United Parcel Services (UPS)

Updated June 18th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$117	**5 Year CAGR Estimate:**	12.3%	**Quality Percentile:**	N/A
Fair Value Price:	$129	**5 Year Growth Estimate:**	7.2%	**Momentum Percentile:**	N/A
% Fair Value:	91%	**5 Year Valuation Multiple Estimate:**	2.0%	**Total Return Percentile:**	N/A
Dividend Yield:	3.1%	**5 Year Price Target**	$184	**Valuation Percentile:**	

Overview & Current Events

United Parcel Services (UPS) is a logistics and package delivery company that offers services including transportation, distribution, ground freight, ocean freight, insurance and financing. Its operations are split into three segments: US Domestic Package, International Package, and Supply Chain & Freight. UPS is valued at $101 billion. The company was founded in 1907 and is headquartered in Atlanta, GA.

UPS reported its most recent quarterly results on April 26, the company earned $1.55 per share during the first quarter (up 17% year over year). UPS recorded revenues of $17.1 billion, an increase of 10% versus the prior year's first quarter, and the company also announced that it expects earnings per share of $7.03 to $7.37 during 2018. Free cash flow generation was very strong during Q1 ($2.6 billion), but is always distributed unevenly over the year, guidance for 2018 sees free cash flows of ~$4.5 billion.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$3.50	$2.31	$3.56	$4.23	$4.53	$4.61	$4.75	$5.43	$5.75	$6.01	***$7.20***	***$10.20***
DPS	$1.77	$1.80	$1.88	$2.08	$2.28	$2.48	$2.68	$2.92	$3.12	$3.32	***$3.64***	***$5.35***

During the last financial crisis UPS' profitability declined substantially (earnings per share dropped from $4.11 in 2007 to $2.31 in 2009), but since then profits have risen relatively consistently. When we look at the 2008-2018 time frame earnings per share grew by 7.5% annually (based on the midpoint of UPS' guidance for the current year).

Profit growth during 2018 will be higher than in recent years, which is due to the positive one-time impact of a tax rate decline due to tax legislation changes in late 2017. Even without that impact the growth rate would not be bad, though, as UPS benefits from macro tailwinds and is performing well operationally at the same time.

One such tailwind is e-commerce, which leads to growth in the amount of packages that have to be transported across the country. UPS was able to grow volumes in the US by 5% during the most recent quarter, whilst also growing the revenue per piece as higher base-rate pricing and fuel surcharges came into effect. International results were even better, as growth in the Export segment allowed for a 15% revenue gain.

The strong economy drives demand for UPS' services by businesses as well as by consumers (which increase their spending due to higher disposable incomes), and with online shopping growth continuing to outpace brick-and-mortar growth in the foreseeable future UPS should continue to benefit from strong demand for its services.

UPS has pointed to a favorable pricing environment that could positively impact margins going forward. And, UPS has also reduced its share count in recent years, which allowed for some additional earnings per share growth. We expect that UPS will continue to grow its profits per share at a high-single digits pace going forward. UPS did not cut its dividend during the financial crisis and continues to lift it at a solid pace (the most recent hike was a bit higher, at 10%).

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	18.4	22.6	18.1	16.7	16.7	19.3	21.2	18.5	18.4	18.6	***16.3***	***18.0***
Avg. Yld.	2.7%	3.5%	2.9%	2.9%	3.0%	2.8%	2.7%	2.9%	2.9%	3.0%	***3.1%***	***3.0%***

UPS' shares trade at a bit more than 16 times this year's earnings. The current valuation is at the low end of the historic range. Relative to the long term median P/E ratio of 18 shares trade at a discount of ~10%, which provides some share price appreciation potential. Shares offer a dividend yield of 3.1%, which is substantially more than the broad market's dividend yield, and which is relatively attractive when we factor in the high-single digits dividend growth rate.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	124%	113%	28%	114%	104%	115%	123%	119%	117%	109%	***110%***	***110%***
Debt/A	78.7%	75.9%	76.0%	79.5%	87.8%	82.1%	93.9%	93.5%	98.9%	97.7%	***96.0%***	***93.0%***
Int. Cov.	12.4	8.6	15.9	17.6	3.5	18.6	14.1	22.5	14.5	16.8	***18.0***	***18.0***
Payout	50.6%	77.9%	52.8%	49.2%	50.3%	53.8%	56.4%	53.8%	54.3%	55.2%	***50.6%***	***52.5%***
Std. Dev.	31.6%	36.4%	20.4%	19.3%	11.9%	12.7%	15.8%	15.4%	14.4%	12.1%	***14.0%***	***15.0%***

UPS produces a very high amount of gross profits relative to the assets the company possesses, although we have to note that operating profits and net profits are substantially lower than the company's gross profits. The return on assets is therefore a lot lower, at 11.5%, which is still relatively attractive.

UPS is highly leveraged in terms of debt to all assets, but since the interest coverage ratio is quite high the debt levels are not problematic at all. The company could easily reduce its debt levels meaningfully thanks to strong cash generation, and if it would stop its buybacks more equity would build up on the balance sheet, which would result in a lower debt to assets ratio.

UPS is the biggest logistics / package delivery company in the US (by market capitalization). Its top peers include FedEx, DHL Express, and the United States Postal Service. Due to a macro environment that is beneficial for the whole industry (online shopping, strong economy) none of the big players has any interest in a price war, as volumes are rising even if they increase the base pricing for their services. Competitive pressures should therefore remain muted for the foreseeable future. During the last financial crisis profits were roughly cut in half, as lower economic activity and lower consumer spending hurts UPS, but a less severe recession will not lead to such an extensive impact on UPS.

Final Thoughts & Recommendation

UPS is a key player in an industry with a favorable outlook. UPS can offer compelling total returns over the coming years through a combination of solid growth, a relatively high dividend yield and an inexpensive valuation. The company is a buy at current prices for conservative dividend growth investors looking for double-digit total returns.

Total Return Breakdown by Year