

14 August 2012 | 7 pages

Air Freight & Logistics (GICS) | Air Freight/Logistics (Citi)
North America | United States

United Parcel Service Inc. (UPS)

Alert: EU Commission Temporarily Suspends Review

■ Company Update

■ Review Deadline is Temporarily Suspended, But Likely Not A Material Delay –

The EU commission has temporarily suspended its December 12th deadline for completion of its review of UPS's TNT Express acquisition as it is seeking additional information. The delay was not a judgment of the merits of the deal; however, until the requested information is provided, additional time will be added to the existing December 12th deadline. The length of the delay has not been determined, although it will likely amount to a number of days, not multiple weeks or months. While additional delays are not optimal, this announcement does not change our original thesis that this deal has a high likelihood of approval (albeit likely with some concessions). TNT Express and UPS both still believe that the deal is likely to close in the fourth quarter; however, we are maintaining our target for an expected close between late December and late February 2013, which still allows for at least three quarters of TNT contribution to UPS results in 2013.

■ Timing Does Not Impact Estimates –

While we expect the TNT acquisition to be accretive by approximately 7% in the first full year post closing, we have not included the benefit in our model (and we do not feel that consensus fully includes it at this point either). Further, we do not expect a contribution from TNT to begin until 1Q13. In addition, while UPS has noted financing will be made up heavily of cash (\$5.0 billion cash and \$1.4 billion of debt), the company generates more than \$1 billion of quarterly free cash flow, with an extra quarter adding to the company's ample deleveraging power.

■ Next Day Delivery "Market" Definition Is Likely Too Narrow –

We believe some recent discussions of a very narrow market definition, which includes only earliest possible next day delivery (by 9am or similar), appears to be too exclusionary. In our opinion, this definition has to be included as a product set within the competitive market, but is far too narrow to be considered a market of its own. Additionally, as we have highlighted in our recent meetings with UPS management, [Big Brown Bear? Not Really; Management Meeting Takeaways](#), UPS has noted that it has run several scenarios of potential remedies and feels comfortable completing the transaction in all of them.

■ Reit. Buy; TNT and Normalizing Fundamentals Are Solid Catalysts for 2013 –

We believe that 2013 could see a meaningful re-acceleration of EPS growth (we target +14% growth YoY without contribution from TNT), as fundamentals (volumes and mix) normalize and the TNT acquisition begins to contribute. We believe its acquisition of TNT Express will prove to be a strong, long term value, particularly given the target's depressed stock price and our estimate for solid earnings accretion (greater than \$1 of EPS power longer term). As such, we reiterate our Buy rating and \$86 price target on UPS shares. Our price target is based on a 16x multiple of our 2013 EPS estimate, which is below the low end of the company's historical average forward P/E trading range of 17.3x-24.9x.

Buy	1
Price (14 Aug 12)	US\$76.19
Target price	US\$86.00
Expected share price return	12.9%
Expected dividend yield	3.0%
Expected total return	15.9%
Market Cap	US\$73,024M

Price Performance (RIC: UPS.N, BB: UPS US)



Christian Wetherbee

+1-212-816-9051
christian.wetherbee@citi.com

Seth R Lowry
seth.r.lowry@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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United Parcel Service Inc.

Valuation

Our target price of \$86 is based on a 16x multiple of our 2013 EPS estimate. A 16x multiple is below the low end of the company's historical average forward P/E trading range of 17.3x-24.9x. We believe that placing a multiple below the low end of the company's long-term average range is appropriate as macroeconomic conditions seem to be slowing and we believe the average is skewed upwards due to the company's lofty tech-like multiple following its IPO during the dot-com boom.

Risks

For United Parcel Service, we highlight the following risks to achieving our price target and earnings forecasts:

Economic cyclicity. The transportation industry is subject to cyclical factors, including economic conditions, customers' business conditions, credit markets, and seasonal patterns, which may adversely affect customer shipping volumes and industry freight demand.

Competitive market. Freight rates are subject to competitive pricing pressures from other transportation providers that may limit growth opportunity and adversely affect operating results. In addition, package carriers compete globally with government owned/sponsored entities which may make uneconomic business decisions which can undermine the competitive nature of markets.

Highly regulated industry. The airfreight/package industry is subject to various laws and regulations that govern industry-related and environmental activities. Changes or violations of these laws and regulations could adversely affect operations.

Fluctuating fuel prices. Fuel price changes may adversely affect operating results because increases in fuel-surge revenue may not offset increases in fuel costs, and increases in freight revenue may not offset the resulting reduction in fuel-surge revenue from lower fuel costs. In addition, sudden spikes in fuel costs are difficult to match to surcharges, potentially lowering effective coverage levels.

Emerging markets are volatile. A significant portion of expected future growth is likely to be driven by volume growth in emerging market, which given their relative size and potential for geopolitical disruptions are likely to be volatile.

Appendix A-1

Analyst Certification

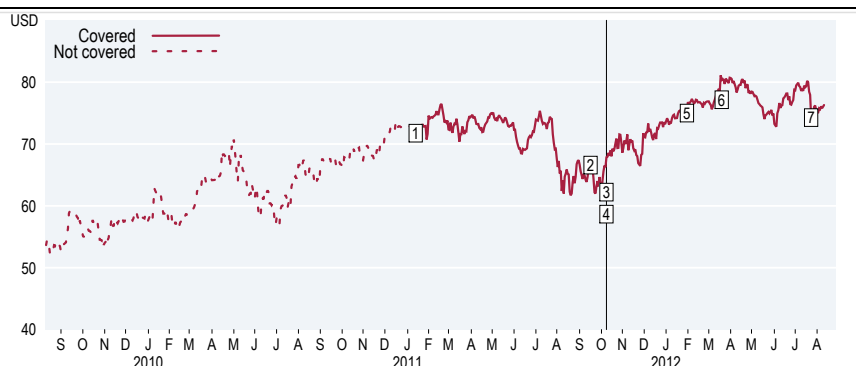
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Analyst: Christian Wetherbee
Covered since January 13 2011



	Date	Rating	Target Price	Closing Price
1	13-Jan-11	1L	*84.00	72.25
2	16-Sep-11	1L	*80.00	66.59
3	8-Oct-11	Stock rating system changed		

* Indicates change

	Date	Rating	Target Price	Closing Price
4	8-Oct-11	*1	80.00	66.26
5	31-Jan-12	1	*86.00	75.65
6	20-Mar-12	1	*92.00	80.39

	Date	Rating	Target Price	Closing Price
7	24-Jul-12	1	*86.00	74.34

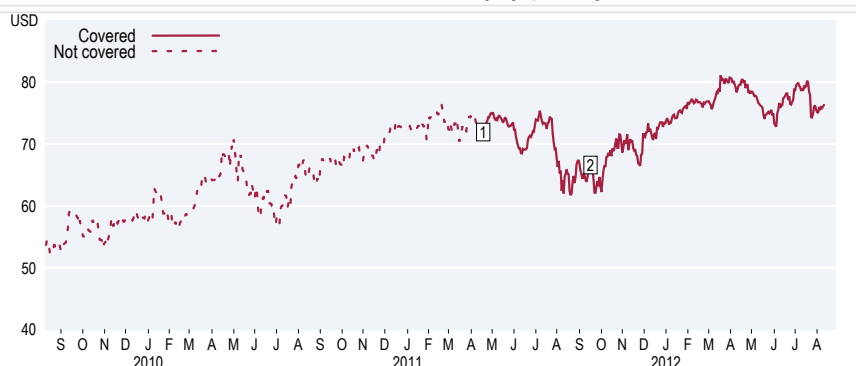
Rating/target price changes above reflect Eastern Standard Time

United Parcel Service Inc. (UPS)

Ratings and Target Price History Best Ideas Research

Relative Call (3 Month)

Analyst: Christian Wetherbee
Covered since January 13 2011



	Date	Rating	Target Price	Closing Price
1	19-Apr-11	*ADD MP	-	71.98

* Indicates change

	Date	Rating	Target Price	Closing Price
2	16-Sep-11	*REM MP	-	66.59

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Citi Research Ratings Distribution

Data current as of 30 Jun 2012

Citi Research Global Fundamental Coverage

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
53%	37%	10%	10%	80%	10%

% of companies in each rating category that are investment banking clients 44% 43% 40% 48% 43% 45%

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