Why FedEx and UPS Could Benefit From the Post Office’s Pension Problem

By Al Root

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Which $70 billion logistics behemoth has hit a rough patch because of a changing shipping landscape?

Is it United Parcel Service (ticker: UPS)? Or perhaps FedEx (FDX)? Both publicly traded parcel shippers generate around $70 billion in sales.

No, the answer is the United States Postal Service. And struggle it does.

For starters, the USPS loses about $400 million each month, but the losses aren’t its biggest problem. That would be the size of its pension obligations. Fixing the financial standing of the mail service isn’t easy, but it could turn into a big benefit to publicly traded parcel shippers—a benefit that would dwarf current concerns, such as new competition from Amazon.com (AMZN).

Post office expenses consistently exceed revenue.

The USPS retirement obligations dwarf those of FedEx and UPS. It makes some intuitive sense that the retirement obligations of the USPS are large. It is an old organization. In fact, the Post Office has been around longer than the country. Benjamin Franklin was the first post master general, appointed by the Continental Congress in 1775, a year before America declared its independence from Britain. Today, the USPS employs more than 630,000 full and part-time workers and handles roughly 146 billion pieces of mail each year.

USPS retirement obligations total about $322 billion, more than four times the combined pension obligations of FedEx and UPS. And the USPS plans are underfunded by about $43.5 billion.

For perspective, all U.S. civil-servant pension obligations, which include the USPS, total more than $1.8 trillion, and the government has set aside only about $900 billion to cover future payments. That is a big problem, but one, ultimately, for U.S. taxpayers. The Office of Personnel Management, which oversees civil servants, wasn’t available for comment.

Even though the Post Office loses money, it generates cash flow. That’s because, while retirement expenses are accrued in accordance with common accounting principles, the payments don’t come until far in the future. Eventually, covering the cash expenses could mean higher pricing. That would be a benefit to FedEx and UPS. Both compete with the Post Office for volume and the postal service is traditionally a negative influence on pricing in the marketplace.

“A rising tide can lift all boats,” Glenn Gooding, president of iDrive Logistics said. “UPS and FedEx look at the USPS for baseline pricing.” iDrive helps business price and secure logistic services for small parcels.

With first-class mail volumes declining, USPS will become increasingly reliant on what it calls “competitive services,” such as parcel delivery. The Post Office seems to recognize this reality and has been boosting prices in recent years. “We implemented price increases on certain competitive services that averaged 4.1% in January 2018, 3.9% in January 2017, and 9.5% in January 2016,” the Post Office said in its annual report.

Investors we speak with worry that Amazon will become a third logistics competitor to UPS and FedEx, but it is better to call Amazon a fourth competitor. The Post Office already has about $23 billion in parcel-delivery sales. What’s more, Amazon has a long way to go to build up the networks of UPS, FedEx or the Post Office. Goldman Sachs analyst Jordan Alliger estimates it would take more than $120 billion in new investment by Amazon.

That means Amazon isn’t a the real threat to UPS and FedEx in the way that investors envision. Amazon does put pressure on pricing because it dominates the e-commerce landscape.

*@realDonaldTrump*

*Only fools, or worse, are saying that our money losing Post Office makes money with Amazon. THEY LOSE A FORTUNE, and this will be changed. Also, our fully tax paying retailers are closing stores all over the country...not a level playing field*!

Pricing for profitability in the so-called competitive-service offerings would be a plus for U.S. taxpayers, potentially shrinking losses and helping to cover large pension obligations. And it also would help FedEx and UPS shareholders.

Investors don’t usually consider the Post Office as delivery-service competition, and perhaps they should. USPS prices need to rise to cover losses—which would benefit FedX and UPS. What’s more Amazon.com gets low pricing on e-commerce services from the Post Office. That needs to change, which again would benefit the rivals.

Barron’s recently wrote positively about UPS, recommending the shares.