United Parcel Services (UPS)

Updated July 27th, 2018 by Jonathan Weber

Key Metrics

Current Price:	$119	**5 Year CAGR Estimate:**	12.1%	**Volatility Percentile:**	28.6%
Fair Value Price:	$130	**5 Year Growth Estimate:**	7.2%	**Momentum Percentile:**	58.3%
% Fair Value:	92%	**5 Year Valuation Multiple Estimate:**	1.8%	**Valuation Percentile:**	75.9%
Dividend Yield:	3.1%	**5 Year Price Target**	$184	**Total Return Percentile:**	79.8%

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 trades with a market capitalization of $103 billion. The company was founded in 1907 and is headquartered in Atlanta, GA.

UPS reported its second quarter results on July 25. The company grossed revenues of $17.5 billion, an increase of 10% year over year. Earnings per share totaled $1.94 during the second quarter, up 23% versus Q2 2017. Earnings per share guidance for 2018 was unchanged, but UPS lifted its free cash flow guidance from $4.5 billion to $5.0 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. Since then profits have risen relatively consistently, though. 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 its revenues in the US by 6% during the second quarter, primarily due to higher 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 14% revenue gain during Q2.

The strong economy drives demand for UPS' services by businesses as well as by consumers which increase their spending due to higher disposable incomes. 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 relatively high, 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	***16.5***	***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%***

Disclosure: This analyst has no position in the security discussed in this article, and no plans to initiate one in the next 72 hours.

UPS' shares trade at 16.5 times this year's earnings right now, which is a quite low valuation relative to how shares were valued in the past. We believe that shares have some upside potential to a fair valuation of about 18 times earnings. Shareholders also get a relatively attractive dividend yield of 3.1% right now, coupled with solid dividend growth rates.

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%***

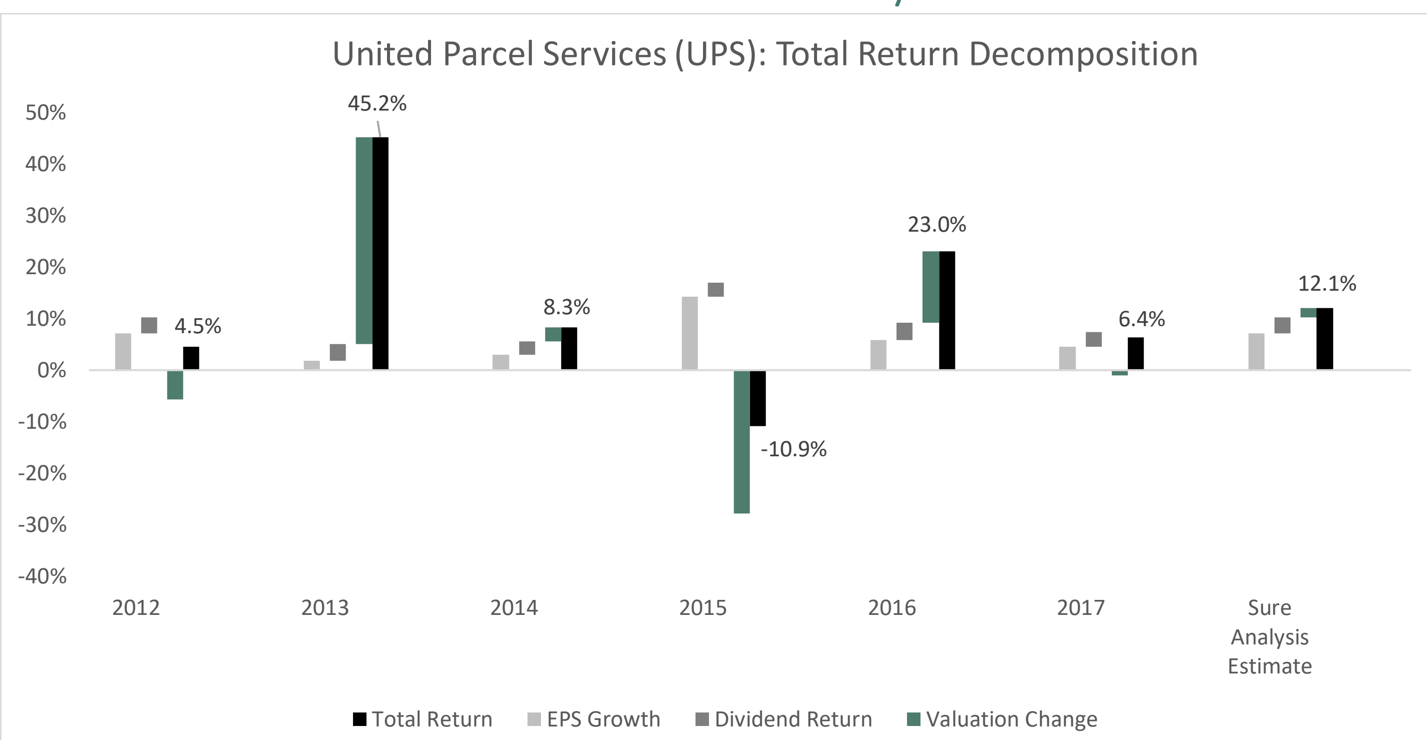
UPS produces a very high amount of gross profits relative to the assets the company possesses, although we have to note that operating profits and net profits are substantially lower than the company's gross profits. UPS is highly leveraged in terms of debt to all assets, but since the interest coverage ratio is quite high the debt levels are not problematic at all.

UPS is the biggest logistics / package delivery company in the US. Its top peers include FedEx, DHL Express, and the United States Postal Service. The macro environment is beneficial for the whole industry, thanks to megatrend online shopping and a strong economy. None of the big players has any interest in a price war, volumes will continue to rise 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

The logistics industry has a favorable outlook, and UPS is one of the top players in this industry. UPS will be able to deliver compelling total returns through a combination of dividends, earnings growth and multiple appreciation going forward. We believe that shares look like a buy for dividend growth investors at current prices.

Total Return Breakdown by Year



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