specialized groups that work together with our general sales organization to support the sale of e-commerce and customer technology solutions, international package delivery, LTL and freight transportation, and warehousing and distribution services.

Our worldwide marketing organization also supports both our traditional U.S. domestic and international small package delivery business and our Supply Chain & Freight business. Our corporate marketing function is engaged in market and customer research, brand management, rate-making and revenue management policy, new product development, product portfolio management, marketing alliances and e-commerce, including the non-technical aspects of our web presence. Advertising, public relations, and most formal marketing communications are centrally developed and controlled.

In addition to our corporate marketing group, field-based marketing personnel are assigned to our individual operating units, and are primarily engaged in business planning, bid preparation and revenue management activities. These local marketing teams support the execution of corporate initiatives while also managing limited promotional and public relations activities pertinent to their local markets.

Employees

As of December 31, 2005, we had approximately 407,000 employees.

We have received numerous awards and wide recognition as an employer-of-choice, including the following:

- In February 2006, we were rated the "America's Most Admired" company in our industry in a FORTUNE magazine survey, as well as ranked in the Top 20 among all American companies. We achieved Top 10 rankings for "people management" and "management quality".
- In 2005, we were ranked in the Top 5 companies in *The Wall Street Journal / Harris Interactive* Corporate Reputation Study.
- *Hispanic Magazine* recognized us in 2005 as a leader in its annual "Corporate 100," a list of companies providing the most opportunities for Hispanics.
- In August 2005, *Black Professionals Magazine* named UPS to its "Top 25 Companies for African Americans" list, based on workforce diversity initiatives.
- In 2004, we were named one of *DiversityInc* magazine's "Top 50 Companies for Diversity" and "Top 10 Companies for Latinos".
- In 2004, we were ranked ninth in *Computer World's* "100 Best Places to Work in IT".

As of December 31, 2005, we had approximately 241,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters ("Teamsters"). These agreements run through July 31, 2008. The majority of our pilots are employed under a collective bargaining agreement with the Independent Pilots Association, which became amendable December 31, 2003. Negotiations are ongoing with the assistance of the National Mediation Board. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which becomes amendable on November 1, 2006. In addition, the majority of our ground mechanics who are not employed under agreements with the Teamsters are employed under collective bargaining agreements with the International Association of Machinists and Aerospace Workers. These agreements run through July 31, 2009.

We believe that our relations with our employees are good. Every year we survey all our employees to determine their level of job satisfaction. Areas of concern receive management attention as we strive to keep UPS the employer of choice among our employees.

Competition

We are the largest package delivery company in the world, in terms of both revenue and volume. We offer a broad array of services in the package delivery industry and, therefore, compete with many different companies and services on a local, regional, national and international basis. Our competitors include the postal services of the United States and other nations, various motor carriers, express companies, freight forwarders, air couriers and others.

We believe one increasingly important element of competition is a carrier's ability to integrate its distribution and information systems with its customers' systems to provide transportation solutions at competitive prices. We rely on our vast infrastructure and service portfolio to attract and maintain customers. As we expand our supply chain solutions service offerings, we compete with a number of participants in the supply chain, financial services and information technology industries.

Government Regulation

The U.S. Department of Homeland Security, through the Transportation Security Administration ("TSA"), the U.S. Department of Transportation ("DOT") and the Federal Aviation Administration ("FAA"), regulates air transportation services.

The TSA regulates various security aspects of air cargo transportation in a manner consistent with the TSA mission statement to "protect[s] the Nation's transportation systems to ensure freedom of movement for people and commerce."

The DOT's authority primarily relates to economic aspects of air transportation, such as discriminatory pricing, non-competitive practices, interlocking relations and cooperative agreements. The DOT also regulates, subject to the authority of the President of the United States, international routes, fares, rates and practices, and is authorized to investigate and take action against discriminatory treatment of U.S. air carriers abroad. We are subject to U.S. customs laws and related DOT regulations regarding the import and export of shipments to and from the U.S. In addition, our customs brokerage entities are subject to those same laws and regulations as they relate to the filing of documents on behalf of client importers and exporters.

The FAA's authority primarily relates to safety aspects of air transportation, including aircraft standards and maintenance, personnel and ground facilities. In 1988, the FAA granted us an operating certificate, which remains in effect so long as we meet the operational requirements of federal aviation regulations.

FAA regulations mandate an aircraft corrosion control program, and aircraft inspection and repair at periodic intervals specified by approved programs and procedures, for all aircraft. Our total expenditures under these programs for 2005 were $14 million. The future cost of repairs pursuant to these programs may fluctuate. All mandated repairs have been completed, or are scheduled to be completed, within the timeframes specified by the FAA.

Our ground transportation of packages in the U.S. is subject to the DOT's jurisdiction with respect to the regulation of routes and to both the DOT's and the states' jurisdiction with respect to the regulation of safety, insurance and hazardous materials.

We are subject to similar regulation in many non-U.S. jurisdictions. In addition, we are subject to non-U.S. government regulation of aviation rights to and beyond non-U.S. jurisdictions, and non-U.S. customs regulation.

The Postal Reorganization Act of 1970 created the U.S. Postal Service as an independent establishment of the executive branch of the federal government, and vested the power to recommend domestic postal rates in a regulatory body, the Postal Rate Commission. We participate in the proceedings before the Postal Rate Commission in an attempt to secure fair postal rates for competitive services.

We are subject to numerous other laws and regulations in connection with our non-package businesses, including customs regulations, Food and Drug Administration regulation of our transportation of pharmaceuticals and state and federal lending regulations.

Where You Can Find More Information

We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to these reports available free of charge through the investor relations page of our website, located at *www.shareholder.com/ups*, as soon as reasonably practicable after they are filed with or furnished to the SEC.

We have adopted a written Code of Business Conduct that applies to all of our directors, officers and employees, including our principal executive officer and senior financial officers. It is available in the governance section of the investor relations page of our website, located at *www.shareholder.com/ups*. In the event that we make changes in, or provide waivers from, the provisions of the Code of Business Conduct that the SEC requires us to disclose, we intend to disclose these events in the governance section of our investor relations website.

Our Corporate Governance Guidelines and the charters for our Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee are also available free of charge in the governance section of the investor relations page of our website.

See Footnote 12 to our consolidated financial statements for financial information regarding our reporting segments and geographic areas in which we operate.

Executive Officers of the Registrant

Name and Office	Age	Principal Occupation and Employment For the Last Five Years
David P. Abney Senior Vice President and President, UPS International	50	Senior Vice President and President, UPS International (2003 – present), UPS/Fritz Companies Integration Manager (2001 – 2002), UPS SonicAir® Manager (1995 – 2000).
David A. Barnes Senior Vice President and Chief Information Officer	50	Senior Vice President and Chief Information Officer (2005 – present), Corporate IS Portfolio Coordinator (2001 – 2004), CIM Process Manager (1998 – 2001).
John J. Beystehner Senior Vice President, Chief Operating Officer and President — UPS Airlines	54	Chief Operating Officer and President — UPS Airlines (2004 – present), Director (2005 – present), Senior Vice President (1999 – present), Marketing Group Manager (2001 – 2003), Worldwide Sales Group Manager (1997 – 2003).
D. Scott Davis Senior Vice President, Chief Financial Officer and Treasurer	54	Senior Vice President, Chief Financial Officer and Treasurer (2001 – present), Director (2006 – present), Vice President — Finance (2000 – 2001), Chief Executive Officer of Overseas Partners Ltd. (1999 – 2000).
Michael L. Eskew Chairman and Chief Executive Officer	56	Chairman and Chief Executive Officer (2002 – present), Vice Chairman (2000 – 2001), Executive Vice President (1999 – 2001), Director (1998 – present), Corporate Development Group Manager (1999 – 2000), Senior Vice President (1996 – 1999), Engineering Group Manager (1996 – 2000).
Allen E. Hill Senior Vice President	50	Senior Vice President and Human Resources and Public Affairs Group Manager (2006 – present), Senior Vice President, Secretary and Legal and Public Affairs Group Manager (2004 – 2006), Corporate Legal Department Manager (1995 – 2004).

Name and Office	Age	Principal Occupation and Employment For the Last Five Years
Kurt P. Kuehn Senior Vice President	51	Senior Vice President and Worldwide Sales and Marketing Group Manager (2004 – present), Vice President, Investor Relations (1999 – 2003).
John J. McDevitt Senior Vice President	47	Senior Vice President, Transportation Group Manager and Labor Relations Group Manager (2005 – present), Senior Vice President, Strategic Integration (2003 – 2005), Air Region Manager (2001 – 2002), Corporate Labor Relations Manager (1997 – 2000).
Teri P. McClure Senior Vice President and Secretary	42	Senior Vice President, General Counsel and Secretary (2006 – present), Corporate Legal Department Manager (2005 – 2006), District Manager (2003 – 2005), and Vice President (1999 – 2003).
Christine M. Owens Senior Vice President	50	Senior Vice President, Communications and Brand Group Manager (2005 – present), Corporate Transportation Group Manager (2004 – 2005), and Region Manager (1997 – 2004).
Robert E. Stoffel Senior Vice President	50	Senior Vice President of Supply Chain Group (2004 – present), President, UPS Supply Chain Solutions, Inc. (2002 – 2003), Vice President, UPS Logistics Group, Inc. (2000 – 2002), Department Manager (1995 – 2000).
James F. Winestock Senior Vice President	54	Senior Vice President and U.S. Operations Manager (2004 – present), Region Manager (1998 – 2003).

Item 1A. *Risk Factors*

Information about risk factors can be found in Item 7 of this report under the caption “Risk Factors”.

Item 1B. *Unresolved Staff Comments*

Not applicable.

Item 2. *Properties*

Operating Facilities

We own our headquarters, which are located in Atlanta, Georgia and consist of about 735,000 square feet of office space on an office campus, and our UPS Supply Chain Solutions group’s headquarters, which are located in Alpharetta, Georgia and consist of about 310,000 square feet of office space.

We also own our 27 principal U.S. package operating facilities, which have floor spaces that range from about 310,000 to 693,000 square feet. In addition, we have a 1.9 million square foot operating facility near Chicago, Illinois, which is designed to streamline shipments between East Coast and West Coast destinations, and we own or lease over 1,000 additional smaller package operating facilities in the U.S. The smaller of these facilities have vehicles and drivers stationed for the pickup of packages and facilities for the sorting, transfer and delivery of packages. The larger of these facilities also service our vehicles and equipment and employ specialized mechanical installations for the sorting and handling of packages.

We own or lease almost 600 facilities that support our international package operations and over 1,000 facilities that support our freight forwarding and logistics operations. Our freight forwarding and logistics operations maintain facilities with about 35 million square feet of floor space. We own and operate a logistics campus consisting of approximately 3.5 million square feet in Louisville, Kentucky.

UPS Freight operates over 200 service centers with a total of 4.3 million square feet of floor space. UPS Freight owns 170 of these service centers, while the remainder are occupied under operating lease agreements.

Our aircraft are operated in a hub and spokes pattern in the U.S. Our principal air hub in the U.S., known as Worldport, is located in Louisville, KY. The Worldport facility consists of over 3.5 million square feet and the site includes approximately 350 acres. We are able to sort over 300,000 packages per hour in the Worldport facility. We also have regional air hubs in Columbia, SC; Dallas, TX; Dayton, OH; Hartford, CT; Ontario, CA; Philadelphia, PA; and Rockford, IL. These hubs house facilities for the sorting, transfer and delivery of packages. In February 2005, we announced our intention to transfer operations currently taking place at the former Menlo Worldwide Forwarding air freight facility in Dayton, OH to other UPS facilities, including a facility consisting of approximately 715,000 square feet in Louisville and five regional air freight facilities in Ontario, CA; Rockford, IL; Dallas, TX; Philadelphia, PA; and Columbia, SC. Each of these facilities is under construction and is expected to be completed in 2006. Our European air hub is located in Cologne, Germany, and our Asia-Pacific air hub is located in Taipei, Taiwan. Our intra-Asia air hub is located at Clark Air Force Base in Pampanga, Philippines, and our regional air hub in Canada is located in Hamilton, Ontario.

Our computer operations are consolidated in a 435,000 square foot owned facility, the Ramapo Ridge facility, which is located on a 39-acre site in Mahwah, New Jersey. We also own a 175,000 square foot facility located on a 25-acre site in Alpharetta, Georgia, which serves as a backup to the main computer operations facility in New Jersey. This facility provides production functions and backup capacity in the event that a power outage or other disaster incapacitates the main data center. It also helps us to meet communication needs.

We believe that our facilities are adequate to support our current operations.

Fleet

Aircraft

The following table shows information about our aircraft fleet as of December 31, 2005:

Description	Owned and Capital Leases	Short-term Leased or Chartered From Others	On Order	Under Option
McDonnell-Douglas DC-8-71	21	—	—	—
McDonnell-Douglas DC-8-73	26	—	—	—
Boeing 727-100	32	—	—	—
Boeing 727-200	2	—	—	—
Boeing 747-100	8	—	—	—
Boeing 747-200	4	—	—	—
Boeing 747-400F	—	—	8	—
Boeing 747-400SF	—	—	2	—
Boeing 757-200	75	—	—	—
Boeing 767-300	32	—	—	—
Boeing MD-11	21	—	13	—
Airbus A300-600	47	—	6	—
Airbus A380-800	—	—	10	10
Other	—	309	—	—
Total	268	309	39	10

We maintain an inventory of spare engines and parts for each aircraft.

All of the aircraft we own meet Stage III federal noise regulations and can operate at airports that have aircraft noise restrictions. We became the first major airline to successfully operate a 100% Stage III fleet more than three years in advance of the date required by federal regulations.

During 2005, we took delivery of six Boeing MD-11 aircraft and seven Airbus A300-600 aircraft. The final six firm Airbus A300-600 aircraft are scheduled for delivery by July 2006. We have firm commitments to purchase 13 Boeing MD-11 aircraft, and we expect to take delivery of these aircraft during 2006 and 2007. In 2005, we made firm commitments to purchase eight Boeing 747-400F aircraft scheduled for delivery during 2007 and 2008, and two Boeing 747-400SF aircraft scheduled for delivery during 2008. In addition, we have a firm commitment to purchase 10 Airbus A380 aircraft and options to purchase 10 additional A380 aircraft. The A380 aircraft deliveries are scheduled between 2009 and 2012. These aircraft purchase orders will provide for the replacement of existing capacity and anticipated future growth.

Vehicles

We operate a ground fleet of approximately 98,000 package cars, vans, tractors and motorcycles.

Our ground support fleet consists of over 26,000 pieces of equipment designed specifically to support our aircraft fleet, ranging from non-powered container dollies and racks to powered aircraft main deck loaders and cargo tractors. We also have about 41,000 containers used to transport cargo in our aircraft.

Safety

We promote safety throughout our operations.

Our Automotive Fleet Safety Program is built with the following components:

- *Selection.* Five out of every six drivers come from our part-time ranks. Therefore, many of our new drivers are familiar with our philosophies, policies, practices and training programs.
- *Training.* Training is the cornerstone of our Fleet Safety Program. Our approach starts with training the trainer. All trainers are certified to ensure that they have the skills and motivation to effectively train novice drivers. A new driver’s employment includes five hours of classroom training and 15 hours of on-road training, followed by three safety training rides integrated into his or her training cycle.
- *Responsibility.* Our operations managers are responsible for their drivers’ safety records. We investigate every accident. If we determine that an accident could have been prevented, we retrain the driver.
- *Preventive Maintenance.* An integral part of our Fleet Safety Program is a comprehensive Preventive Maintenance Program. Our fleet is tracked by computer to ensure that each vehicle is serviced before a breakdown or accident is likely to occur.
- *Honor Plan.* A well-defined safe driver honor plan recognizes and rewards our drivers when they achieve success. We have over 3,600 drivers who have driven for 25 years or more without an avoidable accident.

Our workplace safety program is built upon a comprehensive health and safety process. The foundation of this process is our employee-management health and safety committees. The workplace safety process focuses on employee conditioning and safety-related habits. Our employee co-chaired health and safety committees complete comprehensive facility audits and injury analyses, and recommend facility and work process changes.

Item 3. *Legal Proceedings*

We were named as a defendant in twenty-six now-dismissed lawsuits that sought to hold us liable for the collection of premiums for reinsured excess value ("EV") insurance in connection with package shipments since 1984. These actions were all filed after an August 9, 1999 U.S. Tax Court decision that the U.S. Court of Appeals for the Eleventh Circuit later reversed. These twenty-six cases were consolidated for pre-trial purposes in a multi-district litigation proceeding ("MDL Proceeding") in federal court in New York. In addition to the cases in which UPS was named as a defendant, there also was an action, Smith v. Mail Boxes Etc., against Mail Boxes Etc. and its franchisees relating to UPS EV insurance and related services purchased through Mail Boxes Etc. centers. That case also was consolidated into the MDL Proceeding.

In late 2003, the parties reached a global settlement resolving all claims and all cases in the MDL Proceeding. In reaching the settlement, we and the other defendants expressly denied any and all liability. On July 30, 2004, the court issued an order granting final approval to the substantive terms of the settlement. No appeals were filed and the settlement became effective on September 8, 2004.

Pursuant to the settlement, UPS provided qualifying settlement class members with vouchers toward the purchase of specified UPS services and agreed to pay the plaintiffs' attorneys' fees and costs. Other defendants contributed to the costs of the litigation and settlement. The vouchers expired in July 2005 and the value of services for which vouchers were redeemed totaled $5 million. On November 2, 2005, the court issued an order awarding plaintiffs' counsel fees and costs in the total amount of $3 million. The settlement did not have a material effect on our financial condition, results of operations, or liquidity.

We are a defendant in a number of lawsuits filed in state and federal courts containing various class-action allegations under state wage-and-hour laws. In one of these cases, Marlo v. UPS, which has been certified as a class action in a California federal court, plaintiffs allege that they improperly were denied overtime, and seek penalties for missed meal and rest periods, and interest and attorneys' fees. Plaintiffs purport to represent a class of 1,200 full-time supervisors.

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

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

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

None

PART II

Item 5. ***Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Our Class A common stock is not listed on a national securities exchange or traded in an organized over-the-counter market, but each share of our Class A common stock is convertible into one share of our Class B common stock.

The following is a summary of our Class B common stock price activity and dividend information for 2005 and 2004. Our Class B common stock is listed on the New York Stock Exchange under the symbol "UPS."

	High	Low	Close	Dividends Declared
2005:				
First Quarter	$85.84	$71.59	$72.74	$0.33
Second Quarter	$75.88	$66.80	$69.16	$0.33
Third Quarter	$74.21	$66.75	$69.13	$0.33
Fourth Quarter	$79.97	$66.90	$75.15	$0.33
2004:				
First Quarter	$74.46	$67.51	$69.84	$0.28
Second Quarter	$75.26	$68.57	$75.17	$0.28
Third Quarter	$76.00	$69.15	$75.92	$0.28
Fourth Quarter	$87.70	$75.76	$85.46	$0.28

As of February 21, 2006, there were 171,893 and 16,611 record holders of Class A and Class B common stock, respectively.

The policy of our Board of Directors is to declare dividends each year out of current earnings. The declaration of future dividends is subject to the discretion of the Board of Directors in light of all relevant facts, including earnings, general business conditions and working capital requirements.

On February 9, 2006, our Board declared a dividend of $0.38 per share, which was payable on March 7, 2006 to shareowners of record on February 21, 2006.

In August 2005, the Board of Directors authorized an increase in our share repurchase program of $2.0 billion. This amount was in addition to the remaining authority available under the previously authorized $2.0 billion share repurchase program approved in October 2004. As of December 31, 2005, we had a total of $1.338 billion in remaining authority available under our share repurchase program. Unless terminated earlier by the resolution of our Board, the program will expire when we have purchased all shares authorized for repurchase under the program.

A summary of repurchases of our Class A and Class B common stock during the fourth quarter of 2005 is as follows (in millions, except per share amounts):

	Total Number of Shares Purchased(1)	Average Price Paid Per Share(1)	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program
October 1 – October 31, 2005	2.1	$69.88	2.0	$1,722
November 1 – November 30, 2005	2.0	75.35	1.9	1,578
December 1 – December 31, 2005	3.2	76.17	3.2	1,338
Total October 1 – December 31, 2005	7.3	$74.15	7.1	$1,338

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

Item 6. *Selected Financial Data*

The following table sets forth selected financial data for each of the five years in the period ended December 31, 2005 (amounts in millions, except per share amounts). This financial data should be read together with our consolidated financial statements and related notes, Management's Discussion and Analysis of Financial Condition and Results of Operations, and other financial data appearing elsewhere in this report.

	Years Ended December 31,				
	2005	2004	2003	2002	2001
Selected Income Statement Data					
Revenue:					
U.S. Domestic Package	$28,610	$26,960	$25,362	$24,280	$24,391
International Package	7,977	6,809	5,609	4,720	4,280
Supply Chain and Freight	5,994	2,813	2,514	2,272	1,650
Total revenue	42,581	36,582	33,485	31,272	30,321
Operating expenses:					
Compensation and benefits	22,517	20,823	19,251	17,849	17,311
Other	13,921	10,770	9,789	9,327	9,048
Total operating expenses	36,438	31,593	29,040	27,176	26,359
Operating profit (loss):					
U.S. Domestic Package	4,493	3,702	3,657	3,925	3,969
International Package	1,494	1,149	732	338	139
Supply Chain and Freight	156	138	56	(167)	(146)
Total operating profit	6,143	4,989	4,445	4,096	3,962
Other income (expense):					
Investment income	104	82	18	63	159
Interest expense	(172)	(149)	(121)	(173)	(184)
Gain on redemption of long-term debt	—	—	28	—	—
Reversal of tax assessment	—	—	—	1,023	—
Income before income taxes	6,075	4,922	4,370	5,009	3,937
Income taxes	(2,205)	(1,589)	(1,472)	(1,755)	(1,512)
Cumulative effect of changes in accounting principles	—	—	—	(72)	(26)
Net income	$ 3,870	$ 3,333	$ 2,898	$ 3,182	$ 2,399
Per share amounts:					
Basic earnings per share	$ 3.48	$ 2.95	$ 2.57	$ 2.84	$ 2.13
Diluted earnings per share	$ 3.47	$ 2.93	$ 2.55	$ 2.81	$ 2.10
Dividends declared per share	$ 1.32	$ 1.12	$ 0.92	$ 0.76	$ 0.76
Weighted average shares outstanding:					
Basic	1,113	1,129	1,128	1,120	1,126
Diluted	1,116	1,137	1,138	1,134	1,144

	As of December 31,				
	2005	2004	2003	2002	2001
Selected Balance Sheet Data					
Cash and marketable securities	$ 3,041	$ 5,197	$ 3,952	$ 3,014	$ 1,616
Total assets	35,222	33,088	29,734	26,868	24,636
Long-term debt	3,159	3,261	3,149	3,495	4,648
Shareowners' equity	16,884	16,378	14,852	12,455	10,248

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

Operations

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

	Year Ended December 31,		Change	
	2005	2004	$	%
Revenue (in millions):				
U.S. Domestic Package:				
Next Day Air	$ 6,381	$ 6,084	$ 297	4.9%
Deferred	3,258	3,193	65	2.0
Ground	18,971	17,683	1,288	7.3
Total U.S. Domestic Package	28,610	26,960	1,650	6.1
International Package:				
Domestic	1,588	1,346	242	18.0
Export	5,856	4,991	865	17.3
Cargo	533	472	61	12.9
Total International Package	7,977	6,809	1,168	17.2
Supply Chain and Freight:				
Forwarding Services and Logistics	4,737	2,379	2,358	99.1
UPS Freight	797	—	797	N/A
Other	460	434	26	6.0
Total Supply Chain and Freight	5,994	2,813	3,181	113.1
Consolidated	$42,581	$36,582	$5,999	16.4%
Average Daily Package Volume (in thousands):			#	
U.S. Domestic Package:				
Next Day Air	1,228	1,194	34	2.8%
Deferred	946	910	36	4.0
Ground	11,044	10,676	368	3.4
Total U.S. Domestic Package	13,218	12,780	438	3.4
International Package:				
Domestic	916	815	101	12.4
Export	616	541	75	13.9
Total International Package	1,532	1,356	176	13.0
Consolidated	14,750	14,136	614	4.3%
Operating days in period	254	254		
Average Revenue Per Piece:			$	
U.S. Domestic Package:				
Next Day Air	$ 20.46	$ 20.06	$ 0.40	2.0%
Deferred	13.56	13.81	(0.25)	(1.8)
Ground	6.76	6.52	0.24	3.7
Total U.S. Domestic Package	8.52	8.31	0.21	2.5
International Package:				
Domestic	6.83	6.50	0.33	5.1
Export	37.43	36.32	1.11	3.1
Total International Package	19.13	18.40	0.73	4.0
Consolidated	$ 9.62	$ 9.27	$ 0.35	3.8%

	Year Ended December 31, 2004	2003	Change $	%
Revenue (in millions):				
U.S. Domestic Package:				
Next Day Air	$ 6,084	$ 5,621	$ 463	8.2%
Deferred	3,193	3,015	178	5.9
Ground	17,683	16,726	957	5.7
Total U.S. Domestic Package	26,960	25,362	1,598	6.3
International Package:				
Domestic	1,346	1,134	212	18.7
Export	4,991	4,049	942	23.3
Cargo	472	426	46	10.8
Total International Package	6,809	5,609	1,200	21.4
Supply Chain and Freight:				
Forwarding Services and Logistics	2,379	2,126	253	11.9
UPS Freight	—	—	—	—
Other	434	388	46	11.9
Total Supply Chain and Freight	2,813	2,514	299	11.9
Consolidated	$36,582	$33,485	$3,097	9.2%
Average Daily Package Volume (in thousands):			#	
U.S. Domestic Package:				
Next Day Air	1,194	1,185	9	0.8%
Deferred	910	918	(8)	(0.9)
Ground	10,676	10,268	408	4.0
Total U.S. Domestic Package	12,780	12,371	409	3.3
International Package:				
Domestic	815	786	29	3.7
Export	541	481	60	12.5
Total International Package	1,356	1,267	89	7.0
Consolidated	14,136	13,638	498	3.7%
Operating days in period	254	252		
Average Revenue Per Piece:			$	
U.S. Domestic Package:				
Next Day Air	$ 20.06	$ 18.82	$ 1.24	6.6%
Deferred	13.81	13.03	0.78	6.0
Ground	6.52	6.46	0.06	0.9
Total U.S. Domestic Package	8.31	8.14	0.17	2.1
International Package:				
Domestic	6.50	5.73	0.77	13.4
Export	36.32	33.40	2.92	8.7
Total International Package	18.40	16.23	2.17	13.4
Consolidated	$ 9.27	$ 8.89	$ 0.38	4.3%

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

	Year Ended December 31,		Change	
	2005	2004	$	%
LTL revenue (in millions)	$ 690	—	$ 690	N/A
LTL revenue per LTL hundredweight	$17.35	—	$17.35	N/A
LTL shipments (in thousands)	4,126	—	4,126	N/A
LTL shipments per day (in thousands)	41	—	41	N/A
LTL gross weight hauled (in millions of pounds)	3,978	—	3,978	N/A
LTL weight per shipment	964	—	964	N/A

Overnite Corp., now known as UPS Freight, was acquired on August 5, 2005. The information presented above reflects the performance of Overnite for the period subsequent to the date of acquisition.

Operating Profit and Operating Margin

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

	Year Ended December 31,		Change	
	2005	2004	$	%
Reporting Segment				
U.S. Domestic Package	$4,493	$3,702	$ 791	21.4%
International Package	1,494	1,149	345	30.0
Supply Chain & Freight	156	138	18	13.0
Consolidated Operating Profit	$6,143	$4,989	$1,154	23.1%

	Year Ended December 31,		Change	
	2004	2003	$	%
Reporting Segment				
U.S. Domestic Package	$3,702	$3,657	$ 45	1.2%
International Package	1,149	732	417	57.0
Supply Chain & Freight	138	56	82	146.4
Consolidated Operating Profit	$4,989	$4,445	$ 544	12.2%

	Year Ended December 31,		
	2005	2004	2003
Reporting Segment			
U.S. Domestic Package	15.7%	13.7%	14.4%
International Package	18.7%	16.9%	13.1%
Supply Chain & Freight	2.6%	4.9%	2.2%
Consolidated Operating Margin	14.4%	13.6%	13.3%

U.S. Domestic Package Operations

2005 compared to 2004

U.S. Domestic Package revenue increased $1.650 billion, or 6.1%, for the year, primarily due to a 3.4% increase in average daily package volume and a 2.5% increase in revenue per piece. Ground volume grew 3.4%, and was positively impacted by a solid U.S. economy and our focus on middle market sales initiatives. Next Day Air volume grew 2.8% and deferred volume increased 4.0%, with growth in the manufacturing, business services, telecommunications and retail sectors. The growth in total U.S. Domestic Package volume strengthened throughout the year.

Ground revenue per piece increased 3.7% for the year, primarily due to the impact of a rate increase that took effect in 2005, as well as the implementation of a fuel surcharge on ground products. Next Day Air revenue per piece increased 2.0% for the year, primarily due to the rate increase and an increased fuel surcharge rate in 2005 compared to 2004. Next Day Air revenue per piece was adversely affected by relatively higher growth in our Saver product. Both Next Day Air and deferred revenue per piece were adversely affected by lighter average package weights.

On January 3, 2005, a rate increase took effect which was in line with previous years' rate increases. We increased rates 2.9% on UPS Next Day Air, UPS 2nd Day Air, UPS 3 Day Select, and UPS Ground. Other pricing changes included an increase of $0.25 for delivery area surcharge on both residential and commercial services to certain ZIP codes. The residential surcharge increased $0.10 for UPS Ground services and $0.35 for UPS Next Day Air, UPS 2nd Day Air and UPS 3 Day Select.

In January 2005, we modified the fuel surcharge on domestic air services by setting a maximum cap of 9.50%, which was increased to 12.50% effective in October 2005. This fuel surcharge continues to be based on the U.S. Energy Department's Gulf Coast spot price for a gallon of kerosene-type jet fuel. Based on published rates, the average fuel surcharge on domestic air products was 10.23% in 2005, as compared with 7.07% in 2004. Additionally, an initial fuel surcharge of 2.00% was applied to UPS Ground services in January 2005, which fluctuates based on the U.S. Energy Department's On-Highway Diesel Fuel Price. Based on published rates, the average fuel surcharge on domestic ground products was 2.90% in 2005. Total domestic fuel surcharge revenue increased by $683 million for the year, due to higher jet and diesel fuel prices, volume increases, and the modifications to our fuel surcharges noted above. These fuel surcharges are used to provide some protection against the increased fuel expense that we incur due to higher fuel prices, as well as the increased purchased transportation expense which is also affected by higher fuel prices.

U.S. Domestic Package operating profit increased $791 million, or 21.4%, for the year, and domestic operating margin increased by 200 basis points. Operating profit increased by $274 million due to a change in our Management Incentive Awards program (discussed below in "Operating Expenses"), which also favorably impacted the operating margin. The remaining increase in operating profit and margin resulted from the revenue growth described previously, as well as controlled growth of operating expenses.

2004 compared to 2003

U.S. Domestic Package revenue increased $1.598 billion, or 6.3%, for the year, which resulted from a 3.3% increase in average daily package volume and a 2.1% increase in revenue per piece. Ground volume increased 4.0% during the year, driven in part by the improving U.S. economy, and reflects growth in both commercial and residential deliveries. Ground volume increased 4.8% during the first nine months of the year, but slowed to 1.5% during the fourth quarter. Total Next Day Air volume (up 0.8%) and total deferred volume (down 0.9%) were both significantly affected by declines in letter volume, but offset by an increase in Next Day Air package volume. The 2004 decline in Next Day Air and deferred letter volume is largely due to the slowdown in mortgage refinancing, which was notably strong in 2003.

Ground revenue per piece increased 0.9% for the year primarily due to the impact of a rate increase that took effect in 2004, but growth was adversely impacted by approximately 130 basis points due to the removal of the fuel surcharge on ground products, as discussed below. Next Day Air revenue per piece increased 6.6%, while deferred revenue per piece increased 6.0%, primarily due to the shift in product mix from letters to packages, the rate increase, and the modified fuel surcharge on domestic air products.

On January 5, 2004, we increased rates for standard ground shipments by an average of 1.9% for commercial deliveries. The ground residential surcharge increased $0.25 to $1.40 over the commercial ground rate. An additional delivery area surcharge of $1.00 was implemented for commercial deliveries in certain ZIP codes. Rates for UPS Hundredweight increased 5.9%. In addition, we increased rates for UPS Next Day Air an average of 2.9% and increased rates for deferred services by 2.9%.

In addition, in 2004 we discontinued the fuel surcharge on ground products, while we began to apply a new indexed surcharge to domestic air products. This indexed fuel surcharge for the domestic air products is based on the U.S. Energy Department's Gulf Coast spot price for a gallon of kerosene-type jet fuel. Based on published rates, the average fuel surcharge applied to our air products during 2004 was 7.07%, compared with the average surcharge of 1.47% applied to both air and ground products in 2003, resulting in an increase in domestic fuel surcharge revenue of $290 million during the year.

U.S. Domestic Package operating profit increased $45 million, or 1.2%, primarily due to the increase in volume and revenue growth discussed previously, but was somewhat offset by increased aircraft impairment charges ($91 million in 2004 compared to $69 million in 2003) and a $63 million pension charge related to the consolidation of data systems used to collect and accumulate plan participant data. Domestic operating margin declined 70 basis points, and was impacted by the aircraft impairment and pension charges noted above, as well as the sale of our Aviation Technologies business unit.

During the third quarter of 2003, we sold our Aviation Technologies business unit and recognized a pre-tax gain of $24 million ($15 million after-tax, or $0.01 per diluted share), which is recorded in other operating expenses within the U.S. Domestic Package segment. The operating results of the Aviation Technologies unit were previously included in our U.S. Domestic Package segment, and were not material to our consolidated operating results in any of the periods presented.

International Package Operations

2005 compared to 2004

International Package revenue improved $1.168 billion, or 17.2%, for the year, primarily due to the 13.9% volume growth for our export products and revenue per piece improvements. The improvements in revenue per piece were impacted by rate changes, currency fluctuations, and the fuel surcharge applied to international shipments. Revenue increased $121 million during the year due to currency fluctuations, net of hedging activity, and also increased by $133 million during the year due to business acquisitions.

In January 2005, we increased rates 2.9% for international shipments originating in the United States, which includes our Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard services. Rate changes for international shipments originating outside the United States vary by geographical market and occur throughout the year.

In January 2005, we modified the fuel surcharge on U.S. export products by setting a maximum cap of 9.50%, which was increased to 12.50% effective in October 2005. The fuel surcharge for products originating outside the United States continues to be indexed to fuel prices in our different international regions, depending upon where the shipment takes place. Total international fuel surcharge revenue increased by $258 million during the year, due to higher jet fuel prices and increased international air volume.

Export volume increased throughout the world, with strong growth in Asia and Europe. Asian export volume, which increased 29% for the year, was driven by export growth from China. Asian export volume continues to benefit from our expanding international delivery network, including the additional flights from Shanghai, China that were added in the fourth quarter of 2004, and express air service between the U.S. and Guangzhou, China that began in the second quarter of 2005. European export volume increased 13% for the year, while export volume from the U.S. and Americas also showed solid increases. International domestic volume increased 12.4% for the year, due to volume growth in Canada and Europe, which also benefited from the acquisition of Messenger Service Stolica S.A. in Poland during the second quarter of 2005 and Lynx Express Ltd. in the United Kingdom in the third quarter of 2005. Excluding the impact of acquisitions, international domestic volume increased 3.7%.

Export revenue per piece increased 3.1% for the year (1.4% currency-adjusted), due to the rate increases discussed previously and the impact of the fuel surcharge, but was adversely affected by relatively higher growth in lower revenue per piece transborder product. In total, international average daily package volume increased 13.0% and average revenue per piece increased 4.0% (2.4% currency-adjusted).

The improvement in operating profit for our International Package operations was $345 million for the year, or 30.0%, with an increase in the operating margin of 180 basis points. This increase in operating profit and margin was positively impacted by the strong volume growth described previously, as well as better network utilization due to volume growth and geographic service expansion. The increase in operating profit was also favorably affected by $78 million due to the impact of currency fluctuations on revenue and expense (net of hedging activity), and by $45 million due to a change in our Management Incentive Awards program (discussed below in “Operating Expenses”). Operating profit was negatively affected in 2005 by $23 million in currency repatriation losses, as compared with repatriation gains of $32 million in 2004.

2004 compared to 2003

International Package revenue improved $1.200 billion, or 21.4%, for the year primarily due to the 12.5% volume growth for our export products and strong revenue per piece improvements. Revenue increased $295 million during the year due to currency fluctuations. Revenue growth was also impacted by the change to our fuel surcharge (discussed below) as well as rate changes, which vary by geographical market and occur throughout the year. Rates for international shipments originating in the United States (Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard service) increased an average of 3.5%.

In January 2004, changes were made to the calculation of our fuel surcharge on international products (including U.S. export products). The surcharge began to be indexed to fuel prices in our different international regions, depending on where the shipment takes place. The surcharge began to be applied only to our international express products, while the previous surcharge was applied to all international products. These changes, along with higher fuel prices, had the effect of increasing International Package revenue by $231 million during the year.

We experienced double-digit export volume growth in each region throughout the world, with the Asia-Pacific region leading with 24% export volume growth, including a 101% increase in China export volume. Export volume continued to benefit from our expanding international network, such as the six additional flights to Shanghai, China that were added in the fourth quarter of 2004. European export volume grew in excess of 10%, and was positively influenced by the addition of 10 countries to the European Union during the year. Non-U.S. domestic volume increased 3.7% for the year, and primarily reflected improvements in our European and Canadian domestic delivery businesses.

Export revenue per piece increased 8.7% for the year (2.9% currency-adjusted), benefiting from rate increases and the impact of the fuel surcharge. In total, international average daily package volume increased 7.0% and average revenue per piece increased 13.4% (6.5% currency-adjusted).

The improvement in operating profit for our International Package operations was $417 million, or 57.0%, for the year, $54 million of which was due to favorable currency fluctuations. The remaining increase in operating profit was primarily due to the solid export volume growth and revenue per piece increases described previously, and a strong 380 basis point increase in operating margin primarily due to better network utilization. International operating profit was adversely affected by aircraft impairment charges of $19 million in 2004, compared to a $6 million charge in 2003.

Supply Chain & Freight Operations

2005 compared to 2004

Supply Chain & Freight revenue increased $3.181 billion, or 113.1%, for the year. Forwarding services and logistics revenue increased by $2.358 billion during the year, largely due to the acquisition of Menlo Worldwide Forwarding in December 2004. The growth in our existing forwarding services and logistics businesses (excluding Menlo Worldwide Forwarding) was driven by solid growth in our ocean and ground forwarding operations. Revenue increased by $17 million during the year due to favorable currency fluctuations. Overall growth continues to benefit from the expansion of our freight forwarding network throughout the world, as well as the increase in global trade and the increased outsourcing of manufacturing and distribution.

During the third quarter of 2005, we completed our acquisition of Overnite Corp., now known as UPS Freight, which offers a variety of less-than-truckload (LTL) and truckload services to customers in North America. Overnite's results have been included in the Supply Chain & Freight reporting segment since the August 5, 2005 acquisition date. Overnite generally reported improvements in its operating performance measures in the post-acquisition period versus the same period a year ago when it was not a part of UPS, including improvements in average daily LTL shipments and average LTL revenue per LTL hundredweight.

The other businesses within Supply Chain & Freight, which include our retail franchising business, our mail and consulting services, and our financial business, increased revenue by 6.0% during the year. This revenue growth was primarily due to increased revenue at our mail and financial services units.

Operating profit for the Supply Chain & Freight segment increased by $18 million, or 13.0%, for the year, largely due to the operating profits generated by Overnite. Operating profit and margin were negatively affected by operating losses incurred in the acquired Menlo Worldwide Forwarding operations, as well as costs incurred in integrating this business into our existing forwarding services business. Currency fluctuations positively affected operating profit by $4 million during the year. Operating profit also was favorably impacted by $15 million due to a change in our Management Incentive Awards program (discussed below in "Operating Expenses").

2004 compared to 2003

Supply Chain & Freight revenue increased $299 million, or 11.9%, for the year. Freight services and logistics revenue increased by 11.9% during the year, with strong growth in our air and ground freight forwarding businesses, as well as our logistics business. The acquisition of Menlo Worldwide Forwarding, which was completed in December 2004, increased freight services and logistics revenue by $33 million. Favorable currency fluctuations provided $73 million of the increase in revenue for the year. The other businesses within Supply Chain & Freight, which includes our retail franchising business, our mail and consulting services, and our financial business, increased revenue by 11.9% for the year, largely due to strong double-digit franchise and royalty revenue growth at our retail franchising business resulting from an expanding store base.

Supply Chain & Freight operating profit increased $82 million, or 146.4%, and operating margin increased by 270 basis points for the year, primarily due to improved results from our financial business (largely due to a lower loan loss provision), and our mail services business, which was affected in 2003 by the sale of our Mail Technologies business unit as described in the next paragraph. Our retail franchising business also experienced profit growth, due to the increased franchise and royalty revenue noted previously. These increases were partially offset by somewhat lower profits at our freight services and logistics operations.

During the second quarter of 2003, we sold our Mail Technologies business unit in a transaction that increased net income by $14 million, or $0.01 per diluted share. The gain consisted of a pre-tax loss of $24 million recorded in other operating expenses within the Supply Chain & Freight segment, and a tax benefit of $38 million recognized in conjunction with the sale. The tax benefit exceeded the pre-tax loss from this sale primarily because the goodwill impairment charge we previously recorded for the Mail Technologies business unit was not deductible for income tax purposes. Consequently, our tax basis was greater than our book basis, thus producing the tax benefit described above. The operating results of the Mail Technologies unit were previously included in our Supply Chain & Freight segment, and were not material to our consolidated operating results in any of the periods presented.

Operating Expenses

2005 compared to 2004

Consolidated operating expenses increased by $4.845 billion, or 15.3%, for the year, and were significantly impacted by the acquisitions of Menlo Worldwide Forwarding and Overnite. Operating expenses also increased $56 million for the year due to the impact on revenue and expense of currency fluctuations (net of hedging activity) in our International Package and Supply Chain & Freight segments, and increased $55 million for the year due to currency repatriation losses in our International Package segment.

Compensation and benefits increased by $1.694 billion, or 8.1%, for the year, largely due to the acquisitions of Menlo Worldwide Forwarding and Overnite, as well as increased health and welfare benefit costs and higher pension expense for our union benefit plans. Stock-based and other management incentive compensation expense decreased $297 million, or 33.4%, in the year, due to a change in our Management Incentive Awards program implemented in 2005, described in the next paragraph, which was partially offset by the impact of prospectively adopting the measurement provisions of FAS 123 beginning with 2003 stock-based compensation awards.

During the first quarter of 2005, we modified our Management Incentive Awards program under our Incentive Compensation Plan to provide that half of the annual award be made in restricted stock units ("RSUs"). The RSUs granted in November 2005 under this program have a five-year graded vesting period, with approximately 20% of the total RSU award vesting at each anniversary date of the grant. The other half of the award granted in November 2005 was in the form of cash and unrestricted shares of Class A common stock and was fully vested at the time of grant. Previous awards under the Management Incentive Awards program were made in common stock that was fully vested in the year of grant. This change had the effect of lowering 2005 expense. As a result, 2005 expense for our Management Incentive Awards program (reported in operating expenses under "compensation and benefits"), including the RSUs, decreased $334 million ($213 million after-tax, or $0.19 per diluted share) compared with 2004.

Other operating expenses increased by $3.151 billion, or 29.3%, for the year, largely due to the Menlo Worldwide Forwarding and Overnite acquisitions, as well as increases in fuel expense and purchased transportation. The 47.2% increase in fuel expense for the year was impacted by higher prices for jet-A, diesel and unleaded gasoline, as well as higher fuel usage, but was partially mitigated with hedging gains. The 96.7% increase in purchased transportation was primarily due to the Menlo Worldwide Forwarding acquisition, but was also influenced by volume growth in our International Package business and higher fuel prices. The 9.2% increase in repairs and maintenance was largely due to higher expense on vehicle parts (partially affected by the Overnite acquisition), airframe and aircraft engine maintenance. The 6.5% increase in depreciation and amortization for the year was impacted by higher depreciation expense on buildings (largely due to acquisitions), aircraft, and capitalized software. The 16.0% increase in other occupancy expense was largely due to higher facilities rent expense in our Supply Chain & Freight segment, which was impacted by the Menlo Worldwide Forwarding acquisition, and increased utilities expense. The 4.5% increase in other expenses was primarily due to the Overnite acquisition, but partially offset by the absence in 2005 of the $110 million aircraft impairment charge that we incurred in 2004.

2004 compared to 2003

Consolidated operating expenses increased by $2.553 billion, or 8.8%, for the year, $311 million of which was due to currency fluctuations in our International Package and Supply Chain & Freight segments. Compensation and benefits increased by $1.572 billion, or 8.2%, for the year, largely due to increased payroll costs, increased health and welfare expense, and higher pension expense for our union pension plans. Stock-based compensation expense increased $167 million, or 23.2%, during the year, primarily as a result of increased Management Incentive Awards expense and adopting the measurement provisions of FAS 123 prospectively beginning with 2003 stock-based compensation awards.

Other operating expenses increased by $981 million, or 10.0%, for the year, largely due to a 34.9% increase in fuel expense and a 12.6% increase in purchased transportation, but were somewhat offset by a decline in depreciation and amortization expense. The increase in fuel expense was primarily due to higher prices for Jet-A, diesel, and unleaded gasoline, in addition to somewhat higher fuel usage and lower hedging gains. The increase in purchased transportation expense was influenced by the impact of currency, higher fuel prices, and volume growth in our international package business. The decline in depreciation and amortization for the year was impacted by lower depreciation expense on aircraft engines, largely due to the retirement of some older aircraft. The increase in repairs and maintenance expense was affected by increased expense on vehicle parts and airframe and engine maintenance. The increase in other occupancy expense was largely related to higher rent expense, but somewhat offset by lower real estate taxes. The increase in other expenses was affected by the $110 million impairment of aircraft, engines, and parts, as well as the $63 million pension charge discussed previously, in addition to higher advertising costs.

Investment Income and Interest Expense

2005 compared to 2004

The increase in investment income of $22 million during the year was primarily due to higher average yields earned caused by the increasing short-term interest rates in the United States, but partially offset by a lower average balance of interest-earning investments, increased equity-method losses on certain investment partnerships, and an investment impairment charge on certain available-for-sale securities. We periodically review our investments for indications of other than temporary impairment considering many factors, including the extent and duration to which a security's fair value has been less than its cost, overall economic and market conditions, and the financial condition and specific prospects for the issuer. After considering these factors, we recorded an impairment charge of $16 million in the fourth quarter of 2005 related to several variable rate preferred securities issued by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC).

The $23 million increase in interest expense for the year was primarily due to higher floating interest rates on variable rate debt and interest rate swaps, as well as higher imputed interest expense associated with certain investment partnerships.

2004 compared to 2003

Investment income increased by $64 million during the year, primarily due to a $58 million impairment charge recognized during 2003. During the first quarter of 2003, after considering the continued decline in the U.S. equity markets, we recognized an impairment charge of $58 million, primarily related to our investment in S&P 500 equity portfolios. Investment income also increased in 2004 due to higher interest rates earned on cash balances, but was somewhat offset by increased equity-method losses on certain investment partnerships.

The $28 million increase in interest expense during 2004 was primarily due to the impact of higher interest rates on variable rate debt and certain interest rate swaps, as well as the impact of currency exchange rates and imputed interest expense associated with certain investment partnerships. The impact of higher interest rates was somewhat offset by lower average debt balances outstanding in 2004 compared to 2003.

In December 2003, we redeemed $300 million in cash-settled convertible senior notes at a price of 102.703, and also terminated the swap transaction associated with the notes. The redemption amount paid was lower than the amount recorded for the fair value of the notes at the time of redemption, which, along with the cash settlement received on the swap, resulted in a $28 million non-operating gain recorded in 2003 results.

Net Income and Earnings Per Share

2005 compared to 2004

Net income for 2005 was $3.870 billion, a 16.1% increase from the $3.333 billion achieved in 2004, resulting in an 18.4% increase in diluted earnings per share to $3.47 in 2005 from $2.93 in 2004. The increase in net income for 2005 was largely due to higher operating profit for both our U.S. Domestic and International Package segments. Net income was adversely impacted by an increase in our effective tax rate to 36.3% in 2005 from 32.3% in 2004. The lower tax rate in 2004 was impacted by credits to income tax expense totaling $142 million ($0.13 per diluted share) related to various items, including the resolution of certain tax matters, the removal of a portion of the valuation allowance on certain deferred tax assets on net operating loss carryforwards, and an adjustment for identified tax contingency items.

Net income in 2004 was adversely impacted by a $70 million after-tax impairment charge ($0.06 per diluted share) on Boeing 727, 747, and McDonnell Douglas DC-8 aircraft, engines, and parts, as well as a $40 million after-tax charge ($0.04 per diluted share) to pension expense resulting from the consolidation of data systems used to collect and accumulate plan participant data.

2004 compared to 2003

2004 net income was $3.333 billion, a 15.0% increase from the $2.898 billion in 2003, resulting in an increase in diluted earnings per share to $2.93 in 2004 from $2.55 in 2003. Net income in 2004 was impacted by the aircraft impairment, pension charge, and tax items discussed previously.

Net income in 2003 was favorably impacted by the $14 million after-tax gain ($0.01 per diluted share) on the sale of Mail Technologies, the $15 million after-tax gain ($0.01 per diluted share) on the sale of Aviation Technologies, and the $18 million after-tax gain ($0.02 per diluted share) recognized upon redemption of our $300 million cash-settled senior convertible notes. Net income in 2003 was adversely impacted by the $37 million after-tax investment impairment charge ($0.03 per diluted share) described previously. Net income in 2003 was also favorably impacted by reductions in income tax expense of $116 million ($0.10 per diluted share) due to the resolution of various tax issues with the IRS, a favorable court ruling on the tax treatment of jet engine maintenance costs, and a lower effective state tax rate.

Liquidity and Capital Resources

Net Cash From Operating Activities

Net cash provided by operating activities was $5.793, $5.331, and $4.576 billion in 2005, 2004, and 2003, respectively. The increase in 2005 operating cash flows compared with 2004 was primarily due to higher net income, but partially offset by higher pension and retirement plan fundings. In 2005, we funded $995 million to our pension and postretirement benefit plans as compared to $585 million in 2004. As discussed in Note 5 to the consolidated financial statements, pension and postretirement health contributions to plan trusts in 2006 are projected to be approximately $828 million. In 2005, we received a $374 million tax refund associated with the 1985-1990 settlement with the Internal Revenue Service (“IRS”) reached previously, primarily on tax matters related to excess value package insurance. In 2004, we received $610 million from a tax settlement with the IRS for tax years 1983-84 and 1991-98.

On November 18, 2005, we announced a rate increase and a change in the fuel surcharge that took effect on January 2, 2006. We increased rates 5.5% on UPS Next Day Air, UPS 2nd Day Air, and UPS 3 Day Select, and

3.9% on UPS Ground. We also increased rates 5.5% for international shipments originating in the United States (Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard service). Other pricing changes include a new charge for undeliverable packages after three delivery attempts and an increase in rates for proof of delivery features for our Delivery Required and Signature Confirmation services. The residential surcharge increased $0.25 for UPS Ground services and $0.35 for UPS Next Day Air, UPS 2nd Day Air and UPS 3 Day Select. These rate changes are customary, and are consistent with previous years' rate increases. Additionally, in January 2006 we modified the fuel surcharge on domestic and international air services by reducing by 2% the index used to determine the fuel surcharge. The air fuel surcharge continues to remain subject to a maximum cap of 12.5%. The UPS Ground fuel surcharge continues to fluctuate based on the U.S. Energy Department's On-Highway Diesel Fuel Price. Rate changes for shipments originating outside the U.S. were made throughout the past year and varied by geographic market.

Net Cash Used In Investing Activities

Net cash used in investing activities was $975 million, $3.638 billion, and $2.742 billion in 2005, 2004, and 2003, respectively. The decrease in 2005 compared with 2004 was primarily due to the net sales of marketable securities and short-term investments to fund business acquisitions and the aforementioned benefit plan contributions. In 2005, we spent $1.488 billion on business acquisitions, primarily Overnite Corp., Lynx Express Ltd. in the United Kingdom, Messenger Service Stolica S.A. in Poland, and the express operations of Sinotrans Air Transportation Development Co. Ltd. in China. In 2004, we spent $238 million on business acquisitions, primarily Menlo Worldwide Forwarding, Inc. and the 49% minority interest in Yamato Express Co. in Japan (See Note 7). We expect to make additional payments related to business acquisitions of approximately $50 million during 2006, primarily related to the Sinotrans transaction. We generated cash of $95 and $318 million in 2005 and 2004, respectively, due to the sales and customer paydowns of finance receivables, primarily in our leasing, asset-based lending, and receivable factoring businesses.

Capital expenditures represent a primary use of cash in investing activities, as follows (in millions):

	2005	2004	2003
Buildings and facilities	$ 495	$ 547	$ 451
Aircraft and parts	874	829	1,019
Vehicles	456	393	161
Information technology	362	358	316
	$2,187	$2,127	$1,947

As described in the "Commitments" section below, we have commitments for the purchase of aircraft, vehicles, equipment and other fixed assets to provide for the replacement of existing capacity and anticipated future growth. We fund our capital expenditures with our cash from operations.

Net Cash Used In Financing Activities

Net cash used in financing activities was $4.175, $2.014, and $2.110 billion in 2005, 2004, and 2003, respectively. Our primary uses of cash in financing activities have been to repurchase stock, pay dividends, and repay long-term debt. In August 2005, the Board of Directors authorized an additional $2.0 billion for future share repurchases, in addition to the amount remaining under our October 2004 share repurchase authorization. We repurchased a total of 33.9 million shares of Class A and Class B common stock for $2.479 billion in 2005, and 18.1 million shares for $1.310 billion in 2004. As of December 31, 2005, we had $1.338 billion of our share repurchase authorization remaining.

We increased our quarterly cash dividend payment to $0.33 per share in 2005 from $0.28 per share in 2004, resulting in an increase in total cash dividends paid to $1.391 billion from $1.208 billion. 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 expect to continue the practice of paying regular cash dividends.

During 2005, we repaid $589 million in debt, primarily consisting of paydowns of commercial paper, scheduled principal payments on capital lease obligations, and repayments of debt that was previously assumed with the acquisitions of Lynx Express Ltd. and Overnite Corp. Issuances of debt were $128 million in 2005, and consisted primarily of loans related to our investment in certain equity-method real estate partnerships. 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.

Sources of Credit

We maintain two commercial paper programs under which we are authorized to borrow up to $7.0 billion in the United States. We had $739 million outstanding under these programs as of December 31, 2005, with an average interest rate of 4.01%. The entire balance outstanding has been classified as a current liability in our balance sheet. We also maintain a European commercial paper program under which we are authorized to borrow up to €1.0 billion in a variety of currencies. There were no amounts outstanding under this program as of December 31, 2005.

We maintain two credit agreements with a consortium of banks. These agreements provide revolving credit facilities of $1.0 billion each, with one expiring on April 20, 2006 and the other on April 21, 2010. Interest on any amounts we borrow under these facilities would be charged at 90-day LIBOR plus 15 basis points. There were no borrowings under either of these agreements as of December 31, 2005.

In August 2003, we filed a $2.0 billion shelf registration statement under which we may issue debt securities in the United States. There was approximately $126 million issued under this shelf registration statement at December 31, 2005, all of which consists of issuances under our UPS Notes program.

Our existing debt instruments and credit facilities do not have cross-default or ratings triggers, however these debt instruments and credit facilities do subject us to certain financial covenants. These covenants generally require us to maintain a $3.0 billion minimum net worth and limit the amount of secured indebtedness available to the company. These covenants are not considered material to the overall financial condition of the company, and all covenant tests were satisfied as of December 31, 2005.

Commitments

We have contractual obligations and commitments in the form of operating leases, capital leases, debt obligations, purchase commitments, and certain other liabilities. We intend to satisfy these obligations through the use of cash flow from operations. The following table summarizes our contractual obligations and commitments as of December 31, 2005 (in millions):

Year	Capitalized Leases	Operating Leases	Debt Principal	Purchase Commitments	Other Liabilities
2006	$ 64	$ 403	$ 774	$1,280	$ 48
2007	107	348	70	826	68
2008	115	248	37	738	69
2009	66	176	104	652	65
2010	61	126	30	478	62
After 2010	1	544	2,637	689	285
Total	$414	$1,845	$3,652	$4,663	$597

During 2005, we took delivery of six Boeing MD-11 aircraft and seven Airbus A300-600 aircraft. The final six firm Airbus A300-600 aircraft are scheduled for delivery by July 2006. We have firm commitments to purchase 13 Boeing MD-11 aircraft, and we expect to take delivery of these aircraft during 2006 and 2007. In 2005, we made firm commitments to purchase eight Boeing 747-400F aircraft scheduled for delivery during 2007 and 2008, and two Boeing 747-400SF aircraft scheduled for delivery during 2008. In addition, we have a firm commitment to purchase 10 Airbus A380 aircraft and options to purchase 10 additional A380 aircraft. The A380 aircraft deliveries are scheduled between 2009 and 2012. These aircraft purchase orders will provide for the replacement of existing capacity and anticipated future growth.

As of December 31, 2005, we had outstanding letters of credit totaling approximately $2.095 billion issued in connection with routine business requirements. As of December 31, 2005, we had unfunded loan commitments totaling $416 million associated with our financial business.

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

Contingencies

We are a defendant in a number of lawsuits filed in state and federal courts containing various class-action allegations under state wage-and-hour laws. In one of these cases, Marlo v. UPS, which has been certified as a class action in a California federal court, plaintiffs allege that they improperly were denied overtime, and seek penalties for missed meal and rest periods, and interest and attorneys' fees. Plaintiffs purport to represent a class of 1,200 full-time supervisors.

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

With the assistance of outside counsel, we have undertaken an internal investigation of certain conduct within our Supply Chain Solutions subsidiary in certain locations outside the United States. Our investigation has determined that certain conduct, which commenced prior to our subsidiary's 2001 acquisition of a freight forwarding business that was part of Fritz Companies Inc., may have violated the United States Foreign Corrupt Practices Act. Our investigation also determined that a small number of former employees directed the conduct in question. The monetary value involved in this conduct appears to be immaterial. We have implemented numerous remediation steps, and our investigation continues. In March 2006 we informed the SEC and the Department of Justice of our investigation, and we intend to cooperate fully with any review by the government of these issues. We do not believe that the results of this investigation, the remediation or related penalties, if any, will have a material adverse effect on our financial condition, liquidity or results of operations, nor do we believe that these matters will have a material adverse effect on our business and prospects.

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

As of December 31, 2005, we had approximately 241,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters ("Teamsters"). These agreements run through July 31, 2008. The majority of our pilots are employed under a collective bargaining agreement with the Independent Pilots Association, which became amendable December 31, 2003. Negotiations are ongoing with the assistance of the National Mediation Board. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which becomes amendable on November 1, 2006. In addition, the majority of our ground mechanics who are not employed under agreements with the Teamsters are employed under collective bargaining agreements with the International Association of Machinists and Aerospace Workers. These agreements run through July 31, 2009.

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 foreign exchange, interest rate, equity and commodity forward contracts, options, and swaps.

The following analysis provides quantitative information regarding our exposure to commodity price risk, foreign currency exchange risk, interest rate risk, and equity price risk. We utilize valuation models to evaluate the sensitivity of the fair value of financial instruments with exposure to market risk that assume instantaneous, parallel shifts in exchange rates, interest rate yield curves, and commodity and equity prices. For options and instruments with non-linear returns, models appropriate to the instrument are utilized to determine the impact of market shifts. There are certain limitations inherent in the sensitivity analyses presented, primarily due to the assumption that exchange rates change in a parallel fashion and that interest rates change instantaneously. In addition, the analyses are unable to reflect the complex market reactions that normally would arise from the market shifts modeled.

A discussion of our accounting policies for derivative instruments and further disclosures are provided in Note 16 to the consolidated financial statements.

Commodity Price Risk

We are exposed to an increase in the prices of refined fuels, principally jet-A, diesel, and unleaded gasoline, which are used in the transportation of packages. Additionally, we are exposed to an increase in the prices of other energy products, primarily natural gas and electricity, used in our operating facilities throughout the world. We use a combination of options, swaps, and futures contracts to provide some protection from rising fuel and energy prices. These derivative instruments generally cover forecasted fuel and energy consumption for periods of one to three years. The net fair value of such contracts subject to price risk, excluding the underlying exposures, as of December 31, 2005 and 2004 was an asset of $192 and $101 million, respectively. The potential loss in the fair value of these derivative contracts, assuming a hypothetical 10% adverse change in the underlying commodity price, would be approximately $35 and $32 million at December 31, 2005 and 2004, respectively. This amount excludes the offsetting impact of the price risk inherent in the physical purchase of the underlying commodities.

Foreign Currency Exchange Risk

We have foreign currency risks related to our revenue, operating expenses, and financing transactions in currencies other than the local currencies in which we operate. We are exposed to currency risk from the potential changes in functional currency values of our foreign currency-denominated assets, liabilities, and cash flows. Our most significant foreign currency exposures relate to the Euro, the British Pound Sterling and the Canadian Dollar. We use a combination of purchased and written options and forward contracts to hedge cash flow currency exposures. These derivative instruments generally cover forecasted foreign currency exposures for periods up to one year. As of December 31, 2005 and 2004, the net fair value of the hedging instruments described above was an asset (liability) of \$52 and \$(28) million, respectively. The potential loss in fair value for such instruments from a hypothetical 10% adverse change in quoted foreign currency exchange rates would be approximately \$65 and \$117 million at December 31, 2005 and 2004, respectively. This sensitivity analysis assumes a parallel shift in the foreign currency exchange rates. Exchange rates rarely move in the same direction. The assumption that exchange rates change in a parallel fashion may overstate the impact of changing exchange rates on assets and liabilities denominated in a foreign currency.

Interest Rate Risk

As described in Note 8 to the consolidated financial statements, we have issued debt instruments, including debt associated with capital leases, that accrue expense at fixed and floating rates of interest. We use a combination of derivative instruments, including interest rate swaps and cross-currency interest rate swaps, as part of our program to manage the fixed and floating interest rate mix of our total debt portfolio and related overall cost of borrowing. These swaps are generally entered into concurrently with the issuance of the debt that they are intended to modify, and the notional amount, interest payment, and maturity dates of the swaps match the terms of the associated debt.

Our floating rate debt and interest rate swaps subject us to risk resulting from changes in short-term (primarily LIBOR) interest rates. The potential change in annual interest expense resulting from a hypothetical 100 basis point change in short-term interest rates applied to our floating rate debt and swap instruments at both December 31, 2005 and 2004 would be approximately \$29 million.

As described in Note 2 to the consolidated financial statements, we have certain investments in debt, auction rate, and preferred securities that accrue income at variable rates of interest. The potential change in annual investment income resulting from a hypothetical 100 basis point change in interest rates applied to our investments exposed to variable interest rates at December 31, 2005 and 2004 would be approximately \$14 and \$45 million, respectively.

Additionally, as described in Note 3 to the consolidated financial statements, we hold a portfolio of finance receivables that accrue income at fixed and floating rates of interest. The potential change in the annual income resulting from a hypothetical 100 basis point change in interest rates applied to our variable rate finance receivables at December 31, 2005 and 2004 would be immaterial.

This interest rate sensitivity analysis assumes interest rate changes are instantaneous, parallel shifts in the yield curve. In reality, interest rate changes are rarely instantaneous or parallel. While this is our best estimate of the impact of the specified interest rate scenarios, these estimates should not be viewed as forecasts. We adjust the fixed and floating interest rate mix of our interest rate sensitive assets and liabilities in response to changes in market conditions.

Equity Price Risk

We hold investments in various common equity securities that are subject to price risk, and for certain of these securities, we utilize options to hedge this price risk. At December 31, 2005 and 2004, the fair value of such investments was \$89 and \$77 million, respectively. The potential change in the fair value of such investments, assuming a 10% change in equity prices net of the offsetting impact of any hedges, would be approximately \$9 and \$8 million at December 31, 2005 and 2004.

Credit Risk

The forward contracts, swaps, and options previously discussed contain an element of risk that the counterparties may be unable to meet the terms of the agreements. However, we minimize such risk exposures for these instruments by limiting the counterparties to large banks and financial institutions that meet established credit guidelines. We do not expect to incur any losses as a result of counterparty default.

New Accounting Pronouncements

In December 2004, the FASB issued Statement No. 123 (revised 2004), "Share-Based Payment" ("FAS 123(R)"), which replaces FAS 123 and supercedes APB 25. FAS 123(R) requires all share-based awards to employees, including grants of employee stock options, to be measured based on their fair values and expensed over the period during which an employee is required to provide service in exchange for the award (the vesting period). We had previously adopted the fair value recognition provisions of the original FAS 123, prospectively for all new stock compensation awards granted to employees subsequent to January 1, 2003. FAS 123(R) was effective beginning with the first interim or annual period after June 15, 2005; the SEC deferred the effective date, and as a result, we adopted FAS 123(R) on January 1, 2006. On that date, there were no unvested stock options or other forms of employee stock compensation issued prior to January 1, 2003.

We issue employee share-based awards, under our Incentive Compensation Plan, that are subject to specific vesting conditions; generally, the awards cliff vest or vest ratably over a five year period, "the nominal vesting period," or at the date the employee retires (as defined by the plan), if earlier. For awards that specify an employee vests in the award upon retirement, we account for the awards using the nominal vesting period approach. Under this approach, we record compensation expense over the nominal vesting period. If the employee retires before the end of the nominal vesting period, any remaining unrecognized compensation expense is recorded at the date of retirement.

Upon our adoption of FAS 123(R), we will revise our approach to apply the non-substantive vesting period approach to all new share-based compensation awards. Under this approach, compensation cost will be recognized immediately for awards granted to retirement-eligible employees, or over the period from the grant date to the date retirement eligibility is achieved, if that is expected to occur during the nominal vesting period. We will continue to apply the nominal vesting period approach for any awards granted prior to January 1, 2006, and for the remaining portion of the then unvested outstanding awards.

If we had accounted for all share-based compensation awards granted prior to January 1, 2006 under the non-substantive vesting period approach, the impact to our net income and earnings per share would have been immaterial for all prior periods. The adoption of the non-substantive vesting period approach is expected to reduce 2006 net income by an estimated $29 million, or $0.03 per diluted share, based on share-based awards that we are anticipating granting in 2006.

The adoption of the following recent accounting pronouncements did not have a material impact on our results of operations or financial condition:

- FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations";
- EITF 05-6, "Determining the Amortization Period for Leasehold Improvements"; and
- FASB Statement No. 150, "Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity".

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which are prepared in accordance with accounting principles generally accepted in the United States of America. As indicated in Note 1 to our consolidated financial statements, the amounts of assets, liabilities, revenue, and expenses reported in our financial statements are affected by estimates and judgments that are necessary to comply with generally accepted accounting principles. We base our estimates on prior experience and other assumptions that we consider reasonable to our circumstances. Actual results could differ from our estimates, which would affect the related amounts reported in our financial statements. While estimates and judgments are applied in arriving at many reported amounts, we believe that the following matters may involve a higher degree of judgment and complexity.

Contingencies—As discussed in Note 10 to our consolidated financial statements, we are involved in various legal proceedings and contingencies. We have recorded liabilities for these matters in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" ("FAS 5"). FAS 5 requires a liability to be recorded based on our estimate of the probable cost of the resolution of a contingency. The actual resolution of these contingencies may differ from our estimates. If a contingency is settled for an amount greater than our estimate, a future charge to income would result. Likewise, if a contingency is settled for an amount that is less than our estimate, a future credit to income would result.

The events that may impact our contingent liabilities are often unique and generally are not predictable. At the time a contingency is identified, we consider all relevant facts as part of our FAS 5 evaluation. We record a liability for a loss that meets the recognition criteria of FAS 5. These criteria require recognition of a liability when the loss is probable of occurring and reasonably estimable. Events may arise that were not anticipated and the outcome of a contingency may result in a loss to us that differs from our previously estimated liability. These factors could result in a material difference between estimated and actual operating results. Contingent losses that meet the recognition criteria under FAS 5, excluding those related to income taxes and self insurance which are discussed further below, were not material to the Company's financial position as of December 31, 2005. In addition, we have certain contingent liabilities that have not been recognized as of December 31, 2005, because a loss is not reasonably estimable.

Goodwill Impairment—We account for goodwill in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("FAS 142"), which requires annual impairment testing of goodwill for each of our reporting units. Goodwill impairment testing requires that we estimate the fair value of our goodwill and compare that estimate to the amount of goodwill recorded on our balance sheet.

We use a discounted cash flow model (DCF model) to estimate the fair value of our goodwill. The completion of the DCF model requires that we make a number of significant assumptions to produce an estimate of future cash flows. These assumptions include projections of future revenue, costs and working capital changes. In addition, we make assumptions about the estimated cost of capital and other relevant variables, as required, in estimating the fair value of our reporting units. The projections that we use in our DCF model are updated annually and will change over time based on the historical performance and changing business conditions for each of our reporting units.

As of December 31, 2005, our recorded goodwill was $2.549 billion, of which $2.259 billion relates to our Supply Chain and Freight segment. This segment of our business has experienced rapid growth over the last several years, largely due to a number of acquisitions that we have made. Because of its growth, this segment continues to experience significant change as we integrate the acquired companies, resulting in higher volatility in our DCF model projections than for our other segments. Our annual impairment tests performed in 2005, 2004 and 2003 resulted in no goodwill impairment.

Self-Insurance Accruals—We self-insure costs associated with workers' compensation claims, automotive liability, health and welfare, and general business liabilities, up to certain limits. Insurance reserves are established for estimates of the loss that we will ultimately incur on reported claims, as well as estimates of claims that have been incurred but not yet reported. Recorded balances are based on reserve levels determined by outside actuaries, who incorporate historical loss experience and judgments about the present and expected levels of cost per claim. Trends in actual experience are a significant factor in the determination of such reserves. We believe our estimated reserves for such claims are adequate, but actual experience in claim frequency and/or severity could materially differ from our estimates and affect our results of operations.

Workers compensation, automobile liability and general liability insurance claims may take several years to completely settle. Consequently, actuarial estimates are required to project the ultimate cost that will be incurred to fully resolve the claims. A number of factors can affect the actual cost of a claim, including the length of time the claim remains open, trends in health care costs and the results of related litigation. Furthermore, claims may emerge in future years for events that occurred in a prior year at a rate that differs from previous actuarial projections. Changes in state legislation with respect to workers compensation can affect the adequacy of our self-insurance accruals. All of these factors can result in revisions to prior actuarial projections and produce a material difference between estimated and actual operating results.

We sponsor a number of health and welfare insurance plans for our employees. We use estimates from third party actuaries to establish the liabilities for these plans. These liabilities and related expenses are based on estimates of the number of employees and eligible dependents covered under the plans, anticipated medical usage by participants and overall trends in medical costs and inflation. Actual results may differ from these estimates and, therefore, produce a material difference between estimated and actual operating results.

Pension and Postretirement Medical Benefits—Our pension and other postretirement benefit costs are calculated using various actuarial assumptions and methodologies as prescribed by Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" and Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions." These assumptions include discount rates, health care cost trend rates, inflation, rate of compensation increases, expected return on plan assets, mortality rates, and other factors. Actual results that differ from our assumptions are accumulated and amortized over future periods and, therefore, generally affect our recognized expense and recorded obligation in such future periods. We believe that the assumptions utilized in recording the obligations under our plans are reasonable based on input from our outside actuaries and other advisors and information as to historical experience and performance. Differences in actual experience or changes in assumptions may affect our pension and other postretirement obligations and future expense. A 25 basis point change in the assumed discount rate, expected return on assets, and health care cost trend rate for the pension and postretirement benefit plans would result in the following increases (decreases) on the Company's costs and obligations for the year 2005 (in millions):

	25 Basis Point Increase	25 Basis Point Decrease
Pension Plans		
Discount Rate:		
Effect on net periodic benefit cost	$ (54)	$ 55
Effect on projected benefit obligation	(548)	571
Return on Assets:		
Effect on net periodic benefit cost	(26)	26
Postretirement Medical Plans		
Discount Rate:		
Effect on net periodic benefit cost	(5)	5
Effect on projected benefit obligation	(77)	79
Health Care Cost Trend Rate:		
Effect on net periodic benefit cost	3	(2)
Effect on projected benefit obligation	22	(14)

Financial Instruments—As discussed in Notes 2, 3, 8, and 16 to our consolidated financial statements, and in the "Market Risk" section of this report, we hold and issue financial instruments that contain elements of market risk. Certain of these financial instruments are required to be recorded at fair value. Fair values are based on listed market prices, when such prices are available. To the extent that listed market prices are not available, fair value is determined based on other relevant factors, including dealer price quotations. Certain financial instruments, including over-the-counter derivative instruments, are valued using pricing models that consider, among other factors, contractual and market prices, correlations, time value, credit spreads, and yield curve volatility factors. Changes in the fixed income, equity, foreign exchange, and commodity markets will impact our estimates of fair value in the future, potentially affecting our results of operations. A quantitative sensitivity analysis of our exposure to changes in commodity prices, foreign currency exchange rates, interest rates, and equity prices is presented in the "Market Risk" section of this report.

Depreciation, Residual Value, and Impairment of Fixed Assets—As of December 31, 2005, we had approximately $15.289 billion of net fixed assets, the most significant category of which is aircraft. In accounting for fixed assets, we make estimates about the expected useful lives and the expected residual values of the assets, and the potential for impairment based on the fair values of the assets and the cash flows generated by these assets.

In estimating the lives and expected residual values of aircraft, we have relied upon actual experience with the same or similar aircraft types. Subsequent revisions to these estimates could be caused by changes to our maintenance program, changes in the utilization of the aircraft, governmental regulations on aging aircraft, and changing market prices of new and used aircraft of the same or similar types. We periodically evaluate these estimates and assumptions, and adjust the estimates and assumptions as necessary. Adjustments to the expected lives and residual values are accounted for on a prospective basis through depreciation expense.

In accordance with the provisions of Statement of Financial Accounting Standards No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" ("FAS 144"), we review long-lived assets for impairment when circumstances indicate the carrying amount of an asset may not be recoverable based on the undiscounted future cash flows of the asset. If the carrying amount of the asset is determined not to be recoverable, a write-down to fair value is recorded. Fair values are determined based on quoted market values, discounted cash flows, or external appraisals, as applicable. We review long-lived assets for impairment at the individual asset or the asset group level for which the lowest level of independent cash flows can be identified. The circumstances that would indicate potential impairment may include, but are not limited to, a significant change in the extent to which an asset is utilized, a significant decrease in the market value of an asset, and operating or cash flow losses associated with the use of the asset. In estimating cash flows, we project future volume levels for our different air express products in all geographic regions in which we do business. Adverse changes in these volume forecasts, or a shortfall of our actual volume compared with our projections, could result in our current aircraft capacity exceeding current or projected demand. This situation would lead to an excess of a particular aircraft type, resulting in an aircraft impairment charge or a reduction of the expected life of an aircraft type (thus resulting in increased depreciation expense).

In December 2003, we permanently removed from service a number of Boeing 727 and McDonnell Douglas DC-8 aircraft. As a result, we conducted an impairment evaluation, which resulted in a $75 million impairment charge during the fourth quarter for these aircraft (including the related engines), $69 million of which impacted the U.S. domestic package segment and $6 million of which impacted the international package segment.

In December 2004, we permanently removed from service a number of Boeing 727, 747 and McDonnell Douglas DC-8 aircraft. As a result of the actual and planned retirement of these aircraft, we conducted an impairment evaluation, which resulted in a $110 million impairment charge during the fourth quarter for these aircraft (including the related engines and parts), $91 million of which impacted the U.S. domestic package segment and $19 million of which impacted the international package segment.

These charges are classified in the caption "other expenses" within other operating expenses (see Note 13 to the consolidated financial statements). UPS continues to operate all of its other aircraft and continues to experience positive cash flow, and no impairments of aircraft were recognized in 2005.

Income Taxes—We operate in numerous countries around the world and are subject to income taxes in many jurisdictions. We estimate our annual effective income tax rate based on statutory income tax rates in these jurisdictions and take into consideration items that are treated differently for financial reporting and tax purposes. The process of estimating our effective income tax rate involves judgments related to tax planning and expectations regarding future events, including the impact of adjustments, if any, resulting from the resolution of audits of open tax years by the Internal Revenue Service or other taxing authorities.

We recognize deferred tax assets for items that will generate tax deductions or credits in future years. Realization of deferred tax assets requires sufficient future taxable income (subject to any carry-forward limitations) in the applicable jurisdictions. We make judgments regarding the realizability of deferred tax assets based, in part, on estimates of future taxable income. A valuation allowance is established for the portion, if any, of the deferred tax assets that we conclude cannot be realized. Income tax related contingency matters also affect our effective income tax rate. In this regard, we make judgments related to the identification and quantification of income tax related contingency matters.

During 2004 and 2003, the resolution of tax matters with the Internal Revenue Service and other taxing authorities produced reductions in income tax expense of $142 and $77 million, respectively.

Forward-Looking Statements

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

Risk Factors

The following are some of the factors that could cause our actual results to differ materially from the expected results described in our forward-looking statements:

- The effect of general economic and other conditions in the markets in which we operate, both in the United States and internationally. Our operations in international markets are also affected by currency exchange and inflation risks.
- The impact of competition on a local, regional, national, and international basis. Our competitors include the postal services of the U.S. and other nations, various motor carriers, express companies, freight forwarders, air couriers and others. Our industry is undergoing rapid consolidation, and the combining entities are competing aggressively for business.
- The impact of complex and stringent aviation, transportation, environmental, labor, employment and other governmental laws and regulations, and the impact of new laws and regulations that may result from increased concerns about homeland security. Our failure to comply with applicable laws, ordinances or regulations could result in substantial fines or possible revocation of our authority to conduct our operations.
- Strikes, work stoppages and slowdowns by our employees. Such actions may affect our ability to meet our customers needs, and customers may do more business with competitors if they believe that such actions may adversely affect our ability to provide service. We may face permanent loss of customers if we are unable to provide uninterrupted service. The terms of future collective bargaining agreements also may affect our competitive position and results of operations.

- Possible disruption of supplies, or an increase in the prices, of gasoline, diesel and jet fuel for our aircraft and delivery vehicles as a result of war or other factors. We require significant quantities of fuel and are exposed to the commodity price risk associated with variations in the market price for petroleum products.
- Cyclical and seasonal fluctuations in our operating results due to decreased demand for our services.

Item 7A. ***Quantitative and Qualitative Disclosures about Market Risk***

Information about market risk can be found in Item 7 of this report under the caption "Market Risk."

Item 8. ***Financial Statements and Supplementary Data***

Our financial statements are filed together with this report. See the Index to Financial Statements and Financial Statement Schedules on page F-1 for a list of the financial statements filed together with this report. Supplementary data appear in Note 18 to our financial statements.

Item 9. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

None.

Item 9A. ***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 and internal controls over financial reporting. Based upon, and as of the date of the evaluation, our chief executive officer and chief financial officer concluded that the disclosure controls and procedures and internal controls over financial reporting were effective to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is recorded, processed, summarized and reported as and when required.

During 2005, the Supply Chain and Freight segment of our Company migrated significant freight services transaction volume previously processed by separate operating systems to a single freight operating system (E2K). The E2K freight operating system was utilized by Menlo Worldwide Forwarding, a company we acquired in 2004. This migration represents a significant change to the processes and controls for this segment of our business.

Also during 2005, the Company completed the acquisitions of Overnite Corporation and other entities. The Company performed due diligence procedures associated with the acquisition of these entities and is in the process of incorporating the separate financial reporting processes applicable to these entities into the Company's internal control structure.

There were no other changes in the Company's internal controls over financial reporting during the year ended December 31, 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

See page F-2 for management's report on internal control over financial reporting.

Item 9B. ***Other Information***

None.

PART III

Item 10. ***Directors and Executive Officers of the Registrant***

Information about our directors and our audit committee financial expert is presented under the captions "Election of Directors" and "Committees of the Board of Directors — Audit Committee" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 4, 2006 and is incorporated herein by reference.

Information about our executive officers can be found in Part I of this report under the caption "Executive Officers of the Registrant" in accordance with Instruction 3 of Item 401(b) of Regulation S-K and General Instruction G(3) of Form 10-K.

Information about our Code of Business Conduct is presented under the caption "Where You Can Find More Information" in Part I, Item 1 of this report.

Information about our compliance with Section 16 of the Exchange Act of 1934, as amended, is presented under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 4, 2006 and is incorporated herein by reference.

Item 11. ***Executive Compensation***

Information about executive compensation is presented under the caption "Compensation of Executive Officers and Directors," excluding the information under the caption "Report of the Compensation Committee," in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 4, 2006 and is incorporated herein by reference.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

Information about security ownership is presented under the caption "Beneficial Ownership of Common Stock" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 4, 2006 and is incorporated herein by reference.

Information about our equity compensation plans is presented under the caption "Equity Compensation Plans" in our definitive Proxy Statement for the Annual Meeting of Shareowners to be held on May 4, 2006 and is incorporated herein by reference.

Item 13. ***Certain Relationships and Related Transactions***

None.

Item 14. ***Principal Accountant and Fees and Services***

Information about aggregate fees billed to us by our principal accountant is presented under the caption "Principal Accounting Firm Fees" in our definitive Proxy Statement for the Annual Meetings of Shareowners to be held on May 4, 2006 and is incorporated herein by reference.

PART IV

Item 15. ***Exhibits and Financial Statement Schedules***

(a) 1. *Financial Statements*.

See the Index to Financial Statements on page F-1 for a list of the financial statements filed with this report.

2. *Financial Statement Schedules*.

None.

3. *List of Exhibits*.

See the Exhibit Index for a list of the exhibits incorporated by reference into or filed with this report.

(b) *Exhibits required by Item 601 of Regulation S-K*.

See the Exhibit Index for a list of the exhibits incorporated by reference into or filed with this report.

(c) *Financial Statement Schedules*.

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, United Parcel Service, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

UNITED PARCEL SERVICE, INC.
(REGISTRANT)

By: /s/ MICHAEL L. ESKEW

Michael L. Eskew
Chairman and
Chief Executive Officer

Date: March 14, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ JOHN J. BEYSTEHNER **John J. Beystehner**	Chief Operating Officer and Director	March 14, 2006
/s/ MICHAEL J. BURNS **Michael J. Burns**	Director	March 11, 2006
/s/ D. SCOTT DAVIS **D. Scott Davis**	Senior Vice President, Chief Financial Officer and Treasurer and Director (Principal Financial and Accounting Officer)	March 14, 2006
/s/ STUART E. EIZENSTAT **Stuart E. Eizenstat**	Director	March 12, 2006
/s/ MICHAEL L. ESKEW **Michael L. Eskew**	Chairman, Chief Executive Officer and Director (Principal Executive Officer)	March 14, 2006
/s/ JAMES P. KELLY **James P. Kelly**	Director	March 10, 2006
Ann M. Livermore	Director	
/s/ GARY E. MACDOUGAL **Gary E. MacDougal**	Director	March 14, 2006
/s/ VICTOR A. PELSON **Victor A. Pelson**	Director	March 10, 2006
/s/ JOHN W. THOMPSON **John W. Thompson**	Director	March 14, 2006
/s/ CAROL B. TOMÉ **Carol B. Tomé**	Director	March 14, 2006
/s/ BEN VERWAAYEN **Ben Verwaayen**	Director	March 14, 2006

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

INDEX TO FINANCIAL STATEMENTS

Item 8—Financial Statements

Management's Report on Internal Control Over Financial Reporting

UPS management is responsible for establishing and maintaining adequate internal controls over financial reporting for United Parcel Service, Inc. and its subsidiaries ("the Company"). Based on the criteria for effective internal control over financial reporting established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, management has assessed the Company's internal control over financial reporting as effective as of December 31, 2005. The registered independent public accounting firm of Deloitte & Touche LLP, as auditors of the consolidated balance sheet of United Parcel Service, Inc. and its subsidiaries as of December 31, 2005 and the related consolidated statements of income, shareowners' equity and cash flows for the year ended December 31, 2005, has issued an attestation report on management's assessment of the Company's internal control over financial reporting.

United Parcel Service, Inc.
March 14, 2006

Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

Board of Directors and Shareowners
United Parcel Service, Inc.
Atlanta, Georgia

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that United Parcel Service, Inc. and its subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of United Parcel Service, Inc. and its subsidiaries as of December 31, 2005, and the related consolidated statements of income, shareowners' equity, and cash flows for the year ended December 31, 2005 of the Company and our report dated March 14, 2006 expressed an unqualified opinion on those financial statements.

Deloitte & Touche LLP

Atlanta, Georgia
March 14, 2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareowners
United Parcel Service, Inc.
Atlanta, Georgia

We have audited the accompanying consolidated balance sheets of United Parcel Service, Inc. and its subsidiaries (the "Company") as of December 31, 2005 and 2004, and the related consolidated statements of income, shareowners' equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of United Parcel Service, Inc. and its subsidiaries at December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the consolidated financial statements, the Company began applying prospectively the provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," effective January 1, 2003.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 14, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Deloitte & Touche LLP

Atlanta, Georgia
March 14, 2006

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In millions, except per share amounts)

	December 31, 2005	December 31, 2004
ASSETS		
Current Assets:		
Cash & cash equivalents	$ 1,369	$ 739
Marketable securities & short-term investments	1,672	4,458
Accounts receivable, net	5,950	5,156
Finance receivables, net	411	524
Income tax receivable	—	371
Deferred income taxes	475	392
Other current assets	1,126	965
Total Current Assets	11,003	12,605
Property, Plant & Equipment—at cost, net of accumulated depreciation & amortization of $14,268 and $13,505 in 2005 and 2004	15,289	13,973
Prepaid Pension Costs	3,932	3,222
Goodwill	2,549	1,255
Intangible Assets, Net	684	669
Other Assets	1,765	1,364
	$35,222	$33,088
LIABILITIES AND SHAREOWNERS' EQUITY		
Current Liabilities:		
Current maturities of long-term debt and commercial paper	$ 821	$ 1,187
Accounts payable	2,352	2,312
Accrued wages & withholdings	1,324	1,197
Dividends payable	364	315
Income taxes payable	180	79
Other current liabilities	1,752	1,439
Total Current Liabilities	6,793	6,529
Long-Term Debt	3,159	3,261
Accumulated Postretirement Benefit Obligation, Net	1,704	1,470
Deferred Taxes, Credits & Other Liabilities	6,682	5,450
Shareowners' Equity:		
Preferred stock, no par value, authorized 200 shares, none issued	—	—
Class A common stock, par value $.01 per share, authorized 4,600 shares, issued 454 and 515 in 2005 and 2004	5	5
Class B common stock, par value $.01 per share, authorized 5,600 shares, issued 646 and 614 in 2005 and 2004	6	6
Additional paid-in capital	—	417
Retained earnings	17,037	16,192
Accumulated other comprehensive loss	(164)	(242)
Deferred compensation obligations	161	169
	17,045	16,547
Less: Treasury stock (3 shares in 2005 and 2004)	(161)	(169)
	16,884	16,378
	$35,222	$33,088

See notes to consolidated financial statements.

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED INCOME
(In millions, except per share amounts)

	Years Ended December 31, 2005	2004	2003
Revenue	$42,581	$36,582	$33,485
Operating Expenses:			
Compensation and benefits	22,517	20,823	19,251
Other	13,921	10,770	9,789
	36,438	31,593	29,040
Operating Profit	6,143	4,989	4,445
Other Income and (Expense):			
Investment income	104	82	18
Interest expense	(172)	(149)	(121)
Gain on redemption of long-term debt	—	—	28
	(68)	(67)	(75)
Income Before Income Taxes	6,075	4,922	4,370
Income Taxes	2,205	1,589	1,472
Net Income	$ 3,870	$ 3,333	$ 2,898
Basic Earnings Per Share	$ 3.48	$ 2.95	$ 2.57
Diluted Earnings Per Share	$ 3.47	$ 2.93	$ 2.55

See notes to consolidated financial statements.

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED SHAREOWNERS' EQUITY
(In millions, except per share amounts)

	2005 Shares	2005 Dollars	2004 Shares	2004 Dollars	2003 Shares	2003 Dollars
Class A Common Stock						
Balance at beginning of year	515	$ 5	571	$ 6	642	$ 7
Common stock purchases	(16)	—	(12)	—	(5)	—
Stock award plans	2	—	12	—	12	—
Common stock issuances	3	—	3	—	2	—
Conversions of Class A to Class B common stock	(50)	—	(59)	(1)	(80)	(1)
Balance at end of year	454	5	515	5	571	6
Class B Common Stock						
Balance at beginning of year	614	6	560	5	482	4
Common stock purchases	(18)	—	(5)	—	(2)	—
Conversions of Class A to Class B common stock	50	—	59	1	80	1
Balance at end of year	646	6	614	6	560	5
Additional Paid-In Capital						
Balance at beginning of year		417		662		387
Stock award plans		335		677		545
Common stock purchases		(922)		(1,075)		(398)
Common stock issuances		170		153		128
Balance at end of year		—		417		662
Retained Earnings						
Balance at beginning of year		16,192		14,356		12,495
Net income		3,870		3,333		2,898
Dividends ($1.32, $1.12, and $0.92)		(1,468)		(1,262)		(1,037)
Common stock purchases		(1,557)		(235)		—
Balance at end of year		17,037		16,192		14,356
Accumulated Other Comprehensive Income (Loss)						
Foreign currency translation adjustment:						
Balance at beginning of year		(127)		(56)		(328)
Aggregate adjustment for the year		(36)		(71)		272
Balance at end of year		(163)		(127)		(56)
Unrealized gain (loss) on marketable securities, net of tax:						
Balance at beginning of year		(5)		14		(34)
Current period changes in fair value (net of tax effect of $0, $(10), and $13)		—		(18)		21
Reclassification to earnings (net of tax effect of $10, $(1), and $17)		16		(1)		27
Balance at end of year		11		(5)		14
Unrealized gain (loss) on cash flow hedges, net of tax:						
Balance at beginning of year		(29)		(72)		(26)
Current period changes in fair value (net of tax effect of $81, $21, and $(6))		135		37		(9)
Reclassification to earnings (net of tax effect of $(14), $4, and $(21))		(23)		6		(37)
Balance at end of year		83		(29)		(72)
Additional minimum pension liability, net of tax:						
Balance at beginning of year		(81)		(63)		(50)
Minimum pension liability adjustment (net of tax effect of $(8), $(10), and $(6))		(14)		(18)		(13)
Balance at end of year		(95)		(81)		(63)
Accumulated other comprehensive income (loss) at end of year		(164)		(242)		(177)
Deferred Compensation Obligations						
Balance at beginning of year		169		136		84
Common stock held for deferred compensation obligations		(8)		33		52
Balance at end of year		161		169		136
Treasury Stock						
Balance at beginning of year	(3)	(169)	(2)	(136)	(1)	(84)
Common stock held for deferred compensation obligations	—	8	(1)	(33)	(1)	(52)
Balance at end of year	(3)	(161)	(3)	(169)	(2)	(136)
Total Shareowners' Equity at End of Year		$16,884		$16,378		$14,852
Comprehensive Income		$ 3,948		$ 3,268		$ 3,159

See notes to consolidated financial statements.

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

STATEMENTS OF CONSOLIDATED CASH FLOWS
(In millions)

	Years Ended December 31,		
	2005	2004	2003
Cash Flows From Operating Activities:			
Net income	$ 3,870	$ 3,333	$ 2,898
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	1,644	1,543	1,549
Postretirement benefits	115	135	84
Deferred taxes, credits and other	477	289	317
Stock award plans	234	610	497
Other (gains) losses	28	144	151
Changes in assets and liabilities, net of effect of acquisitions:			
Accounts receivable, net	(647)	(686)	(264)
Other current assets	213	390	13
Prepaid pension costs	(695)	(238)	(990)
Accounts payable	158	318	66
Accrued wages and withholdings	56	(73)	83
Income taxes payable	179	(399)	204
Other current liabilities	161	(35)	(32)
Net cash from operating activities	5,793	5,331	4,576
Cash Flows From Investing Activities:			
Capital expenditures	(2,187)	(2,127)	(1,947)
Disposals of property, plant and equipment	27	75	118
Purchases of marketable securities and short-term investments	(7,623)	(6,322)	(8,083)
Sales and maturities of marketable securities and short-term investments	10,375	4,724	7,118
Net decrease in finance receivables	95	318	50
Cash received (paid) for business acquisitions & dispositions	(1,488)	(238)	8
Other investing activities	(174)	(68)	(6)
Net cash (used in) investing activities	(975)	(3,638)	(2,742)
Cash Flows From Financing Activities:			
Proceeds from borrowings	128	811	361
Repayments of borrowings	(589)	(468)	(1,245)
Purchases of common stock	(2,479)	(1,310)	(398)
Issuances of common stock	164	193	154
Dividends	(1,391)	(1,208)	(956)
Other financing activities	(8)	(32)	(26)
Net cash (used in) financing activities	(4,175)	(2,014)	(2,110)
Effect Of Exchange Rate Changes On Cash	(13)	(4)	216
Net Increase (Decrease) In Cash And Cash Equivalents	630	(325)	(60)
Cash And Cash Equivalents:			
Beginning of period	739	1,064	1,124
End of period	$ 1,369	$ 739	$ 1,064
Cash Paid During The Period For:			
Interest (net of amount capitalized)	$ 169	$ 120	$ 126
Income taxes	$ 1,465	$ 2,037	$ 1,097

See notes to consolidated financial statements.

UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF ACCOUNTING POLICIES

Basis of Financial Statements and Business Activities

The accompanying financial statements include the accounts of United Parcel Service, Inc., and all of its consolidated subsidiaries (collectively "UPS" or the "Company"). All intercompany balances and transactions have been eliminated.

UPS concentrates its operations in the field of transportation services, primarily domestic and international letter and package delivery. Through our Supply Chain & Freight subsidiaries, we are also a global provider of specialized transportation, logistics, and financial services.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

U.S. Domestic and International Package Operations—Revenue is recognized upon delivery of a letter or package.

Forwarding Services and Logistics—Freight forwarding revenue and the expense related to the transportation of freight is recognized at the time the services are performed in accordance with EITF 99-19 "Reporting Revenue Gross as a Principal Versus Net as an Agent". Material management and distribution revenue is recognized upon performance of the service provided. Customs brokerage revenue is recognized upon completing documents necessary for customs entry purposes.

UPS Capital—Income on loans and direct finance leases is recognized on the effective interest method. Accrual of interest income is suspended at the earlier of the time at which collection of an account becomes doubtful or the account becomes 90 days delinquent. Income on operating leases is recognized on the straight-line method over the terms of the underlying leases.

UPS Freight—Revenue is recognized in accordance with EITF 91-9 "Revenue and Expense Recognition for Freight Services in Process." For transactions in which we are the sole service provider, we use the percentage of completion method, based upon average transit time to recognize revenue.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments that are readily convertible into cash. We consider securities with maturities of three months or less, when purchased, to be cash equivalents. The carrying amount of these securities approximates fair value because of the short-term maturity of these instruments.

Marketable Securities and Short-Term Investments

Marketable securities are classified as available-for-sale and are carried at fair value, with related unrealized gains and losses reported, net of tax, as accumulated other comprehensive income ("OCI"), a separate component of shareowners' equity. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion is included in investment income, along with interest and dividends. The cost of securities sold is based on the specific identification method; realized gains and losses resulting from such sales are included in investment income.

Investment securities are reviewed for impairment in accordance with FASB Statement No. 115 "Accounting for Certain Investments in Debt and Equity Securities" and FASB Staff Position (FSP) 115-1 "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." We periodically review our investments for indications of other than temporary impairment considering many factors, including the extent and duration to which a security's fair value has been less than its cost, overall economic and market conditions, and the financial condition and specific prospects for the issuer. Impairment of investment securities results in a charge to income when a market decline below cost is other than temporary.

Property, Plant and Equipment

Property, plant and equipment are carried at cost. Depreciation and amortization are provided by the straight-line method over the estimated useful lives of the assets, which are as follows: Vehicles—4.5 to 15 years; Aircraft—12 to 20 years; Buildings—10 to 40 years; Leasehold Improvements—lives of leases; Plant Equipment—5 to 10 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.

Interest incurred during the construction period of certain property, plant and equipment is capitalized until the underlying assets are placed in service, at which time amortization of the capitalized interest begins, straight-line, over the estimated useful lives of the related assets. Capitalized interest was $32, $25, and $25 million for 2005, 2004, and 2003, respectively.

Impairment of Long-Lived Assets

In accordance with the provisions of FASB Statement No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," we review long-lived assets for impairment when circumstances indicate the carrying amount of an asset may not be recoverable based on the undiscounted future cash flows of the asset. If the carrying amount of the asset is determined not to be recoverable, a write-down to fair value is recorded. Fair values are determined based on quoted market values, discounted cash flows, or external appraisals, as applicable. We review long-lived assets for impairment at the individual asset or the asset group level for which the lowest level of independent cash flows can be identified.

In December 2003, we permanently removed from service a number of Boeing 727 and McDonnell Douglas DC-8 aircraft. As a result, we conducted an impairment evaluation, which resulted in a $75 million impairment charge during the fourth quarter for these aircraft (including the related engines), $69 million of which impacted the U.S. domestic package segment and $6 million of which impacted the international package segment.

In December 2004, we permanently removed from service a number of Boeing 727, 747 and McDonnell Douglas DC-8 aircraft. As a result of the actual and planned retirement of these aircraft, we conducted an impairment evaluation, which resulted in a $110 million impairment charge during the fourth quarter for these aircraft (including the related engines and parts), $91 million of which impacted the U.S. domestic package segment and $19 million of which impacted the international package segment.

These charges are classified in the caption "other expenses" within other operating expenses (see Note 13). UPS continues to operate all of its other aircraft and continues to experience positive cash flow, and no impairments of aircraft were recognized in 2005.

Goodwill and Intangible Assets

Costs of purchased businesses in excess of net assets acquired (goodwill), and intangible assets are accounted for under the provisions of FASB Statement No. 142 "Goodwill and Other Intangible Assets" ("FAS 142"). Under FAS 142, we are required to test all goodwill for impairment at least annually, unless changes in circumstances indicate an impairment may have occurred sooner. We are required to test goodwill on a "reporting unit" basis. A reporting unit is the operating segment unless, for businesses within that operating segment, discrete financial information is prepared and regularly reviewed by management, in which case such a component business is the reporting unit.

A fair value approach is used to test goodwill for impairment. An impairment charge is recognized for the amount, if any, by which the carrying amount of goodwill exceeds its fair value. Fair values are established using discounted cash flows. When available and as appropriate, comparative market multiples were used to corroborate discounted cash flow results. Our annual impairment tests performed in 2005, 2004, and 2003 resulted in no goodwill impairment.

Finite-lived intangible assets, including trademarks, licenses, patents, customer lists and franchise rights are amortized over the estimated useful lives of the assets, which range from 2 to 20 years. Capitalized software is amortized over periods ranging from 3 to 5 years.

Self-Insurance Accruals

We self-insure costs associated with workers' compensation claims, automotive liability, health and welfare, and general business liabilities, up to certain limits. Insurance reserves are established for estimates of the loss that we will ultimately incur on reported claims, as well as estimates of claims that have been incurred but not yet reported. Recorded balances are based on reserve levels determined by outside actuaries, who incorporate historical loss experience and judgments about the present and expected levels of cost per claim.

Income Taxes

Income taxes are accounted for under FASB Statement No. 109, "Accounting for Income Taxes" ("FAS 109"). FAS 109 is an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. In estimating future tax consequences, FAS 109 generally considers all expected future events other than proposed changes in the tax law or rates. Valuation allowances are provided if it is more likely than not that a deferred tax asset will not be realized.

We record accruals for tax contingencies related to potential assessments by tax authorities. Such accruals are based on management's judgment and best estimate as to the ultimate outcome of any potential tax audits. Actual tax audit results could vary from these estimates.

Foreign Currency Translation

We translate the results of operations of our foreign subsidiaries using average exchange rates during each period, whereas balance sheet accounts are translated using exchange rates at the end of each period. Balance sheet currency translation adjustments are recorded in OCI. Net currency transaction gains and losses included in other operating expenses were pre-tax gains (losses) of $(22), $44, and $21 million in 2005, 2004 and 2003, respectively.

Stock-Based Compensation

Effective January 1, 2003, we adopted the fair value measurement provisions of FASB Statement No. 123 "Accounting for Stock-Based Compensation" ("FAS 123"). In years prior to 2003, we used the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under APB 25, we did not have to recognize compensation expense for our stock option grants and our discounted stock purchase plan, however we did recognize compensation expense for our management incentive awards and certain other stock awards (see Note 11 for a description of these plans).

Under the provisions of FASB Statement No. 148 "Accounting for Stock-Based Compensation—Transition and Disclosure," we have elected to adopt the measurement provisions of FAS 123 using the prospective method. Under this approach, all stock-based compensation granted subsequent to January 1, 2003 will be expensed to compensation and benefits over the vesting period based on the fair value at the date the stock-based compensation is granted. Stock compensation awards granted to date include stock options, management incentive awards, restricted performance units, and employer matching contributions (in shares of UPS stock) for a defined contribution benefit plan. The adoption of the measurement provisions of FAS 123 reduced 2005, 2004, and 2003 net income by $52 million ($0.05 per diluted share), $35 million ($0.03 per diluted share), and $20 million ($0.02 per diluted share), respectively.

The following provides pro forma information as to the impact on net income and earnings per share if we had used the fair value measurement provisions of FAS 123 to account for all stock-based compensation awards granted prior to January 1, 2003 (in millions, except per share amounts).

	2005	2004	2003
Net income	$3,870	$3,333	$2,898
Add: Stock-based employee compensation expense included in net income, net of tax effects	157	563	456
Less: Total pro forma stock-based employee compensation expense, net of tax effects	(165)	(588)	(507)
Pro forma net income	$3,862	$3,308	$2,847
Basic earnings per share			
As reported	$ 3.48	$ 2.95	$ 2.57
Pro forma	$ 3.47	$ 2.93	$ 2.52
Diluted earnings per share			
As reported	$ 3.47	$ 2.93	$ 2.55
Pro forma	$ 3.46	$ 2.91	$ 2.50

The fair value of each option grant is estimated using the Black-Scholes option pricing model. Compensation cost is also measured for the fair value of employees' purchase rights under our discounted stock purchase plan using the Black-Scholes option pricing model. The weighted-average assumptions used, by year, and the calculated weighted average fair value of options and employees' purchase rights granted, are as follows:

	2005	2004	2003
Stock options:			
Expected dividend yield	1.60%	1.50%	1.22%
Risk-free interest rate	4.18%	4.31%	3.70%
Expected life in years	7	7	8
Expected volatility	18.21%	15.69%	19.55%
Weighted average fair value of options granted	$17.33	$16.24	$17.02

	2005	2004	2003
Discounted stock purchase plan:			
Expected dividend yield	1.62%	1.42%	1.12%
Risk-free interest rate	2.84%	1.18%	1.06%
Expected life in years	0.25	0.25	0.25
Expected volatility	15.46%	16.83%	19.79%
Weighted average fair value of purchase rights*	$ 9.46	$ 9.56	$ 8.53

* Includes the 10% discount from the market price (see Note 11).

Expected volatilities are based on the historical returns on our stock and, due to our limited history of being a publicly-traded company, an index of peer companies. The expected dividend yield is based on the recent historical dividend yields for our stock, taking into account changes in dividend policy. The risk-free interest rate is based on the term structure of interest rates at the time of the option grant. The expected life represents an estimate of the period of time options are expected to remain outstanding.

Derivative Instruments

Derivative instruments are accounted for in accordance with FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"), as amended, which requires all financial derivative instruments to be recorded on our balance sheet at fair value. Derivatives not designated as hedges must be adjusted to fair value through income. If a derivative is designated as a hedge, depending on the nature of the hedge, changes in its fair value that are considered to be effective, as defined, either offset the change in fair value of the hedged assets, liabilities, or firm commitments through income, or are recorded in OCI until the hedged item is recorded in income. Any portion of a change in a derivative's fair value that is considered to be ineffective, or is excluded from the measurement of effectiveness, is recorded immediately in income.

New Accounting Pronouncements

In December 2004, the FASB issued Statement No. 123 (revised 2004), "Share-Based Payment" ("FAS 123(R)"), which replaces FAS 123 and supercedes APB 25. FAS 123(R) requires all share-based awards to employees, including grants of employee stock options, to be measured based on their fair values and expensed over the period during which an employee is required to provide service in exchange for the award (the vesting period). We had previously adopted the fair value recognition provisions of the original FAS 123, prospectively for all new stock compensation awards granted to employees subsequent to January 1, 2003. FAS 123(R) was effective beginning with the first interim or annual period after June 15, 2005; the SEC deferred the effective date, and as a result, we adopted FAS 123(R) on January 1, 2006. On that date, there were no unvested stock options or other forms of employee stock compensation issued prior to January 1, 2003.

We issue employee share-based awards, under our Incentive Compensation Plan, that are subject to specific vesting conditions; generally, the awards cliff vest or vest ratably over a five year period, "the nominal vesting period," or at the date the employee retires (as defined by the plan), if earlier. For awards that specify an employee vests in the award upon retirement, we account for the awards using the nominal vesting period approach. Under this approach, we record compensation expense over the nominal vesting period. If the employee retires before the end of the nominal vesting period, any remaining unrecognized compensation expense is recorded at the date of retirement.

Upon our adoption of FAS 123(R), we will revise our approach to apply the non-substantive vesting period approach to all new share-based compensation awards. Under this approach, compensation cost will be recognized immediately for awards granted to retirement-eligible employees, or over the period from the grant date to the date retirement eligibility is achieved, if that is expected to occur during the nominal vesting period. We will continue to apply the nominal vesting period approach for any awards granted prior to January 1, 2006, and for the remaining portion of the then unvested outstanding awards.

If we had accounted for all share-based compensation awards granted prior to January 1, 2006 under the non-substantive vesting period approach, the impact to our net income and earnings per share would have been immaterial for all prior periods. The adoption of the non-substantive vesting period approach is expected to reduce 2006 net income by an estimated $29 million, or $0.03 per diluted share, based on share-based awards that we are anticipating granting in 2006.

The adoption of the following recent accounting pronouncements did not have a material impact on our results of operations or financial condition:

- FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations";
- EITF 05-6, "Determining the Amortization Period for Leasehold Improvements"; and
- FASB Statement No. 150, "Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity".

Changes in Presentation

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

NOTE 2. MARKETABLE SECURITIES AND SHORT-TERM INVESTMENTS

The following is a summary of marketable securities and short-term investments at December 31, 2005 and 2004 (in millions):

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
2005				
U.S. government & agency securities	$ 400	$ 1	$ 3	$ 398
U.S. mortgage & asset-backed securities	393	1	5	389
U.S. corporate securities	425	—	4	421
U.S. state and local municipal securities	70	—	—	70
Other debt securities	2	—	—	2
Total debt securities	1,290	2	12	1,280
Common equity securities	42	19	—	61
Preferred equity securities	331	—	—	331
Current marketable securities & short-term investments	1,663	21	12	1,672
Non-current common equity securities	21	7	—	28
Total marketable securities & short-term investments	$1,684	$ 28	$ 12	$1,700

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
2004				
U.S. government & agency securities	$ 269	$ 1	$ 1	$ 269
U.S. mortgage & asset-backed securities	1,042	1	1	1,042
U.S. corporate securities	446	1	1	446
U.S. state and local municipal securities	1,098	—	—	1,098
Other debt securities	2	—	—	2
Total debt securities	2,857	3	3	2,857
Common equity securities	63	14	—	77
Preferred equity securities	1,546	—	22	1,524
Current marketable securities & short-term investments	4,466	17	25	4,458
Non-current common equity securities	—	—	—	—
Total marketable securities & short-term investments	$4,466	$ 17	$ 25	$4,458

The gross realized gains on sales of marketable securities totaled $2, $7, and $21 million in 2005, 2004, and 2003, respectively. The gross realized losses totaled $12, $5, and $7 million in 2005, 2004, and 2003, respectively. Impairment losses recognized on marketable securities and short-term investments totaled $16, $0, and $58 million during 2005, 2004, and 2003, respectively.

The following table presents the age of gross unrealized losses and fair value by investment category for all securities in a loss position as of December 31, 2005 (in millions):

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government & agency securities	$270	$ 2	$ 41	$ 1	$311	$ 3
U.S. mortgage & asset-backed securities	209	3	74	2	283	5
U.S. corporate securities	245	3	92	1	337	4
U.S. state and local municipal securities	—	—	—	—	—	—
Other debt securities	—	—	—	—	—	—
Total debt securities	724	8	207	4	931	12
Common equity securities	—	—	—	—	—	—
Preferred equity securities	7	—	7	—	14	—
	$731	$ 8	$214	$ 4	$945	$ 12

The unrealized losses in the U.S. government & agency securities, mortgage & asset-backed securities, and corporate securities relate to various fixed income securities, and are primarily due to changes in market interest rates. We have both the intent and ability to hold the securities contained in the previous table for a time necessary to recover the cost basis.

The amortized cost and estimated fair value of marketable securities and short-term investments at December 31, 2005, 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	$ 122	$ 121
Due after one year through three years	648	642
Due after three years through five years	89	89
Due after five years	431	428
	1,290	1,280
Equity securities	394	420
	$1,684	$1,700

NOTE 3. FINANCE RECEIVABLES

The following is a summary of finance receivables at December 31, 2005 and 2004 (in millions):

	2005	2004
Commercial term loans	$317	$ 360
Investment in finance leases	153	188
Asset-based lending	281	285
Receivable factoring	151	191
Gross finance receivables	902	1,024
Less: Allowance for credit losses	(20)	(25)
Balance at December 31	$882	$ 999

Outstanding receivable balances at December 31, 2005 and 2004 are net of unearned income of $34 and $35 million, respectively. When we “factor” (i.e., purchase) a customer invoice from a client, we record the customer receivable as an asset and also establish a liability for the funds due to the client, which is recorded in accounts payable on the consolidated balance sheet. The following is a reconciliation of receivable factoring balances at December 31, 2005 and 2004 (in millions):

	2005	2004
Customer receivable balances	$ 151	$ 191
Less: Amounts due to client	(101)	(112)
Net funds employed	$ 50	$ 79

Non-earning finance receivables were $24 and $38 million at December 31, 2005 and 2004, respectively. The following is a rollforward of the allowance for credit losses on finance receivables (in millions):

	2005	2004
Balance at January 1	$ 25	$ 52
Provisions charged to operations	11	14
Charge-offs, net of recoveries	(16)	(41)
Balance at December 31	$ 20	$ 25

The carrying value of finance receivables at December 31, 2005, by contractual maturity, is shown below (in millions). Actual maturities may differ from contractual maturities because some borrowers have the right to prepay these receivables without prepayment penalties.

	Carrying Value
Due in one year or less	$423
Due after one year through three years	82
Due after three years through five years	61
Due after five years	336
	$902

Based on interest rates for financial instruments with similar terms and maturities, the estimated fair value of finance receivables is approximately $883 and $991 million as of December 31, 2005 and 2004, respectively. At December 31, 2005, we had unfunded loan commitments totaling $416 million, consisting of standby letters of credit of $42 million and other unfunded lending commitments of $374 million.

NOTE 4. PROPERTY, PLANT AND EQUIPMENT

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

	2005	2004
Vehicles	$ 4,286	$ 3,784
Aircraft (including aircraft under capitalized leases)	12,289	11,590
Land	968	760
Buildings	2,404	2,164
Leasehold improvements	2,469	2,347
Plant equipment	4,982	4,641
Technology equipment	1,639	1,596
Equipment under operating lease	87	57
Construction-in-progress	433	539
	29,557	27,478
Less: Accumulated depreciation and amortization	(14,268)	(13,505)
	$ 15,289	$ 13,973

NOTE 5. EMPLOYEE BENEFIT PLANS

We sponsor various retirement and pension plans, including defined benefit and defined contribution plans which cover our employees worldwide. In the U.S. we maintain the following defined benefit pension plans (the "Plans"): UPS Retirement Plan, UPS Pension Plan, Retirement Plan for employees of Overnite Transportation Company, Pension Plan for Employees of Motor Cargo (a subsidiary of Overnite), and several non-qualified plans including the UPS Excess Coordinating Benefit Plan.

We also sponsor various retirement and pension plans covering certain of our non-U.S. employees. The majority of our non-U.S. obligations are for pension plans in Canada and the United Kingdom (including the Lynx acquisition in 2005). In addition, many of our non-U.S. employees are covered by government-sponsored retirement and pension plans. We are not directly responsible for providing benefits to participants of government-sponsored plans. In the pension benefits disclosures presented below, these non-U.S. plans are aggregated with our U.S. plans, as the non-U.S. plans we sponsor are not significant for disclosure purposes.

The UPS Retirement Plan is noncontributory and includes substantially all eligible employees of participating domestic subsidiaries who are not members of a collective bargaining unit. The Plan generally provides for retirement benefits based on average compensation levels earned by employees prior to retirement. Benefits payable under this Plan are subject to maximum compensation limits and the annual benefit limits for a tax qualified defined benefit plan as prescribed by the Internal Revenue Service. Effective December 31, 2005, the qualified defined benefit plans covering Overnite and Motor Cargo employees were merged with the UPS Retirement Plan and UPS Pension Plan.

The UPS Excess Coordinating Benefit Plan is a non-qualified plan that provides benefits to participants in the UPS Retirement Plan for amounts that exceed the benefit limits described above.

The UPS Pension Plan is noncontributory and includes certain eligible employees of participating domestic subsidiaries and members of collective bargaining units that elect to participate in the plan. The Plan provides for retirement benefits based on service credits earned by employees prior to retirement. Effective December 31, 2005, this plan includes those participants included in the Overnite acquisition who are covered by a collective bargaining agreement.

We also sponsor postretirement medical plans in the U.S. that provide health care benefits to our retirees who meet certain eligibility requirements and who are not otherwise covered by multi-employer plans. Generally, this includes employees with at least 10 years of service who have reached age 55 and employees who are eligible for postretirement medical benefits from a Company-sponsored plan pursuant to collective bargaining agreements. We have the right to modify or terminate certain of these plans. These benefits have been provided to certain retirees on a noncontributory basis; however, in many cases, retirees are required to contribute all or a portion of the total cost of the coverage.

Net Periodic Benefit Cost

Information about net periodic benefit cost for the pension and postretirement benefit plans is as follows (in millions):

	Pension Benefits			Postretirement Medical Benefits		
	2005	2004	2003	2005	2004	2003
Net Periodic Cost:						
Service cost	$ 388	$ 344	$ 282	$ 92	$ 91	$ 79
Interest cost	628	533	465	170	164	148
Expected return on assets	(935)	(809)	(669)	(38)	(34)	(29)
Amortization of:						
Transition obligation	3	6	8	—	—	—
Prior service cost	38	37	37	(7)	—	1
Actuarial (gain) loss	72	121	28	31	30	15
Net periodic benefit cost	$ 194	$ 232	$ 151	$248	$251	$214

Actuarial Assumptions

The table below provides the weighted-average actuarial assumptions used to determine the net periodic benefit cost.

	Pension Benefits			Postretirement Medical Benefits		
	2005	2004	2003	2005	2004	2003
Discount rate	6.09%	6.24%	6.75%	6.25%	6.25%	6.75%
Rate of compensation increase	3.98%	3.97%	4.00%	N/A	N/A	N/A
Expected return on assets	8.94%	8.95%	9.21%	9.00%	9.00%	9.25%

The table below provides the weighted-average actuarial assumptions used to determine the benefit obligations of our plans.

	Pension Benefits		Postretirement Medical Benefits	
	2005	2004	2005	2004
Discount rate	5.72%	6.09%	5.75%	6.25%
Rate of compensation increase	4.00%	3.98%	N/A	N/A

Our pension and other postretirement benefit costs are calculated using various actuarial assumptions and methodologies as prescribed by Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" and Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions." These assumptions include discount rates, expected return on plan assets, health care cost trend rates, inflation, rate of compensation increases, mortality rates, and other factors. Actuarial assumptions are reviewed on an annual basis.

A discount rate is used to determine the present value of our future benefit obligations. For U.S. plans, the discount rate is determined by matching the expected cash flows to a yield curve based on long-term, high quality fixed income debt instruments available as of the measurement date. For international plans, the discount rate is selected based on high quality fixed income indices available in the country in which the plan is domiciled. This assumption is updated every year for each plan.

An assumption for return on plan assets is used to determine the expected return on asset component of net periodic benefit cost for the fiscal year. This assumption for our U.S. plans was evaluated using input from third-party consultants and various pension plan asset managers, including their long-term projection of returns for each asset class and our target allocation. For our U.S. plans, the 10-year U.S. Treasury yield is the foundation for all other asset class returns, and various risk premiums are added to determine the expected return for each allocation.

For plans outside the U.S., consideration is given to local market expectations of long-term returns. Strategic asset allocations are determined by country, based on the nature of liabilities and considering the demographic composition of the plan participants.

Health care cost trends are used to project future postretirement benefits payable from our plans. Future postretirement medical benefit costs were forecasted assuming an initial annual increase of 8.5%, decreasing to 5.0% by the year 2009 and with consistent annual increases at those ultimate levels thereafter.

Assumed health care cost trends have a significant effect on the amounts reported for the U.S. postretirement medical plans. A one-percent change in assumed health care cost trend rates would have the following effects (in millions):

	1% Increase	1% Decrease
Effect on total of service cost and interest cost	$ 7	$ (6)
Effect on postretirement benefit obligation	$88	$(58)

Benefit Obligations and Funded Status

The following table provides a reconciliation of the changes in the plans' benefit obligations and funded status as of our measurement date on September 30 (in millions):

	Pension Benefits		Postretirement Medical Benefits	
	2005	2004	2005	2004
Net benefit obligation at October 1, prior year	$ 9,280	$8,287	$2,648	$2,592
Service cost	388	344	92	91
Interest cost	628	533	170	164
Plan participants contributions	1	1	10	9
Plan amendments	13	3	(21)	(115)
Acquired businesses	1,476	—	119	—
Actuarial (gain) loss	1,260	299	58	36
Foreign currency exchange rate changes	(16)	18	—	—
Curtailments and settlements	(6)	—	—	—
Gross benefits paid	(249)	(205)	(149)	(129)
Net benefit obligation at September 30	$12,775	$9,280	$2,927	$2,648

	Pension Benefits		Postretirement Medical Benefits	
	2005	2004	2005	2004
Fair value of plan assets at September 30	$ 13,209	$10,094	$ 509	$ 455
Benefit obligation at September 30	(12,775)	(9,280)	(2,927)	(2,648)
Funded status at September 30	434	814	(2,418)	(2,193)
Amounts not yet recognized:				
Unrecognized net actuarial loss	2,613	1,996	817	810
Unrecognized prior service cost	274	298	(118)	(104)
Unrecognized net transition obligation	15	18	—	—
Employer contributions	8	6	15	17
Net asset (liability) recorded at December 31	$ 3,344	$ 3,132	$(1,704)	$(1,470)
Prepaid pension cost	$ 3,932	$ 3,222	$ —	$ —
Accrued benefit cost	(750)	(221)	(1,704)	(1,470)
Intangible asset	13	4	—	—
Accumulated other comprehensive income (pre-tax)	149	127	—	—
Net asset (liability) recorded at December 31	$ 3,344	$ 3,132	$(1,704)	$(1,470)

The accumulated benefit obligation for our pension plans as of September 30, 2005 and 2004 was $11.485 and $8.307 billion, respectively. In general, we use a measurement date of September 30 for our pension and postretirement benefit plans.

For our U.S. and international pension plans in which the accumulated benefit obligation exceeds the assets, we have recorded a minimum pension liability of $312 and $221 million at December 31, 2005 and 2004, respectively. This liability is included in accrued pension costs, as detailed in Note 9. As of December 31, 2005 and 2004, the Company has recorded an intangible asset of $13 and $4 million, respectively, representing the net unrecognized prior service cost for our unfunded plans. A total of $149 and $127 million at December 31, 2005 and 2004, respectively, were recorded as a reduction of other comprehensive income in shareowners' equity (net of the tax effect of $54 and $46 million, respectively).

Plan Assets

The following table provides a reconciliation of the changes in the pension and postretirement medical benefit plan assets as of September 30 (in millions):

	Pension Benefits		Postretirement Medical Benefits	
	2005	2004	2005	2004
Fair value of plan assets at October 1, prior year	$10,094	$ 7,933	$ 455	$ 409
Actual return on plan assets	1,499	1,139	62	51
Employer contributions	864	1,216	131	115
Plan participants' contributions	1	1	10	9
Acquired businesses	1,012	—	—	—
Foreign currency exchange rate changes	(7)	10	—	—
Settlements	(5)	—	—	—
Gross benefits paid	(249)	(205)	(149)	(129)
Fair value of plan assets at September 30	$13,209	$10,094	$ 509	$ 455

Employer contributions and benefits paid under the pension plans include $9 and $8 million paid from employer assets in 2005 and 2004, respectively. Employer contributions and benefits paid (net of participant contributions) under the postretirement medical benefit plans include $69 and $57 million paid from employer assets in 2005 and 2004, respectively.

The asset allocation for our U.S. pension and other postretirement plans as of September 30, 2005 and 2004 and the target allocation for 2006, by asset category, are as follows:

	Weighted Average Target Allocation 2006	Percentage of Plan Assets at September 30, 2005	Percentage of Plan Assets at September 30, 2004
Equity securities	55% - 65%	62.1%	60.6%
Fixed income securities	20% - 30%	25.9%	28.0%
Real estate / other	10% - 15%	12.0%	11.4%
Total		100.0%	100.0%

Equity securities include UPS Class A shares of common stock in the amounts of $423 (3.4% of total plan assets) and $466 million (4.5% of total plan assets), as of September 30, 2005 and 2004, respectively.

The applicable benefit plan committees establish investment guidelines and strategies, and regularly monitor the performance of the funds and portfolio managers. Our investment strategy with respect to pension assets is to invest the assets in accordance with applicable laws and regulations. The long-term primary objectives for our pension assets are to (1) provide for a reasonable amount of long-term growth of capital, without undue exposure to risk; and protect the assets from erosion of purchasing power, and (2) provide investment results that meet or exceed the plans' actuarially assumed long-term rate of return.

At September 30, 2005 and 2004, the projected benefit obligation, the accumulated benefit obligation, and the fair value of plan assets for pension plans with a projected benefit obligation in excess of plan assets and for pension plans with an accumulated benefit obligation in excess of plan assets were as follows (in millions):

	Projected Benefit Obligation Exceeds the Fair Value of Plan Assets		Accumulated Benefit Obligation Exceeds the Fair Value of Plan Assets	
	2005	2004	2005	2004
As of September 30				
Projected benefit obligation	$705	$438	$705	$433
Accumulated benefit obligation	578	354	578	350
Fair value of plan assets	266	132	266	129

The accumulated postretirement benefit obligation exceeds plan assets for all of our other postretirement benefit plans.

Expected Cash Flows

Information about expected cash flows for the pension and postretirement benefit plans is as follows (in millions):

	Pension Benefits	Postretirement Medical Benefits
Employer Contributions:		
2006 (expected) to plan trusts	$ 763	$ 65
2006 (expected) to plan participants	30	65
Expected Benefit Payments:		
2006	$ 322	$ 132
2007	338	140
2008	376	149
2009	410	160
2010	454	170
2011 - 2015	3,136	1,000

Expected benefit payments for pensions will be primarily paid from plan trusts. Expected benefit payments for postretirement benefits will be paid from plan trusts and corporate assets. Our funding policy for U.S. plans is to contribute amounts annually that are at least equal to the amounts required by applicable laws and regulations, or to directly fund payments to plan participants, as applicable. International plans will be funded in accordance with local regulations. Additional discretionary contributions will be made when deemed appropriate to meet the long-term obligations of the plans.

Other Plans

We also contribute to several multi-employer pension plans for which the previous disclosure information is not determinable. Amounts charged to operations for pension contributions to these multi-employer plans were $1.289, $1.163, and $1.066 billion during 2005, 2004, and 2003, respectively.

We also contribute to several multi-employer health and welfare plans that cover both active and retired employees for which the previous disclosure information is not determinable. Amounts charged to operations for contributions to multi-employer health and welfare plans were $798, $761, and $691 million during 2005, 2004, and 2003, respectively.

We also sponsor a defined contribution plan for all employees not covered under collective bargaining agreements. The Company matches, in shares of UPS common stock, a portion of the participating employees' contributions. Matching contributions charged to expense were $105, $94, and $87 million for 2005, 2004, and 2003, respectively.

NOTE 6. GOODWILL, INTANGIBLES, AND OTHER ASSETS

The following table indicates the allocation of goodwill by reportable segment (in millions):

	U.S. Domestic Package	International Package	Supply Chain & Freight	Consolidated
December 31, 2003 balance	$—	$100	$1,073	$1,173
Acquired	—	41	38	79
Impaired	—	—	—	—
Currency / Other	—	—	3	3
December 31, 2004 balance	—	141	1,114	1,255
Acquired	—	145	1,171	1,316
Impaired	—	—	—	—
Currency / Other	—	4	(26)	(22)
December 31, 2005 balance	$—	$290	$2,259	$2,549

The goodwill acquired in the International Package segment during 2005 resulted primarily from the purchase of Lynx Express Ltd. in the United Kingdom, Messenger Service Stolica S.A. in Poland, and the express operations of Sinotrans Air Transportation Development Co. Ltd. in China. The goodwill acquired in the Supply Chain & Freight segment during 2005 resulted primarily from the purchase of Overnite Corp., as well as the restructuring costs incurred in exiting certain activities from the Menlo Worldwide Forwarding operations acquired previously. The goodwill acquired in the International Package segment during 2004 resulted from the purchase of the remaining minority interest in UPS Yamato Express Co., while the goodwill acquired in the Supply Chain & Freight segment in 2004 resulted primarily from the purchase of Menlo Worldwide Forwarding. The currency/other balance includes escrow reimbursements from acquisitions completed previously. See Note 7 for further discussion of these business acquisition transactions.

The following is a summary of intangible assets at December 31, 2005 and 2004 (in millions):

	Trademarks, Licenses, Patents, and Other	Franchise Rights	Capitalized Software	Intangible Pension Asset	Total Intangible Assets
December 31, 2005:					
Gross carrying amount	$139	$ 108	$1,391	$ 13	$1,651
Accumulated amortization	(31)	(23)	(913)	—	(967)
Net carrying value	$108	$ 85	$ 478	$ 13	$ 684
Weighted-average amortization period (in years)	9.6	20.0	3.1	N/A	4.8
December 31, 2004:					
Gross carrying amount	$ 29	$ 97	$1,249	$ 4	$1,379
Accumulated amortization	(16)	(18)	(676)	—	(710)
Net carrying value	$ 13	$ 79	$ 573	$ 4	$ 669

Amortization of intangible assets was $255, $221, and $196 million during 2005, 2004 and 2003, respectively. Expected amortization of finite-lived intangible assets recorded as of December 31, 2005 for the next five years is as follows (in millions): 2006—$179; 2007—$180; 2008—$179; 2009—$23; 2010—$23. Amortization expense in future periods will be affected by business acquisitions, software development, and other factors.

Other assets as of December 31 consist of the following (in millions):

	2005	2004
Non-current finance receivables, net of allowance for credit losses	$ 471	$ 475
Other non-current assets	1,294	889
	$1,765	$1,364

NOTE 7. BUSINESS ACQUISITIONS AND DISPOSITIONS

We regularly explore opportunities to make acquisitions that would enhance our businesses. During the three years ended December 31, 2005, we completed several acquisitions, including both domestic and international transactions, which were accounted for under the purchase method of accounting. In connection with these transactions, we paid cash (net of cash acquired) in the aggregate amount of $1.488 billion, $238 million, and $30 million in 2005, 2004, and 2003, respectively. Pro forma results of operations have not been presented for any of the acquisitions because the effects of these transactions were not material on either an individual or aggregate basis. The results of operations of each acquired company are included in our statements of consolidated income from the date of acquisition. The purchase price allocations of acquired companies can be modified up to one year after the date of acquisition.

During the second quarter of 2003, we sold our Mail Technologies business unit in a transaction that increased net income by $14 million, or $0.01 per diluted share. The gain consisted of a pre-tax loss of $24 million recorded in other operating expenses within the Supply Chain & Freight segment, and a tax benefit of $38 million recognized in conjunction with the sale. The tax benefit exceeded the pre-tax loss from this sale primarily because a goodwill impairment charge we previously recorded for the Mail Technologies business unit was not deductible for income tax purposes. Consequently, our tax basis was greater than our book basis, thus producing the tax benefit described above. The operating results of the Mail Technologies unit were previously included in the Supply Chain & Freight segment, and were not material to our operating results in any of the periods presented.

During the third quarter of 2003, we sold our Aviation Technologies business unit and recognized a pre-tax gain of $24 million ($15 million after-tax, or $0.01 per diluted share), which was recorded in other operating expenses within the U.S. Domestic Package segment. The operating results of the Aviation Technologies unit were previously included in the U.S. Domestic Package segment, and were not material to our operating results in any of the periods presented.

In March 2004, we acquired the remaining 49% minority interest in UPS Yamato Express Co., which was previously a joint venture with Yamato Transport Co. in Japan, for $65 million in cash. UPS Yamato Express provides express package delivery services in Japan. Upon the close of the acquisition, UPS Yamato Express became a wholly-owned subsidiary of UPS, and is included in our International Package reporting segment. The acquisition had no material effect on our financial condition or results of operations.

In December 2004, we acquired the Menlo Worldwide Forwarding, Inc. from CNF Inc. for $150 million in cash (net of cash acquired) plus the assumption of $110 million in principal amount of debt and capital lease obligations. Menlo Worldwide Forwarding, Inc. is a global freight forwarder that provides a full suite of heavy air freight forwarding services, ocean services and international trade management, including customs brokerage. Menlo Worldwide Forwarding, Inc. is now included as part of our Supply Chain & Freight reporting segment.

In December 2004, we agreed with Sinotrans Air Transportation Development Co., Ltd. ("Sinotrans") to acquire direct control of the international express operations in 23 cities within China, and to purchase Sintotrans' interest in our current joint venture in China. The agreement will result in the payment of $121 million to Sinotrans in 2005 and 2006. As of December 31, 2005, we have paid cash of $71 million, and have taken direct control of operations in all 23 locations. The operations being acquired are reported within our International Package reporting segment from the dates of acquisition.

In May 2005, we acquired Messenger Service Stolica S.A. ("Stolica"), one of the leading parcel and express delivery companies in Poland. Stolica's operating results are included in our International Package reporting segment from the date of acquisition.

In August 2005, we acquired Overnite Corporation ("Overnite") for approximately $1.225 billion in cash. Overnite offers a variety of less-than-truckload and truckload services to more than 60,000 customers in North America. The operating results of Overnite, which is now known as UPS Freight, are included in our Supply Chain and Freight reporting segment from the date of acquisition.

In September 2005, we acquired Lynx Express Ltd. ("Lynx") for approximately $68 million in cash. Lynx Express was one of the largest independent parcel carriers in the United Kingdom. Lynx also offers customers a broad suite of logistics and spare parts logistics services. The operating results of Lynx are included in our International Package reporting segment from the date of acquisition.

We are in the process of finalizing the independent appraisals for certain assets and liabilities to assist management in allocating the purchase price of Lynx and Overnite to the individual assets acquired and liabilities assumed. This may result in adjustments to the carrying values of Lynx's and Overnite's recorded assets and liabilities, including the amount of any residual value allocated to goodwill. The preliminary allocation of the purchase price included in the current period balance sheet is based on the current best estimates of management and is subject to revision based on final determination of fair values of acquired assets and assumed liabilities. We anticipate the valuations and other studies will be completed prior to the anniversary dates of the acquisitions.

The allocation of the total purchase price of the 2005 acquisitions discussed above (preliminary allocation in the case of Lynx and Overnite) and other smaller acquisitions, as well as the 2005 purchase price adjustments related to acquisitions closed in 2004, resulted in the following condensed balance sheet of assets acquired and liabilities assumed (in millions):

	Assets		Liabilities
Cash and cash equivalents	$ 25	Accounts payable	$ 77
Accounts receivable	246	Accrued wages and withholdings	41
Other current assets	57	Other current liabilities	254
Property, plant, and equipment	701	Current maturities of long-term debt	48
Goodwill	1,316	Deferred taxes, credits and other liabilities	338
Intangible assets	119	Long-term debt	78
Other assets	4	Accumulated postretirement benefit obligation	119
	$2,468		$955

NOTE 8. LONG-TERM DEBT AND COMMITMENTS

Long-term debt, as of December 31, consists of the following (in millions):

	2005	2004
8.38% debentures, due April 1, 2020 (i)	$ 457	$ 463
8.38% debentures, due April 1, 2030 (i)	293	276
Commercial paper (ii)	739	1,015
Industrial development bonds, Philadelphia Airport facilities, due December 1, 2015 (iii)	100	100
Special facilities revenue bonds, Louisville Airport facilities, due January 1, 2029 (iv)	149	149
Floating rate senior notes (v)	441	441
Capitalized lease obligations (vi)	278	401
UPS Notes (vii)	377	393
5.50% Pound Sterling notes, due February 12, 2031	863	961
Special facilities revenue bonds, Dayton, OH facilities (viii)	119	121
Installment notes, mortgages, and bonds at various rates	164	128
	3,980	4,448
Less current maturities	(821)	(1,187)
	$3,159	$ 3,261

(i) On January 22, 1998, we exchanged $276 million of an original $700 million in debentures for new debentures of equal principal with a maturity of April 1, 2030. The new debentures have the same interest rate as the 8.38% debentures due 2020 until April 1, 2020, and, thereafter, the interest rate will be 7.62% for the final 10 years. The 2030 debentures are redeemable in whole or in part at our option at any time. The redemption price is equal to the greater of 100% of the principal amount and accrued interest or the sum of the present values of the remaining scheduled payout of principal and interest thereon discounted to the date of redemption at a benchmark treasury yield plus five basis points plus accrued interest. The remaining $424 million of 2020 debentures are not subject to redemption prior to maturity. Interest is payable semiannually on the first of April and October for both debentures and neither debenture is subject to sinking fund requirements. Portions of the fixed obligations associated with the debentures were swapped to floating rates during 2004 and 2005, based on six month LIBOR plus a spread. Including the effect of the swaps, the average interest rate paid on the debentures for 2005 and 2004 was 7.39% and 7.49%, respectively.

(ii) The weighted average interest rate on the commercial paper outstanding as of December 31, 2005 and 2004, was 4.01% and 2.10%, respectively. At December 31, 2005 and 2004, the entire commercial paper balance has been classified as a current liability. The amount of commercial paper outstanding in 2006 is expected to fluctuate. We are authorized to borrow up to $7.0 billion under the two U.S. commercial paper programs we maintain as of December 31, 2005. We also maintain a European commercial paper program under which we are authorized to borrow up to €1.0 billion in a variety of currencies, however no amounts were outstanding under this program as of December 31, 2005.

(iii) The industrial development bonds bear interest at a daily variable rate. The average interest rates for 2005 and 2004 were 2.21% and 1.08%, respectively.

(iv) The special facilities revenue bonds bear interest at a daily variable rate. The average interest rates for 2005 and 2004 were 2.41% and 1.20%, respectively.

(v) The floating rate senior notes bear interest at one-month LIBOR less 45 basis points. The average interest rates for 2005 and 2004 were 2.87% and 1.00%, respectively. These notes are callable at various times after 30 years at a stated percentage of par value, and putable by the note holders at various times after 10 years at a stated percentage of par value. The notes have maturities ranging from 2049 through 2053.

(vi) We have certain aircraft subject to capital leases. Some of the obligations associated with these capital leases have been legally defeased. The recorded value of aircraft subject to capital leases, which are included in Property, Plant and Equipment is as follows as of December 31 (in millions):

	2005	2004
Aircraft	$2,054	$1,795
Accumulated amortization	(315)	(257)
	$1,739	$1,538

(vii) The UPS Notes program involves the periodic issuance of fixed rate notes in $1,000 increments with various terms and maturities. At December 31, 2005, the coupon rates of the outstanding notes varied between 3.00% and 6.20%, and the interest payments are made either monthly, quarterly or semiannually. The maturities of the notes range from 2006 to 2024. Substantially all of the fixed obligations associated with the notes were swapped to floating rates, based on different LIBOR indices plus or minus a spread. The average interest rate payable on the swaps for 2005 and 2004 was 3.09% and 1.13%, respectively.

(viii) The special facilities revenue bonds were assumed in the acquisition of Menlo Worldwide Forwarding in December 2004 (see Note 7). The bonds have a par value of $108 million, $62 million of which is due in 2009, while the remaining $46 million is due in 2018. The bonds due in 2018 are callable beginning in 2008. The bonds due in 2018 bear interest at a fixed rate of 5.63%, while the bonds due in 2009 bear interest at fixed rates ranging from 6.05% to 6.20%. The bonds were recorded at fair value on the date of acquisition.

Based on the borrowing rates currently available to the Company for long-term debt with similar terms and maturities, the fair value of long-term debt, including current maturities, is approximately $4.327 and $4.708 billion as of December 31, 2005 and 2004, respectively.

We lease certain aircraft, facilities, equipment and vehicles under operating leases, which expire at various dates through 2055. Certain of the leases contain escalation clauses and renewal or purchase options. Rent expense related to our operating leases was $742, $693, and $678 million for 2005, 2004 and 2003, respectively.

The following table sets forth the aggregate minimum lease payments under capitalized and operating leases, the aggregate annual principal payments due under our long-term debt, and the aggregate amounts expected to be spent for purchase commitments (in millions).

Year	Capitalized Leases	Operating Leases	Debt Principal	Purchase Commitments
2006	$ 64	$ 403	$ 774	$1,280
2007	107	348	70	826
2008	115	248	37	738
2009	66	176	104	652
2010	61	126	30	478
After 2010	1	544	2,637	689
Total	414	$1,845	$3,652	$4,663
Less: imputed interest	(136)			
Present value of minimum capitalized lease payments	278			
Less: current portion	(54)			
Long-term capitalized lease obligations	$ 224			

As of December 31, 2005, we had outstanding letters of credit totaling approximately $2.095 billion issued in connection with routine business requirements.

We maintain two credit agreements with a consortium of banks that provide revolving credit facilities of $1.0 billion each, with one expiring April 20, 2006 and the other April 21, 2010. Interest on any amounts we borrow under these facilities would be charged at 90-day LIBOR plus 15 basis points. At December 31, 2005, there were no outstanding borrowings under these facilities.

We have a $2.0 billion shelf registration statement under which we may issue debt securities in the U.S. The debt may be denominated in a variety of currencies. There was approximately $126 million issued under this shelf registration statement at December 31, 2005.

Our existing debt instruments and credit facilities do not have cross-default or ratings triggers, however these debt instruments and credit facilities do subject us to certain financial covenants. These covenants generally require us to maintain a $3.0 billion minimum net worth and limit the amount of secured indebtedness available to the company. These covenants are not considered material to the overall financial condition of the company, and all covenant tests were passed as of December 31, 2005.

In December 2003, we redeemed our $300 million cash-settled convertible senior notes at a price of 102.703, and also terminated the swap transaction associated with the notes. The redemption amount paid was lower than the amount recorded for the fair value of the notes at the time of redemption, which, along with the cash settlement received on the swap, resulted in a $28 million pre-tax gain recorded in 2003 results.

NOTE 9. DEFERRED TAXES, CREDITS, AND OTHER LIABILITIES

Deferred taxes, credits, and other liabilities as of December 31 consist of the following (in millions):

	2005	2004
Deferred income taxes (see Note 14)	$3,425	$3,274
Insurance reserves	1,354	1,136
Accrued pension cost (see Note 5)	750	221
Other credits and non-current liabilities	1,153	819
	$6,682	$5,450

NOTE 10. LEGAL PROCEEDINGS AND CONTINGENCIES

We were named as a defendant in twenty-six now-dismissed lawsuits that sought to hold us liable for the collection of premiums for reinsured excess value (“EV”) insurance in connection with package shipments since 1984. These actions were all filed after an August 9, 1999 U.S. Tax Court decision that the U.S. Court of Appeals for the Eleventh Circuit later reversed. These twenty-six cases were consolidated for pre-trial purposes in a multi-district litigation proceeding (“MDL Proceeding”) in federal court in New York. In addition to the cases in which UPS was named as a defendant, there also was an action, Smith v. Mail Boxes Etc., against Mail Boxes Etc. and its franchisees relating to UPS EV insurance and related services purchased through Mail Boxes Etc. centers. That case also was consolidated into the MDL Proceeding.

In late 2003, the parties reached a global settlement resolving all claims and all cases in the MDL Proceeding. In reaching the settlement, we and the other defendants expressly denied any and all liability. On July 30, 2004, the court issued an order granting final approval to the substantive terms of the settlement. No appeals were filed and the settlement became effective on September 8, 2004.

Pursuant to the settlement, UPS provided qualifying settlement class members with vouchers toward the purchase of specified UPS services and agreed to pay the plaintiffs’ attorneys’ fees and costs. Other defendants contributed to the costs of the litigation and settlement. The vouchers expired in July 2005 and the value of services for which vouchers were redeemed totaled $5 million. On November 2, 2005, the court issued an order awarding plaintiffs' counsel fees and costs in the total amount of $3 million. The settlement did not have a material effect on our financial condition, results of operations, or liquidity.

We are a defendant in a number of lawsuits filed in state and federal courts containing various class-action allegations under state wage-and-hour laws. In one of these cases, Marlo v. UPS, which has been certified as a class action in a California federal court, plaintiffs allege that they improperly were denied overtime, and seek penalties for missed meal and rest periods, and interest and attorneys' fees. Plaintiffs purport to represent a class of 1,200 full-time supervisors.

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

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

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

NOTE 11. CAPITAL STOCK AND STOCK-BASED COMPENSATION

Capital Stock

We maintain two classes of common stock, which are distinguished from each other by their respective voting rights. Class A shares of UPS are entitled to 10 votes per share, whereas Class B shares are entitled to one vote per share. Class A shares are primarily held by UPS employees and retirees, and these shares are fully convertible into Class B shares at any time. Class B shares are publicly traded on the New York Stock Exchange (NYSE) under the symbol "UPS."

Incentive Compensation Plan

The UPS Incentive Compensation Plan permits the grant of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, performance shares, performance units, and management incentive awards to eligible employees. The number of shares reserved for issuance under the Plan is 112 million, with the number of shares reserved for issuance as restricted stock limited to 34 million. As of December 31, 2005, management incentive awards, stock options, restricted performance units, and restricted stock units had been granted under the Incentive Compensation Plan.

Management Incentive Awards & Restricted Stock Units

Persons earning the right to receive management incentive awards are determined annually by the Compensation Committee of the UPS Board of Directors. In years prior to 2005, management incentive awards consisted entirely of UPS Class A common stock that was fully vested in the year of grant. During the first quarter of 2005, we modified our management incentive awards program to provide that half of the annual management incentive award, with certain exceptions, be made in restricted stock units, which generally vest over a five-year period. The other half of the award granted in November 2005 was in the form of cash or unrestricted shares of Class A common stock and was fully vested at the time of grant. Amounts expensed for management incentive awards, including the restricted stock units, were $404, $738, and $606 million during 2005, 2004, and 2003, respectively.

Upon vesting, restricted stock units result in the issuance of the equivalent number of UPS Class A common shares after required tax withholdings. Except in the case of death, disability, or retirement, restricted stock units vest over a five year period with approximately 20% of the award vesting at each anniversary date of the grant. All restricted stock units granted are subject to earlier cancellation or vesting under certain conditions. Dividends earned on restricted stock units are reinvested in additional restricted stock units at each dividend payable date. As of December 31, 2005, we had a total of 5.108 million restricted stock units outstanding, with approximately 1.022 million units, before tax withholdings, vesting each year from 2006 through 2010.

Nonqualified Stock Options

We maintain fixed stock option plans, under which options are granted to purchase shares of UPS Class A common stock. Stock options granted in connection with the Incentive Compensation Plan must have an exercise price at least equal to the NYSE closing price of UPS class B common stock on the date the option was granted.

Persons earning the right to receive stock options are determined each year by the Compensation Committee. Except in the case of death, disability, or retirement, options granted under the Incentive Compensation Plan are generally exercisable three to five years from the date of grant and before the expiration of the option 10 years after the date of grant. All options granted are subject to earlier cancellation or exercise under certain conditions. Options granted to eligible employees will generally be granted annually during the first half of each year at the discretion of the Compensation Committee.

The following is an analysis of options to purchase shares of Class A common stock issued and outstanding:

	2005		2004		2003	
	Weighted Average Price	Shares (in thousands)	Weighted Average Price	Shares (in thousands)	Weighted Average Price	Shares (in thousands)
Outstanding at beginning of year	$59.96	17,701	$48.02	22,745	$38.73	27,745
Exercised	56.44	(1,325)	26.97	(7,351)	18.59	(7,297)
Granted	72.18	2,667	70.70	2,663	62.40	2,860
Forfeited / expired	67.09	(309)	58.70	(356)	44.63	(563)
Outstanding at end of year	$61.84	18,734	$59.96	17,701	$48.02	22,745

The following table summarizes information about stock options outstanding and exercisable at December 31, 2005:

	Options Outstanding			Options Exercisable	
Exercise Price Range	Shares (in thousands)	Average Life (in years)	Average Exercise Price	Shares (in thousands)	Average Exercise Price
$ 16.60 - $50.00	2,052	3.85	$49.90	2,052	$49.90
$ 50.37 - $56.90	3,953	5.22	56.85	3,953	56.85
$ 57.45 - $60.22	4,831	6.26	60.19	4,831	60.19
$ 60.38 - $70.70	5,253	7.81	66.43	28	61.94
$ 71.88 - $116.48	2,645	9.28	72.43	29	94.85
	18,734	6.64	$61.84	10,893	$57.13

Restricted Performance Units

Beginning in 2003, we issued restricted performance units under the Incentive Compensation Plan. Upon vesting, restricted performance units result in the issuance of the equivalent number of UPS Class A common shares after required tax withholdings. Persons earning the right to receive restricted performance units are determined each year by the Compensation Committee. Except in the case of death, disability, or retirement, restricted performance units vest five years after the date of grant. All restricted performance units granted are subject to earlier cancellation or vesting under certain conditions. Dividends earned on restricted performance units are reinvested in additional restricted performance units at each dividend payable date. Restricted performance units also allow for bonus shares to be issued, comprising 10% of the original award, if certain company-wide performance goals are attained in the year of vesting. During 2005, 2004, and 2003, the Company issued 1.076, 1.083, and 1.164 million restricted performance units, respectively. As of December 31, 2005, we had the following restricted performance units outstanding, including reinvested dividends:

Year of Award	Units Outstanding (in thousands)	Remaining Vesting Period (in years)	Average Fair Value at Grant Date
2003	1,129	2.33	$62.40
2004	1,067	3.33	70.70
2005	1,068	4.33	72.07
	3,264	3.31	$68.28

Discounted Employee Stock Purchase Plan

We maintain an employee stock purchase plan for all eligible employees. Under the plan, shares of UPS Class A common stock may be purchased at quarterly intervals at 90% of the lower of the NYSE closing price of UPS Class B common stock on the first or the last day of each quarterly period. Employees purchased 2.0, 1.8, and 1.9 million shares at average prices of $64.54, $62.75, and $54.08 per share during 2005, 2004, and 2003, respectively.

Deferred Compensation Obligations

We maintain a deferred compensation plan whereby certain employees may elect to defer the gains on stock option exercises by deferring the shares received upon exercise into a rabbi trust. The shares held in this trust are classified as treasury stock, and the liability to participating employees is classified as “Deferred compensation obligations" in the shareowners' equity section of the balance sheet. The amount of shares needed to settle the liability for deferred compensation obligations is included in the denominator in both the basic and diluted earnings per share calculations.

NOTE 12. SEGMENT AND GEOGRAPHIC INFORMATION

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

U.S. Domestic Package

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

International Package

International Package operations include delivery to more than 200 countries and territories worldwide, including shipments wholly outside the United States, as well as shipments with either origin or distribution outside the United States. Our International Package reporting segment includes the operations of our Europe, Asia, and Americas operating segments.

Supply Chain & Freight

Supply Chain & Freight includes our forwarding services and logistics operations, the operations of Overnite Corp. (acquired August 2005, and now known as UPS Freight), and other aggregated business units. Our forwarding services and logistics business include the operations acquired with the purchase of Menlo Worldwide Forwarding, Inc. (now collectively known as UPS Supply Chain Solutions). Forwarding services and logistics includes supply chain design and management, freight distribution and customs brokerage services. UPS Freight offers a variety of less-than-truckload (LTL) and truckload services to customers in North America. Other aggregated business units within this segment include Mail Boxes, Etc. (the franchisor of Mail Boxes, Etc. and The UPS Store), UPS Capital, mail, consulting and professional services.

In evaluating financial performance, we focus on operating profit as a segment's measure of profit or loss. Operating profit is before investment income, interest expense, and income taxes. The accounting policies of the reportable segments are the same as those described in the summary of accounting policies (see Note 1), with certain expenses allocated between the segments using activity-based costing methods. Unallocated assets are comprised primarily of cash, marketable securities, short-term investments, and equity-method real estate investments.

Segment information as of, and for the years ended, December 31 is as follows (in millions):

	2005	2004	2003
Revenue:			
U.S. Domestic Package	$28,610	$26,960	$25,362
International Package	7,977	6,809	5,609
Supply Chain & Freight	5,994	2,813	2,514
Consolidated	$42,581	$36,582	$33,485
Operating Profit:			
U.S. Domestic Package	$ 4,493	$ 3,702	$ 3,657
International Package	1,494	1,149	732
Supply Chain & Freight	156	138	56
Consolidated	$ 6,143	$ 4,989	$ 4,445
Assets:			
U.S. Domestic Package	$20,781	$18,944	$18,156
International Package	4,987	4,728	4,287
Supply Chain & Freight	7,126	4,878	4,498
Unallocated	2,328	4,538	2,793
Consolidated	$35,222	$33,088	$29,734
Depreciation and Amortization Expense:			
U.S. Domestic Package	$ 1,005	$ 971	$ 993
International Package	491	465	454
Supply Chain & Freight	148	107	102
Consolidated	$ 1,644	$ 1,543	$ 1,549

Revenue by product type for the years ended December 31 is as follows (in millions):

	2005	2004	2003
U.S. Domestic Package:			
Next Day Air	$ 6,381	$ 6,084	$ 5,621
Deferred	3,258	3,193	3,015
Ground	18,971	17,683	16,726
Total U.S. Domestic Package	28,610	26,960	25,362
International Package:			
Domestic	1,588	1,346	1,134
Export	5,856	4,991	4,049
Cargo	533	472	426
Total International Package	7,977	6,809	5,609
Supply Chain & Freight:			
Forwarding Services and Logistics	4,737	2,379	2,126
UPS Freight	797	—	—
Other	460	434	388
Total Supply Chain & Freight	5,994	2,813	2,514
Consolidated	$42,581	$36,582	$33,485

Geographic information as of, and for the years ended, December 31 is as follows (in millions):

	2005	2004	2003
United States:			
Revenue	$31,871	$28,035	$26,968
Long-lived assets	$19,704	$16,033	$15,634
International:			
Revenue	$10,710	$ 8,547	$ 6,517
Long-lived assets	$ 4,044	$ 3,975	$ 3,567
Consolidated:			
Revenue	$42,581	$36,582	$33,485
Long-lived assets	$23,748	$20,008	$19,201

Revenue, for geographic disclosure, is based on the location in which service originates. Long-lived assets include property, plant and equipment, prepaid pension costs, long-term investments, goodwill, and intangible assets.

NOTE 13. OTHER OPERATING EXPENSES

The major components of other operating expenses for the years ended December 31 are as follows (in millions):

	2005	2004	2003
Repairs and maintenance	$ 1,097	$ 1,005	$ 955
Depreciation and amortization	1,644	1,543	1,549
Purchased transportation	4,050	2,059	1,828
Fuel	2,085	1,416	1,050
Other occupancy	872	752	730
Other expenses	4,173	3,995	3,677
	$13,921	$10,770	$9,789

In 2005, we reclassified certain amounts between “other expenses” and “compensation and benefits” expense, related to the capitalization of internally-developed software. Amounts were also reclassified in all prior periods for consistent presentation in our consolidated income statement. The reclassification had the effect of increasing other expenses, and reducing compensation and benefits expense, by $92, $93, and $77 million in 2005, 2004, and 2003, respectively.

NOTE 14. INCOME TAXES

The income tax expense (benefit) for the years ended December 31 consists of the following (in millions):

	2005	2004	2003
Current:			
U.S. Federal	$1,683	$1,675	$1,103
U.S. State & Local	176	71	112
Non-U.S.	135	98	86
Total Current	1,994	1,844	1,301
Deferred:			
U.S. Federal	211	(155)	181
U.S. State & Local	6	(84)	(11)
Non-U.S.	(6)	(16)	1
Total Deferred	211	(255)	171
Total	$2,205	$1,589	$1,472

Income before income taxes includes income of non-U.S. subsidiaries of $337, $270, and $237 million in 2005, 2004, and 2003, respectively.

A reconciliation of the statutory federal income tax rate to the effective income tax rate for the years ended December 31 consists of the following:

	2005	2004	2003
Statutory U.S. federal income tax rate	35.0%	35.0%	35.0%
U.S. state & local income taxes (net of federal benefit)	2.0	1.2	1.5
Other	(0.7)	(3.9)	(2.8)
Effective income tax rate	36.3%	32.3%	33.7%

During the third quarter of 2004, we recognized a $99 million reduction of income tax expense related to the favorable settlement of various U.S. federal tax contingency matters with the IRS pertaining to tax years 1985 through 1998, and various state and non-U.S. tax contingency matters.

During the fourth quarter of 2004, we recognized a $109 million reduction of income tax expense primarily related to the favorable resolution of a U.S. state tax contingency matter, improvements in U.S. state and non-U.S. effective tax rates, and the reversal of valuation allowances associated with certain U.S. state & local and non-U.S. net operating loss and credit carryforwards due to sufficient positive evidence that the related subsidiaries will be profitable and generate taxable income before such carryforwards expire.

During the first quarter of 2003, we recognized a $55 million reduction of income tax expense due to the favorable resolution of several outstanding contingency matters with the IRS. During the third quarter of 2003, we recognized a $22 million credit to income tax expense as a result of a favorable tax court ruling in relation to an outstanding contingency matter with the IRS.

After filing our 2002 state tax returns during the fourth quarter of 2003, we completed a review of the taxability of our operations in various U.S. state taxing jurisdictions and the effects of available state tax credits. As a result of this review, we recorded a decrease of $39 million in the income tax provision in the fourth quarter of 2003. This decrease includes a reduction in our estimated state tax liabilities and the effect of the estimated state income tax effective rate applied to our temporary differences.

Deferred tax liabilities and assets are comprised of the following at December 31 (in millions):

	2005	2004
Property, plant and equipment	$2,572	$2,624
Goodwill and intangible assets	491	428
Pension plans	1,722	1,481
Other	396	167
Gross deferred tax liabilities	5,181	4,700
Other postretirement benefits	681	684
Loss and credit carryforwards (non-U.S. and state)	113	135
Insurance reserves	543	469
Vacation pay accrual	154	145
Other	794	471
Gross deferred tax assets	2,285	1,904
Deferred tax assets valuation allowance	(54)	(86)
Net deferred tax assets	2,231	1,818
Net deferred tax liability	2,950	2,882
Current deferred tax asset	(475)	(392)
Long-term liability—see Note 9	$3,425	$3,274

The valuation allowance increased (decreased) by $(32), $(31), and $25 million during the years ended December 31, 2005, 2004 and 2003, respectively.

As of December 31, 2005, we have U.S. state & local operating loss and credit carryforwards of approximately $1.060 billion and $40 million, respectively. The operating loss carryforwards expire at varying dates through 2025. The majority of the credit carryforwards may be carried forward indefinitely. We also have non-U.S. loss carryforwards of approximately $644 million as of December 31, 2005, the majority of which may be carried forward indefinitely. As indicated in the table above, we have established a valuation allowance for certain non-U.S. and state loss carryforwards, due to the uncertainty resulting from a lack of previous taxable income within the applicable tax jurisdictions.

Undistributed earnings of our non-U.S. subsidiaries amounted to approximately $1.062 billion at December 31, 2005. Those earnings are considered to be indefinitely reinvested and, accordingly, no U.S. federal or state deferred income taxes have been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, we would be subject to U.S. income taxes and withholding taxes payable in various non-U.S. jurisdictions, which could potentially be offset by foreign tax credits. Determination of the amount of unrecognized deferred U.S. income tax liability is not practicable because of the complexities associated with its hypothetical calculation.

The American Jobs Creation Act of 2004, which provided for a temporary 85% dividends received deduction on certain foreign earnings repatriated during a one-year period (expired in December 2005), did not have an impact on UPS as we did not repatriate any earnings subject to the Act.

NOTE 15. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (in millions except per share amounts):

	2005	2004	2003
Numerator:			
Net income	$3,870	$3,333	$2,898
Denominator:			
Weighted average shares	1,110	1,125	1,125
Management incentive awards	—	1	1
Deferred compensation obligations	3	3	2
Denominator for basic earnings per share	1,113	1,129	1,128
Effect of dilutive securities:			
Management incentive awards	—	4	4
Restricted performance units	1	—	—
Stock option plans	2	4	6
Denominator for diluted earnings per share	1,116	1,137	1,138
Basic earnings per share	$ 3.48	$ 2.95	$ 2.57
Diluted earnings per share	$ 3.47	$ 2.93	$ 2.55

Diluted earnings per share for the years ended December 31, 2005, 2004, and 2003 exclude the effect of 5.2, 2.7, and 2.9 million shares, respectively, of common stock that may be issued upon the exercise of employee stock options because such effect would be antidilutive.

NOTE 16. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT

We are exposed to market risk, primarily related to foreign exchange rates, commodity prices, equity prices, and interest rates. These exposures are actively monitored by management. To manage the volatility relating to certain of these exposures, we enter into a variety of derivative financial instruments. Our objective is to reduce, where it is deemed appropriate to do so, fluctuations in earnings and cash flows associated with changes in foreign currency rates, commodity prices, equity prices, and interest rates. It is our policy and practice to use derivative financial instruments only to the extent necessary to manage exposures. As we use price sensitive instruments to hedge a certain portion of our existing and anticipated transactions, we expect that any loss in value for those instruments generally would be offset by increases in the value of those hedged transactions.

We do not hold or issue derivative financial instruments for trading or speculative purposes.

Commodity Price Risk Management

We are exposed to an increase in the prices of refined fuels, principally jet-A, diesel, and unleaded gasoline. Additionally, we are exposed to an increase in the prices of other energy products, principally natural gas and electricity. We use a combination of options, swaps, and futures contracts to provide partial protection from rising fuel and energy prices. The net fair value of such contracts subject to price risk, excluding the underlying exposures, as of December 31, 2005 and 2004 was an asset of $192 and $101 million, respectively. We have designated and account for these contracts as cash flow hedges, and, therefore, the resulting gains and losses from these hedges are recognized as a component of fuel expense or other occupancy expense when the underlying fuel or energy product being hedged is consumed.

Foreign Currency Exchange Risk Management

We have foreign currency risks related to our revenue, operating expenses, and financing transactions in currencies other than the local currencies in which we operate. We are exposed to currency risk from the potential changes in functional currency values of our foreign currency denominated assets, liabilities, and cash flows. Our most significant foreign currency exposures relate to the Euro, the British Pound Sterling, and the Canadian Dollar. We use a combination of purchased and written options and forward contracts to hedge currency cash flow exposures. As of December 31, 2005 and 2004, the net fair value of the hedging instruments described above was an asset (liability) of $52 and $(28) million, respectively. We have designated and account for these contracts as cash flow hedges of anticipated foreign currency denominated revenue and, therefore, the resulting gains and losses from these hedges are recognized as a component of international package revenue when the underlying sales occur.

Interest Rate Risk Management

Our indebtedness under our various financing arrangements creates interest rate risk. We use a combination of derivative instruments, including interest rate swaps and cross-currency interest rate swaps, as part of our program to manage the fixed and floating interest rate mix of our total debt portfolio and related overall cost of borrowing. These swaps are entered into concurrently with the issuance of the debt that they are intended to modify, and the notional amount, interest payment, and maturity dates of the swaps match the terms of the associated debt. Interest rate swaps allow us to maintain a target range of floating rate debt.

We have designated and account for these contracts as either hedges of the fair value of the associated debt instruments, or as hedges of the variability in expected future interest payments. Any periodic settlement payments are accrued monthly, as either a charge or credit to interest expense, and are not material to net income. The net fair value of our interest rate swaps at December 31, 2005 and 2004 was a liability of $(47) and $(32) million, respectively.

Credit Risk Management

The forward contracts, swaps, and options previously discussed contain an element of risk that the counterparties may be unable to meet the terms of the agreements. However, we minimize such risk exposures for these instruments by limiting the counterparties to large banks and financial institutions that meet established credit guidelines. We do not expect to incur any losses as a result of counterparty default.

Derivatives Not Designated As Hedges

Derivatives not designated as hedges primarily consist of a small portfolio of stock warrants in public and private companies that are held for investment purposes. These warrants are recorded at fair value, and the impact of these warrants on our results was immaterial for 2005, 2004 and 2003.

Income Effects of Derivatives

In the context of hedging relationships, “effectiveness” refers to the degree to which fair value changes in the hedging instrument offset corresponding changes in the hedged item. Certain elements of hedge positions cannot qualify for hedge accounting under FAS 133 whether effective or not, and must therefore be marked to market through income. Both the effective and ineffective portions of gains and losses on hedges are reported in the income statement category related to the hedged exposure. Both the ineffective portion of hedge positions and the elements excluded from the measure of effectiveness were immaterial for 2005, 2004 and 2003.

As of December 31, 2005, $64 million in gains related to cash flow hedges that are currently deferred in OCI are expected to be reclassified to income over the 12 month period ending December 31, 2006. 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. No amounts were reclassified to income during 2005 in connection with forecasted transactions that were no longer considered probable of occurring.

At December 31, 2005, the maximum term of derivative instruments that hedge forecasted transactions, except those related to cross-currency interest rate swaps on existing financial instruments, was two years. We maintain cross-currency interest rate swaps that extend through 2009.

Fair Value of Financial Instruments

At December 31, 2005 and 2004, our financial instruments included cash and cash equivalents, marketable securities and short-term investments, accounts receivable, finance receivables, accounts payable, short-term and long-term borrowings, and commodity, interest rate, foreign currency, and equity options, forwards, and swaps. The fair values of cash and cash equivalents, accounts receivable, and accounts payable approximate carrying values because of the short-term nature of these instruments. The fair value of our marketable securities and short-term investments is disclosed in Note 2, finance receivables in Note 3, and debt instruments in Note 8.

NOTE 17. MENLO RESTRUCTURING PROGRAM AND RELATED EXPENSES

In February 2005, we announced our intention to transfer operations currently taking place at the Menlo Worldwide Forwarding facility in Dayton, Ohio to other UPS facilities over approximately 12 to 18 months. This action is being taken to remove redundancies between the Menlo Worldwide Forwarding and existing UPS transportation networks, and thus provide efficiencies and better leverage the current UPS facilities in the movement of air freight. During the third quarter of 2005, we finalized our plans to exit the Dayton facility, as well as various other Menlo Worldwide Forwarding facilities, and accrued certain costs related to employee severance, lease terminations, and related items. As part of this program, the recorded value of the Dayton facility was reduced to its fair market value as of the date of the acquisition. These accrued costs, and related reductions in the fair value of recorded assets, resulted in an adjustment to the amount of goodwill initially recorded in the Menlo Worldwide Forwarding acquisition.

The total cost of the program is estimated at $229 million, of which $160 million resulted in an adjustment of the purchase price allocation of Menlo Worldwide Forwarding. The remaining $69 million of the total program cost relates to integration activities, such as employee relocations, the moving of inventory and fixed assets, and the consolidation of information systems, and are therefore being expensed as incurred. The program will be completed by the end of 2006.

Set forth below is a summary of activity related to the restructuring program and resulting liability for 2005 (in millions):

	Employee Severance	Asset Impairment	Facility Consolidation	Other	Total
Balance at January 1, 2005	$—	$—	$—	$—	$—
Costs accrued	31	56	48	25	160
Cash spent	(7)	—	(1)	—	(8)
Charges against assets	—	(56)	—	—	(56)
Balance at December 31, 2005	$ 24	$—	$ 47	$ 25	$ 96

Employee Severance

Employee severance costs relate to severance packages for approximately 550 people. The packages are involuntary and are formula-driven based on salary levels and past service. The current and planned separations span the entire business unit, including the operations, information technology, finance, and business development functions.

Asset Impairment

Asset impairment charges result from establishing new carrying values for assets that have been or will be abandoned. Impaired assets consist primarily of the Menlo Worldwide Forwarding facility in Dayton, Ohio, which we plan to close by June 2006. Other impaired assets include capitalized software that is redundant with existing UPS software, and will thus no longer be used.

Facility Consolidation

Facility consolidation costs are associated with terminating operating leases on offices, warehouses, and other Menlo Worldwide Forwarding facilities.

Other Costs

Other costs consist primarily of costs associated with the termination of certain Menlo Worldwide Forwarding legal entities and joint ventures, as well as environmental remediation costs.

NOTE 18. QUARTERLY INFORMATION (unaudited)

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	2005	2004	2005	2004	2005	2004	2005	2004
Revenue:								
U.S. Domestic Package	$6,811	$6,625	$ 6,942	$6,567	$ 7,033	$6,581	$ 7,824	$7,187
International Package	1,842	1,630	1,997	1,627	1,918	1,675	2,220	1,877
Supply Chain & Freight	1,233	664	1,252	677	1,599	696	1,910	776
Total revenue	9,886	8,919	10,191	8,871	10,550	8,952	11,954	9,840
Operating profit:								
U.S. Domestic Package	1,028	912	1,118	988	1,110	941	1,237	861
International Package	348	277	397	281	318	266	431	325
Supply Chain & Freight	9	28	34	41	70	51	43	18
Total operating profit	1,385	1,217	1,549	1,310	1,498	1,258	1,711	1,204
Net income	$ 882	$ 759	$ 986	$ 818	$ 953	$ 890	$ 1,049	$ 866
Earnings per share:								
Basic	$ 0.78	$ 0.67	$ 0.88	$ 0.73	$ 0.86	$ 0.79	$ 0.95	$ 0.77
Diluted	$ 0.78	$ 0.67	$ 0.88	$ 0.72	$ 0.86	$ 0.78	$ 0.95	$ 0.76

Third quarter 2004 net income includes a credit to tax expense ($99 million, $0.09 per diluted share) related to the resolution of various tax matters. Fourth quarter 2004 net income includes an impairment charge ($70 million after-tax, $0.06 per diluted share) on Boeing 727, 747, and McDonnell Douglas DC-8 aircraft, and related engines and parts, and a charge to pension expense ($40 million after-tax, $0.04 per diluted share) resulting from the consolidation of data collection systems. Fourth quarter 2004 net income also includes credits to income tax expense ($43 million, $0.04 per diluted share) related to various items, including the resolution of certain tax matters, the removal of a portion of the valuation allowances on certain deferred tax assets on net operating loss carryforwards, and an adjustment for identified tax contingency items.

EXHIBIT INDEX

Exhibit No.		Description
2.1	—	Agreement and Plan of Merger, dated as of September 22, 1999, among United Parcel Service of America, Inc., United Parcel Service, Inc. and UPS Merger Subsidiary, Inc. (incorporated by reference to the registration statement on Form S-4 (No. 333-83349), filed on July 21, 1999, as amended).
2.2	—	Agreement and Plan of Merger, dated as of May 15, 2005, among United Parcel Service, Inc., Overnite Corporation, and Olympic Merger Sub, Inc. (incorporated by reference to the Form 8-K, filed on May 18, 2005).
3.1	—	Form of Restated Certificate of Incorporation of United Parcel Service, Inc. (incorporated by reference to Exhibit 3.1 to Form 10-Q for the Quarter Ended June 30, 2002).
3.2	—	Form of Bylaws of United Parcel Service, Inc. (incorporated by reference to Exhibit 3.2 to the registration statement on Form S-4 (No. 333-83349), filed on July 21, 1999, as amended).
4.1	—	Form of Class A Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the registration statement on Form S-4 (No. 333-83349), filed on July 21, 1999, as amended).
4.2	—	Form of Class B Common Stock Certificate (incorporated by reference to Exhibit 4.2 to the registration statement on Form S-4 (No. 333-83349), filed on July 21, 1999).
4.3	—	Specimen Certificate of 8⅜% Debentures due April 1, 2020 (incorporated by reference to Exhibit 4(c) to Registration Statement No. 33-32481, filed December 7, 1989).
4.4	—	Indenture relating to 8⅜% Debentures due April 1, 2020 (incorporated by reference to Exhibit 4(c) to Registration Statement No. 33-32481, filed December 7, 1989).
4.5	—	Specimen Certificate of 8⅜% Debentures due April 1, 2030 (incorporated by reference to Exhibit T-3C to Form T-3 filed December 18, 1997).
4.6	—	Indenture relating to Exchange Offer Notes Due 2030 (incorporated by reference to Exhibit T-3C to Form T-3 filed December 18, 1997).
4.7	—	Indenture relating to $2,000,000,000 of debt securities (incorporated by reference to Exhibit 4.1 to Pre-Effective Amendment No. 1 to Registration Statement on Form S-3 (No. 333-08369), filed on January 26, 1999).
4.8	—	Form of Supplemental Indenture relating to $2,000,000,000 of debt securities (incorporated by reference to Exhibit 4.2 to Post-Effective Amendment No. 1 to Registration Statement on Form S-3 (No. 333-08369-01), filed on March 15, 2000).
4.9	—	Form of Second Supplemental Indenture relating to $2,000,000,000 of debt securities (incorporated by reference to Exhibit 4 to Form 10-Q for the Quarter Ended September 30, 2001).
4.10	—	Form of Indenture relating to $2,000,000,000 of debt securities (incorporated by reference to Exhibit 4.1 to Registration Statement on Form S-3 (No. 333-108272), filed on August 27, 2003).
4.11	—	Underwriting Agreement relating to 1.75% Cash-Settled Convertible Senior Notes due September 27, 2007 (incorporated by reference to Exhibit 1 to Form 10-Q for the Quarter Ended September 30, 2000).
4.12	—	Form of Underwriting Agreement relating to $2,000,000,000 of debt securities (incorporated by reference to Exhibit 1.1 to Registration Statement on Form S-3 (No. 333-108272), filed on August 27, 2003).
4.13	—	Selling Agent Agreement relating to UPS Notes with maturities of 9 months or more from date of issue (incorporated by reference to Exhibit 1.1 to Form 8-K filed September 12, 2003) and Form of Note (incorporated by reference to Exhibit 4.1 to Form 8-K filed September 12, 2003).

Exhibit No.		Description
10.1	—	UPS Thrift Plan, as Amended and Restated, including Amendment Nos. 1 through 24 (incorporated by reference to Exhibit 10.1 to 2001 Annual Report on Form 10-K). (1) Amendment No. 25 to the UPS Thrift Plan (incorporated by reference to Exhibit 10.1(1) to 2002 Annual Report on Form 10-K).
10.2	—	UPS Retirement Plan (including Amendment Nos. 1-4) (incorporated by reference to Exhibit 9 to 1979 Annual Report on Form 10-K).

(1) Amendment No. 5 to the UPS Retirement Plan (incorporated by reference to Exhibit 20(a) to 1980 Annual Report on Form 10-K).

(2) Amendment No. 6 to the UPS Retirement Plan (incorporated by reference to Exhibit 19(a) to 1983 Annual Report on Form 10-K).

(3) Amendment No. 7 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(3) to 1984 Annual Report on Form 10-K).

(4) Amendment No. 8 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(4) to 1985 Annual Report on Form 10-K).

(5) Amendment No. 9 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(5) to 1985 Annual Report on Form 10-K).

(6) Amendment No. 10 to the UPS Retirement Plan (incorporated by reference to Exhibit 19(a) to 1988 Annual Report on Form 10-K).

(7) Amendment No. 11 to the UPS Retirement Plan (incorporated by reference to Exhibit 19(b) to 1988 Annual Report on Form 10-K).

(8) Amendment No. 12 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b) (8) to 1989 Annual Report on Form 10-K).

(9) Amendment No. 13 to the UPS Retirement Plan (incorporated by Reference to Exhibit 10(b) (9) to 1989 Annual Report on Form 10-K).

(10) Amendment No. 14 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(10) to 1990 Annual Report on Form 10-K).

(11) Amendment No. 15 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(11) to 1992 Annual Report on Form 10-K).

(12) Amendment No. 16 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(12) to 1994 Annual Report on Form 10-K).

(13) Amendment No. 17 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(13) to 1994 Annual Report on Form 10-K).

(14) Amendment No. 18 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(14) to 1995 Annual Report on Form 10-K).

(15) Amendment No. 19 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(15) to 1995 Annual Report on Form 10-K).

(16) Amendment No. 20 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(16) to 1995 Annual Report on Form 10-K).

(17) Amendment No. 21 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(17) to 1996 Annual Report on Form 10-K).

(18) Amendment No. 22 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(18) to 1997 Annual Report on Form 10-K).

Exhibit No.		Description
		(19) Amendment No. 23 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(19) to 1998 Annual Report on Form 10-K).
		(20) Amendment No. 24 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(20) to 2000 Annual Report on Form 10-K).
		(21) Amendment No. 25 to the UPS Retirement Plan (incorporated by reference to Exhibit 10(b)(20) to 2000 Annual Report on Form 10-K).
		(22) Amendment No. 26 to the UPS Retirement Plan (incorporated by reference to Exhibit 10.2(22) to 2001 Annual Report on Form 10-K).
		(23) Amendment No. 27 to the UPS Retirement Plan (incorporated by reference to Exhibit 10.2(23) to 2002 Annual Report on Form 10-K).
		(24) Amendment No. 28 to the UPS Retirement Plan (incorporated by reference to Exhibit 10.2(24) to 2002 Annual Report on Form 10-K).
		(25) Amendment No. 29 to the UPS Retirement Plan (incorporated by reference to Exhibit 10.3 to Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2005).
		†(26) Amendment No. 30 to the UPS Retirement Plan.
		†(27) Amendment No. 31 to the UPS Retirement Plan.
		†(28) Amendment No. 32 to the UPS Retirement Plan.
		†(29) Amendment No. 33 to the UPS Retirement Plan.
10.3	—	UPS Savings Plan, as Amended and Restated, including Restatement Amendment Nos. 1 through 8 (incorporated by reference to Exhibit 10.3 to 2001 Annual Report on Form 10-K).
		(1) Amendment No. 1 to the UPS Savings Plan (incorporated by reference to Exhibit 10.3(1) to 2004 Annual Report on Form 10-K).
		(2) Amendment No. 2 to the UPS Savings Plan (incorporated by reference to Exhibit 10.3(2) to 2004 Annual Report on Form 10-K).
		(3) Amendment No. 3 to the UPS Savings Plan (incorporated by reference to Exhibit 10.4 to Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2005).
10.4	—	Credit Agreement (364-Day Facility), dated April 21, 2005 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Securities Inc. as Joint Arrangers, Bank of America, N.A., Barclays Bank PLC, and BNP Paribas as Co-Documentation Agents and Citibank, N.A. as Administrative Agent and JPMorgan Chase Bank, N.A. as Syndication Agent (incorporated by reference to Exhibit 10.1 to Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2005).
10.5	—	Credit Agreement (Five-Year Facility) dated April 21, 2005 among United Parcel Service, Inc., the initial lenders named therein, Citigroup Global Markets Inc. and J.P. Morgan Securities Inc. as Joint Arrangers, Bank of America, N.A., Barclays Bank PLC, and BNP Paribas, as Co-Documentation Agents and Citibank, N.A. as Administrative Agent and JPMorgan Chase Bank, N.A. as Syndication Agent (incorporated by reference to Exhibit 10.2 to Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2005).
10.6	—	UPS Excess Coordinating Benefit Plan (incorporated by reference to Exhibit 10.8 to 2003 Annual Report on Form 10-K).
10.7	—	UPS 1996 Stock Option Plan, as amended and restated (incorporated by reference to Exhibit 10.9 to 2003 Annual Report on Form 10-K).

Exhibit No.		Description
10.8	—	UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 4.1 to Registration Statement No. 333-67479, filed November 18, 1998).
		(1) Amendment No. 1 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.19(1) to 1999 Annual Report on Form 10-K).
		(2) Amendment No. 2 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.19(2) to 1999 Annual Report on Form 10-K).
		(3) Amendment No. 3 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.19(3) to 1999 Annual Report on Form 10-K).
		(4) Amendment No. 4 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.19(4) to 2000 Annual Report on Form 10-K).
		(5) Amendment No. 5 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.8(5) to 2001 Annual Report on Form 10-K).
		(6) Amendment No. 6 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.8(6) to 2001 Annual Report on Form 10-K).
		(7) Amendment No. 7 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.8(7) to 2002 Annual Report on Form 10-K).
		(8) Amendment No. 8 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.10(8) to 2003 Annual Report on Form 10-K).
		(9) Amendment No. 9 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.10(9) to 2003 Annual Report on Form 10-K).
		(10) Amendment No. 10 to the UPS Qualified Stock Ownership Plan and Trust Agreement (incorporated by reference to Exhibit 10.5 to Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2005).
10.9	—	Form of United Parcel Service, Inc. Incentive Compensation Plan (incorporated by reference to the registration statement on Form S-4 (No. 333-83349), filed on July 21, 1999, as amended).
		(1) Form of Non-Qualified Stock Option Award Agreement and Restricted Performance Unit Award Agreement (incorporated by reference to Exhibit 10.11(1) to 2004 Annual Report on Form 10-K).
		(2) Form of Restricted Stock Award Agreement (incorporated by reference to Exhibit 10.7 to Quarterly Report on Form 10-Q for the Quarter Ended March 31, 2005).
		(3) Form of Restricted Stock Unit Award Agreement for the 2006 Long-Term Incentive Performance Awards (incorporated by reference to Exhibit 10.1 to Form 8-K filed March 7, 2006).
10.10	—	UPS Deferred Compensation Plan (incorporated by reference to Exhibit 10.10 to 2000 Annual Report on Form 10-K).
		(1) Amendment to the UPS Deferred Compensation Plan (incorporated by reference to Exhibit 10.12(1) to 2004 Annual Report on Form 10-K).
10.11	—	United Parcel Service, Inc. Nonqualified Employee Stock Purchase Plan (incorporated by reference to the registration statement on Form S-8 (No. 333-34054), filed on April 5, 2000.
10.12	—	Form of United Parcel Service, Inc. Discounted Employee Stock Purchase Plan (incorporated by reference to Appendix B to Definitive Proxy Statement for 2001 Annual Meeting of Shareowners).
		†(1) Amendment to the Discounted Employee Stock Purchase Plan.
†12	—	Ratio of Earnings to Fixed Charges.

Exhibit No.		Description
†21	—	Subsidiaries of the Registrant.
†23	—	Consent of Deloitte & Touche LLP.
†31.1	—	Certificate of Chief Executive Officer Pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
†31.2	—	Certificate of 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.

† Filed herewith.

Investor Information

Annual Meeting

Our annual meeting of shareowners will be held at 8:00 A.M. on May 4, 2006 at the Hotel du Pont, 11th and Market Streets, Wilmington, DE. Shareowners of record as of March 9, 2006 are entitled to vote at the meeting.

Exchange Listing

Our Class B common stock is listed on the New York Stock Exchange under the symbol "UPS."

Certifications

UPS has included as Exhibits 31.1, 31.2, 32.1, and 32.2 to its Annual Report on Form 10-K filed with the Securities and Exchange Commission certificates of the Chief Executive Officer and Chief Financial Officer attesting to the quality of UPS's public disclosure. In addition, the Chief Executive Officer certified to the New York Stock Exchange on May 26, 2005 that he was not aware of any violations by UPS of the New York Stock Exchange corporate governance listing standards.

Investor Relations

You can contact the Investor Relations Department at:

UPS
55 Glenlake Pkwy., N.E.
Atlanta, GA 30328-3474

800-877-1503
404-828-6059
www.shareholder.com/ups

Transfer Agent and Registrar: **Mellon Investor Services LLC**

Direct notices of address changes or questions regarding account status, stock transfers, lost certificates, or dividend payments to:

United Parcel Service, Inc.
c/o Mellon Investor Services LLC
P.O. Box 3415
South Hackensack, NJ 07606-3415

or

480 Washington Boulevard
Jersey City, NJ 07310

Form 10-K

Our Annual Report on Form 10-K for the year ended December 31, 2005 is part of this UPS Annual Report 2005. If you would like an additional copy of our Form 10-K, you can access it through the Investor Relations Web site, *www.shareholder.com/ups*, or at the Securities and Exchange Commission Web site, *www.sec.gov*. The Form 10-K is available free of charge by calling or writing Investor Relations.

UPS Shareowner Services

Convenient access 24 hours a day, seven days a week.

Class A Common Shareowners
www.melloninvestor.com
Select "MellonOne"
888-663-8325

Class B Common Shareowners
www.melloninvestor.com
Select "For Investors" and then "Investor ServiceDirect"
800-758-4674

Calls from outside the United States: 201-680-6612
TDD for hearing impaired: 800-231-5469
TDD for non-U.S. shareowners: 201-680-6610

Direct Stock Purchase Plan

To make an initial purchase of Class B shares go to *www.melloninvestor.com* and select "For Investors." Search for "Direct Investment Plans" and access the "Enrollment Wizard."

Current Class B shareowners can enroll in the plan online by accessing their account through *www.melloninvestor.com/isd* or calling 800-758-4674.

Dividend Reinvestment Plan

To reinvest dividends in the purchase of additional UPS shares:

- Class A shareowners: follow instructions under "**UPS Shareowner Services**"
- Class B shareowners: go to *www.melloninvestor.com/isd*

Online Access to Shareowner Materials

You may receive shareowner information electronically. To enroll, follow the MLink® enrollment instructions when you access your UPS Class A or Class B shareowner account via the Web addresses above.

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