

United Parcel Service (UPS)

\$96.79 (As of 03/17/20)

Price Target (6-12 Months): **\$103.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/11/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: B

Growth: A

Momentum: F

Summary

UPS expects the coronavirus outbreak to dent its first-quarter 2020 results as shipment of goods is being hampered. Due to the rapid spread of the coronavirus, UPS' shares have declined more than 9% over the past month. The weak air freight market due to lackluster demand from China is another negative as UPS has significant exposure to China. High capital expenditures and debt levels pose further challenges to UPS. However, we are impressed with the company's efforts to reward its shareholders through dividends and buybacks. The latest shareholder-friendly move came in February when UPS hiked its quarterly dividend payout by 5.2% to \$1.01 per share. Robust free cash-flow generation by UPS is an added positive and might lead to an uptick in shareholder-oriented activities. Adjusted free cash flow for 2019 exceeded \$4.1 billion.

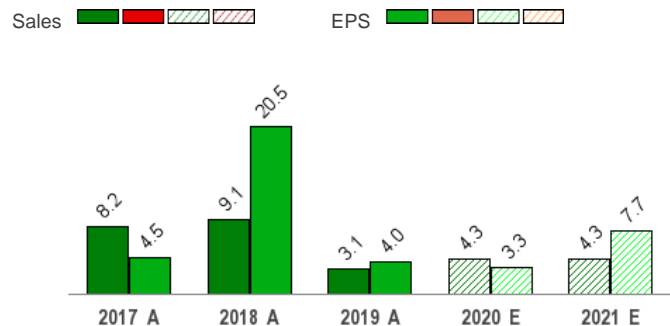
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$125.31 - \$82.00
20 Day Average Volume (sh)	7,665,221
Market Cap	\$83.1 B
YTD Price Change	-17.3%
Beta	1.21
Dividend / Div Yld	\$4.04 / 4.2%
Industry	<u>Transportation - Air Freight and Cargo</u>
Zacks Industry Rank	Top 44% (111 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	0.5%
Last Sales Surprise	-0.1%
EPS F1 Est- 4 week change	-1.5%
Expected Report Date	04/23/2020
Earnings ESP	-9.4%
P/E TTM	12.9
P/E F1	12.4
PEG F1	1.4
P/S TTM	1.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	18,910 E	19,717 E	20,281 E	23,298 E	80,612 E
2020	17,954 E	18,581 E	19,240 E	21,606 E	77,287 E
2019	17,160 A	18,048 A	18,318 A	20,568 A	74,094 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.63 E	\$2.32 E	\$2.37 E	\$2.56 E	\$8.38 E
2020	\$1.40 E	\$2.02 E	\$2.07 E	\$2.18 E	\$7.78 E
2019	\$1.39 A	\$1.96 A	\$2.07 A	\$2.11 A	\$7.53 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 03/17/2020. The reports text is as of 03/18/2020.

Overview

Based in Atlanta, United Parcel Service is the world's largest express carrier and package delivery company. The company, founded in 1907, provides specialized transportation and logistics services in the United States and internationally.

UPS offers a range of supply chain solutions, such as, freight forwarding, customs brokerage, fulfillment, returns, financial transactions, and repairs. UPS transports millions of packages each business day across the globe. In 2019, the company delivered 21.9 million pieces per day on an average. This translated into 5.5 billion packages in the year.

UPS operates a ground fleet of multiple vehicles in the United States. The company also operates an air fleet of over 500 aircraft. Its primary air hub is in Louisville, KY. Regional air hubs are located in Hartford, CT; Ontario, Canada; Philadelphia, PA, and Rockford, IL. Its international air hub is in Cologne, Germany, while other hubs are located in Miami, FL; Canada; Hong Kong; Singapore; Taiwan; China, and the Philippines.

The company, which expects total operating profits in 2020 to grow in mid to high-single-digits, has the following three core business segments:

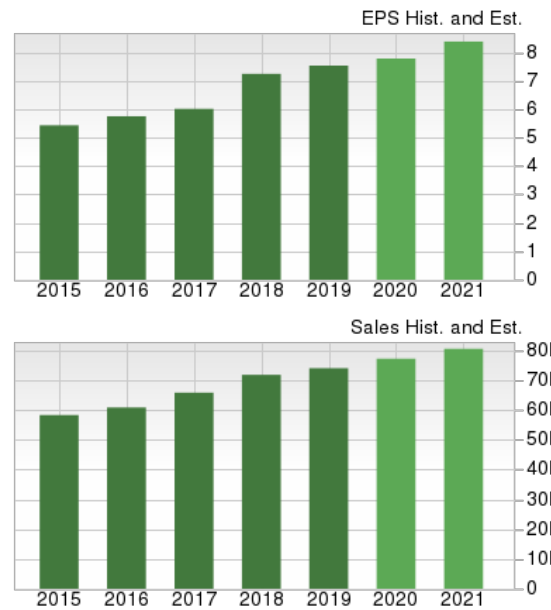
The **U.S. domestic package** operations (accounted for 62.7% of 2019 revenues) involve ground delivery services, deferred air delivery, and next day air services. Segmental revenues are expected to grow between 4% and 7% in 2020.

The **International package** operations (19.2%) encompass delivery of letters, documents and packages to multiple countries and territories worldwide, including shipments outside the U.S. as well as shipments from or to the United States with another country as the destination or origin point. Segmental revenues are expected to increase between 4% and 6% in 2020.

The **Supply chain and freight** segment (18.1%) is engaged in logistics, excess value package insurance, and freight and ancillary services. The segment, which includes the forwarding, logistics, truckload brokerage, UPS Freight and UPS Capital businesses, is expected to witness revenue-growth in the 4-6% band in 2020..

The U.S. Domestic Package and International Package businesses are collectively referred to as the company's global small package operations.

UPS' fiscal year coincides with its fiscal year.



Reasons To Buy:

- ▲ We are impressed with the company's efforts to reward investors. In 2018, UPS rewarded its shareholders to the tune of \$4.2 billion through dividends (\$3.2 billion) and buybacks (\$1 billion). In 2019, the company paid \$3.3 billion as dividends, reflecting an increase of 5.5% on a year-over-year basis. Moreover, the company repurchased more than 9 million shares for roughly \$1 billion in 2019. Additionally, in February, UPS raised its dividend by 5.2% to \$1.01 per share (\$4.04 annually).
- ▲ We are encouraged by UPS' solid free cash flow. UPS' free cash flow in 2018 surged to \$6.13 billion, exceeding its expectation. In 2019, UPS generated adjusted free cash flow in excess of \$4.1 billion. Cash from operations were \$8.6 billion. Robust free cash-flow generation by UPS is a major positive and might lead to an uptick in shareholder-friendly activities. Cash from operations for the current year is anticipated to be around \$10 billion. Adjusted free cash flow is expected to be between \$4.3 billion and \$4.7 billion in 2020. Effective tax rate is expected between 22.5% and 23.5% for 2020.
- ▲ UPS' primary revenue-generating segment, U.S. Domestic, has been performing well for the past few quarters. Segmental revenues increased 6.6% year over year to \$13,408 million in fourth-quarter 2019, aided by more than 8% volume growth across all products. Additionally, unit costs (on an adjusted basis) declined 3.2%, leading to positive operating leverage.

We are impressed with the company's efforts to reward investors. Strong performance of the U.S. Domestic segment is an added positive.

Reasons To Sell:

▼ The company has been making investments in upgrading its facilities to meet the surge in demand following rapid growth in e-commerce. UPS spent \$6.6 billion as capital expenditures (adjusted) in 2018, bulk of which was directed toward new technology, aircraft and automated capacity. This reflects a massive increase from the 2016 levels, when the company spent nearly \$3 billion on capital expenditures. In 2019, the company made capital investments worth \$6.5 billion. Capex is expected to be \$6.7 billion in 2020. The higher amount of capital spending primarily is due to UPS' intention to invest in additional automated sorting hubs to expand its retail client base. This is expected to dent 2020 earnings per share by roughly 33 cents.

▼ The sluggish air freight market due to lackluster demand from China is a negative as UPS as it has Chinese exposure. For instance, UPS joined forces with SF Holding in 2017 to strengthen its footprint in the Chinese market. With the phase one trade deal signed in January, trade tensions between the United States and China might ease. However, volumes are likely to remain weak unless the issue is fully resolved. The coronavirus outbreak is a further setback for the already-struggling air-freight market. In fact, the company's management stated that the virus outbreak might hamper shipment of goods, which in turn, is expected to hurt first-quarter 2020 performance.

▼ UPS is a highly leveraged company. This is indicated by the fact that the ratio of its long-term debt-to-capitalization (expressed as a percentage) currently reads 88.1. This compares unfavorably to the figure of 68.5 for its industry. Additionally, UPS' debt equity ratio (expressed as a percentage) currently exceeds 100. A high debt equity ratio implies that the company is funding most of its ventures with debt.

Increased capital expenditures are limiting bottom-line growth at UPS. Notably, 2020 capex is expected to be higher than 2019 levels.

Last Earnings Report

Earnings Beat at UPS in Q4

UPS' fourth-quarter 2019 earnings (excluding \$2.23 from non-recurring items) of \$2.11 per share edged past the Zacks Consensus Estimate by a penny. The bottom line also increased 8.8% year over year, primarily due to impressive volume growth in the U.S. Domestic segment.

UPS generated revenues of \$20,568 million in the quarter, which fell short of the Zacks Consensus Estimate of \$20,578.5 million. However, the top line improved 3.6% on a year-over-year basis. Results were aided by higher average daily volumes. Operating profit increased 13.7% on an adjusted basis in the final quarter of 2019.

Quarter Ending **12/2019**

Report Date	Jan 30, 2020
Sales Surprise	-0.05%
EPS Surprise	0.48%
Quarterly EPS	2.11
Annual EPS (TTM)	7.53

Segmental Details

U.S. Domestic Package revenues increased 6.6% year over year to \$13,408 million in the fourth quarter, driven by more than 8% volume growth across all products. The greatest increase (up nearly 26%) was in UPS Next Day Air volume. Results were aided by increased automated capacity and introduction of new planes to the fleet. Segmental operating profit improved more than 20% on an adjusted basis to \$1,207 million in the quarter. Additionally, unit costs (on an adjusted basis) declined 3.2%, leading to positive operating leverage.

Revenues at the International Package division came in at \$3,762 million, down 1.7%. Export volumes declined due to sluggishness in the Asia-U.S. trade lane among other factors. Segmental operating profit came in at \$809 million in the reported quarter on an adjusted basis, reflecting an increase of 3.6%. Results were aided by UPS' cost management initiatives among other factors.

Supply Chain and Freight revenues decreased more than 1% to \$3,398 million. Operating profits in the segment increased 17% on an adjusted basis to \$262 million in the fourth quarter. Prudent cost management and efforts to increase its customer base for Small- and Medium-sized Businesses (SMB) aided results.

Other Details

Cash from operations were \$8.6 billion at the end of 2019. UPS generated free cash flow of more than \$4.1 billion on an adjusted basis in the same period. The company spent \$6.5 billion as capital expenditures (adjusted) in 2019. In 2019, the company paid \$3.3 billion as dividends, reflecting an increase of 5.5% on a year-over-year basis. Moreover, the company repurchased more than 9 million shares for roughly \$1 billion in 2019.

2020 Outlook

The company expects 2020 adjusted earnings per share between \$7.76 and \$8.06. Cash from operations is anticipated to be around \$10 billion. Adjusted free cash flow is expected to be between \$4.3 billion and \$4.7 billion. Effective tax rate is expected between 22.5% and 23.5% for 2020. Capital expenditure is expected to be around \$6.7 billion for 2020.

Recent News

New CEO Chosen - Mar 12, 2020

UPS has chosen Carol Tome to succeed David Abney as the new CEO, effective Jun 1. Tomé has been a member of the UPS board since 2003 and currently serves as the chairperson of the Audit Committee. Previously, she served as the chief financial officer of The Home Depot, a home improvement retailer in the United States, for 18 years. Abney will assume the role of executive chairman of the board from Jun 1 onward. He is set to retire from the board on Sep 30. However, he will remain attached to the company until this year-end to help with the transitional process and a successful peak season, which runs from November to early next January. Meanwhile, UPS' lead independent director William Johnson will become the non-executive chairman come Sep 30.

Valuation

UPS shares are down 12.3% over the trailing 12-month period. Stocks in the Zacks sub-industry and sector are down 24.4% and 27.9% in a year's time respectively. The S&P 500 index is down 16.5% in the past year.

The stock is currently trading at 8.59X trailing 12-month Enterprise Value/EBITDA, which compares to 7.22X for the Zacks sub-industry, 6.21X for the Zacks sector and 9.35X for the S&P 500 index.

Over the past five years, the stock has traded as high as 13.33X and as low as 7.85X, with a 5-year median of 10.45X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$103 price target reflects 9.14X trailing 12-month sales.

The table below shows summary valuation data for UPS

Valuation Multiples - UPS					
		Stock	Sub-Industry	Sector	S&P 500
EV/EBITDA TTM	Current	8.59	7.22	6.21	9.35
	5-Year High	13.33	12.98	11.11	12.88
	5-Year Low	7.85	6.76	5.85	8.31
	5-Year Median	10.45	9.53	7.41	10.78
P/S TTM	Current	1.13	4.29	0.86	2.74
	5-Year High	1.77	7.22	1.58	3.68
	5-Year Low	1	4.12	0.82	2.5
	5-Year Median	1.51	6.04	1.32	3.19
P/BTTM	Current	25.25	8.95	2.12	3.4
	5-Year High	NA	23.13	4.64	4.55
	5-Year Low	17.38	8.15	2.02	2.85
	5-Year Median	39.64	14.68	3.41	3.63

As of 03/17/2020

Industry Analysis Zacks Industry Rank: Top 44% (111 out of 253)



Top Peers

Atlas Air Worldwide Holdings (AAWW)	Neutral
Amazon.com, Inc. (AMZN)	Neutral
CSX Corporation (CSX)	Neutral
FedEx Corporation (FDX)	Neutral
Radiant Logistics, Inc. (RLGT)	Neutral
Union Pacific Corporation (UNP)	Neutral
XPO Logistics, Inc. (XPO)	Neutral
C.H. Robinson Worldwide, Inc. (CHRW)	Underperform

Industry Comparison Industry: Transportation - Air Freight And Cargo				Industry Peers		
	UPS Neutral	X Industry	S&P 500	CHRW Underperform	FDX Neutral	XPO Neutral
VGM Score	B	-	-	B	B	A
Market Cap	83.09 B	614.91 M	17.72 B	8.71 B	24.80 B	5.56 B
# of Analysts	12	2	13	12	10	12
Dividend Yield	4.17%	0.00%	2.51%	3.16%	2.74%	0.00%
Value Score	B	-	-	D	B	A
Cash/Price	0.07	0.07	0.06	0.05	0.07	0.07
EV/EBITDA	11.72	5.72	10.97	11.11	11.72	7.61
PEG Ratio	1.43	1.10	1.54	1.94	0.75	0.44
Price/Book (P/B)	25.25	1.51	2.39	5.23	1.33	1.94
Price/Cash Flow (P/CF)	9.31	3.31	9.36	12.90	3.31	4.60
P/E (F1)	12.44	9.94	13.98	17.46	9.05	12.42
Price/Sales (P/S)	1.12	0.23	1.87	0.57	0.36	0.33
Earnings Yield	8.04%	9.24%	7.13%	5.73%	11.06%	8.05%
Debt/Equity	7.37	1.67	0.70	0.65	1.67	2.44
Cash Flow (\$/share)	10.39	6.69	7.01	5.01	28.66	13.08
Growth Score	A	-	-	A	C	A
Hist. EPS Growth (3-5 yrs)	9.22%	11.81%	10.85%	8.43%	14.41%	66.94%
Proj. EPS Growth (F1/F0)	3.30%	3.43%	5.38%	-11.71%	-32.36%	20.16%
Curr. Cash Flow Growth	4.64%	4.64%	6.15%	-11.01%	-2.30%	2.29%
Hist. Cash Flow Growth (3-5 yrs)	7.12%	19.15%	8.55%	5.98%	9.78%	79.21%
Current Ratio	1.11	1.11	1.24	1.70	1.25	1.03
Debt/Capital	88.06%	70.51%	42.57%	39.54%	62.52%	70.61%
Net Margin	5.99%	1.63%	11.57%	3.77%	-0.50%	2.44%
Return on Equity	156.11%	17.20%	16.74%	34.67%	17.20%	15.91%
Sales/Assets	1.37	1.08	0.54	3.28	1.08	1.18
Proj. Sales Growth (F1/F0)	4.31%	0.00%	3.33%	-0.40%	-1.21%	3.51%
Momentum Score	F	-	-	A	D	D
Daily Price Chg	11.18%	11.18%	5.62%	5.80%	4.94%	9.64%
1 Week Price Chg	0.24%	-16.22%	-11.01%	-5.61%	-16.49%	-5.98%
4 Week Price Chg	-9.05%	-20.38%	-28.54%	-10.84%	-40.12%	-38.65%
12 Week Price Chg	-18.20%	-31.34%	-25.74%	-16.69%	-37.02%	-23.71%
52 Week Price Chg	-12.29%	-39.75%	-18.88%	-26.85%	-47.65%	18.35%
20 Day Average Volume	7,665,221	813,464	3,651,283	2,208,450	3,721,738	1,656,579
(F1) EPS Est 1 week change	-0.32%	0.00%	0.00%	0.00%	-1.41%	0.00%
(F1) EPS Est 4 week change	-1.50%	-1.46%	-0.58%	0.00%	-2.93%	1.72%
(F1) EPS Est 12 week change	-2.58%	-2.58%	-1.18%	-15.21%	-5.28%	3.13%
(Q1) EPS Est Mthly Chg	-1.33%	-5.92%	-0.77%	0.00%	-2.74%	-0.91%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	A
Momentum Score	F
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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