

Analysis of Sales/Earnings
Tough 4Q13 Leads to Greater Investments to Improve Planning/Efficiency in 2014

UPS reported 4Q13 EPS of \$1.25, in-line with the company's preannouncement a couple weeks ago, which was weaker than the Street anticipated (prior to the preannouncement) due to the stronger-than-expected e-commerce holiday shipping season and lack of capacity to handle the sudden surge in volumes. European volumes (including B2C) were also better than expected in 4Q13, but international airfreight remained weak. With a challenging quarter behind them now, we believe UPS should again benefit from the secular growth in e-commerce and improving global trade and better general economic conditions in 2014. We believe the shares are fairly valued at 16.5x our revised 2015 EPS estimate of \$5.80, so we maintain our Hold rating. In our view, UPS is simply a cash flow generating stock buyback machine that pays a modest dividend.

- **U.S. Domestic Package** saw higher-than-expected hiring/training, overtime, weekend operations, and repositioning costs, along with lower productivity, which increased segment operating expenses by \$125mm-\$150mm in 4Q13. Furthermore, revenue was reduced by ~\$50mm due to service refunds, while yields declined (due to mix change, growth in SurePost, and service refunds). Rollout of Orion is expected to accelerate in 2014, with 45% of driver routes targeted for route optimization by year-end (up from 10% now).
- **International Package** reported 8.8% package volume growth and 30bp margin expansion, driven by robust European demand (Europe trans-border daily volume rose 18% during peak), although negative currency comps held back profit growth (otherwise EBIT would've risen >12% y/y).
- **Supply Chain & Freight** reported a y/y decline in revenue directly related to its freight forwarding unit, which was solely driven by the company's airfreight forwarding operation, as volumes continued to be weak and pricing fell. Distribution and LTL both had revenue growth, with margins expanding slightly.
- **2014 Guidance:** *Domestic Package* - U.S. average daily volume +3%-4% with revenues up a little higher, and core pricing (not yields) 2%-3% higher, leading to 14% EBIT margin. *International Package* – should see revenue growth lower than the expected 4%-6% volume growth, while EBIT should grow 12%-14% y/y; *Supply Chain & Freight* – revenues +4%-7%, ~8% EBIT margin, and challenging 1H14. *Tax rate* - 36%. *CapEx* - \$2.5bn. *Share repurchase* - \$2.7bn. The pension expense benefit expected of \$180mm should be largely offset by higher healthcare costs, thanks to ObamaCare.
- We are reducing our 2014 and 2015 EPS estimates from \$5.40 and \$6.15 to \$5.20 and \$5.80, respectively, due mainly to lower international growth (which is yield-driven), thinner domestic package margins, and a smaller-than-expected share buyback.

| Changes | Previous | Current |
|-----------------|----------|----------|
| Rating | — | Hold |
| Target Price | — | NA |
| FY13A EPS (Net) | — | \$4.57 |
| FY14E EPS (Net) | \$5.40 | \$5.20 |
| FY13A Rev (Net) | \$55.52B | \$55.44B |
| FY14E Rev (Net) | \$58.54B | \$57.86B |

| | |
|-----------------------|---------------|
| Price (01/30/14): | \$95.78 |
| 52-Week Range: | \$105 – \$79 |
| Market Cap.(mm): | 89,171.2 |
| Shr.O/S-Diluted (mm): | 931.0 |
| Enterprise Val. (mm): | \$96,450.9 |
| Avg Daily Vol (3 Mo): | 3,388,209 |
| LT Debt/Total Cap.: | 65.9% |
| Net Cash/Share: | \$0.00 |
| Book Value/Share: | \$6.97 |
| Dividend(\$ / %) | \$2.48 / 2.6% |
| S&P Index | 1,794.19 |

| EPS (Net) | 2012A | 2013A | 2014E |
|-----------|---------|---------|--------|
| Q1 | \$1.00 | \$1.04 | \$1.10 |
| Q2 | 1.15 | 1.13 | 1.25 |
| Q3 | 1.06 | 1.16 | 1.31 |
| Q4 | 1.32 | 1.25 | 1.54 |
| FY Dec | \$4.53A | \$4.57A | \$5.20 |
| P/E | 21.1x | 21.0x | 18.4x |

| Rev (Net) | 2012A | 2013A | 2014E |
|------------|----------|----------|----------|
| FY Dec | \$54.13B | \$55.44B | \$57.86B |
| EV/Revenue | 1.8x | 1.7x | 1.7x |

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Comments around the difficult holiday season, where the company had to hire 55% more part-time help than anticipated

- E-commerce started strong and continued to rise after Cyberweek
- Delivery volume per day up 14%+ y/y (almost 2x what UPS planned for)
- Last-minute e-tailer promotions drove big volumes
- Peak day was six days later than expected – Dec 23rd, with the volume up 16% over the prior year
- There were over 70 online retailers guaranteeing next-day delivery on purchases made up to 11pm on 12/23
- TX/OK networks shut down for up to three days due to December ice storm
- UPS has been working since with high-impact customers on how collaboration can improve for the next holiday season
- Management is also looking at how to enhance the throughput of its network through job simplification, better technology, and expanded infrastructure
- The company's goal is to have 45% of its driver routes using Orion by the end of 2014 (up from 10% now) – and expects this to add 200 additional heads to the Orion team (now about 700)
- Many trailers are now dropped at UPS with limited visibility as to the contents, so the company is looking to work with its customers to learn ahead of time what's in the trailers

Company Description

United Parcel Service, Inc. is the largest integrated package delivery network in the world. The company delivers approximately 17 million packages per day globally and is the largest player in the U.S. small package market, the largest package market in the world. The company is endeavoring to leverage its strong positioning (brand awareness, reputation for providing high-quality service, sales penetration and technology platforms) in the package market to provide its customers with competitive advantage through creative yet practical logistics solutions on a global basis. Its Supply Chain & Freight segment offers customers freight forwarding, contract logistics, customs brokerage, LTL and other services.

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Equity Comps - Transportation

Comparative Valuation Matrix

(figures in \$US millions, except per share amounts)

| Company name (Ticker) | Rating | Closing Price 1/30/2014 | Diluted S/O | Market cap. | Total Debt | Cash & equiv. | TEV ^(a) | Equity value as a multiple of | | | | Enterprise value as a multiple of | | | | | TTM ROA | TTM ROE | TTM ROIC | PEG ratio ^(d) | Div. Yield | 2014E FCF Yld |
|--------------------------------------|---------------|----------------------------|----------------|-----------------|-----------------|------------------|--------------------|-------------------------------|--------------|--------------|---------------|-----------------------------------|-----------------|---------------|-------------------------------|--------------|--------------|--------------|--------------|-----------------------------|---------------|------------------|
| | | | | | | | | Earnings per Share | | | Book value | TTM Revenue | 2014E EBITDA | TTM EBITDA | TTM EBITDAR ^(c) | TTM EBIT | | | | | | |
| Global Integrators | | | | | | | | | | | | | | | | | | | | | | |
| Deutsche Post DHL (DPW-DE) | Hold | € 26.15 | 1,211.8 | 43,236.6 | 6,745.1 | 2,812.2 | 49,470.8 | 19.4x | 17.9x | 16.8x | 3.4x | 0.6x | 8.1x | 8.4x | 7.4x | 12.5x | 5.7% | 18.4% | 14.7% | 1.1 | 2.7% | 6.1% |
| FedEx Corp. (FDX) | Hold | 133.77 | 316.6 | 42,357.2 | 2,990.0 | 3,935.0 | 41,412.2 | 21.2x | 20.4x | 16.5x | 2.4x | 0.9x | 5.9x | 7.1x | 6.9x | 12.3x | 5.1% | 9.9% | 8.8% | 1.3 | 0.4% | 3.8% |
| TNT Express NV (TNTE-NL) | NC | € 6.55 | 543.3 | 4,856.0 | 246.1 | 778.8 | 4,323.3 | NE | NE | NE | 1.5x | 0.4x | NE | 5.2x | 4.8x | NM | -4.0% | -6.7% | -5.7% | NM | 0.0% | NM |
| United Parcel Service (UPS) | Hold | 95.78 | 931.0 | 89,168.9 | 12,527.0 | 5,245.0 | 96,450.9 | 21.1x | 21.0x | 18.4x | 13.7x | 1.7x | 9.9x | 10.8x | 10.9x | 13.6x | 11.6% | 77.3% | 25.0% | 1.7 | 2.6% | 5.8% |
| | Min | | | 4,856.0 | 246.1 | 778.8 | 4,323.3 | 19.4x | 17.9x | 16.5x | 1.5x | 0.4x | 5.9x | 5.2x | 4.8x | 12.3x | -4.0% | -6.7% | -5.7% | 1.1 | 0.0% | 3.8% |
| | Mean | | | 44,904.7 | 5,627.0 | 3,192.7 | 47,914.3 | 20.6x | 19.8x | 17.2x | 5.3x | 0.9x | 8.0x | 7.9x | 7.5x | 12.8x | 4.6% | 24.7% | 10.7% | 1.4 | 1.4% | 5.2% |
| | Median | | | 42,796.9 | 4,867.6 | 3,373.6 | 45,441.5 | 21.1x | 20.4x | 16.8x | 2.9x | 0.8x | 8.1x | 7.7x | 7.1x | 12.5x | 5.4% | 14.2% | 11.7% | 1.3 | 1.5% | 5.8% |
| | Max | | | 89,168.9 | 12,527.0 | 5,245.0 | 96,450.9 | 21.2x | 21.0x | 18.4x | 13.7x | 1.7x | 9.9x | 10.8x | 10.9x | 13.6x | 11.6% | 77.3% | 25.0% | 1.7 | 2.7% | 6.1% |
| Stifel Transportation Average | | | | 9,200.3 | 1,597.5 | 431.1 | 10,463.9 | 22.7x | 21.4x | 18.6x | 3.6x | 2.2x | 9.2x | 10.0x | 8.7x | 14.7x | 5.4% | 13.9% | 10.0% | 1.5 | 0.9% | 3.9% |

(a) Total Enterprise Value = Market Capitalization of Equity + Total Debt - Cash + Market Value of Minority Interest

(b) Stifel estimates for those rated and First Call mean estimates for unrated securities

(c) Enterprise value adjusted to include the capitalization of off balance sheet operating leases with lease expense (or rent expense) being added back to EBITDA for the valuation multiple calculation

(d) 2014E P/E divided by First Call mean or Stifel estimated long-term growth rate

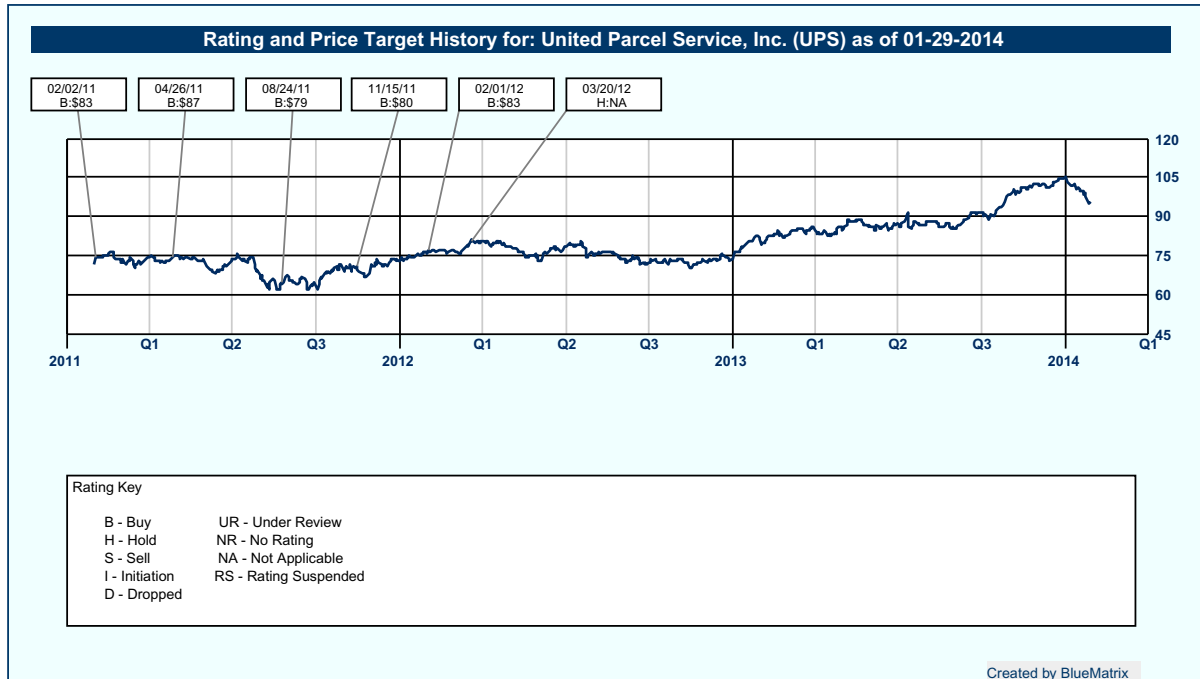
Excludes non-recurring items

Calculations may vary due to rounding

Source: Company data, First Call, and Stifel estimates

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For a price chart with our ratings and target price changes for UPS go to <http://sf.bluematrix.com/bluematrix/Disclosure?ticker=UPS>

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Stifel makes a market in the securities of United Parcel Service, Inc..

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