financial highlights

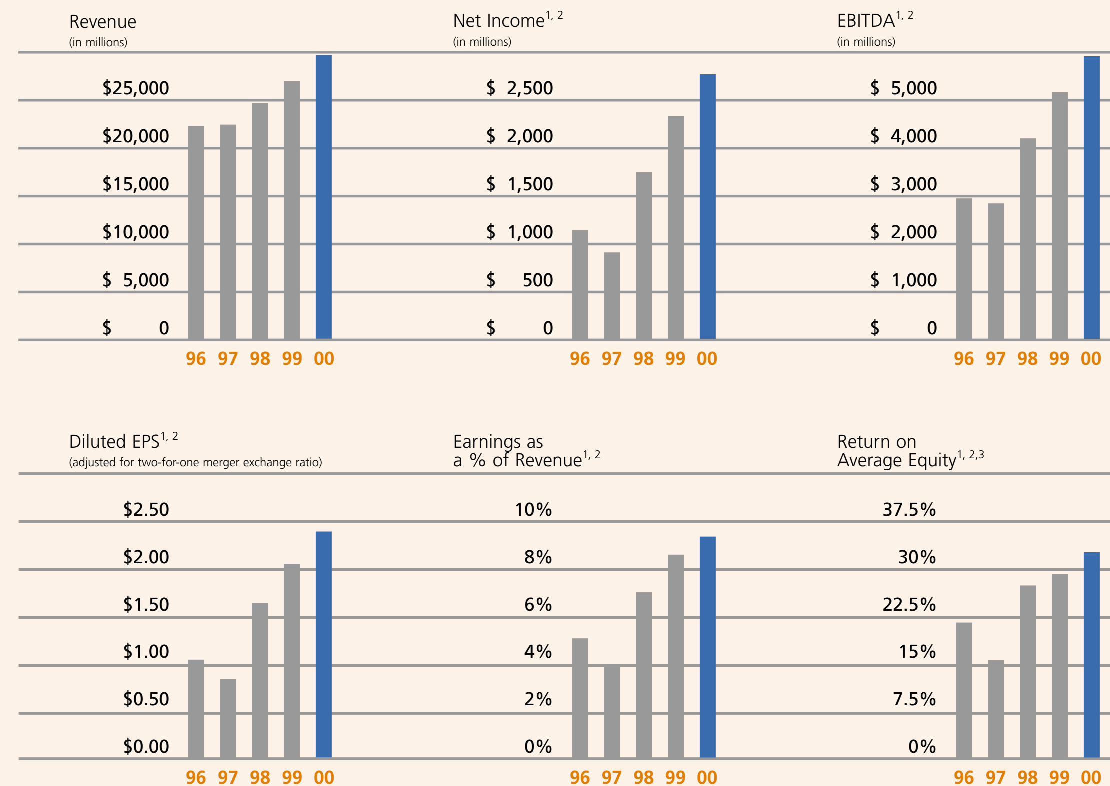
(In millions)		2000		1999	% Change	CAGR[4]
Revenue	$	**29,771**	$	27,052	10.1%	7.2%
Operating Expenses	$	**25,259**	$	23,147	9.1%	5.9%
Net Income (Adjusted)	$	**2,795**[1]	$	2,325[2]	20.2%	21.8%
Assets	$	**21,662**	$	23,028	-5.9%	–
Capital Expenditures	$	**2,147**	$	1,476	45.5%	–
Long-Term Debt	$	**2,981**	$	1,912	55.9%	–
Shareowners' Equity	$	**9,735**	$	12,474	-22.0%[3]	–

1 Net income reported above excludes several non-recurring transactions that added $139 million to 2000 net income. Actual net income reported in 2000 was $2.934 billion.

2 Net income reported above excludes a $1.442 billion tax assessment charge in 1999. Actual net income reported in 1999 was $883 million.

3 Shareowners' equity as of December 31, 1999 included $5.266 billion in proceeds from the November 1999 IPO. In March 2000, $4.1 billion was expended as part of a tender offer and an additional $1.1 billion was used to purchase shares during the remainder of 2000.

4 Compound Annual Growth Rate (CAGR) from 1995 to 2000.



1 Amounts reported above exclude a $1.442 billion tax assessment charge in 1999.

2 Amounts reported above exclude several non-recurring items that added $139 million to 2000 net income.

3 Excluding $5.266 billion net IPO proceeds in 1999 and 2000.

independent auditors' report

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 as of December 31, 2000 and 1999, and the related consolidated statements of income, shareowners' equity, and cash flows for each of the three years in the period ended December 31, 2000. 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 auditing standards generally accepted in the United States of America. 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, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Atlanta, Georgia
January 30, 2001

consolidated balance sheets

December 31,

(In millions except share and per share amounts)	2000	1999
Assets		
Current assets:		
Cash and cash equivalents	**$ 879**	$ 4,204
Marketable securities and short-term investments	**1,073**	2,074
Accounts receivable	**4,140**	3,167
Prepaid health and welfare benefit costs	**408**	381
Other current assets	**624**	366
Total current assets	**7,124**	10,192
Property, plant and equipment:		
Vehicles	**3,244**	3,444
Aircraft (including aircraft under capitalized leases)	**8,663**	8,173
Land	**649**	656
Buildings	**1,612**	1,467
Leasehold improvements	**2,006**	1,902
Plant equipment	**4,902**	4,334
Construction-in-progress	**918**	494
	21,994	20,470
Less accumulated depreciation and amortization	**9,665**	8,891
	12,329	11,579
Prepaid pension costs	**1,593**	931
Other assets	**616**	326
	$ 21,662	$ 23,028
Liabilities and Shareowners' Equity		
Current liabilities:		
Commercial paper	**$ 366**	$ –
Accounts payable	**1,674**	1,295
Accrued wages and withholdings	**1,134**	998
Dividends payable	**192**	361
Tax assessment	**146**	457
Current maturities of long-term debt	**257**	512
Other current liabilities	**732**	575
Total current liabilities	**4,501**	4,198
Long-term debt (including capitalized lease obligations)	**2,981**	1,912
Accumulated postretirement benefit obligation	**1,049**	990
Deferred taxes, credits, and other liabilities	**3,396**	3,454
Shareowners' equity:		
Preferred stock, no par value, authorized 200,000,000 shares, none issued	**–**	–
Class A common stock, par value $.01 per share, authorized 4,600,000,000 shares, issued 935,873,745 and 1,101,295,534 in 2000 and 1999	**9**	11
Class B common stock, par value $.01 per share, authorized 5,600,000,000 shares, issued 198,819,384 and 109,400,000 in 2000 and 1999	**2**	1
Additional paid-in capital	**267**	5,096
Retained earnings	**9,684**	7,536
Accumulated other comprehensive loss	**(227)**	(170)
	9,735	12,474
	$ 21,662	$ 23,028

See notes to consolidated financial statements.

statements of consolidated income

Years Ended December 31,

(In millions except per share amounts)	2000	1999	1998
Revenue	**$ 29,771**	$ 27,052	$ 24,788
Operating expenses:			
Compensation and benefits	**16,546**	15,285	14,346
Other	**8,713**	7,862	7,439
	25,259	23,147	21,785
Operating profit	**4,512**	3,905	3,003
Other income and (expense):			
Investment income	**527**	197	126
Interest expense	**(205)**	(228)	(227)
Tax assessment	**–**	(1,786)	–
	322	(1,817)	(101)
Income before income taxes	**4,834**	2,088	2,902
Income taxes	**1,900**	1,205	1,161
Net income	**$ 2,934**	$ 883	$ 1,741
Basic earnings per share	**$ 2.54**	$ 0.79	$ 1.59
Diluted earnings per share	**$ 2.50**	$ 0.77	$ 1.57

See notes to consolidated financial statements.

statements of consolidated shareowners' equity

(In millions except per share amounts)	Class A Common Stock Shares	Class A Common Stock Amount	Class B Common Stock Shares	Class B Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock Shares	Treasury Stock Amount	Total Shareowners' Equity
Balance, January 1, 1998	1,124	$ 11	–	$ –	$ –	$ 6,157	$ (81)	–	$ –	$ 6,087
Comprehensive income:										
Net income	–	–	–	–	–	1,741	–	–	–	1,741
Foreign currency adjustments	–	–	–	–	–	–	19	–	–	19
Unrealized loss on marketable securities	–	–	–	–	–	–	(1)	–	–	(1)
Comprehensive income										1,759
Constructive retirement of common stock	(6)	–	–	–	–	(90)	–	–	–	(90)
Dividends ($.43 per share)	–	–	–	–	–	(466)	–	–	–	(466)
Gain on issuance of treasury stock	–	–	–	–	70	–	–	–	–	70
Stock award plans	–	–	–	–	255	(17)	–	–	–	238
Reclassification of common stock held for stock plans	–	–	–	–	–	–	–	(23)	(425)	(425)
Balance, December 31, 1998	1,118	11	–	–	325	7,325	(63)	(23)	(425)	7,173
Comprehensive income:										
Net income	–	–	–	–	–	883	–	–	–	883
Foreign currency adjustments	–	–	–	–	–	–	(104)	–	–	(104)
Unrealized loss on marketable securities	–	–	–	–	–	–	(3)	–	–	(3)
Comprehensive income										776
Dividends ($.58 per share)	–	–	–	–	–	(672)	–	–	–	(672)
Gain on issuance of treasury stock	–	–	–	–	5	–	–	–	–	5
Stock award plans	7	–	–	–	91	–	–	21	434	525
Treasury stock purchases	–	–	–	–	–	–	–	(54)	(1,232)	(1,232)
Treasury stock issuances	–	–	–	–	–	–	–	32	633	633
Issuance of Class B common stock in public offering, net of issuance costs	–	–	109	1	5,265	–	–	–	–	5,266
Retirement of treasury stock	(24)	–	–	–	(590)	–	–	24	590	–
Balance, December 31, 1999	1,101	11	109	1	5,096	7,536	(170)	–	–	12,474
Comprehensive income:										
Net income	–	–	–	–	–	2,934	–	–	–	2,934
Foreign currency adjustments	–	–	–	–	–	–	(56)	–	–	(56)
Unrealized loss on marketable securities	–	–	–	–	–	–	(1)	–	–	(1)
Comprehensive income										2,877
Dividends ($.68 per share)	–	–	–	–	–	(786)	–	–	–	(786)
Stock award plans	15	–	–	–	602	–	–	–	–	602
Common stock purchases:										
Tender offer	(68)	(1)	–	–	(4,069)	–	–	–	–	(4,070)
Other	(16)	–	(7)	–	(1,395)	–	–	–	–	(1,395)
Common stock issuances	1	–	–	–	33	–	–	–	–	33
Conversion of Class A Common Stock to Class B Common Stock	(97)	(1)	97	1	–	–	–	–	–	–
Balance, December 31, 2000	**936**	**$ 9**	**199**	**$ 2**	**$ 267**	**$ 9,684**	**$ (227)**	**–**	**$ –**	**$ 9,735**

See notes to consolidated financial statements.

statements of consolidated cash flows

Years Ended December 31,

(In millions)	2000	1999	1998
Cash flows from operating activities:			
Net income	**$ 2,934**	$ 883	$ 1,741
Adjustments to reconcile net income to net cash from operating activities:			
Depreciation and amortization	**1,173**	1,139	1,112
Postretirement benefits	**57**	21	58
Deferred taxes, credits and other	**(81)**	562	23
Stock award plans	**539**	443	347
Gain on investments and sale of business	**(263)**	–	–
Changes in assets and liabilities, net of effect of acquisitions:			
Accounts receivable	**(913)**	(454)	(308)
Prepaid health and welfare benefit costs	**(27)**	(31)	(25)
Other current assets	**(252)**	(3)	37
Prepaid pension costs	**(662)**	(593)	(9)
Accounts payable	**317**	(27)	115
Accrued wages and withholdings	**131**	(94)	(137)
Dividends payable	**(169)**	114	56
Tax assessment	**(311)**	226	–
Other current liabilities	**269**	73	(74)
Net cash from operating activities	**2,742**	2,259	2,936
Cash flows from investing activities:			
Capital expenditures	**(2,147)**	(1,476)	(1,645)
Disposals of property, plant, and equipment	**251**	213	216
Purchases of marketable securities and short-term investments	**(8,127)**	(3,981)	(390)
Sales and maturities of marketable securities and short-term investments	**9,345**	2,290	–
Construction funds in escrow	**90**	(111)	–
Payments for acquisitions, net of cash acquired	**(245)**	(63)	–
Other asset receipts (payments)	**(42)**	3	164
Net cash (used in) investing activities	**(875)**	(3,125)	(1,655)
Cash flows from financing activities:			
Proceeds from borrowings	**2,297**	502	287
Repayments of borrowings	**(1,168)**	(679)	(310)
Issuance of Class B common stock in public offering, net of issuance costs	**–**	5,266	–
Purchases of common stock via tender	**(4,070)**	–	–
Other purchases of common stock	**(1,395)**	(1,232)	(823)
Issuances of common stock pursuant to stock awards and employee stock purchase plans	**88**	685	750
Dividends	**(786)**	(672)	(466)
Other transactions	**(127)**	(1)	61
Net cash from (used in) financing activities	**(5,161)**	3,869	(501)
Effect of exchange rate changes on cash	**(31)**	(39)	–
Net increase (decrease) in cash and cash equivalents	**(3,325)**	2,964	780
Cash and cash equivalents:			
Beginning of year	**4,204**	1,240	460
End of year	**$ 879**	$ 4,204	$ 1,240
Cash paid during the period for:			
Interest, net of amount capitalized	**$ 363**	$ 982	$ 298
Income taxes	**$ 1,567**	$ 773	$ 1,181

See notes to consolidated financial statements.

notes to consolidated financial statements

note 1. summary of accounting policies

Initial Public Offering of Common Stock

In November 1999, we became a publicly traded company by issuing 109.4 million shares of Class B common stock of United Parcel Service, Inc., a newly formed corporation with a new capital structure, which became the parent of United Parcel Service of America, Inc. Class A shares of United Parcel Service, Inc. are entitled to ten votes each, whereas Class B shares are entitled to one vote each. The Class A shares initially issued by United Parcel Service, Inc. were equally allocated among Class A-1, A-2, and A-3 common stock. The different types of Class A common stock are identical except for applicable transfer restriction periods. The transfer restriction periods applicable to Class A-1 and Class A-2 shares have lapsed; approximately 365 million Class A-3 shares are subject to transfer restrictions until May 3, 2001. The new capital structure has been given retroactive effect in our financial statements with no changes to previously reported net income. All of the net proceeds of the IPO of $5.266 billion have subsequently been used for a tender offer and other repurchases of our Class A and Class B shares.

Basis of Financial Statements and Business Activities

The accompanying consolidated financial statements include the accounts of United Parcel Service, Inc., and all of its subsidiaries (collectively "UPS" or the "Company"). All material 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. Revenue is recognized upon delivery of a letter or package.

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.

As of December 31, 2000, we had approximately 214,000 employees (60% of total 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, 2002. The majority of our pilots are employed under a collective bargaining agreement with the Independent Pilots Association ("IPA"), which becomes amendable January 1, 2004. Our airline mechanics are covered by a collective bargaining agreement with Teamster Local 2727, which becomes amendable on July 31, 2001. 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 have various expiration dates between July 31, 2002 and May 31, 2003.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments (including investments in debt and auction rate securities of $714 million and $3.933 billion at December 31, 2000 and 1999, respectively) that are readily convertible into cash. The carrying amount approximates fair value because of the short-term maturity of these instruments.

Marketable Securities

Marketable securities are classified as available-for-sale and are carried at fair value, with related unrealized gains and losses reported as other comprehensive income and as 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.

Property, Plant, and Equipment

Property, plant, and equipment are carried at cost. Depreciation (including amortization) is provided by the straight-line method over the estimated useful lives of the assets, which are as follows: Vehicles – 9 years; Aircraft – 12 to 20 years; Buildings – 20 to 40 years; Leasehold Improvements – lives of leases; Plant Equipment – five to 8⅓ years.

The costs of major airframe and engine overhauls, as well as other routine maintenance and repairs, are charged to expense as incurred.

Costs in Excess of Net Assets Acquired

Costs of purchased businesses in excess of net assets acquired are amortized over either a 10-year or 20-year period using the straight-line method.

Impairment of Long-Lived Assets

We review long-lived assets for impairment when circumstances indicate the carrying amount of an asset may not be recoverable. If the carrying amount of the asset is determined not to be recoverable, a write-down to fair value is recorded.

Income Taxes

Income taxes are accounted for under Financial Accounting Standards Board ("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.

Capitalized Interest

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 $26, $20, and $27 million for 2000, 1999, and 1998, respectively.

notes to consolidated financial statements

Stock Option Plans

We have adopted the disclosure provisions of FASB Statement No. 123 (“FAS 123”), “Accounting for Stock-Based Compensation.” Under FAS 123, companies have the option to measure compensation costs for stock option plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 (“APB 25”), “Accounting for Stock Issued to Employees.” Under APB 25, compensation expense is generally not recognized when both the exercise price is the same as the market price and the number of shares to be issued is set on the date the employee stock option is granted. Since our employee stock options are granted on this basis and we have chosen to use the intrinsic value method, we do not recognize compensation expense for grants under our plans. We do, however, include in Note 6 pro forma disclosures of net income and earnings per share as if the fair value method of accounting had been applied.

Capitalized Software

Effective January 1, 1999, we adopted the Accounting Standards Executive Committee Statement of Position (“SOP”) 98-1, “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,” which requires that certain costs to develop or obtain computer software for internal use be capitalized. Prior to the adoption of SOP 98-1, we expensed all internal use software costs as incurred. The effect of adopting the SOP was to increase net income for 2000 and 1999 by $100 and $89 million, or $0.09 and $0.08 per share on a basic and diluted basis, respectively. Capitalized costs for this software are amortized using the straight-line method over periods ranging from three to five years.

SAB 101

In December 1999, the SEC issued Staff Accounting Bulletin No. 101, “Revenue Recognition in Financial Statements (“SAB 101”),” which provides guidance on applying generally accepted accounting principles to revenue recognition issues in financial statements. We adopted SAB 101, as required, in the fourth quarter of 2000 without a material impact on our financial position or results of operations.

New Accounting Pronouncements

In June 1998, the FASB issued Statement No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“FAS 133”), as amended by Statements No. 137 and No. 138, which provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. After adoption on January 1, 2001, all derivative instruments will be recognized on the balance sheet at fair value, and changes in the fair values of such instruments will be recognized currently in earnings unless specific hedge accounting criteria are met. We will record a one-time cumulative effect, after-tax charge totaling $14 million in the income statement, as well as an unrealized accumulated transition adjustment gain of $23 million to accumulated other comprehensive loss for the initial adoption of FAS 133 in the quarter ended March 31, 2001.

Changes in Presentation

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

note 2. long-term debt and commitments

Long-term debt, as of December 31, consists of the following:

(In millions)	2000	1999
8⅜% debentures, due April 1, 2020[(i)]	$ 424	$ 424
8⅜% debentures, due April 1, 2030[(i)]	276	276
Commercial paper[(ii)]	1,366	102
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, due October 26, 2049 and March 27, 2050[(v)]	105	55
1.75% Cash-settled convertible senior notes, due September 27, 2007[(vi)]	300	–
Capitalized lease obligations[(vii)]	562	558
6.875% 100 million Pound Sterling notes, due February 25, 2000	–	166
6.625% EuroNotes, due April 25, 2001	200	200
6.25% EuroNotes, due July 7, 2000	–	300
4.5% 100 million Singapore Dollar notes, due November 11, 2004	58	60
Installment notes, mortgages and bonds at various rates from 5.4 % to 8.0%	64	34
	3,604	2,424
Less current maturities	(623)	(512)
	$ 2,981	$ 1,912

(i) On January 22, 1998, we exchanged $276 million of the original $700 million debentures for new debentures of equal principal amount with a maturity of April 1, 2030. The new debentures have the same interest rate as the 8⅜% debentures due 2020 until April 1, 2020, and thereafter the interest rate will be 7.62% for the final 10 years. The new 2030 debentures are redeemable in whole or in part at the option of the Company 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 payouts 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.

(ii) The weighted average interest rate on the commercial paper outstanding as of December 31, 2000 and 1999, was 6.5% and 5.8%, respectively. Of the total commercial paper balance outstanding as of December 31, 2000, $1.0 billion has been classified as long-term debt in accordance with our intention and ability to refinance such obligations on a long-term basis under our revolving credit facilities. However, the amount of commercial paper outstanding in 2001 is expected to fluctuate. We are authorized to borrow up to $7.0 billion under the two commercial paper programs we maintain as of December 31, 2000.

(iii) The industrial development bonds bear interest at a daily variable rate. The average interest rates for 2000 and 1999 were 4.0% and 3.1%, respectively.

(iv) The special facilities revenue bonds bear interest at a daily variable rate. The average interest rates for 2000 and 1999 were 4.1% and 3.3%, respectively.

(v) The floating rate senior notes bear interest at one-month LIBOR less 45 basis points. The average interest rates for 2000 and 1999 were 6.1% and 5.1%, 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.

(vi) The cash-settled convertible senior notes bear interest at a stated rate of 1.75% and are callable after three years. The notes may be exchanged for an amount of cash that is indexed to the trading price of our Class B common stock. In conjunction with the debt offering, we entered into a swap transaction in which UPS pays 30-day LIBOR less 38 basis points, and receives the 1.75% cash coupon plus any equity appreciation payable in cash on the notes. The average interest rate payable on the swap for 2000 was 6.3%.

(vii) We have capitalized lease obligations for certain aircraft, which are included in Property, Plant, and Equipment at December 31 as follows:

(In millions)	2000	1999
Aircraft	$ 768	$ 614
Accumulated amortization	(81)	(59)
	$ 687	$ 555

notes to consolidated financial statements

The aggregate annual principal payments for the next five years, excluding capitalized leases, are (in millions): 2001 – $579; 2002 – $12; 2003 – $12; 2004 – $58; and 2005 – $1.

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 $3.7 billion and $2.5 billion as of December 31, 2000 and 1999.

We lease certain aircraft, facilities, equipment, and vehicles under operating leases, which expire at various dates through 2039. Total aggregate minimum lease payments under capitalized leases and under operating leases are as follows (in millions):

Year	Capitalized Leases	Operating Leases
2001	$ 67	$ 304
2002	67	243
2003	67	188
2004	67	130
2005	92	110
After 2005	427	518
Total minimum lease payments	787	$ 1,493
Less imputed interest	(225)	
Present value of minimum capitalized lease payments	562	
Less current portion	(44)	
Long-term capitalized lease obligations	$ 518	

As of December 31, 2000, we have outstanding letters of credit totaling approximately $1.1 billion issued in connection with routine business requirements.

As of December 31, 2000, we have commitments outstanding for capital expenditures under purchase orders and contracts of approximately $6.9 billion, with the following amounts expected to be spent during the next five years (in millions): 2001 – $1,765; 2002 – $1,295; 2003 – $786; 2004 – $605; and 2005 – $518.

We maintain two credit agreements with a consortium of banks that provide revolving credit facilities of $1.25 billion each, with one expiring April 26, 2001, and the other April 27, 2005. Interest on any amounts we borrow under these facilities would be charged at 90-day LIBOR plus 15 basis points. At December 31, 2000, there were no outstanding borrowings under these facilities.

We also maintain a $1.0 billion European medium-term note program. Under this program, we may issue notes from time to time, denominated in a variety of currencies. At December 31, 2000, $1.0 billion was available under this program. The $200 million outstanding at December 31, 2000, which was issued under this program in 1997, bears interest at a stated rate of 6.625%.

We have filed a shelf registration statement under which we may issue debt securities in the United States of up to $2.0 billion. The debt may be denominated in a variety of currencies. In September 2000, we issued $300 million cash-settled convertible senior notes due September 27, 2007 pursuant to our shelf registration statement. The notes were sold at par with a stated interest rate of 1.75% and are callable after three years. The notes may be exchanged for an amount of cash that is indexed to the trading price of our Class B common stock. There was approximately $405 million issued under this shelf registration statement at December 31, 2000.

note 3. earnings per share

The following table sets forth the computation of basic and diluted earnings per share:

(In millions except per share amounts)	2000	1999	1998
Numerator:			
Numerator for basic and diluted earnings per share – net income	**$ 2,934**	$ 883	$ 1,741
Denominator:			
Weighted average shares	**1,152**	1,119	1,090
Contingent shares – Management Incentive Awards	**1**	2	3
Denominator for basic earnings per share	**1,153**	1,121	1,093
Effect of dilutive securities:			
Additional contingent shares – Management Incentive Awards	**6**	9	9
Stock option plans	**16**	11	6
Denominator for diluted earnings per share	**1,175**	1,141	1,108
Basic earnings per share	**$ 2.54**	$ 0.79	$ 1.59
Diluted earnings per share	**$ 2.50**	$ 0.77	$ 1.57

note 4. legal proceedings and contingencies

On August 9, 1999 the U.S. Tax Court issued an opinion unfavorable to UPS regarding a Notice of Deficiency asserting that we are liable for additional tax for the 1983 and 1984 tax years. The Court held that we are liable for tax on income of Overseas Partners Ltd. ("OPL"), a Bermuda company, which had reinsured excess value package insurance purchased by our customers beginning in 1984. The Court held that for the 1984 tax year we are liable for taxes of $31 million on income reported by OPL, penalties and penalty interest of $93 million, and interest for a total after-tax exposure estimated at approximately $246 million. In February 2000, the U.S. Tax Court entered a decision in accord with its opinion.

In addition, during the first quarter of 1999, the IRS issued two Notices of Deficiency asserting that we are liable for additional tax for the 1985 through 1987 tax years, and the 1988 through 1990 tax years. The primary assertions by the IRS relate to the reinsurance of excess value package insurance, the issue raised for the 1984 tax year. The IRS has based its assertions on the same theories included in the 1983–1984 Notice of Deficiency.

The IRS, in an issued report, has taken similar positions for tax years 1991 through 1994. We expect the IRS to take similar positions for tax years 1995 through 1999. Based on the Tax Court opinion, we currently estimate that our total after-tax exposure for the tax years 1984 through 1999 could be as high as $2.353 billion. We believe that a number of aspects of the Tax Court decision are incorrect, and we have appealed the decision to the U.S. Court of Appeals for the Eleventh Circuit. The Eleventh Circuit has heard oral arguments. We do not know when the court will render a decision.

In our second quarter 1999 financial statements, we recorded a tax assessment charge of $1.786 billion, which included an amount for related state tax liabilities. The charge included taxes of $915 million and interest of $871 million. This assessment resulted in a tax benefit of $344 million related to the interest component of the assessment. As a result, our net charge to net income for the tax assessment was $1.442 billion, increasing our total after-tax reserve at that time with respect to these matters to $1.672 billion. The tax benefit of deductible interest is included in income taxes; however, since none of the income on which this tax assessment is based is our income, we have not classified the tax charge as income taxes.

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We determined the size of our reserve with respect to these matters in accordance with accounting principles generally accepted in the United States of America based on our estimate of our most likely liability. In making this determination, we concluded that it is more likely that we will be required to pay taxes on income reported by OPL and interest, but that it is not probable that we will be required to pay any penalties and penalty interest. If penalties and penalty interest ultimately are determined to be payable, we would have to record an additional charge of up to $681 million.

On August 31, 1999, we deposited $1.349 billion, and on August 8, 2000, we deposited an additional $91 million with the IRS related to these matters for the 1984 through 1994 tax years. We included the profit of the excess value package insurance program, using the IRS's methodology for calculating these amounts, for both 1998 and 1999 in filings we made with the IRS in 1999. In February 2000, we deposited $339 million with the IRS related to these matters for the 1995 through 1997 tax years. These deposits and filings were made in order to stop the accrual of interest, where applicable, on that amount of the IRS's claim, without conceding the IRS's positions or giving up our right to appeal the Tax Court's decision.

After the Tax Court decision, National Union Fire Insurance Company, a subsidiary of American International Group, Inc., notified OPL that effective September 30, 1999, it would terminate the five underlying policies that provide shippers' risk insurance for UPS customers. The termination of these policies triggered the immediate termination of the reinsurance agreement between National Union and OPL.

UPS, on behalf of our customers, and National Union agreed on a restructuring of this program, which became effective October 1, 1999. Commencing on October 1, 1999, National Union issued five new policies that include coverage for UPS customers. Glenlake Insurance Agency, Inc., a licensed insurance agency formed in 1998 and a wholly owned subsidiary of UPS Capital Corporation, now offers excess value package insurance to be issued under the five new policies.

UPS Re Ltd., a wholly owned subsidiary of UPS, has entered into a reinsurance agreement under which it will reinsure substantially all of the risks underwritten by National Union in exchange for substantially all of the premiums collected. UPS Re Ltd. is a licensed reinsurance company formed in 1999 to reinsure risks related to UPS and its subsidiaries. UPS Re Ltd., which is domiciled in Bermuda, has elected to be taxed on its income as part of UPS's consolidated income tax return for federal income tax purposes. This revised arrangement should eliminate the issues considered by the Tax Court in the Notices of Deficiency relating to OPL for the periods after September 1999.

The IRS has proposed adjustments, unrelated to the OPL matters discussed above, regarding the allowance of deductions and certain losses, the characterization of expenses as capital rather than ordinary, the treatment of certain income, and our entitlement to the investment tax credit and the research tax credit in the 1985 through 1990 tax years. These proposed adjustments would result in $15 million in additional income tax expense. Also, the IRS has issued a report taking a similar position with respect to some of these issues for each of the years from 1991 through 1994. This report proposes adjustments that would result in $155 million in additional income tax expense. For the 1985 through 1994 tax years, unpaid interest on these adjustments through 2000 could aggregate up to $368 million, after the benefit of related tax deductions. We expect that we will prevail on substantially all these issues. Specifically, we believe that our practice of expensing the items that the IRS alleges should have been capitalized is consistent with the practices of other industry participants. The IRS may take similar positions with respect to some of these issues for each of the years from 1995 through 2000. The IRS's proposed adjustments include penalties and penalty interest. We believe that the possibility that such penalties and penalty interest will be sustained is remote. We believe the eventual resolution of the these issues will not result in a material adverse effect on our financial condition, results of operations, or liquidity.

We have been named as a defendant in 23 lawsuits that seek to hold us (and, in certain cases, other defendants) liable for the collection of premiums for excess value package insurance in connection with package shipments since 1984 (or, in some of the cases, for shorter time periods). These cases generally claim that we acted as an insurer in violation of our shipping contract and without complying with state insurance laws and regulations, and that the price for excess value package insurance was excessive. Eighteen of these cases have been consolidated for pre-trial purposes in a multi-district litigation proceeding ("MDL Proceeding") before the United States District Court for the Southern District of New York. An amended consolidated complaint in the MDL Proceeding also alleges a violation of the federal RICO statute. Another complaint in the MDL Proceeding alleges violations of federal antitrust laws. We are in the process of seeking to have four of the remaining cases consolidated into the MDL Proceeding. The other remaining case was remanded from federal court to state court in Madison County, Illinois, and is proceeding independent of the MDL Proceeding. No class has been certified in any of these cases. These actions all developed after the August 9, 1999 Tax Court opinion was rendered. We believe the allegations in these cases have no merit and intend to continue to defend them vigorously. The ultimate resolution of these matters cannot presently be determined.

In November 2000, the U.S. Occupational Safety and Health Administration ("OSHA") published its final ergonomics standard, which would have required American industry to take expansive compliance steps in the workplace when an employee reported a musculoskeletal complaint such as low back pain. If OSHA had enforced these regulations by seeking the same ergonomic measures it has advocated in the past under its general authority to remedy "recognized hazards," it might have demanded extensive changes in the physical layout of our distribution centers as well as the hiring of significant numbers of additional full-time and part-time employees. Our competitors, as well as the remainder of American industry, also would have incurred proportionately comparable costs.

The rule was challenged by a broad coalition of trade associations and businesses in actions consolidated in the United States Court of Appeals for the D.C. Circuit. Among other arguments against the rule, opponents asserted that OSHA did not comply with the statutory mandate of establishing significant risk of material health impairment or properly analyze the costs and benefits of the proposed regulations. We believed that either implementation of the rule would be stayed, that a reviewing court would reject the rule, or that, if ergonomic regulations resembling this proposal had been sustained by a reviewing court, we would have prevailed in an enforcement proceeding based on substantial defenses.

OSHA took the position that the cost of compliance with the proposed regulations would have been only $4.5 billion per year over a ten-year period for all of American industry. We maintained that these estimates were unrealistic and estimated that the cost of compliance could have been significantly greater, both in initial costs and in incremental annual costs. We also estimated that such expenditures, if required to be incurred, would have materially and adversely affected our financial condition, results of operations, and liquidity.

Subsequent to December 31, 2000, the United States Senate and the House of Representatives passed joint resolutions disapproving the OSHA ergonomics standard and declaring that the standard shall have no force or effect. We anticipate that President Bush will approve these actions in the near future. If this occurs, we anticipate that the legal proceedings described above will be dismissed as moot.

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In addition, we are a defendant in various other lawsuits that arose in the normal course of business. In our opinion, none of these cases is expected to have a material effect on our financial condition, results of operations, or liquidity.

note 5. employee benefit plans

We maintain several defined benefit pension plans (the "Plans"). The Plans are noncontributory and include all employees who meet certain minimum age and years of service requirements, except those employees covered by certain multi-employer plans provided for under collective bargaining agreements.

The Plans provide for retirement benefits based on either service credits or average compensation levels earned by employees prior to retirement. The Plans' assets consist primarily of publicly traded stocks and bonds and include approximately 24.5 and 26.9 million shares of UPS common stock at December 31, 2000 and 1999, respectively. Our funding policy is consistent with relevant federal tax regulations. Accordingly, we contribute amounts deductible for federal income tax purposes.

We also sponsor postretirement medical plans 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. We have the right to modify or terminate certain of these plans. In many cases, these benefits have been provided to retirees on a noncontributory basis; however, in certain cases, retirees are required to contribute towards the cost of the coverage.

The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets, and a statement of funded status as of September 30, with certain amounts included in the balance sheet as of December 31:

(In millions)	Pension Benefits 2000	Pension Benefits 1999	Postretirement Medical Benefits 2000	Postretirement Medical Benefits 1999
Change in benefit obligation				
Net benefit obligation at October 1, prior year	$ 4,196	$ 4,203	$ 1,397	$ 1,212
Service cost	181	187	50	41
Interest cost	324	293	106	83
Plan participants' contributions	–	–	2	2
Plan amendments	–	96	3	10
Actuarial (gain) loss	(13)	(455)	8	104
Gross benefits paid	(141)	(128)	(66)	(55)
Net benefit obligation at September 30	4,547	4,196	1,500	1,397
Change in plan assets				
Fair value of plan assets at October 1, prior year	5,507	3,930	374	290
Actual return on plan assets	1,563	938	96	61
Employer contributions	732	767	61	76
Plan participants' contributions	–	–	2	2
Gross benefits paid	(141)	(128)	(66)	(55)
Fair value of plan assets at September 30	7,661	5,507	467	374
Funded status at September 30	3,114	1,311	(1,033)	(1,023)
Unrecognized net actuarial (gain) loss	(1,874)	(770)	(16)	39
Unrecognized prior service cost	305	335	(7)	(11)
Unrecognized net transition obligation	47	55	–	–
Employer contributions	1	–	7	5
Net asset (liability) recorded at end of year	$ 1,593	$ 931	$ (1,049)	$ (990)

Net periodic benefit cost for the years ended December 31 included the following components:

(In millions)	Pension Benefits 2000	Pension Benefits 1999	Pension Benefits 1998	Postretirement Medical Benefits 2000	Postretirement Medical Benefits 1999	Postretirement Medical Benefits 1998
Service cost	$ 181	$ 187	$ 147	$ 50	$ 41	$ 39
Interest cost	324	293	260	106	83	86
Expected return on assets	(471)	(351)	(310)	(34)	(26)	(26)
Amortization of:						
Transition obligation	8	8	8	–	–	–
Prior service cost	30	23	23	(1)	(2)	1
Actuarial (gain) loss	(1)	6	–	1	–	–
Net periodic benefit cost	$ 71	$ 166	$ 128	$ 122	$ 96	$ 100

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The significant assumptions used in the measurement of our benefit obligations are as follows:

	2000	1999	1998
Expected long-term annual rate of earnings on plan assets	**9.5%**	9.5%	9.5%
Discount rate	**7.75%**	7.5%	6.75%
Rate of annual increase in future compensation levels for pension benefits	**4.0%**	4.0%	4.0%

Future postretirement medical benefit costs were forecasted assuming an initial annual increase of 7.50% for pre-65 and post-65 medical costs, decreasing to 5.50% for pre-65 and post-65 by the year 2004 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 health care 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 and interest cost components	$ 5	$ (5)
Effect on postretirement benefit obligation	$ 39	$ (38)

We also contribute to several multi-employer pension plans for which the above disclosure information is not determinable. Amounts charged to operations for pension contributions to these multi-employer plans were $897, $809, and $757 million during 2000, 1999, and 1998, respectively.

We also contribute to several multi-employer health and welfare plans that cover both active and retired employees for which the above disclosure information is not determinable. Amounts charged to operations for contributions to multi-employer health and welfare plans were $501, $463, and $458 million during 2000, 1999, and 1998, 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 $61, $55, and $49 million for 2000, 1999, and 1998, respectively.

note 6. incentive compensation plans

We adopted the UPS Incentive Compensation Plan in October 1999. The 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 shares. As of December 31, 2000, only management incentive awards and stock option grants had been made under the Incentive Compensation Plan.

Management Incentive Awards

Persons earning the right to receive Management Incentive Awards are determined annually by the Compensation Committee of the UPS Board of Directors. This Committee in its sole discretion determines the total award, which consists of UPS Class A-1 common stock, given in any year. The total of all such awards historically has been 15% of consolidated income before income taxes for the 12-month period ending each September 30, exclusive of gains and losses from the sale of real estate and stock of subsidiaries and the effect of certain other nonrecurring transactions or accounting changes. Amounts charged to operations for Management Incentive Awards were $735, $588, and $448 million during 2000, 1999, and 1998, respectively.

Nonqualified and Incentive Stock Options

We maintain fixed stock option plans under which options are granted to purchase shares of UPS Class A common stock. Prior to adoption of the Incentive Compensation Plan, these options were granted at the current price of UPS shares as determined by the Board of Directors on the date of option grant. 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. We apply the measurement provisions of APB Opinion 25 and related Interpretations in accounting for these plans. Accordingly, no compensation expense has been recorded for the grant of stock options during 2000, 1999, or 1998. Pro forma information regarding net income and earnings per share has been determined as if we accounted for our employee stock options under the fair value method of FAS 123. For purposes of pro forma disclosures, the estimated fair value of the options granted in 2000, 1999, and 1998 is amortized to expense over the vesting period of the options.

The pro forma information is as follows :

(In millions except per share amounts)		2000	1999	1998
Net income	As reported	**$ 2,934**	$ 883	$ 1,741
	Pro forma	**$ 2,907**	$ 870	$ 1,734
Basic earnings per share	As reported	**$ 2.54**	$ 0.79	$ 1.59
	Pro forma	**$ 2.52**	$ 0.78	$ 1.59
Diluted earnings per share	As reported	**$ 2.50**	$ 0.77	$ 1.57
	Pro forma	**$ 2.47**	$ 0.76	$ 1.56

The assumptions used, by year, and the calculated weighted average fair value of options granted, are as follows:

	2000(1)	1999(1)	1999	1998
Semi-annual dividend per share	**n/a**	n/a	$ 0.30	$ 0.23
Expected yield	**1.00%**	1.00%	n/a	n/a
Risk-free interest rate	**6.26%**	5.88%	5.14%	5.56%
Expected life in years	**5**	5	5	5
Expected volatility	**40.0%**	40.0%	n/a	n/a
Weighted average fair value of options granted	**$ 32.67**	$ 20.29	$ 2.08	$ 1.80

(1) Pro forma information for options granted in 2000 and November 1999 was calculated using the Black-Scholes option pricing model as these options were granted in connection with, or subsequent to, the IPO. Pro forma information for all options granted prior to the IPO was calculated using the minimum value method for nonpublic entities.

Persons earning the right to receive stock options are determined each year by the Compensation Committee of the UPS Board of Directors. Except in the case of death, disability, or retirement, options granted prior to the adoption of our Incentive Compensation Plan are exercisable only during a limited period after the expiration of five years from the date of grant, while options granted under the Incentive Compensation Plan are generally exercisable after three years from the date of grant and before the expiration of the option ten years after the date of grant. All options granted are subject to earlier cancellation or exercise under certain conditions.

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The following is an analysis of options for shares of Class A-1 common stock issued and outstanding:

	Weighted Average Exercise Price	Number of Shares (In thousands)
Outstanding at January 1, 1998	$ 11.88	35,898
Exercised	9.38	(7,787)
Granted	16.00	8,300
Canceled	12.38	(440)
Outstanding at December 31, 1998	13.37	35,971
Exercised	10.63	(7,571)
Granted	30.37	11,139
Canceled	14.61	(1,059)
Outstanding at December 31, 1999	18.76	38,480
Exercised	11.88	(7,277)
Granted	59.38	194
Canceled	18.77	(2,085)
Outstanding at December 31, 2000	$ 20.57	29,312

Options were granted to eligible employees under the 1996 Stock Option Plan in March 1999 and under the Incentive Compensation Plan in November 1999. Options will no longer be granted under the 1996 Stock Option Plan, and a limited option grant to certain employees under the Incentive Compensation Plan occurred in 2000. Beginning in 2001, options to eligible employees will generally be granted only in the first quarter of each year at the discretion of the Board of Directors.

No options were exercisable at December 31, 2000, 1999, or 1998. The following table summarizes information about stock options outstanding at December 31, 2000:

Number of Shares (In thousands)	Weighted Average Remaining Life (In years)	Weighted Average Exercise Price
5,785	0.3	$ 13.50
5,818	1.3	$ 14.88
7,347	2.3	$ 16.00
6,967	3.3	$ 21.50
3,261	8.9	$ 50.00
134	9.3	$ 59.38
29,312	2.7	$ 20.57

note 7. income taxes

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

(In millions)	2000	1999	1998
Current:			
Federal	**$ 1,709**	$ 834	$ 917
State	**215**	99	127
Total current	**1,924**	933	1,044
Deferred:			
Federal	**(21)**	236	104
State	**(3)**	36	13
Total deferred	**(24)**	272	117
Total	**$ 1,900**	$ 1,205	$ 1,161

Income before income taxes includes income of foreign subsidiaries of $9 and $7 million in 2000 and 1999, respectively, and a loss of $20 million for 1998.

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:

	2000	1999	1998
Statutory federal income tax rate	**35.0%**	35.0%	35.0%
Tax assessment	**–**	17.7	–
State income taxes (net of federal benefit)	**2.9**	4.2	3.1
Other	**1.4**	0.8	1.9
Effective income tax rate	**39.3%**	57.7%	40.0%

Deferred tax liabilities and assets are comprised of the following at December 31:

(In millions)	2000	1999
Excess of tax over book depreciation	**$ 2,079**	$ 2,096
Pension plans	**631**	662
Prepaid health and welfare	**136**	129
Other	**612**	346
Gross deferred tax liabilities	**3,458**	3,233
Other postretirement benefits	**456**	421
Loss carryforwards (foreign)	**304**	283
Insurance reserves	**147**	175
Vacation pay accrual	**176**	106
Other	**334**	152
Gross deferred tax assets	**1,417**	1,137
Deferred tax assets valuation allowance	**(304)**	(283)
Net deferred tax assets	**1,113**	854
Net deferred tax liability	**2,345**	2,379
Less: Amount included in other current liabilities	**10**	6
Long-term portion – see Note 8	**$ 2,335**	$ 2,373

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The valuation allowance increased by $21 and decreased by $25 and $14 million during the years ended December 31, 2000, 1999, and 1998, respectively.

UPS has foreign loss carryforwards of approximately $714 million as of December 31, 2000. Of this amount, $301 million expires in varying amounts through 2010. The remaining $413 million may be carried forward indefinitely. These foreign loss carryforwards have been fully reserved in the deferred tax assets valuation allowance due to the uncertainty resulting from a lack of previous foreign taxable income within certain foreign tax jurisdictions. In addition, a portion of these losses has been deducted on the U.S. tax return, which could affect the amount of any future benefit.

note 8. deferred taxes, credits, and other liabilities

Deferred taxes, credits, and other liabilities as of December 31 consist of the following:

(In millions)	2000	1999
Deferred federal and state income taxes	$ 2,335	$ 2,373
Insurance reserves	798	829
Other credits and noncurrent liabilities	263	252
	$ 3,396	$ 3,454

note 9. other operating expenses

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

(In millions)	2000	1999	1998
Repairs and maintenance	$ 958	$ 945	$ 864
Depreciation and amortization	1,173	1,139	1,112
Purchased transportation	1,952	1,679	1,519
Fuel	954	681	604
Other occupancy	412	373	375
Other expenses	3,264	3,045	2,965
	$ 8,713	$ 7,862	$ 7,439

note 10. segment and geographic information

We report our operations in three segments: U.S. domestic package operations, international package operations, and non-package operations. Package operations represent our core 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. International package operations include shipments wholly outside the United States as well as shipments with either origin or distribution outside the United States. Non-package operations, which include the UPS Logistics Group, are distinct from package operations and are thus managed and reported separately. Based on the requirements of FAS 131, reportable segments include U.S. domestic package operations, international package operations, and non-package operations.

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 (Note 1), with certain expenses allocated between the segments using activity-based costing methods.

Segment information as of, and for the years ended, December 31 is as follows:

(In millions)	2000	1999	1998
Revenue:			
U.S. domestic package	$ 24,002	$ 22,313	$ 20,650
International package	4,166	3,730	3,399
Non-package	1,603	1,009	739
Consolidated	$ 29,771	$ 27,052	$ 24,788
Operating Profit:			
U.S. domestic package	$ 3,929	$ 3,506	$ 2,815
International package	274	232	29
Non-package	309	167	159
Consolidated	$ 4,512	$ 3,905	$ 3,003
Assets:			
U.S. domestic package	$ 15,032	$ 11,839	$ 11,077
International package	2,918	2,922	2,473
Non-package	2,268	1,998	1,824
Unallocated	1,444	6,269	1,693
Consolidated	$ 21,662	$ 23,028	$ 17,067

Non-package operating profit included $101, $108, and $112 million for 2000, 1999, and 1998, respectively, of intersegment profit, with a corresponding amount of operating expense, which reduces operating profit, included in the U.S. domestic package segment.

Revenue by product type for the years ended December 31 is as follows:

(In millions)	2000	1999	1998
Letters, packages, and cargo	$ 28,168	$ 26,043	$ 24,049
Other	1,603	1,009	739
	$ 29,771	$ 27,052	$ 24,788

Geographic information as of, and for the years ended, December 31 is as follows:

(In millions)	2000	1999	1998
U.S.:			
Revenue	$ 26,325	$ 24,093	$ 22,125
Long-lived assets	$ 12,477	$ 10,725	$ 10,237
International:			
Revenue	$ 3,446	$ 2,959	$ 2,663
Long-lived assets	$ 2,061	$ 2,111	$ 1,758
Consolidated:			
Revenue	$ 29,771	$ 27,052	$ 24,788
Long-lived assets	$ 14,538	$ 12,836	$ 11,995

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, and goodwill.

notes to consolidated financial statements

note 11. marketable securities and short-term investments

The following is a summary of marketable securities and short-term investments at December 31, 2000 and 1999 (in millions):

2000	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government & agency securities	$ 432	$ 4	$ –	$ 436
U.S. corporate securities	230	3	1	232
Other debt securities	22	1	–	23
Total debt securities	684	8	1	691
Equity securities	396	18	32	382
	$ 1,080	$ 26	$ 33	$ 1,073

1999	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government & agency securities	$ 179	$ –	$ 3	$ 176
U.S. corporate securities	1,205	1	4	1,202
Other debt securities	610	–	1	609
Total debt securities	1,994	1	8	1,987
Equity securities	87	5	5	87
	$ 2,081	$ 6	$ 13	$ 2,074

The gross realized gains on sales of marketable securities totaled $69 million in 2000 and $6 million in 1999. The gross realized losses totaled $35 million in 2000 and $12 million in 1999. The adjustment to unrealized holding losses on marketable securities, net of tax, included in other comprehensive income totaled $1 million in 2000 and $3 million in 1999.

The amortized cost and estimated fair value of marketable securities and short-term investments at December 31, 2000, by contractual maturity, are shown below (in millions). Expected maturities will 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	$ 131	$ 132
Due after one year through three years	264	265
Due after three years through five years	22	22
Due after five years	267	272
	684	691
Equity securities	396	382
	$ 1,080	$ 1,073

note 12. business combinations

During the two years ended December 31, 2000, we completed 15 acquisitions that were accounted for under the purchase method of accounting. Pro forma results of operations have not been presented for any of the acquisitions because the effects of these transactions were not material to us on either an individual or aggregate basis. The results of operations of each acquired company are included in our consolidated statement of income from the date of acquisition. During 1999 and 2000, cash and the assumption of liabilities were the only forms of consideration for these acquisitions.

We regularly explore opportunities to acquire companies that would enhance our core package delivery business, as well as our various non-package businesses. Our acquisitions in 1999 and 2000 included both domestic and international transactions. During 2000, we completed a total of 13 transactions with an aggregate purchase value of $433 million, including liabilities assumed. During 1999, we completed two transactions with an aggregate purchase value of $119 million, including liabilities assumed.

Subsequent to December 31, 2000, we announced three additional transactions that are expected to close during 2001. First, we entered into an agreement to acquire Fritz Companies, Inc. in a transaction valued at approximately $450 million (excluding assumed liabilities). Fritz is a freight forwarding, customs brokerage and logistics concern, with $619 million of net revenue for its most recent fiscal year. The acquisition, which will be accounted for as a purchase, will involve the exchange of approximately 7.4 million shares of Class B common stock for all of the outstanding shares of Fritz.

In addition, we entered into an agreement to acquire First International Bancorp, Inc. in a transaction valued at approximately $78 million (excluding assumed liabilities). First International, with a managed loan portfolio of approximately $1.2 billion, offers a variety of structured trade finance, commercial, and government-backed lending products. First International will be integrated with UPS Capital Corporation, the finance subsidiary of UPS, upon the closing of the transaction. The acquisition, which will be accounted for as a purchase, will involve the exchange of approximately 1.3 million shares of Class B common stock for all of the outstanding shares of First International.

Finally, we entered into an agreement to acquire substantially all of the assets of Mail Boxes Etc. (“MBE”) in a cash transaction valued at approximately $191 million. MBE is the world’s largest franchisor of independently owned and operated business, communication, and shipping centers worldwide. The acquisition will be accounted for as a purchase.

note 13. derivative instruments and risk management

We are exposed to market risk, primarily related to foreign exchange, commodity prices, equity prices, and interest rates. These exposures are actively monitored by management. To manage the volatility relating to 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.

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Commodity Price Risk Management

We are exposed to increases in the price of refined fuels, primarily jet-A, diesel, and unleaded gasoline. We use a combination of options, swaps, and futures contracts to provide some protection from rising fuel prices. These derivative instruments generally cover forecasted fuel consumption for periods up to one year. The net fair value of such contracts subject to price risk, excluding the underlying exposures, as of December 31, 2000 and 1999 was an asset (liability) of approximately $(5) and $27 million, respectively. We 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 when the underlying fuel being hedged is consumed.

Foreign Currency Exchange Risk Management

We have foreign currency risks related to our revenue, operating costs, and financial 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 and the British Pound Sterling. We use a combination of purchased and written options and forward contracts to hedge cash flow currency exposures. As of December 31, 2000 and 1999, the net fair value of the hedging instruments described above was a liability of approximately $9 million and none, respectively. We have designated and account for these contracts as cash flow hedges of foreign currency denominated revenue and, therefore, the resulting gains and losses from these hedges are recognized as a component of international 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 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 hedges of the fair value of the associated debt instruments. 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, 2000 and 1999 was an asset of approximately $3 million and $44 million, respectively.

Equity Price Risk Management

We hold investments in various available-for-sale equity securities that are subject to price risk. We use combinations of options to hedge the price risk exposure inherent in these securities. The fair value of such options contracts designated as hedges, as of December 31, 2000 and 1999, was approximately $148 million and none, respectively.

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.

Fair Value of Financial Instruments

At December 31, 2000 and 1999, our financial instruments included cash and cash equivalents, marketable securities and short-term investments, 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 debt instruments is disclosed in Note 2, and the fair value of our marketable securities and short-term investments is disclosed in Note 11.

note 14. quarterly information (unaudited)

(In millions except per share amounts)	First Quarter 2000	First Quarter 1999	Second Quarter 2000	Second Quarter 1999	Third Quarter 2000	Third Quarter 1999	Fourth Quarter 2000	Fourth Quarter 1999
Revenue:								
U.S. domestic package	**$ 5,841**	$ 5,231	**$ 5,890**	$ 5,434	**$ 5,928**	$ 5,574	**$ 6,343**	$ 6,074
International package	**1,023**	885	**1,023**	908	**1,028**	909	**1,092**	1,028
Non-package	**356**	215	**371**	218	**411**	232	**465**	344
Total revenue	**7,220**	6,331	**7,284**	6,560	**7,367**	6,715	**7,900**	7,446
Operating profit:								
U.S. domestic package	**883**	773	**1,024**	888	**1,031**	908	**991**	937
International package	**58**	48	**74**	66	**51**	47	**91**	71
Non-package	**126**	25	**63**	34	**59**	25	**61**	83
Total operating profit	**1,067**	846	**1,161**	988	**1,141**	980	**1,143**	1,091
Net income (loss)	**$ 813**	$ 499	**$ 695**	$ (854)	**$ 702**	$ 577	**$ 724**	$ 661
Earnings (loss) per share:								
Basic	**$ 0.68**	$ 0.45	**$ 0.61**	$ (0.77)	**$ 0.62**	$ 0.53	**$ 0.64**	$ 0.57
Diluted	**$ 0.67**	$ 0.44	**$ 0.60**	$ (0.77)	**$ 0.60**	$ 0.52	**$ 0.63**	$ 0.56

The loss for the second quarter of 1999 resulted from a tax assessment charge discussed in Note 4.

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Operations

2000 Compared to 1999

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, 2000	1999	Change $	%
Revenue (in millions):				
U.S. domestic package:				
Next Day Air	$ 5,664	$ 5,240	$ 424	8.1%
Deferred	2,910	2,694	216	8.0
Ground	15,428	14,379	1,049	7.3
Total U.S. domestic package	24,002	22,313	1,689	7.6
International package:				
Domestic	904	924	(20)	(2.2)
Export	2,837	2,479	358	14.4
Cargo	425	327	98	30.0
Total international package	4,166	3,730	436	11.7
Non-package:				
UPS Logistics Group	1,021	771	250	32.4
Other	582	238	344	144.5
Total non-package	1,603	1,009	594	58.9
Consolidated	$ 29,771	$ 27,052	$ 2,719	10.1%

Average Daily Package Volume (in thousands):	2000	1999	#	%
U.S. domestic package:				
Next Day Air	1,122	1,039	83	8.0%
Deferred	914	852	62	7.3
Ground	10,434	10,016	418	4.2
Total U.S. domestic package	12,470	11,907	563	4.7
International package:				
Domestic	786	711	75	10.5
Export	368	303	65	21.5
Total international package	1,154	1,014	140	13.8
Consolidated	13,624	12,921	703	5.4%

Average Revenue Per Piece:	2000	1999	$	%
U.S. domestic package:				
Next Day Air	$ 19.87	$ 19.86	$ 0.01	0.1%
Deferred	12.53	12.45	0.08	0.6
Ground	5.82	5.65	0.17	3.0
Total U.S. domestic package	7.58	7.38	0.20	2.7
International package:				
Domestic	4.53	5.12	(0.59)	(11.5)
Export	30.35	32.21	(1.86)	(5.8)
Total international package	12.76	13.21	(0.45)	(3.4)
Consolidated	$ 8.02	$ 7.84	$ 0.18	2.3%

U.S. domestic package revenue increased almost $1.7 billion, or 7.6%, primarily due to volume gains across all product lines, combined with a 2.7% increase in average revenue per piece, which was primarily driven by our Ground products. All products contributed to the revenue increase, with our higher revenue per piece express (Next Day Air and Deferred) products increasing at approximately the same rate (8.1% and 8.0% respectively). Our average daily Ground volume grew at a 4.2% rate for the period, helping to bring our total U.S. average daily package volume to almost 12.5 million pieces.

During the first quarter of 2000, we increased rates for standard ground shipments an average of 3.1% for commercial deliveries. The ground residential charge continued to be $1.00 over the commercial ground rate, with an additional delivery area surcharge of $1.50 added to certain less accessible areas. In addition, we increased rates for UPS Next Day Air, UPS Next Day Air Saver, and UPS 2nd Day Air an average of 3.5%. The surcharge for UPS Next Day Air Early A.M. did not change. Rates for international shipments originating in the United States (Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited and UPS International Standard service) increased by 2.9%. Rate changes for shipments originating outside the United States were made throughout the past year and varied by geographic market.

The increase in international package revenue was due to double-digit volume growth for both our domestic and export products, offset by a decline in the revenue per piece for these products. This decline was primarily due to a decline in the value of the Euro relative to the U.S. dollar that occurred during 2000. The value of the Euro averaged $0.92 in 2000 compared to $1.07 in 1999. Overall average daily package volume increased 13.8% for international operations, with our export products, which had an average revenue per piece in excess of $30, increasing at 21.5%.

The increase in non-package revenue resulted primarily from the new arrangement for providing excess value package insurance for our customers, as well as continued growth of UPS Logistics Group. Revenue for UPS Logistics Group increased by $250 million, or 32.4%, to over $1 billion for the year ended December 31, 2000. The new arrangement for providing excess value package insurance began in the fourth quarter of 1999. Consequently, this item will have a reduced impact on the comparability of the revenue for our non-package segment in future periods.

Operating expenses increased by $2.112 billion, or 9.1%, which was less than our revenue increase of 10.1%. Compensation and benefits expenses, the largest component of this increase, accounted for $1.261 billion of the increase and included a $59 million charge recorded in the first quarter of 2000 relating to the creation of 4,000 new full-time hourly jobs resulting from the 1997 Teamsters contract. Other operating expenses increased $851 million primarily due to higher purchased transportation costs, higher fuel costs, and claims expense associated with the new arrangement for providing excess value package insurance for our customers. The increase in purchased transportation costs was primarily due to increased business for our international and logistics operations. The 40.1% increase in fuel costs from $681 million to $954 million was due to the increase in fuel prices during 2000 and the additional fuel usage due to the growth in our average daily package volume, partially offset by cost reductions generated by our fuel hedging program. The increase in other operating expenses of $219 million was slightly offset by the $49 million gain we recognized in the first quarter of 2000 from the sale of our UPS Truck Leasing subsidiary. International operating expenses were favorably impacted by the decline in the value of the Euro relative to the U.S. dollar as discussed above.

To offset the increasing fuel costs we have experienced over the last several quarters and that we expect to continue into the near future, we implemented a temporary 1.25% fuel surcharge effective August 7, 2000. Approximately $130 million in revenue was recorded in 2000 as a result of the surcharge.

Our operating margin, defined as operating profit as a percentage of revenue, improved from 14.4% during 1999 to 15.2% during 2000. This improvement continues our recently reported trends and

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was favorably impacted by continued product mix improvements and our continued successful efforts in obtaining profitable volume growth.

The following table shows the change in operating profit, both in dollars and in percentage terms:

(in millions)	Year Ended December 31, 2000	1999	Change $	%
Operating Segment				
U.S. domestic package	**$ 3,929**	$ 3,506	$ 423	12.1%
International package	**274**	232	42	18.1
Non-package	**309**	167	142	85.0
Consolidated operating profit	**$ 4,512**	$ 3,905	$ 607	15.5%

U.S. domestic package operating profit increased by $423 million, or 12.1%, due to the volume and revenue improvements discussed previously.

The improvement in the operating profit of our international package segment of 18.1%, or $42 million, resulted primarily from increased volume and revenue and was realized despite significantly higher fuel costs. This improvement occurred throughout our international regions. The improvement in operating profit for this segment would have been $36 million greater if the impact of currency fluctuations was excluded.

The increase in non-package operating profit is largely due to the new arrangement for providing excess value package insurance for our customers, which contributed $183 million of additional operating profit for the year. Also contributing to the operating profit improvement was the $49 million gain we recognized during the first quarter of 2000 from the sale of our UPS Truck Leasing subsidiary. These improvements were offset somewhat by start-up costs associated with UPS Logistics Group's service parts logistics offering, UPS e-Ventures, UPS Capital Corporation, and other initiatives.

The increase in investment income of $330 million for the period is primarily due to two factors. First, in the first quarter of 2000, two companies in which our Strategic Enterprise Fund held investments were acquired by other companies, which caused us to recognize a gain of $241 million. Second, we earned income on the $5.3 billion in net IPO proceeds available for investment prior to the tender offer that was completed in early March 2000 and the $1.2 billion in IPO proceeds that were not utilized for the tender offer. In 1999, we had the net IPO proceeds available for investment from mid-November through the end of the year. We announced a share repurchase program on April 20, 2000 under which we would utilize up to the remaining $1.2 billion not used in the tender offer. As of December 31, 2000, approximately $105 million remained available for share repurchases.

Net income for the year ended December 31, 2000 was $2.934 billion, or $2.50 per diluted share, compared to net income of $883 million, or $0.77 per diluted share, for the prior year. Our 2000 results reflect the non-recurring items discussed above, which include the gains on our Strategic Enterprise Fund investments and the sale of our UPS Truck Leasing subsidiary, offset partially by the charge for retroactive costs associated with creating new full-time jobs from existing part-time Teamster jobs. Our 1999 results reflect a tax assessment charge resulting from an unfavorable ruling of the U.S. Tax Court. Excluding these non-recurring transactions for each of these years, adjusted net income for 2000 would have been $2.795 billion, an increase in excess of 20% over adjusted 1999 net income of $2.325 billion. Adjusted diluted earnings per share would have increased from $2.04 in 1999 to $2.38 in 2000.

Our fourth quarter of 2000 results reflected a decline in our previously reported growth rates for both revenue and average daily volume. These declines were caused by an overall weakening of the economy.

1999 Compared to 1998

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, 1999	1998	Change $	%
Revenue (in millions):				
U.S. domestic package:				
Next Day Air	$ 5,240	$ 4,690	$ 550	11.7%
Deferred	2,694	2,464	230	9.3
Ground	14,379	13,496	883	6.5
Total U.S. domestic package	22,313	20,650	1,663	8.1
International package:				
Domestic	924	953	(29)	(3.0)
Export	2,479	2,176	303	13.9
Cargo	327	270	57	21.1
Total international package	3,730	3,399	331	9.7
Non-package:				
UPS Logistics Group	771	631	140	22.2
Other	238	108	130	120.4
Total non-package	1,009	739	270	36.5
Consolidated	$ 27,052	$ 24,788	$ 2,264	9.1%
Average Daily Package Volume (in thousands):			#	%
U.S. domestic package:				
Next Day Air	1,039	938	101	10.8%
Deferred	852	783	69	8.8
Ground	10,016	9,645	371	3.8
Total U.S. domestic package	11,907	11,366	541	4.8
International package:				
Domestic	711	730	(19)	(2.6)
Export	303	256	47	18.4
Total international package	1,014	986	28	2.8
Consolidated	12,921	12,352	569	4.6%
Average Revenue Per Piece:			$	%
U.S. domestic package:				
Next Day Air	$ 19.86	$ 19.69	$ 0.17	0.9%
Deferred	12.45	12.39	0.06	0.5
Ground	5.65	5.51	0.14	2.5
Total U.S. domestic package	7.38	7.15	0.23	3.2
International package:				
Domestic	5.12	5.14	(0.02)	(0.4)
Export	32.21	33.46	(1.25)	(3.7)
Total international package	13.21	12.49	0.72	5.8
Consolidated	$ 7.84	$ 7.58	$ 0.26	3.4%

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U.S. domestic package revenue increased more than $1.6 billion primarily due to a 4.8% increase in average daily package volume combined with a 3.2% improvement in revenue per piece. Package volume growth was experienced in all products, with average volumes for our Next Day Air and Deferred products growing at 10.8% and 8.8%, respectively. We generated substantial growth in our Ground revenue, which comprised 64% of our U.S. domestic package revenue, based on average volume growth of 3.8% and a 2.5% improvement in average revenue per piece.

During the first quarter of 1999, we increased rates for standard ground shipments an average of 2.5% for commercial deliveries. The ground residential charge continued to be $1.00 over the commercial ground rate, with an additional delivery area surcharge added to certain less accessible areas. In addition, we increased rates for UPS Next Day Air, UPS Next Day Air Saver and UPS 2nd Day Air an average of 2.5%, while we decreased the rate for UPS 2nd Day Air A.M. by 2.2%. The rate for UPS Next Day Air Early A.M. did not change. Rates for international shipments originating in the United States did not increase for UPS Worldwide Express, Worldwide Express Plus, UPS Worldwide Expedited, and UPS International Standard service. Rate changes for shipments originating outside the United States were made throughout the past year and varied by geographic market.

The increase in international package revenue was primarily due to an overall improvement in product mix, specifically volume growth for our export products. All international operations posted double-digit volume growth in export services, with the largest increases experienced in our Asia Pacific and European operations. Due to the strong growth of our international export products, our total average revenue per piece for the international segment increased $0.72, or 5.8%.

The growth in non-package revenue resulted primarily from the continued growth of the UPS Logistics Group. This growth reflected both new business and increased business with existing customers. Revenue for the non-package segment was also increased by the new arrangement for providing excess value package insurance for our customers, which commenced in the fourth quarter of 1999.

Operating expenses increased by $1.366 billion, or 6.3%, which was less than our increase in revenue of 9.1%. Compensation and benefit expenses accounted for $939 million of this increase. Purchased transportation costs increased by $160 million and fuel costs increased by $77 million. The operating margin for 1999 was 14.4% compared to 12.1% in 1998. This improvement was largely due to containment of operating expense growth through better utilization of existing capacity and from continued company-wide cost containment efforts.

The following table shows the change in operating profit, both in dollars and in percentage terms:

(in millions)	Year Ended December 31, 1999	1998	Change $	%
Operating Segment				
U.S. domestic package	$ 3,506	$ 2,815	$ 691	24.5%
International package	232	29	203	700.0
Non-package	167	159	8	5.0
Consolidated operating profit	$ 3,905	$ 3,003	$ 902	30.0%

U.S. domestic package operating profit improved due to the volume and revenue improvements discussed previously, combined with the containment of operating expense growth.

Our international package operating profit improved significantly in 1999 due to a shift to higher yielding export packages. Average daily volume for our export products grew 18.4% over 1998. The Europe and Asia Pacific regions contributed significantly to overall operating profit improvements.

The increase in non-package operating profit was largely due to the new arrangement for providing excess value package insurance for our customers. The new arrangement for excess value package insurance, which was implemented in the fourth quarter of 1999, increased non-package operating profit by $60 million. This increase was offset by continued start-up costs at UPS Capital Corporation, higher third-party underwriting losses for UPINSCO, our captive insurance company, and a reduction in intersegment profit. UPS Logistics Group experienced a small decrease in operating profit compared to the preceding year. This decrease was due to third-party transportation costs for the group's service parts logistics offering and higher fuel costs for its UPS Truck Leasing subsidiary. These decreases were offset somewhat by higher operating profits for the group's supply chain management offering.

The increase in investment income of $93 million for the year was due to large cash, cash equivalents, and marketable securities and short-term investments balances we maintained during 1999, including the IPO proceeds received in November.

Net income for 1999 decreased by $858 million from 1998, resulting in a decrease in diluted earnings per share from $1.57 in 1998 to $0.77 in 1999. These results reflect the charge we recorded during the second quarter of 1999, resulting from an unfavorable ruling of the U.S. Tax Court. Excluding the impact of this one-time charge of $1.442 billion, our adjusted net income for 1999 would have been $2.325 billion, with an associated adjusted diluted earnings per share of $2.04. Further discussion of this matter is included in the Liquidity and Capital Resources section.

Liquidity and Capital Resources

Our primary source of liquidity is our cash flow from operations. We maintain significant cash, cash equivalents, marketable securities, and short-term investments, amounting to $2.0 billion at December 31, 2000. Of this amount, approximately $105 million represents the net proceeds remaining from our initial public offering, which was completed in November 1999. In November 1999, we received net proceeds of $5.266 billion from our initial public offering. We used the majority of the IPO proceeds to fund a cash tender offer to purchase Class A-1 shares from shareowners.

The remaining IPO proceeds of approximately $105 million as of December 31, 2000 were available for a share repurchase program that was announced on April 20, 2000. In addition, an additional $750 million has been authorized for share repurchases.

We maintain two commercial paper programs under which we are authorized to borrow up to $7.0 billion. Approximately $1.366 billion was outstanding under these programs as of December 31, 2000. Since we do not intend to refinance the full commercial paper balance outstanding at December 31, 2000, $366 million has been classified as a current liability in our balance sheet. The average interest rate on the amount outstanding at December 31, 2000 was 6.5%.

We maintain two credit agreements with a consortium of banks. These agreements provide revolving credit facilities of $1.25 billion each, with one expiring on April 26, 2001 and the other expiring on April 27, 2005. 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, 2000.

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We also maintain a $1.0 billion European medium-term note program. Under this program, we may issue notes from time to time, denominated in a variety of currencies. At December 31, 2000, $1.0 billion was available under this program. The $200 million outstanding at December 31, 2000, which was issued under this program in 1997, bears interest at a stated rate of 6.625%. Subsequent to December 31, 2000, we issued $736 million of 30-year Pound Sterling bonds under this program, which bear interest at a stated rate of 5.50%.

We have filed a shelf registration statement under which we may issue debt securities in the United States of up to $2.0 billion. The debt may be denominated in a variety of currencies. In September 2000, we issued $300 million cash-settled convertible senior notes due September 27, 2007 pursuant to our shelf registration statement. The notes were sold at par with a stated interest rate of 1.75% and are callable after three years. The notes may be exchanged for an amount of cash that is indexed to the trading price of Class B common stock. There was approximately $405 million issued under this shelf registration statement at December 31, 2000. Subsequent to December 31, 2000, we have issued debt under our UPS Notes program. The notes issued under this program have various terms and maturities, all with fixed interest rates. As of February 28, 2001, $57 million has been issued under this program. Also subsequent to December 31, 2000, we issued $89 million in floating rate senior notes due December 2050, which bear interest at one-month LIBOR less 45 basis points.

On August 9, 1999 the U.S. Tax Court issued an opinion unfavorable to UPS regarding a Notice of Deficiency asserting that we are liable for additional tax for the 1983 and 1984 tax years. The Court held that we are liable for tax on income of Overseas Partners Ltd. ("OPL"), a Bermuda company, which had reinsured excess value package insurance purchased by our customers beginning in 1984. In February 2000, the U.S. Tax Court entered a decision in accord with its opinion.

In addition, during the first quarter of 1999, the IRS issued two Notices of Deficiency asserting that we are liable for additional tax for the 1985 through 1987 tax years, and the 1988 through 1990 tax years. The primary assertions by the IRS relate to the reinsurance of excess value package insurance, the issue raised for the 1984 tax year. The IRS has based its assertions on the same theories included in the 1983–1984 Notice of Deficiency. The IRS, in an issued report, has taken similar positions for tax years 1991 through 1994. We expect the IRS to take similar positions for tax years 1995 through 1999. We believe that a number of aspects of the Tax Court decision are incorrect, and we have appealed the decision to the U.S. Court of Appeals for the Eleventh Circuit. The Eleventh Circuit has heard oral arguments. We do not know when the court will render a decision.

We have been named as a defendant in 23 lawsuits that seek to hold us (and in certain cases, other defendants) liable for the collection of premiums for excess value package insurance in connection with package shipments since 1984 (or, in some of the cases, for shorter time periods). The ultimate resolution of these matters cannot presently be determined.

In addition, we are a defendant in various other lawsuits that arose in the normal course of business. In our opinion, none of these cases is expected to have a material effect on our financial condition, results of operations, or liquidity.

In November 2000, OSHA published its final ergonomics standard, which would have required American industry to take expansive compliance steps in the workplace when employees report musculoskeletal complaints such as low back pain. The rule was subsequently challenged by a broad coalition of trade associations and businesses in actions consolidated in the United States Court of Appeals for the D.C. Circuit. We, our competitors, and other affected parties filed comments with OSHA challenging several aspects of the rule, including the medical support and economic and technical feasibility of the proposed regulations. OSHA took the position that the cost of compliance with the proposed regulations would have been only $4.5 billion per year over a 10-year period for all of American industry. We maintained that these estimates were unrealistic and estimated that the cost of compliance would have been significantly greater, both in initial costs and in incremental annual costs. We estimated that such expenditures, if required to be incurred, would have materially and adversely affected our financial condition, results of operations, and liquidity.

Subsequent to December 31, 2000, the United States Senate and the House of Representatives passed joint resolutions disapproving the OSHA ergonomics standard and declaring that the standard shall have no force or effect. We anticipate that President Bush will approve these actions in the near future. If this occurs, we anticipate that the legal proceedings described above will be dismissed as moot.

Reference is made to Note 4 to the accompanying audited consolidated financial statements for more information on each of the matters (Tax Court decision, lawsuits, and OSHA) discussed previously.

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 through 2009.

Following is a summary of capital expenditures:

(In millions)	Year Ended December 31, 2000	1999	1998
Buildings and facilities	**$ 947**	$ 579	$ 408
Aircraft and parts	**645**	433	942
Vehicles	**156**	139	141
Information technology	**399**	325	154
	$ 2,147	$ 1,476	$ 1,645

We anticipate capital expenditures of approximately $2.8 billion in 2001. These expenditures will provide for replacement of existing capacity and anticipated future growth and include the projected cost of capitalized software.

Market Risk

We are exposed to market risk from changes in foreign currency exchange rates, interest rates, equity prices, and certain commodity prices. All of this market risk arises in the normal course of business, as UPS does 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.

A discussion of our accounting policies for derivative instruments and further disclosures are provided in Note 13 to the consolidated financial statements.

Commodity Price Risk

We are exposed to increases in the price of refined fuels, principally jet-A, diesel, and unleaded gasoline, which are all used in our normal business operations. We use a combination of options, swaps, and futures contracts to provide some protection from rising fuel prices. These derivative instruments generally cover forecasted fuel consumption for periods up to one year. The net fair value of such contracts, subject to price risk, excluding the underlying exposures, as of December 31, 2000 and 1999 was an asset (liability) of approximately $(5) and $27 million, respectively. The potential change in the fair value of these derivative contracts, assuming a 10% change in the underlying commodity price, would be approximately $9 and $12 million at December 31, 2000 and 1999, respectively. This amount excludes the offsetting impact of the price risk inherent in the physical purchase of the underlying commodities.

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Foreign Currency Exchange Risk

We have foreign currency risks related to our revenue, operating costs, 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 and the British Pound Sterling. We use a combination of purchased and written options and forward contracts to hedge cash flow currency exposures. As of December 31, 2000 and 1999, the net fair value of the hedging instruments described above was a liability of approximately $9 million and none, respectively. The potential loss in fair value for such financial instruments from a hypothetical 10% adverse change in quoted foreign currency exchange rates would be approximately $37 million and none for 2000 and 1999, 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 2 to the consolidated financial statements, we have various debt instruments, including debt associated with capital leases, that are issued at fixed rates of interest. Such financial instruments are exposed to fluctuations in fair value resulting from changes in market interest rates. The fair value of our total long-term debt at December 31, 2000 and 1999 was $3.7 and $2.5 billion, respectively. The potential change in fair value resulting from a hypothetical 10% shift in interest rates would be approximately $127 and $78 million for 2000 and 1999, respectively.

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.

The net fair value of our interest rate swaps at December 31, 2000 and 1999 was an asset of approximately $3 and $44 million, respectively. The potential decrease in fair value resulting from a hypothetical 10% shift in interest rates would be approximately $30 and $13 million for 2000 and 1999, respectively.

This sensitivity analysis assumes a parallel shift in the yield curve. Although certain assets and liabilities may have similar maturities or periods to repricing, they may not react correspondingly to changes in market interest rates.

Equity Price Risk

We hold investments in various available-for-sale equity securities that are subject to price risk. The fair value of such investments, as of December 31, 2000 and 1999, was an asset of approximately $382 and $87 million, respectively. In addition, we utilize options to hedge the price risk for certain of these equity securities.The potential change in the fair value of these investments, assuming a 10% change in prices, would be approximately $31 and $9 million for 2000 and 1999, respectively.

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.

Future Accounting Changes

In June 1998, the FASB issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"), as amended by Statements No. 137 and No. 138, which provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. After adoption on January 1, 2001, all derivative instruments will be recognized on the balance sheet at fair value, and changes in the fair values of such instruments will be recognized currently in earnings unless specific hedge accounting criteria are met. We will record a one-time cumulative effect, after-tax charge of FAS 133 totaling $14 million in the income statement, as well as an unrealized accumulated transition adjustment gain of $23 million accumulated other comprehensive loss for the initial adoption of FAS 133 in the quarter ended March 31, 2001.

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 are inherently difficult to predict. 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. These factors include, for example, our competitive environment, economic and other conditions in the markets in which we operate, strikes, work stoppages and slowdowns, governmental regulation, increases in aviation and motor fuel prices, and cyclical and seasonal fluctuations in our operating results. Additional information concerning these risks and uncertainties, and other factors you may wish to consider, are provided in the "Risk Factors" discussed in our Annual Report on Form 10-K for the year ended December 31, 2000 and other documents we file from time to time with the SEC.

selected financial data

The following table sets forth selected financial data for each of the five years in the period ended December 31, 2000. This financial data should be read in conjunction with our Consolidated Financial Statements, Management's Discussion and Analysis of Financial Condition and Results of Operations, and other financial data appearing elsewhere in this report.

Selected Income Statement Data

(In millions except per share amounts)	2000	1999	1998	1997	1996
		Years ended December 31,			
Revenue:					
U.S. domestic package	**$ 24,002**	$ 22,313	$ 20,650	$ 18,868	$ 18,881
International package	**4,166**	3,730	3,399	3,067	3,074
Non-package	**1,603**	1,009	739	523	413
Total revenue	**29,771**	27,052	24,788	22,458	22,368
Operating expenses:					
Compensation and benefits	**16,546**	15,285	14,346	13,289	13,326
Other	**8,713**	7,862	7,439	7,526	7,092
Total operating expenses	**25,259**	23,147	21,785	20,815	20,418
Operating profit (loss):					
U.S. domestic package	**3,929**	3,506	2,815	1,623	2,150
International package	**274**	232	29	(106)	(302)
Non-package	**309**	167	159	126	102
Total operating profit	**4,512**	3,905	3,003	1,643	1,950
Other income (expense):					
Investment income	**527**	197	126	97	55
Interest expense	**(205)**	(228)	(227)	(187)	(95)
Tax assessment	**–**	(1,786)	–	–	–
Income before income taxes	**4,834**	2,088	2,902	1,553	1,910
Income taxes	**1,900**	1,205	1,161	644	764
Net income	**$ 2,934**	$ 883	$ 1,741	$ 909	$ 1,146
Per share amounts:					
Basic earnings per share	**$ 2.54**	$ 0.79	$ 1.59	$ 0.82	$ 1.03
Diluted earnings per share	**$ 2.50**	$ 0.77	$ 1.57	$ 0.81	$ 1.01
Dividends declared per share	**$ 0.68**	$ 0.58	$ 0.43	$ 0.35	$ 0.34
Weighted average shares outstanding					
Basic	**1,153**	1,121	1,093	1,103	1,114
Diluted	**1,175**	1,141	1,108	1,116	1,129
As Adjusted Net Income Data:					
Net income before impact of non-recurring items	**$ 2,795**[1]	$ 2,325[2]	$ 1,741	$ 909	$ 1,146
As a percentage of revenue	**9.4%**	8.6%	7.0%	4.0%	5.1%
Basic earnings per share	**$ 2.42**	$ 2.07	$ 1.59	$ 0.82	$ 1.03
Diluted earnings per share	**$ 2.38**	$ 2.04	$ 1.57	$ 0.81	$ 1.01

Selected Balance Sheet Data

(In millions)	2000	1999	1998	1997	1996
			December 31,		
Working capital	**$ 2,623**	$ 5,994	$ 1,355	$ 734	$ 1,027
Long-term debt	**$ 2,981**	$ 1,912	$ 2,191	$ 2,583	$ 2,573
Total assets	**$ 21,662**	$ 23,028	$ 17,067	$ 15,912	$ 14,954
Shareowners' equity	**$ 9,735**	$ 12,474	$ 7,173	$ 6,087	$ 5,901

(1) Excludes $139 million in net income related primarily to investment gains.

(2) Excludes a $1.442 billion tax assessment charge.

common stock

Price and Dividend Information

The following is a summary of our stock price activity and declared dividend information subsequent to our initial public offering on November 10, 1999.

	High	Low	Close	Dividends Declared
1999				
November 10 – December 31	$ 76.94	$ 61.00	$ 69.00	$ 0.30
2000				
1st Quarter	**$ 69.75**	**$ 49.50**	**$ 63.00**	**$ 0.17**
2nd Quarter	**$ 66.94**	**$ 55.00**	**$ 59.00**	**$ 0.17**
3rd Quarter	**$ 61.50**	**$ 51.88**	**$ 56.38**	**$ 0.17**
4th Quarter	**$ 64.31**	**$ 51.25**	**$ 58.81**	**$ 0.17**

Prior to November 10, 1999, UPS common stock was not listed on a securities exchange and was not sold in an organized over-the-counter market. Prior to November 10, we would notify our shareowners periodically of our willingness to purchase a limited number of shares at specified prices determined by the Board of Directors. In determining the share price, the Board would consider a variety of factors, including past and current earnings, earnings estimates, the ratio of UPS common stock to debt of UPS, other factors affecting the business and long-range prospects of UPS, and general economic conditions, as well as opinions furnished from time to time by investment counselors acting as independent appraisers.

The prices at which we have published notices of our willingness to purchase shares from January 1, 1999, to November 9, 1999, as well as dividends declared during this period, are as follows:

Dates	Price	Dividends Declared
January 1 to February 17, 1999	$ 20.00	–
February 18 to May 19, 1999	$ 21.50	–
May 20 to August 18, 1999	$ 23.50	$ 0.28
August 19 to November 9, 1999	$ 25.50	–

On November 10, 1999, our Class B common shares began to trade on the New York Stock Exchange under the ticker symbol "UPS". As the Class B shares have the same equitable interest in our earnings and the same dividend payments as the Class A shares, we expect that the market price of our Class B common stock will determine the value of our Class A common stock.

As of March 9, 2001, there were 129,753 and 10,280 record holders of Class A and Class B stock, respectively.

investor information

Annual Meeting

The annual meeting of shareowners will be held at 9 a.m. on Thursday, May 17, 2001 at the Hotel du Pont, 11th and Market Streets, Wilmington, Delaware 19801. Shareowners of record as of March 19, 2001 are entitled to vote at the meeting.

Securities Listing

United Parcel Service, Inc. Class B common stock is listed on the New York Stock Exchange under the symbol “UPS”.

Transfer Agent and Registrar

Account information and transactions are managed by First Union National Bank. Please direct notices of address changes or questions regarding account status, stock transfer, lost certificates, or dividend payments to the transfer agent at the following addresses:

For U.S. Mail:

United Parcel Service, Inc.
c/o First Union National Bank
P.O. Box 41784
Philadelphia, PA 19101-1784

For UPS Next Day Air:

United Parcel Service, Inc.
c/o First Union National Bank
Attn: Employee Shareowner Services
123 South Broad Street
Philadelphia, PA 19109-1199

Telephone:

888-663-8325
Calls from outside the United States:
215-985-8569

All Class A shareowners can obtain the most commonly used stock transaction forms from their manager, from UPS’s internal Web site, or from First Union’s Web site at www.firstunion.com/ess. Class B shareowners can also access forms from First Union’s Web site. Additionally, shareowners may contact First Union by mail or telephone.

Investor Relations

UPS has an active Investor Relations program. You can contact the Investor Relations department at:

United Parcel Service, Inc.
55 Glenlake Parkway, N.E.
Atlanta, GA 30328
800-877-1503
404-828-6059

Form 10-K

A copy of the company’s Annual Report on Form 10-K to the Securities and Exchange Commission may be obtained without charge by calling or writing to the Investor Relations department. It is also available through the Internet at www.sec.gov, the Web site for the Securities and Exchange Commission.

UPS’s Web Site

The company maintains a comprehensive Web site at www.ups.com. Investor information is available in the Investor Relations section of the site.

2000 awards

Once again, *Fortune* names UPS “Most Admired”

For the 17th consecutive year, UPS was named “America’s Most Admired Transportation Company” in the Mail, Package & Freight division in a *Fortune* magazine survey. And, for the third consecutive year, *Fortune* named UPS “World’s Most Admired Package Delivery Company.” These distinctions result from a survey of 10,000 senior executives, directors, and analysts, and signify recognition that UPS demonstrated a new-economy style growth strategy while maintaining an old-economy approach to fiscal responsibility.

Forbes names UPS “Company of the Year”

Forbes magazine named UPS its “Company of the Year” in a 2000 cover story titled, “The Missing Link in Web Retailing.” The national business magazine released its “platinum list” of America’s best big companies by noting: “UPS used to be a trucking company with technology. Now it’s a technology company with trucks.” *Forbes* attributes UPS’s success to its investments in technology, along with its international business achievements and ventures into e-commerce, logistics, and electronic funds transfer.

UPS receives “Clicks and Mortar” award

The MIT Sloan School of Management presented UPS with its “Clicks and Mortar” award for 2000. Citing UPS as the company making the greatest advancement in integrating both physical and online business practices, MIT presented the award during its annual eBusiness Awards program. Winners were selected by a judges’ panel comprised of industry leaders from companies including BellSouth, Dell Computer, and Intel Corp.

UPS named No. 2 on the *eWeek* FastTrack 500

eWeek selected UPS as the number two-ranked company on the FastTrack 500 list of e-business innovators for 2000. In 1999, UPS took the number four spot. UPS was credited for its customer-pleasing, industry-first online applications, an aggressive move into offering e-business logistics support services, and continuing investments to improve its innovative and robust information technology environments.

UPS among America’s best companies for minorities

A 2000 *Fortune* magazine survey ranked UPS among the top 50 American companies for minorities. Results were tallied from surveys sent to all companies in the *Fortune* 1000, plus the 200 largest privately held firms in the country. Companies were measured against one another in categories ranging from their percentage of minority new hires to the correlation between performance reviews and bonuses to diversity goals. Special attention was paid to how many minorities are in leadership roles within each company.

UPS among America’s top corporations for women-owned businesses

For the second consecutive year, the Women’s Business Enterprise National Council ranked UPS among America’s Top 16 Corporations for Women Business Enterprises (WBEs). To compile its list, *Fortune* 1000 companies were surveyed on issues including senior management involvement, identification and development of WBEs, internal buyer education, program structure, and development of mentor-protégé initiatives.

UPS receives award for International Corporate Citizenship

The United States Chamber of Commerce presented UPS with its first annual international “Center for Corporate Citizenship” (CCC) Award for exceptional community involvement. UPS was noted for providing education and training for women and minorities as well as implementing environmental initiatives in the communities in which it operates.

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The narrative portion of this Annual Report was printed on paper made from 10% post-consumer fiber. The financial portion was printed on paper made with 50% recycled fiber, including a minimum of 20% of the total fiber content from post-consumer waste.

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UPS is the world's largest integrated package delivery company, transporting approximately 3.5 billion parcels and documents annually. It is a recognized leader in e-commerce and one of the world's premier technology companies. The strength of and trust in the UPS brand are creating new opportunities in logistics, supply chain management, and financial services – increasing value to customers. UPS is more than a transportation company. It is positioned to be the leader in offering total solutions to customers' global commerce needs.