United Parcel Service, Inc. (UPS) CEO David Abney on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-22-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $2.07 beats by $0.01 | Revenue of $18.32B (5.01% Y/Y) misses by $-29.73M

Earning Call Audio

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United Parcel Service, Inc. (NYSE:UPS) Q3 2019 Earnings Conference Call October 22, 2019 8:30 AM ET

Company Participants

David Abney - Chairman and CEO

Richard Peretz - CFO, Retiring December 2019

Brian Newman - CFO

Jim Barber - COO

Kate Gutmann - Chief Sales and Solutions Officer

Juan Perez - Chief Information and Engineering Officer

Scott Price - Chief Strategy and Transformation Officer

Scott Childress - IR Officer

Conference Call Participants

Chris Wetherbee - Citi

Allison Landry - Credit Suisse

Tom Wadewitz - UBS

David Vernon - Sanford C. Bernstein

Ken Hoexter - Bank of America Merrill Lynch

Brian Ossenbeck - J.P. Morgan

Scott Group - Wolfe Research

Scott Schneeberger - Oppenheimer

Jack Atkins - Stephens

Amit Mehrotra - Deutsche Bank

Ben Hartford - Robert W. Baird

David Ross - Stifel Financial Corp.

Operator

Good morning. My name is Steven and I will be your conference facilitator today. At this time, I would like to welcome everyone to the UPS Investor Relations Third Quarter 2019 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. And after the speakers' remarks, there will be a question-and-answer period.

It is now my pleasure to turn the floor over to your host, Mr. Scott Childress, Investor Relations Officer. Sir, the floor is yours.

Scott Childress

Good morning and welcome to the UPS third quarter 2019 earnings call. Joining me today are David Abney, our CEO; Brian Newman, our CFO; who joined us in September; Richard Peretz, our Former CFO; Kate Gutmann, our Chief Sales and Solutions Officer; along with our Chief Operating Officer, Jim Barber; our Chief Information and Engineering Officer, Juan Perez; and Scott Price, our Chief Strategy and Transformation Officer.

Before we begin, I want to review the Safe Harbor language. Some of the comments we'll make today are forward-looking statements and address our expectations for the future performance or operational results of our company. These statements are subject to risk and uncertainties, which are described in detail in our 2018 Form 10-K and other reports filed with the Securities and Exchange Commission. These reports are available on the UPS Investor Relations website and from the SEC.

During the quarter, UPS recorded a pre-tax charge of $63 million or $0.06 per share on an after-tax basis. The charges are primarily from transformation-related activities with the majority split between the U.S Domestic and International segments. In the prior year period, UPS recorded a pre-tax charge for transformation cost of $97 million or $0.09 per share on an after tax basis.

The webcast of today’s call, along with a reconciliation of non-GAAP financial measures are available on UPS Investor Relations website. Unless stated otherwise, discussions today will refer to adjusted financial results. Webcast users can submit live questions during the call. We will attempt to answer questions of a long-term strategic nature. Callers are asked to submit only one question so that we may allow as many as possible to participate. Thank you.

And now I’ll turn the call over to David.

David Abney

Good morning, everyone. Today I’m going to provide highlights from the quarter and discuss several of the exciting industry [per] [ph] solutions we recently announced. Then John will outline our actions for a successful peak and Richard and Brian will cover the financial details.

In fact, I would like to welcome Brian Newman to the call as our CFO. He brings broad international business experience and I'm very happy he has joined UPS. I also want to thank Richard for his numerous outstanding contributions over his 38 year career with UPS. Rich is staying through the remainder of the year to ensure a smooth transition.

Now turning to the results. Again this quarter, we're reporting strong performance in a dynamic environment. Our transformation investments continue to deliver benefits driven by our highly efficient and expanding global network, our focus on targeted growth from the most attractive opportunities and solid execution of our initiatives.

Our innovative solutions are differentiating UPS from others in the industry. As a result, consolidated revenue grew 5% and operating profit grew more than 20% creating strong operating leverage and the highest quarterly operating profit in the company's history.

Margins expanded in all three segments, a testament to the quality of our strategies and disciplined execution. Our integrated network is running well and widespread adoption of next day delivery is an excellent fit of our expanded Air and Ground capabilities.

As you are aware, trade uncertainty continues to create macro challenges for businesses. We are working closely with our customers to help them adjust, while also making the most efficient use of our assets. Here in the U.S., the consumer continues to drive the economy with strong retail, healthcare and e-commerce sales, bolstered by solid consumer economic conditions.

Our strategy is resonating with customers. Despite the slowdown in the industrial sector, as evidenced by B2B volume growth in other sectors for the fourth consecutive quarter, we are benefiting from improved SMB customer mix and expect it will continue as we prepare for another record peak season. We have recently announced several new capabilities and solutions that support our strategic growth imperatives, small and medium-sized businesses, international growth markets, e-commerce and healthcare.

In the healthcare and life sciences area, I'm pleased to introduce UPS Premier, a new technology enabled healthcare shipping solution. We are adding next generation on package sensors and special tracking technology to provide pinpoint location information on each package.

In addition, we have a priority handling program for these shipments that further improves reliability. The sensor technologies and special handling plans provide a high-value solution for great visibility and special contingency actions for critical packages.

E-commerce and the rise of online marketplaces and platforms offers boundless opportunities for customers and for UPS. B2C and B2B sellers of all sizes benefit from the convenience of platforms to reach customers and manage their business. Through our digital access program, we're making it easier for SMBs to use UPS services by embedding our shipping solutions directly into the leading e-commerce platforms.

On these platforms, our customers are already hosting websites, managing orders, fulfillment and other tasks. For example, we just announced a new agreement with Stamps.com where UPS is presented as a preferred shipping partner to their more than 700,000 customers. We have a presence on many other platforms and have more to come. This strategy will enable UPS to increase our market share of high quality B2C and B2B e-commerce packages.

As you have seen in recent media coverage, UPS Flight Forward became the first company to receive full Part 135 Standard approval from the FAA to operate a commercial drone network. We are working to quickly scale and just announced a new healthcare campus delivery program at the University of Utah in partnership with Matternet. We will transport samples, specimens and other cargo via drone instead of using couriers. This new deployment is similar to our initial program launch that WakeMed in North Carolina.

In another Flight Forward development, we're also partnering with CVS Health to establish other drone delivery use cases involving deliveries to residential locations. Together, we will define and implement shipping solutions for urgent deliveries, including pharmaceutical or other CVS Health merchandise. These solutions leverage the speed and point-to-point delivery capabilities of our Flight Forward drone delivery network. This is an important expansion as CVS Health is the first retail partner for UPS Flight Forward's programs.

UPS is also working with AmerisourceBergen to utilize drones for delivery of pharmaceutical supplies on hospital campuses served by the company. We're pleased to help AmerisourceBergen develop improved operating efficiency and timeliness among other benefits realized by drone deliveries.

We have also begun a new program with Kaiser Permanente to develop drone delivery operations at several of their hospital campuses. Together we will identify solutions to improve patient outcomes and increase overall operational efficiency. We envision UPS drones offering innovative delivery solutions for many industries. Again, more to come. Through our investments, we're strengthening our core business as demonstrated by our operating results. These actions also further position us to accelerate performance.

Before I turn the call over to Jim to discuss peak, I want to make a few comments. This morning we announced that Jim Barber our Chief Operating Officer has decided to retire at the end of this year. Jim and his team will maintain our strong focus on several UPS transformation projects and will guide our peak efforts. He has served UPS for 35 years, and like many of our people he rose through the ranks to an important leadership position. He has made tremendous contributions during his many domestic and global assignments. I wish Jim a happy and healthy retirement.

And now I'll turn the call over to Jim.

Jim Barber

Thank you, David. UPS presented many exceptional opportunities that led to remarkable experiences over the course of these 35 years. I had made enduring relationships with many global customers and have enjoyed working with many exceptional UPS people who have become lifelong friends.

I've also had the great fortune to be involved with extraordinary philanthropic causes that make the world a better place. All these experiences have shaped who I am. I will be forever grateful to past and current UPS partners who guided me, worked alongside me and gave their best effort to expand and sustain this wonderful company. UPS has a great future ahead.

That being said, our focus is on putting our customers first, engaging our dedicated people and creating value for our shareholders. So that brings me to peak 2019 and our plan to handle another record holiday season with great service and great operating performance.

We are very confident that our plans will enable us to successfully execute peak again like last year. Our global strategy is focused in three key areas: implementation of the proven tools and best practices from last year; full utilization of our expanded network capacity and deeper collaboration with customers for joint development of daily volume expectations.

We expect another record peak season barring any unforeseen weather events. Retail sales are forecast to grow more than 5% and online holiday retail sales are likely to reach a new high. Our network operations are running extremely well with industry-leading on-time performance and excellent operating efficiency gains, giving us great momentum as we move into the holiday season.

We had a highly successful peak last year. It was well-planned and cleanly executed. We are building on that approach, but have even more assets to reinforce our confidence in dependable performance. Since last peak, we taken delivery of nine new aircraft with two more on the way in support of growing demand for our air services.

We will have added another nearly 5 million square feet of highly automated facilities, including another 400,000 pieces per hour of automated sort capacity. About two-thirds of that sort capacity is already online and operational compared to last year when almost all of our new capacity came online in the fourth quarter.

We also improved the Ground network, widening the reach of our Next Day Ground capabilities and speeding transit times in key lanes. And we expanded the use of technology providing our expert planning and operating teams with enhanced tools to improve execution and efficiency.

In addition, to help support the expected increase in package volume, we are adding about a 100,000 seasonal employees and have shortened their ramp-up time with enhanced global trading. We expect the holiday shipping season to start the week of Thanksgiving, then rise sharply during cyber week and remain heavy through Christmas.

We're also planning for heavy returns volume following cyber week and then again after Christmas through mid-January. Overall, during peak 2019, we expect a greater than 5% increase in daily global deliveries above last year. Plus, we estimate we will deliver more than 32 million packages per day around the world, an increase of more than 50% over our regular daily volume.

What's more, due to e-commerce structural changes, air volume continues to grow at near historic levels. And we expect demand to be strong during peak as Next Day delivery increasingly becomes the new standard for B2C and B2B e-commerce. Our preparations also include deeper collaboration with our customers.

Our joint forecasting process, which runs throughout peak helps us identify planned and unplanned daily Ground and Air volume. Then we align it with available network capacity for increased utilization and operating efficiency. It is a proven approach from 2018 that we know improves service to our customers and helps them take advantage of our network flexibility.

In summary, we are ready to deliver another successful peak season. Our smart global logistics network enabled by our advanced technology and run by talented UPSers worldwide is in top form. And we are fully committed to providing high quality service for all customers and delivering healthy financial returns to our shareowners.

Now I will turn it over to Richard to discuss our results.

Richard Peretz

Thanks, Jim, and good morning, everyone. UPS delivered solid performance in the quarter, reflecting significant progress on our initiatives. This morning I will review a summary of our third-quarter results and Brian will discuss our outlook.

For the company, operating profit grew more than 20% on 5% revenue increase. Operating margin expansion was substantial, up a 150 basis points. Our results are an indication that our strategy and investments are improving the fundamentals of the business, especially in the U.S. What's more, the strategic growth and cost management actions we are taking are helping to offset the headwinds from a weakening global economic environment and slower U.S industrial production.

Now let's turn and review each of the segments. We continue to see progress in the U.S with clear gains in the top and bottom line results, driven by our ability to adjust the network and anticipate changes in demand. Revenue increased nearly 10%. Both Next Day and Deferred grew by double digits and Ground revenue was up nearly 8%.

Total volume across all products grew more than 9%. Next Day volume jumped nearly 24% and Deferred was not far behind up more than 17%. Our growth in Air was diverse across multiple industries. Ground volume was strong, up nearly 7% led by retail and healthcare and mix is now just over 50% residential deliveries.

Reported yields were a bit softer, but were more than offset by a decrease in unit cost, which we will talk about in a moment. The declines in yield were due to a rapid adoption of faster delivery services by large e-commerce customers coupled with increased and lighter weight shipments with average weight per piece down about half a pound. Going forward, we expect yields to grow as our new SMB solutions pickup speed and have broader variety of customers and industries adopt this new standard.

Most importantly for the quarter, unit cost was down 2.5% driven by productivity gains, efficiency in our new automated building and benefits from other transformation initiatives. The combination of strong revenue and enhanced cost efficiency generated substantial bottom-line results this quarter. Operating profit was up nearly 26% and operating margin expanded 130 basis points. As you see, domestic is performing well and we expect momentum to carry us into peak and the upcoming quarters.

Looking at the International segment. International delivered good performance with operating profit increasing more than 20% to $693 million. We saw a lower-than-expected benefit from currency and the business felt the effects of the softness in the global economy, both of which were partly offset by gains on a property sale for approximately $40 million which was above what we’ve anticipated.

To match changes in geographic demand, we frequently made changes and adjustments to the network and our localized strategy. As a result, total export volume was flat. Asia exports continue to grow to virtually all major non-U.S regions of the world and we grew exports within the European continent.

We continue to see volume weakness into and out of the U.K and on the Asia to U.S lane. And we had slight domestic growth overall with a number of countries increasing, including Mexico, France, Spain and notably the U.K. On a currency neutral basis, domestic revenue per piece increased 2.3% for exports, product and lane mix weighed on reported revenue per piece.

International operating margins expanded over 300 basis points this quarter. Our performance was driven by the combination of successful execution, continued structural changes in the network and our ability to target growth markets.

Now let's turn to look at supply chain and freight. The segment continue to adapt in a dynamic environment with disciplined cost control by targeting SMBs and with gains in a number of the business units. Putting it altogether, operating margins expanded on lower revenue and slightly lower profit. Comparisons are difficult to last year's third quarter. As a reminder, profit grew over 33% in 2018.

Ocean, air freight and truckload brokerage revenue were lower this quarter with gains coming from Marken and the logistics unit. Logistics increased revenue more than 7% and generated solid profit, led by customers in healthcare, retail and the manufacturing sectors. On the profit side, healthcare, LTL and logistics were bright spots with Marken and UPS Freight growing profits by double digits. Overall, UPS delivered good performance in the third quarter. Our investments to modernize our global network are improving our results and momentum will continue.

Well, that was the last time I will cover Results. What a good quarter to end on. I’ve had an exciting and fulfilling Career here at UPS. It's surprising how quickly 38 years can go by. It's been an honor to represent the UPS team and this great company each quarter. The outlook for the company is bright.

And now I'll turn it over to Brian.

Brian Newman

Thank you, Richard, and good morning, everyone. I'm very grateful for the opportunity and excited about the growth prospects which UPS represents. I was fortunate to have gain broad experience with one global company and now I'm humbled to join UPS. I've been very impressed by the UPS team and I'm eager to meet our investors as I hit the road over the next few weeks.

Now I'll share the update on our cash position and outlook. One of the hallmarks of UPS is our ability to generate cash. Year-to-date UPS has generated $5.7 billion in cash from operations and adjusted free cash flow was $3.2 billion, which includes capital investments of about $4.5 billion.

Looking at capital expenditures, our projects are generating greater benefits than anticipated, plus, we've made gains in deploying our capital more efficiently. Projects have been standardized and we continue to optimize procurement practices. As a result, we are lowering plan CapEx by about $500 million for 2019 and again in 2020, all while maintaining our network automation targets and other transformation goals. We are also raising our adjusted free cash flow target for 2019 to over $4 billion, predominantly driven by adjusted CapEx and working capital efficiencies.

Now let's turn to shareholder returns. So far this year, UPS distributed more than $2.5 billion in dividends, which represents a 5.5% increase on a per share basis over the same period last year and we repurchased 7 million shares for $753 million.

Moving to tax. Our effective tax rate for the quarter came in just under 21%. As Richard discussed on the second quarter call, there were anticipated one-time benefits in the third quarter. Accordingly, we anticipate our fourth quarter and full-year tax rate will be between 22% and 23%.

Turning to guidance. 2019 is a year of significant progress across the segments. Transformation investments are becoming much more visible in our performance and we expect this momentum to carry forward. Looking at the fourth quarter across all the segments, we expect the U.S consumer to remain strong and the structural shift for faster e-commerce delivery to drive elevated demand for our services, offsetting the current slowdown in U.S industrial production.

This year we added more capacity to the network. All 400,000 pieces per hour of new capacity will be ready ahead of peak. As a result of our positive growth and efficiency factors, we expect strong operating profit improvement and margins to expand on a year-over-year basis.

In the International segment, we continue to make network adjustments to optimize asset utilization and efficiency. In addition, we will further grow in targeted trade lanes and within the international domestic markets. And so we expect International operating profit to continue to grow.

Turning to supply chain and freight. We expect double-digit operating profit growth. Gains in logistics, healthcare and UPS freight were more than offset market headwinds in forwarding and truckload brokerage. Also of note, last year we had a drag on profit driven from the UPS freight contract ratification process. On the whole, we have confidence in all of the factors within our control and we expect to be well within our full-year adjusted earnings per share guidance of $7.45 to $7.75.

Despite weakening macro conditions throughout the year, we’ve maintained our initial guidance range. Our strategy and network investments are generating positive returns as evident in our profit margin gains. However, our guidance is based on the continuation of current conditions, should external conditions deteriorate, our outlook could be negatively affected, yet remain within the range.

I'd like to close by echoing Jim's comments. We are fully prepared to deliver a successful peak season with healthy returns for our shareholders and great service for our customers.

Now, I'll ask the operator to open the line for questions.

Question-and-Answer Session

Operator

I will now turn the program back over to IRO Mr. Scott Childress to start our Q&A segment. Please go ahead, sir.

Scott Childress

Thank you, Steven. Couple of reminders. Please only one question per person, so we may allow as many as possible to participate. And during the call, Richard will take questions on the actual results and Brian will take questions on our outlook.

Our first question comes from Chris Wetherbee of Citi. With the efficiencies from transformation and the benefits from the SMB initiatives, do you think that cost per piece can move lower in the future?

David Abney

Hey, Chris. This is David. Thanks for the question. And we do believe that the costs will continue to be lower than last year. And it's our growth and cost initiatives are gaining momentum. It's a combination of our strategies, of our investments; of course, our automation. Our execution has been very good especially this past quarter. Our transformation initiatives and the structural changes that we're seeing with Next Day Air. Positive operating leverage two quarters in a row, but this quarter just very strong positive operating leverage. Our cost per unit was down 2.5%. You have to go back a long, long way to see that kind of performance. And U.S. operating profit was up nearly 26% and our operating margin expanded 130 basis points. So very successful third quarter. We have momentum. We expect it will continue and we do believe that we will continue to have lower costs than the previous year. Thanks for the question.

Scott Childress

Our next online question will come from Allison Landry of Credit Suisse. How is the UPS network positioned to benefit from the structural shift in both short zone and next day?

Kate Gutmann

Thanks, Allison. UPS is positioned very well. We continue to gain the benefits from the structural change in the market and we've seen increased demand for faster e-commerce and UPS delivering positive operating leverage. Air grew double-digits with Next Day Air nearly at 24% and Deferred at 17%. And we also see Air growth in e-commerce as well as broadly in healthcare, high-tech and throughout small and medium-sized businesses as well. The structure change also means faster shorter zone Ground. And we have had strong Ground growth at nearly 7%, fueled by our solutions like our leading Next Day Extended Ground Service, which is enabled by the flexibility and power of our network which Juan will talk to you.

Juan Perez

Thanks, Kate and thanks, Allison for the question. We continue to work very actively on building our smart logistics network. And I will tell you that the UPS network is really well positioned to accept multiple changes in the market as we continue to see them. That comes as a result of a number of investments we've made. You’ve heard Jim and David talk about some of those investments, but they all come together in the smart logistics network. Additional automation in our network, that's definitely paying off and we’ve additional plans to continue to enhance our automation moving forward. Capacity in our facilities is providing unprecedented flexibility to the UPS network. We expect that to continue to be the case. Investments in technology to improve efficiency definitely the case and we’re not stopping there, we continue to make investments in advanced technologies that are going to continue to make the network more flexible, more capable. So we're excited as to where we are today and where we’re going in the future in adding capabilities to support the business.

Operator

We have a question from the line of Mr. Tom Wadewitz of UBS. Please go ahead.

Tom Wadewitz

Yes, good morning and congratulations on the strong results, particularly that domestic program seems very good in international margin. And just wanted to say congratulations also to Jim and Richard. You guys have had a great run at the company and look forward to working with you Brian. So I guess on the domestic package improvement story, it seems like you’re early on in that. You had first quarter a pretty substantial gain in domestic margin. How do you think about that going into 2020 with the kind of soft industrial with a lot of momentum in your retail. Is it reasonable to think that you're early on in domestic package margin improvements and a lot of momentum going into next year? Or should we be somewhat cautious given the soft macro backdrop? Thank you.

Jim Barber

Hey, Tom, I'm going to start and then Brian is going to take us into 2020 a bit. Look, I think that as we talked about, this was a pivot year for UPS and we continue to pickup pace. The most recent quarter we really have about five or six levers that are coming together here to look at to bring us to what David talked about in the opening comments and in his first question and that's the leverage that we got. You got transformation, that's a tailwind. You have procurement, that's a tailwind. The extra capacity that we've talked about, the automation that we've talked about, you got operational execution. Our operators are executing at a very, very high level. And then the last point, I think we continue to talk about the power of the integrated network and we're able to put the Air and the Ground and the International to at the same time at these high rates that produces what you see on this piece of paper. So it's been a great quarter for us and Brian will talk about the future for a second.

Brian Newman

Yes. Thanks, Jim, and thanks Tom for the question. So Q3, as Jim mentioned, we saw a nice pop of a 130 bps, so it was a good margin expansion. We are looking for good margins in the fourth quarter. But as we look out to 2020, what we are really focused on is the relationship between the revenue per piece and the cost per piece and making sure we drive that leverage. So we will come back to you and talk more about operating margin expectations in the -- on the January call, Tom. Thanks.

Operator

Question from the line of David Vernon of Bernstein. Please go ahead.

David Vernon

It looks like things are just starting to turn here. You are starting to get the leverage we want. And I don't want to sound too indelicate or anything, but like why -- could you talk a little bit about the thought process about why now is the right time to maybe step down? And then, David, could you talk a little bit about kind of what’s your plan is from a management standpoint and a succession standpoint as we’re making some changes at the C level to make sure that the momentum we have here and some of the investment programs is going to continue into 2020 and beyond?

David Abney

This is David. We are very excited about the progress that we have made and we are going to continue to make in the U.S. I think well-deserved recognition. It was due to the transformation initiatives and due to the investments that we have made and those are going to continue. I think we've done an excellent job with our management team. We've got a blend of people, the long-term UPSers like Rich and Jim and then we also have brought in some very good people from the outside. I see that continuing. We have a strong bench and succession planning is something that that we constantly focus on. And this is a natural progression. We have many people that spend their entire years careers at UPS and we appreciate that. And then we have others that are ready to step in and so we're excited about those opportunities too. So feel good about where we are. We have the team that will handle and that will bring transformation initiatives all the way through. I’m as confident as I can be about that. Thanks David for the question.

Scott Childress

Our next question is an online question. There is -- from multiple analysts. Can you provide an update and some color around your CapEx guidance?

Brian Newman

So thanks, Scott. Look, UPS has been a good steward of capital. And if you look at the returns from an ROIC perspective, we're roughly double the industry average. We lowered our CapEx guidance as you saw by $500 million this year and a similar amount next year. And that offer 3 points in terms of reflection. One is the reduction is due largely to efficiency gains in buildings across the network and procurement standardization. Second, the change does not affect our transformation or capacity initiatives. And then lastly, the CapEx reduction has enabled us to actually raise our adjusted free cash flow to north of $4 billion for 2019.

David Abney

An important thing here is we're just getting more done with less and this is what transformation was intended to do. And we're very happy to see that take place.

Operator

Next question will come from the line of Ken Hoexter of Bank of America. Please go ahead.

Ken Hoexter

Hey good morning. And Jim and Richard, thank you for all your help over the years and Brian welcome. Just maybe, David, talk about the deceleration in the Next Day Air. Last year you or last quarter you are up about -- oh no, I’m sorry, last year you are up about a 100,000 packages sequentially. This year up 35,000, so I’m wondering if is this Amazon taking some of the share back? Is it a deceleration in the underlying growth and maybe that transitions to your multiple comments on if the economy decelerates or deteriorate? Is that something you’re already seeing, given the multitude of your commentary on that?

David Abney

When it comes to -- and we will talk about the Air business first. And what we're seeing is an acceleration and it is not due to the economy, although the U.S economy is consumer driven and it is providing a lot of opportunities. But when you look at this quarter, we have taken flight to success, that’s why I’m so sure because our Next Day Air volume is up 24%, our second day of Deferred is up 17%. And it's a structural change and then it's more than just one customer. And Kate would you like to talk a little bit about other customers?

Kate Gutmann

Yes, absolutely. We are excited because we've seen it in e-commerce and across all segments in e-commerce, customers of all size. But that's Air growth, so the speeding is definitely occurring whether it would be two to one or Ground to the Air mode. And then we're also seeing that ground short zone. So this structure change is resonating and we're seeing the benefit to operating leverage.

Ken Hoexter

I'm sorry, I'm not thinking -- I don't think you answered the -- I guess, I'm seeing a deceleration in growth from sequential. Is that not kind of pointing towards the economy or a customer shifting in volumes, just from 2Q to 3Q?

Richard Peretz

No, I think -- this is Richard. Obviously, you have to -- and we actually called it out during the second quarter. There are different seasonalities in average volume per day impacts and we actually called out that during the second quarter, especially earlier in the quarter, your volume levels aren't the same as they are in the third quarter. And so we took advantage where we thought it was appropriate, getting the right return as you see in the bottom line results. But there's going to be seasonality and opportunities from a -- just a level of business, based on how each quarter operates across the entire -- the U.S., there's just more business activity, say in the fourth quarter than the first and more in the third than in the second. So the [multiple speakers] …

Ken Hoexter

Got it. Thank you.

Richard Peretz

… already there.

Ken Hoexter

Okay. Thanks, Rich.

Scott Childress

Our next question comes from Brian Ossenbeck at J.P. Morgan. What are some of the services and partnerships contemplated under the new Digital Access program?

Kate Gutmann

Thank you. This is Kate. We are excited about the Digital Access program. It's a continuation of our small and medium-sized business, strategic imperative and the investments we've been making. So just to crystallize the thought, we are investing to ensure that we enable UPS solutions and integrate them for easy shipping wherever our small and medium-sized business sellers and go to sell as well as where consumers go to shop. And we have already integrated with anything of meaningful size with marketplaces and platforms and excited about the most recent announcement on Stamps.com. Just to put it into more quantified format, with Stamps and Shopify alone, we are actually reaching over 1 million small and medium-sized businesses and there is more to come. We continue this partnership strategy. Scott, did you want to lend a …?

Scott Price

I think just the core investments that we've made to the transformation program. Some of the areas are improved timing trends at the announcement of our 7-day network, and of course the expansion of our Access Point. So all of these solutions hold nicely on those transformation investments improving in our core.

Operator

We have a question from the line of Scott Group of Wolfe Research. Please go ahead.

Scott Group

Hey, thanks. Good morning, guys. Can you clarify, just because I haven't heard it, can you clarify what the actual CapEx guidance is for this year and next year? And then on the U.S. margin side, I know we are not guiding to 2020 margins yet, but do you have maybe some longer term thoughts on where you think U.S. margins can go, once we get through sort of the full few years of transformation?

Scott Childress

Scott, we are going to take one of those questions. So, please make sure it's only a single question per ...

Brian Newman

So from -- its Brian. From a CapEx perspective, we had guided for this year and next to be 8.5% to 10% in terms of sales -- in terms of revenue -- CapEx as a percentage of rev. So within that guidance, what we -- if you take it from the midpoint, we were guiding down $500 million in 2019 and a similar amount in 2020.

Scott Group

Thank you.

Scott Childress

Our next online question comes from Scott Schneeberger of Oppenheimer. In International Package, can you offer some perspectives on the trend that you're seeing in the services and across the globe?

Jim Barber

Scott, it's Jim. So couple of things that we are talking about. First of all, you've heard from everybody on the call about some of the changing trade dynamics. It certainly effect, if you want to call the premium versus non-premium. We see it all as a premium service offering. And I think from an export perspective and Richard talked about it, you've got a lot of lanes growing across this world. There's a couple of power lanes that are slowing down, and when that happens, we got to adjust. You also heard, we will lean into domestic, where our ground networks have great capabilities and then we backstop that with an operating leverage state of mind, when all three business units in this kind of dynamic are able to create operating leverage. And we do that, and we continue forward and grow the business with some of the factors that we're talking about here. So we are pretty proud of it. It will grow again, and we will continue. If you look at our historic rates over the last 2, 5 and 10 years, we are proud of the premium and it will continue to grow in the future, as trade dynamics allow it. So appreciate the question.

Operator

We have a question from the line of Allison Landry. Please go ahead.

Allison Landry

Good morning. Thanks. So last quarter you talked a little bit about leveraging the U.S. post office. I was wondering if you could provide an update on that, and where you see those trends going? How much capacity you think that could free up in your network? Thank you.

David Abney

Thanks for the question. This is David. And, yes, there's couple of instances that I can talk about. First is from a weekend delivery, we've talked about it, one of our options will be using SurePost and on enhanced Saturday and also on Sunday. So we see good indications there. We also see opportunities, when you talk -- and this combines with another question that we received from the web, is the fact that the UPU and the changes that have been made there and how that of folks the Postal Service now, it affects us. And obviously, we applaud the administration for their efforts to modernize the UPUs terminal dues as a structure. What it does, is it raises the floor and it opens opportunities for American SMBs to grow, and of course that falls right into our worldwide economy expansion in our SMB initiatives. So we do have a unique relationship to Postal Service. We are a supplier. They are a supplier and we are competitors at the same time. We do believe there is ways that we can leverage their network for a lot of small delivery, at the same time, add additional capabilities to our own. Thank you.

Scott Childress

Our next online question is coming from Chris Wetherbee of Citi. Can you provide an update on your hub automation initiatives? Will you reach 80% of eligible volume in 2019?

Juan Perez

Yes. Thanks, Chris, for that question. We definitely continue to work to work very actively on our automation and facility modernization efforts. By the end of 2019, we are definitely on track to be right below 80% of our U.S. ground eligible volume to be processed through automation, and the plans are for 2020 to get to 85%. So we continue to be on track with that. As you heard earlier, we -- this year we have 20 new retrofit automated facilities going online, and above and beyond that by the way, we're also putting on -- we're almost done with all of them now, about seven additional automated small sorts across the facility. Each and every one of those keeps adding overall processing capacity to the network. And it goes back to the question that was asked earlier, all these automation keeps adding network flexibility, to provide all these different types of services and capabilities to our customers. So we are well on track to hit our targets, and we definitely have the commitment of the organization to continue to make the right investments to get there. Thank you.

Operator

We will now take a live question from the line of Mr. Chris Wetherbee as well of Citi. Please go ahead.

Chris Wetherbee

Hey, thanks and good morning. I wanted to ask about some of the comments you've made earlier in the year about double-digit growth and the operating profit of all the segments. Is there still targets -- are those targets still good as we think about sort of last quarter of the year? And if they have changed a little bit, can you talk a little bit about the factors that might have impacted them? Thank you.

Richard Peretz

This is Richard. And I will start the question and then Jim will talk about the businesses. But overall, we expect the total enterprise to have operating profit growth in the double digits. At this point, each of the business units have plans in place that was set at the beginning of the year. And you saw what we've done in the last quarter, in the international and the domestic and we expect the momentum to continue. And in the supply chain, we also, as we called out during my talk, that there were some year-over-year comps that's going to continue to show good improvement in operating profit.

Jim Barber

So it's Jim. I would just -- I say, agree with that. I mean, obviously, you've seen the quarter now. We've got one quarter to go. You've seen what we reaffirmed today, and then ultimately it's a situation -- it is a little bit of a different year than when we started, no question about that. But the double digit is clearly still in sight, and then we move on to 2020. So it's about all the factors. And this operating leverage is real key for us to be able to make it in all three business units, and that's what we plan to produce in peak. So appreciate it.

Scott Childress

We've got another online question here. It's from multiple analysts. Can you give some color around your global procurement that you highlighted? And please discuss if -- how that's filling out into the transformation initiatives that you discussed at the conference?

Brian Newman

So I will take the first part of that and then kick it over to Scott from a transformation perspective. We spend roughly $25 billion a year in global procurement, and we're going through multiple waves of the coverage negotiations. We are seeing benefits, as evidenced in the margin expansion and we are continuing to see big pushes in DSO and DPO. So Scott, do you want to hit the transformation side?

Scott Price

Yes. We launched the procurement capability and grew out, basically category by category. We are now fully implemented and I think you see the result of that not only in terms of the operating expense that is covered and the ability to support the lower reduced cost per piece in the U.S., but also the announcement that -- our ability in CapEx to be able to overall operate more efficiently and continue to do 100% of our transformation programs with less CapEx.

Operator

We have a question from the line of Jack Atkins of Stephens. Please go ahead.

Jack Atkins

Good morning and thank you for taking my question. I guess just to go back to the macro for a moment, just to ask the question directly; but David or Jim, are you seeing anything in your business or leading indicators within your business that make you more or less concerned about the direction of the U.S. or global economy. Just any thoughts there I think would be very helpful, just given your role in the global supply chain. Thanks.

David Abney

Okay. This is David and I will certainly talk about it. The global economy remains in growth mode, it's just at a slower pace. And risks are more acute and global industrial production has lowered and we are watching closely to see these trade developments. At the same time, though, that we see the softness, we continue to gain and execute our opportunities as is evidenced by our international results and our domestic results. It's the flexibility of our strategy in our network. A good example of that is we have one of our new large aircraft, 747-8 that was scheduled to operate from China to the U.S. We looked at changing trade flows. We moved it from China to Europe and those are the kinds of proactive steps that we will take. We also have to realize, there are some rays of sunshine that are coming across the horizon. If you compare what we're seeing about Brexit now to the last quarter, the fact that there has been some negotiations between Ireland and the U.K. in between the U.K. and the E.U., it's still to unfold, but we will see this Phase 1 negotiations between the U.S. and China. There are some rays of sunshine there too that we're looking at much more to be developed. The important thing is, regardless of those macroeconomic conditions, we have the flexibility and the agility of our network to meet our customers' needs and we are confident we will continue to do so. Thank you for the question.

Scott Childress

We are going to take a online question from Tom Wadewitz of UBS. How does your expanded drone delivery capabilities fit into the strategies that you've got for growth?

Jim Barber

As David mentioned in his introduction, we are the first to receive the FAA Part 135. We are the first and still only fully certified drone airline in the United States. We actually begin investing in drones several years ago, since our very first residential trial flight actually in February of 2017. We are moving fast. We are quickly scaling, building on the WakeMed program we have announced yesterday, University of Utah, a similar campus. But we see greater opportunity beyond that. We've announced then three partnerships, CVS, Kaiser Permanente and AmerisourceBergen. In partnership with those companies, we are looking for new services and solutions. We are very excited about the opportunity and we see much more to come in this area as we progress. Thank you.

David Abney

Yes. This Flight Forward and this drone strategy, this is just indicative of our transformation initiatives that we are going to charge forward with new technologies, and we are not taking a backseat to anyone. We've made that clear from the start. But the fact that we've already made 1,500 commercial flights, we're doing it on a day-in, day-out basis and you’re going to continue to hear much, much more from us. So really want to commend Scott and his team. But this is UPS embracing the future and we are very excited about it.

Operator

We will take a question from the line of Jack Atkins of Stephens. Please go ahead. Mr. Atkins, your line is open.

Jack Atkins

I'm sorry, my questions have been asked and answered. Thank you.

Operator

We will move on to the line of Mr. Scott Schneeberger of Oppenheimer. Please go ahead.

Scott Schneeberger

Thanks. Good morning and congratulations, Jim, and Richard, and Brian. David or Jim, we've -- it seemingly in for peak season, a condensed calendar, a much shorter period between Thanksgiving and Christmas Eve. Just wondering if you could discuss, how you feel you're prepared to face that challenge heading into this year, and what you've learned from years past and how you are prepared for this condensed calendar? Thanks.

David Abney

Yes, I would like to talk about it. Got a lot of momentum going into peak. It is a shorter peak season, there is no doubt about it. But that didn't just happen over the last few weeks, right? I mean we've known that for years, and so, the capacity that we've added for the past couple of years, we've added 5 million square feet. We've added 400,000 packages an hour capacity over the last two years. And whether it's Jim or Juan, we can talk a little bit more about the peak network in just a second. But the fact that we have buildings in place, we have the plans to hire the people and the fact that we've got momentum, we feel really good about that.

Juan Perez

Yes. And thank you, David. Another couple of points here. We continue to refine our delivery models to improve our overall capacity. This year we will be using an extended -- more impactful personal vehicle driver model across the network, that will add capacity for delivery. In addition to that, the investments we continue to make on technology, like Orion navigation, will make a significant impact in the way that we are going to manage delivery capacity this year because that type of technology just adds additional efficiencies to the way that we complete our deliveries. So to David's point, capacity in our facilities combined with capacity on the delivery side, puts us in a really good position to execute well.

Scott Childress

We are going to take a online question. This question comes from Amit over at Deutsche Bank. He wants to ask about UPS' relationship with Amazon, and the company's ability to lean into Amazon volume?

David Abney

Yes, this is David. I would say that years ago, we made a decision to lean into e-commerce, and there is no doubt about that. And at that time that I think others were considering or had other plans. When we say lean, we are talking about across the e-commerce ecosystem. So it is small and mid-sized businesses, it's other e-tailers and retailers and that includes Amazon. But it is not specific to any one company. When it comes to dealing with large customers that have a lot of volume and that they do some in-sourcing themselves, is really how you negotiate the deal and how you structure the contract, and how you set your pricing that you can help influence the behavior that you want to drive. But the real key to e-commerce, and you can see it in our innovative solutions that we just rolled out, with the Digital Access program and the way we are expanding worldwide economy, is helping small and mid-sized companies worldwide compete with the big retailers and e-tailers. And that is the key to our success. And thus what we are driven to lean into, more than in any other areas. So, e-commerce is here to stay. We've embraced it. We've got a head start and we will continue it. So thank you for the question.

Operator

We will take a question from the line of Amit Mehrotra of Deutsche Bank. Please go ahead.

Amit Mehrotra

Hey, thanks operator. Hi, everybody. I just wanted to understand the year-on-year improvement in domestic margins? Some of that, I would imagine, just reflects the operational penalties you had last year, reflecting the facility build out. So just what domestic margins have expanded, excluding some of those one-time related costs last year, and just given that dynamic, would we expect the pace of -- excuse me, year-on-year expansion to maybe moderate next year because you don't have those tailwinds from the operational penalties?

Richard Peretz

Yes, so this is Richard. And I think the first thing to remind you is, this year and last year we opened up, as David said, 5 million square feet in each year. So the operating penalties for this year in 2019 is about the same as they were in 2018. So the margin improvement was directly related to better efficiency gains in the new buildings as well as opening those buildings earlier, which we called out in the first quarter, that we would have so much of an opening in the second and third quarter, and Jim mentioned, almost two-thirds of it is open as of today. Last year was the end of the year. That's part of it. Part of it is the improvement in the productivity and the operation execution in the U.S. business. And, that's inherent in the numbers. Earlier, someone asked about fourth quarter costs and we said we would continue to see improvement. But you have to remember, the percentage improvement differs by seasonality. It differs by things that are happening inside the business, because we also are seeing a different kind of packages and we're growing more e-commerce and slightly less industrial because of what the macro is doing. But most importantly, it's all fall into the bottom line and we expect that to continue.

Jim Barber

Let me add one thing to it. I think it hasn't come up as much as I think it's important, is that we talked about the structural change in the Air network. David talked about some of the aircraft. Remember, the whole strategy is to bump and roll bigger aircraft back through the network. We've brought big aircraft back to the U.S. to help us handle this. And the real fact is that, this record Air volume we are handling in this integrated network is being put away beautifully, and that's the secret to the margins, is when they run together like they are, and the operators take care of it and Worldport does a great job, the margins come. So that's where we kind of see the whole thing coming together getting ready for peak.

Scott Childress

We are going to take one more online question. This question comes from Ben Hartford of RW Baird. Your SMB products are making progress, but yields continue to move lower. Can you give us some color around the mix in those yield headwinds?

Kate Gutmann

Yes, absolutely This is Kate. Thanks, Ben. I will separate the two a bit. SMB, we are seeing solid momentum you're -- you've heard of the innovative solutions, My Choice for Business, early traction. Every day hundreds of enrollments and just as a point 40% increase month over month, two months in and on track. So our solutions are resonating with SMB. Then separately tied to the yield question, do note that with the structure change that's occurring in the market, we are seeing a lighter weight product, as many SKUs are being added to the shorter zone and also next day type delivery, whether on -- in the air or on the ground. But as I noted before, air growth is occurring broadly and across our small and medium-sized businesses, healthcare, hi-tech and operating leverage is the answer that Jim just noted, that is the score at the end of the game, and that's what we posted.

Operator

We have a question from the line of David Ross of Stifel. Please go ahead.

David Ross

Yes. Thank you for squeezing me in before Jack Atkins again. Got a question on -- a comment you made that I found interesting that Next Day is becoming the new standard for B2B and B2C. We've heard mostly about the next day growth in the B2C world. How much of that 24% year-over-year growth in the quarter do you think came from B2C versus B2B and any other color on the B2B growth in Next Day?

Kate Gutmann

So thanks so much. This is Kate. I will take the question. I will start first of all, with our B2B growth overall 3.4% and that's despite some of the economic slowdown with industrial production. So we do see solid air growth in hi-tech and healthcare and some of the examples would be distribution to hospitals and in e-commerce. Also there is a returns component that is B2B. The returns don't tend to be in the air, but on the healthcare and hi-tech side, we are seeing B2B growth and our solutions continue to enable our customers to move faster and it's resonating.

David Abney

What gets lost in the mix is many of our large B2C shippers are also B2B shippers, and so that's having a big effect there. But this trend is not just to the end consumer, I mean it is absolutely B2B at the same time. We just probably don't talk about it this much.

Operator

I will now turn our conference back over to Mr. Childress. Please go ahead, sir.

Scott Childress

Thank you very much, Stephen. And David, closing comments?

David Abney

I will. UPS is making significant progress, as you've heard in executing our strategies, especially in the U.S. And would like to call out, George Willis, the President of our U.S. operations, and his team as they have worked with Jim and the rest of the management committee and have really implemented these initiatives that we have asked them to do. These transformation initiatives have turned our results around improving efficiency and they are enabling these new innovative solutions that we've covered the last couple of earnings calls and they are just going to continue to be an important part of the future. We see growth opportunities regardless of the environment around us, in both in the U.S. and internationally. And in summary, we expect another successful peak season for our customers and our shareholders and we will continue to accelerate initiatives to move forward fast and just do it at an ever faster pace, and thank you for joining us today. Appreciate it.