

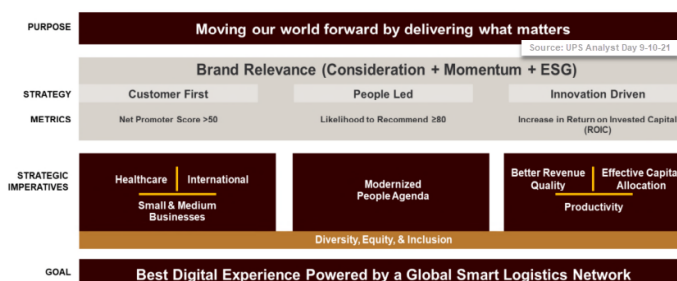
**Rev/Employee: \$170.13 k**
**Number of Employees: 543,000**
**Avg ROIC: 18.4%**
**Transport**

## UPS: Better Framework, Better Returns

Carol Tomé is UPS' 12th CEO in the company's nearly 114-year history and we like her focus on making the firm's capital allocation more efficient and leaving pure volume strategies behind. The CEO's solid execution in her first 18 months, despite pandemic related turmoil, is partly because of her familiarity with UPS as a long-time Director (since 2003). Tomé's ascension to the CEO role was fortuitously timed in March of 2020 and her predecessor David Abney (65), retired after 46 years with UPS. CEO Tomé has refocused UPS on sensible operating efficiency and ROIC while emphasizing both customer and employee satisfaction. She and CFO Brian Newman (52) have systematically reduced debt, boosted margins, and improved customer-focused key performance indicators. We also like the Board's revamping of the executive pay plan and substantial Director refreshment in the last year.



**Management Update:** Both the CEO and her CFO are a break from UPS historical reliance on internally promoted executives. Prior to joining UPS, Carol Tomé was a much respected CFO at Home Depot working with the renown CEO Frank Blake. She is a career finance executive, working as a commercial lender before becoming Director of Banking at Johns-Mansville prior to joining Home Depot in 1995 as a VP and Treasurer. She was promoted to CFO 6 years later and navigated sharp business downturns during her tenure, including 9/11 and the Great Recession. In April, as part of her "Better not Bigger" operating strategy, CEO Tomé completed the sale of UPS Freight to TFI International. The CEO said she viewed the LTL business as non-core and a smart disposal preferring to use the cash to reduce debt. CFO Newman used the \$848 million of proceeds to pay down debt. We also think the UPS CEO succession plan was handled well, with David Abney formally announcing his retirement in March and Tomé becoming CEO at the start of June 2020, while her predecessor became Chairman and then a Special Consultant before departing UPS at the end of last year. A year later, in June 2021, CEO Tomé told investors, "In the year and eight days since I arrived, we have been pushing ourselves to evaluate every aspect of our business and make the appropriate changes. We are using our framework of Better, Not Bigger to focus on what matters the most to our customers and drive improvement in our financial performance." The CEO is focused on "Customer First" principles of reducing the "friction" of doing business, and targeting growth initiatives at SMID size businesses, healthcare, and international markets. We like that the CEO has implemented the use of Net Promoter Scores with customers and internally measures how likely employees are to recommend UPS as a place to work. EBIT and ROIC have become standard reference metrics for operating profitability. CFO Brian Newman (52) joined UPS 2 years ago after working 26 years at PepsiCo (see our Executive Change Report [here](#)). We noted his lack of traditional finance experience but we think he has quickly come up to speed at UPS and the combination with his CEO's strong finance knowledge is good. The CFO delivered a record \$6.8 billion in free cash flow during the first half of this year. The CFO has also systematically reduced pension obligations and net debt (~2x EBITDA). Newman was an investment banker at Paine Webber and was Chief Strategy Officer and EVP, Global Operations at Pepsi. Nando Cesarone (49) is the President of U.S. Operations and replaced George Willis (56) when he abruptly announced last summer that he was retiring for "personal and family reasons." Cesarone has good experience, including overseeing the Asia Pacific Region from 2013 to 2016, where he expanded UPS' presence in China. Then, he headed Europe for the following 2 years before being promoted to President of UPS International which he held from 2018 to 2020. Scott Price (58) President, UPS International joined UPS from Walmart, where he was previously CEO, Walmart Asia, CAO, and EVP of Global Leverage. Kate Gutmann (52) is the Chief Sales and Solutions Officer as well as the EVP, UPS Global Healthcare, which puts a lot on her plate given pushing into this area of logistics is one of CEO Tomé's key focus. Gutmann has spent the last 33 years working for UPS, starting as a Marketing Intern while



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earning her bachelor's degree. Previously, she has been the SVP, Worldwide Sales and Solutions for Europe from 2014 to 2017, SVP, The UPS Store and UPS Capital. Juan Perez (54) is the Chief Information and Engineering Officer and was VP, Information Services from 2011 until he became CIO in 2016.

**Pay & Incentive Alignment:** We think the Board has made substantial serial improvements to the executive pay plan at UPS and that it is now well-aligned with outside investor interests. The CEO is paid a salary of \$1.3 million, plus a 165% target bonus (prorated in 2020), and has a long term equity LTIP target of 825% of salary each year. Her 2020 total pay was worth about \$11 million. Her predecessor, former CEO Abney's \$5.8 million compensation last year included a \$1.3 million salary, and we note that he departed with about \$40 million worth of various retirement benefits. UPS paid CFO Newman \$5.3 million last year. He received a \$741k salary, \$3.2 million cash bonus (including his \$600k cash transition payment), \$1.4 million of equity, and \$97k of other pay. The CEO's target pay is 9% salary, 1% ownership incentive, 15% bonus, and 75% equity LTIP. The other senior officers' target calls for 15% salary, 1% ownership incentive, 20% bonus, and 64% LTIP. We like that the EVP's annual target bonuses are a relatively high 130%. Annual cash bonuses ("MIP") are determined by a good equally weighted mix of Y/Y revenue growth, operating profit growth, and ROIC. The latter two MIP metrics have replaced daily package volumes, and EPS, in the past and we think the change is beneficial for sustained growth and capital efficiency measurement. The MIP also has a good reward system to recognize senior managers who own significant amounts of UPS b shares rewarding them with up to 1 month's salary bonus for high equity ownership amounts. The Equity LTIP is comprised of performance vesting stock and options. We like the LTIP's revised metric mix of 3 yr EPS growth, free cash flow, and relative total return which replaced prior Revenue growth, and ROIC. The LTIP awards are limited to a max of 220% of their targets in any given year and if total return is above the 75th percentile of peers, the payment increases by 20% while decreasing by 25% for below 25th percentile performance. We note a material flaw we see in the relative total return benchmark which is that the group includes CPG and major Restaurant companies but not other major Transports (other than FedEx). The options vest ratably over 5 years and have a 10-year term. We like that the Board has ended any tax gross-ups for executive compensation and has appropriate incentive claw-back provisions for executive incentive awards.

UPS has a dual class structure, with Class A shares having 10:1 voting rights. The former is primarily held by employees, retirees, and the Annie E Casey Foundation (descendants of UPS' founder). Directors and Officers own about 147k Class B shares valued at \$26.7 million and 910k Class A shares. The Foundation, (former CEO Abney still sits on the Board of Trustees), owns 421k Class B shares and 2.3 million Class A shares. CEO Carol Tomé has 13k Class B shares worth \$2.4 million plus 184k Class A shares. Former CEO Abney has only 1k Class B shares but 651k Class A shares and his net proceeds since August of 2020 are about \$10 million, the only material insider sales of note. Major B share active share institutional holders are Fidelity with 17.35 million shares (1.8%) and T. Rowe Price (1.74%).

**Capital Allocation Update:** CFO Newman's priorities have been reducing pension obligations and reinvesting in the business with high-ROIC projects, and building a strong balance sheet. We like that management has not spent cash repurchasing shares this year (but says they'll remain opportunistic) and instead focused on reducing their net debt to only 2x EBITDA. The CFO says that he expects cumulative free cash flow of \$24 billion to \$27 billion from 2021 to 2023. Debt was \$22.6 billion as of Q2 '21, down from 2019's \$25.2 billion. UPS' operating cash flow was \$10.5 billion last year and \$8.5 billion in H1'21. In 2018, the company generated \$12.7 billion, and \$8.6 billion the following year. CFO Newman expects CapEx of 4.5% to 5.5% of sales, or \$13.5 billion to \$14.5 billion cumulatively from 2021 to 2023, with 65% devoted to growth projects. YTD, CapEx is \$1.7 billion versus \$2.1 billion a year ago. In 2020, management spent \$5.4 billion (6.4% of revenue), The largest portion, in the mid-to-upper 40% range, is typically for buildings, facilities, and plant equipment. They spend the balance on aircraft/parts, vehicles, and IT. CapEx was \$6.3 billion and \$6.4 billion in 2018 and 2019 (more than 8.5% of revenue), respectively. The Board has historically increased dividends annually (2.3% yield). CFO Newman says he intends to bring the payout ratio up to 50%. In August, the Board terminated the previous \$8 billion share repurchase program (\$2.1 billion was



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remaining) and authorized a new \$5 billion.

**Fiduciary & Other:** Governance at UPS has improved in the last year. The Board split the Chief Executive Officer and Chairman roles following Carol Tomé becoming CEO in June 2020. Bill Johnson (72), who was Lead Independent Director since 2016, became Chairman. He is the former Chairman, President, and CEO of H.J. Heinz, we note that he has been on UPS' Board since 2009. Refreshment has been a major theme across the 13 Directors in the last two years with 5 new Directors since 2020. Rudy Markham (75) and Sandy Randt (75) did not stand for reelection at 2021's annual meeting after reaching the mandatory retirement age. Newer Directors include Eva Boratto (54) the CFO of CVS Health; Wayne Hewett (56) is Permira's Senior Advisor and Chairman Cambrex; Angela Hwang (55, Group President of Pfizer Biopharmaceuticals Group), Kate Johnson (53, President, Microsoft U.S.), and Russell Stokes (49, CEO, GE Aviation Services and GE Power Portfolio) round out the new Directors. From an ESG perspective we like that the CEO and Board have pledged to reduce absolute greenhouse gas emissions by 12% across global ground operations by 2025 and spent 25% of the annual new vehicle budget on EV and Alt fuel trucks. We note that there were 5 new Directors elected in 2020 that have substantially "refreshed" the Board, including Directors Eva Boratto (55, CFO and Controller at CVS Health) and Kate Johnson (53, divisional president of Microsoft USA). We like that the Board has instituted a formal internal Director engagement program whereby Directors meet with individual executive leaders, visit Company operations and receive in-depth subject matter updates outside of the regular board meeting process.