UPS reports higher volume diversions due to labor unrest

Company says it has recaptured 40% of diverted volumes off worst levels

Mark Solomon • Thursday, October 26, 2023

Labor unrest cost UPS more volumes than expected (Photo: Jim Allen/FreightWaves)

UPS Inc. said Thursday that more daily volumes were diverted to rivals during volatile contract negotiations with the Teamsters union than it expected and that it has recaptured about 40% of the lost business.

The Atlanta-based company said that about 1.5 million daily parcels were diverted due to customer concerns over a possible Teamsters strike that never materialized. That is higher than the company's original diversion estimate of 1.1 million parcels.

About 600,000 parcels have returned to the network, with roughly half of that coming from chief rival FedEx Corp. (NYSE: FDX), UPS executives said. FedEx, for its part, has said it captured about 400,000 daily diverted UPS packages and has retained the lion's share of them.

UPS' (NYSE: UPS) low-water point came in August, when average daily volumes were reported down 15% year over year (y/y). CEO Carol B. Tomé told analysts Thursday that the August numbers reflected in part customers' desire to wait until the Teamsters contract was fully ratified in early September before returning volumes to UPS. For the quarter, average U.S. daily volumes dropped 11.5% y/y, UPS said.

The five-year contract added about $500 million to UPS' third-quarter costs, company executives said. Union wage rates rose 11% in the third quarter as part of what is expected to be a significant compensation bump in year one of the contract. UPS has said that 46% of the overall compensation increases is front-loaded into the first year.

Average daily volume in August was approximately 16 million parcels, according to UPS. That has risen to about 19 million as of October, the company said. Along with volume diversions, UPS had to manage through reduced demand for deliveries as customers ship less due to a slowing economy and more consumers returning to stores, as well as U.S. consumers shifting their spending from goods to what has become known as "experiences."

Tomé said the U.S. consumer remains healthy but is "spending their dollars differently."

In a stark reflection of the round turn the U.S. package delivery business has taken since the end of the massive surge in pandemic-related online ordering, UPS' U.S. package volumes are back to pre-COVID levels, Tomé said.

In response to a query as to whether the pace of diversion may slow down heading into peak season because customers may be reluctant to disrupt their operations during the cycle, Tomé said customers want to return to UPS before the peak because of its "superior service" and that UPS has not incurred any material expense in winning back diverted business.

At the same time, the company backed off earlier projections that y/y volumes would return to flat by the end of 2023, saying there will still be a single-digit deficit as the calendar turns.

A bumpy ride in Q3

UPS didn't sugarcoat the difficult macro environment affecting its global operations. International markets remain weak, and in some cases were weaker than the company originally thought would be the case during the quarter. Overcapacity on international trade lanes had the added effect of reducing UPS' margins, executives said.

The overcapacity problem is most pronounced in the U.S. domestic package segment. In total, the market has the equivalent of 110 million parcels of daily capacity, according to estimates from ShipMatrix. That doesn't include capacity that Amazon.com Inc. is likely to add as it expands its Amazon Shipping service to include daily pickups, ShipMatrix said. By contrast, average daily volumes are currently estimated to be about 69 million, the consultancy said.

ShipMatrix expects peak parcel volumes to be down 7% to 9% from 2022 levels. In response to slowing demand, parcel shippers are resisting the full seasonal delivery surcharges that the carriers are demanding, according to Satish Jindel, ShipMatrix's CEO. Instead of paying a per-package surcharge of, say $1.50, shippers may offer to pay a third of that or even less, he said.

Jindel said the expected peak weakness is part of what is evolving into the most challenging environment for parcel carriers in years as overcapacity collides with slowing demand. He also criticized UPS' plans to hire up to 100,000 seasonal workers, saying the expected holiday demand doesn't justify the added labor expense. UPS never discloses how many seasonal employees it actually hires for peak.

Given the macro headwinds, the diverted volumes and the higher operating costs from the Teamsters contract, UPS expected the third quarter to be a bumpy ride. And it was. Systemwide, revenue fell 12.8% to $21.1 billion from year-earlier levels. Operating profit of $1.3 billion was down 47.7% y/y. Adjusted diluted earnings per share was $1.57, down 47.5% from a year ago but 1-5 cents a share higher than consensus estimates.

UPS' three business units felt the headwinds. The domestic business, its largest, posted an 11.1% revenue drop to $13.6 billion and a near $1 billion drop in adjusted operating margin to $665 million. Deferred air revenue dropped 19.6% y/y, which ShipMatrix said reflected the long-planned wind down of business from Amazon, UPS' largest individual customer and a huge user of its deferred air services.

International revenue fell to $4.26 billion from nearly $4.8 billion in the year-earlier quarter. Adjusted operating profit dropped to $675 million from just over $1 billion. Average daily volume fell 6.6% amid continued weakness on Asia and Europe trade lanes.

Supply Chain Solutions, which encompasses all of UPS' non-package operations, posted revenue of $3.13 billion, a 21.4% decline, due to lower volumes and margin weakness in freight forwarding and truck brokerage, partially offset by growth in the unit's health care business.

Mark Solomon

Formerly the Executive Editor at DC Velocity, Mark Solomon joined FreightWaves as Managing Editor of Freight Markets. Solomon began his journalistic career in 1982 at Traffic World magazine, ran his own public relations firm (Media Based Solutions) from 1994 to 2008, and has been at DC Velocity since then. Over the course of his career, Solomon has covered nearly the whole gamut of the transportation and logistics industry, including trucking, railroads, maritime, 3PLs, and regulatory issues. Solomon witnessed and narrated the rise of Amazon and XPO Logistics and the shift of the U.S. Postal Service from a mail-focused service to parcel, as well as the exponential, e-commerce-driven growth of warehouse square footage and omnichannel fulfillment.