FedEx Q3 FY16 Earnings Call Transcript – March 16, 2016

A. Mickey Foster
Vice President - Investor Relations, FedEx Corp.

Good afternoon and welcome to FedEx Corporation's third-quarter earnings conference call. The third-quarter earnings release and our 26 page stat book are on our website at fedex.com. This call is being broadcast from our website and the replay and podcast will be available for about one year. Written questions are welcome via e-mail or social media. When you send your e-mail, please include your full name and contact information with your question. Send it to ir@fedex.com address. If you would like to send a question via social media, go to stocktwits.com and include $FDX in your message. Preference will be given to inquiries of a long-term strategic nature.

I want to remind all listeners that the FedEx Corporation desires to take advantage of the Safe Harbor Provisions of the Private Securities Litigation Reform Act. Certain statements in this conference call, such as projections regarding future performance, may be considered forward-looking statements within the meaning of the Act. Such forward-looking statements are subject to risks, uncertainties and other factors which could cause actual results to differ materially from those expressed or implied by such forward-looking statements. For additional information on these factors, please refer to our press releases and filings with the SEC. To the extent we disclose any non-GAAP financial measures on this call, please refer to the Investor Relations portion of our website at fedex.com for a reconciliation of such measures to the most directly comparable GAAP measures.

Joining us on the call today are Fred Smith, Chairman; Alan Graf, Executive Vice President and CFO; Mike Glenn, President and CEO of FedEx Services, Chris Richards, Executive Vice President, General Counsel and Secretary; Rob Carter, Executive Vice President, FedEx Information Services and CIO; Dave Bronczek, President and CEO of FedEx Express; Henry Maier, President and CEO of FedEx Ground; and Mike Ducker, President and CEO of FedEx Freight. Following Alan's remarks today, we will have about 45 minutes for questions and answers. Now our Chairman, Fred Smith, will share his views on the quarter.

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

Thank you, Mickey. We appreciate everyone on the call participating in it. Let me begin by thanking hundreds of thousands of FedEx teammates for delivering our Purple Promise every day, including a great 2015 peak season. FedEx Corporation continues to improve margins, financial performance, and competitive position. As noted, our Q3 FY year-over-year earnings per share is up 23%.

I should note there are three recurring areas of concern, however, expressed in various articles and reports. One, future margins, two, industry disruption, and three, capital spending. Regarding margins, the Express profit improvement program will be exceeded by May 31. Express segment margins in the current fourth fiscal quarter will be approximately 12%. Likewise, FedEx Ground, including SmartPost margins, will increase and be 16%-plus this quarter, while the FedEx Ground and supply chain segment will be 15%.

Remember, GENCO is now part of this segment and the margins in this business will not be as high as those of Ground itself; however, the strategic importance of our expanded customer solutions resulting from the GENCO acquisition is profound and will greatly benefit our future financial performance. A significant issue for FedEx Ground over the past year has been the extraordinary growth of oversized shipments, which Mike Glenn and Henry Maier will address. It is truly unfortunate that Congress did not increase the federal twin trailer limit from 28 feet each to 33 feet, which would have benefited consumers, lowered fuel consumption, and reduced highway accidents. We are optimistic about FedEx Freight improving margins in the future as well and Mike Ducker can talk about that.

It's important to note that we manage FedEx operating companies to maximize the Corporation's performance over the long- term, so in any given quarter, we may spend more in one segment to achieve this result. The concerns about industry disruption continue to be fueled by fantastical, and let me emphasize I chose this word carefully, articles and reports which are devoid of in-depth knowledge of logistic systems and the markets which FedEx serves. As we have previously noted, network design, technology, facilities capabilities, and route/stop densities are the key elements in the FedEx, UPS and Postal Service systems that make it highly likely these entities will remain the primary carriers for eCommerce shipments in the U.S. for the foreseeable future.

Finally, FedEx is currently investing in FedEx Express fleet modernization and expansion of FedEx Ground's highly automated facilities. Both these major programs have high returns and are integral to margin expansion. Our cash flows are such that we can easily fund investments at $4 billion to $5 billion per year while retiring debt used to acquire TNT if the transaction is approved and stock repurchases. Of course, we include replacement capex in this projection.

To reiterate, we believe FedEx will continue to improve margins, EPS, capital returns, and increase cash flows, which we have told you repeatedly over the last couple of years and again, have demonstrated this quarter. Let me now turn to Mike Glenn for our economic outlook, followed by Alan Graf with detailed remarks about our financials. Mike?

T. Michael Glenn
Executive Vice President - Market Development & Corporate Communications, FedEx Corp.

Thanks, Fred. I'll open with our economic outlook -- update and outlook and then discuss our performance and business conditions in each segment, including revenue, volume and yield, and provide some commentary on broader industry trends that we are experiencing. On the economic front, we see moderate growth in the global economy. Our U.S. GDP forecast is 2.2% for calendar 2016, 40 basis points lower than our forecast last quarter, and 2.5% for calendar 2017, led by gains in consumer spending. We expect industrial production growth of 0.6% in calendar 2016, 130 basis points lower than last quarter and 2.5% for next year. Our global GDP growth forecast is 2.5% for calendar 2016 which is 30 basis points below last quarter and 2.9% for calendar 2017.

Now I'll review revenue volume and yield trends by segment. In the Express segment, revenue decreased 1% as lower fuel surcharge and unfavorable currency exchange rates more than offset yield growth. U.S. domestic package volume grew by 2% driven by growth in overnight packages. U.S. domestic revenue per package increased 1% despite lower fuel surcharges. Excluding the impact of fuel, year-over-year domestic Express package yields grew 3%, primarily due to rate and discounts.

FedEx International Economy volume grew 2% while FedEx International Priority volume decreased 3%. International export revenue per package decreased 5% as lower fuel surcharges and unfavorable currency exchange rates negatively impacted yields. Excluding fuel, international export Express package yield decreased 1%, primarily driven by the negative impact of exchange rates, which outweighed the positive impact of rate and discount changes.

FedEx Ground increased 30% -- revenue increased 30% in the quarter, driven by higher Ground volume and yield, the recording of SmartPost revenue on a gross basis versus the previous net treatment and due to the inclusion of GENCO results. FedEx Ground average daily volume grew 11% in Q3, primarily driven by growth for demand for residential deliveries related to eCommerce. FedEx Ground revenue per package increased 8% year-over-year in Q3 due to the recording of SmartPost revenues on a gross basis and higher base rates, partially offset by lower fuel surcharges. Excluding the impact of fuel, Ground yield per package, including SmartPost, increased 11% year-over-year, driven primarily by rate and discount and SmartPost customer mix.

FedEx Freight increased revenue 1% as LTL shipments increased 7% and revenue per shipment declined 4%. The increase in shipments is driven by our sales efforts with small and medium customers and reflects the speed, reliability and choice of priority and economy services for our LTL customers. Revenue per LTL shipment declined due to lower fuel surcharges and average weight per shipment. Excluding the impact of fuel surcharge revenue, revenue per shipment was down 1% year-over-year due to lower weight per shipment.

Now I'll discuss in more detail some of the industry dynamics that drove the record peak season and beyond. The 2015 peak season was historic by many measures and it was driven by the continued growth of eCommerce. Demand for residential deliveries across the industry surpassed expectations as consumers increased online shopping in record numbers. Not only was there higher volumes but the types of goods purchased online increased. FedEx experienced record demand, including multiple days of greater than 25 million packages delivered, which is more than double our average daily volume. We're proud of our team members and the incredible job they did with more than 325 million packages delivered during the peak period. We worked very closely with our large e-tail and other peak customers to prepare for their needs and to deliver the holidays.

It is very clear that eCommerce has now enabled a full scale retail revolution. There are several important trends worth noting. First, referring to a specific peak day is quickly becoming a thing of the past. As evidenced this year, there were multiple days where volumes exceeded 25 million packages as consumer buying habits are changing. We view this as a positive as Mother Nature can sometimes play havoc with last-minute eCommerce shoppers. Smoothing sales throughout peak season is a trend that will benefit retailers and transportation companies alike. We believe online shoppers will have increasing incentives to order earlier in the holiday season.

Second, more and more retailers are fulfilling eCommerce orders from individual stores in what we call store-to-home delivery. FedEx is well positioned to service this growing market in the years ahead with our broad portfolio of services, including metro delivery and same-day services.

Third, we're seeing a significant increase in non-traditional items now being purchased online; mattresses, canoes, swing sets and big screen TVs, just to name a few. We welcome this opportunity, but it is important that we price these items accordingly to account for the operational complexities, such as manual sortation, two-person delivery, et cetera. As a result, we will be adjusting the additional handling surcharge for FedEx Ground.

Today, if a package length is greater than 60 inches, the additional handling surcharge will be applied. Beginning June 1, the maximum length will be reduced from 60 inches to 48 inches. We believe 48 inches is appropriate as it is the standard length of an LTL pallet.

It's important to remember that the primary value proposition of eCommerce is the ability to order a product online and have it reliably delivered to the consumer. In that regard, FedEx is and will continue to be a key enabler for eCommerce in the years ahead. By our estimates, more than 95% of all eCommerce orders today are delivered by one of three entities in the United States; FedEx, the United States Postal Service, with whom we have a strategic relationship to transport their priority mail, and UPS. In fact, if we were to isolate our eCommerce business, one could argue that FedEx is one of the most profitable eCommerce companies in business today.

I'd also like to clarify some of the public discussions and speculation concerning Amazon adding some direct transportation capabilities. First, Amazon is a valuable customer that we've worked with for many years and we expect to work with them for many years to come. We've been in constant dialogue with them to understand their transportation needs as they've experienced significant growth. We have been aware of Amazon's need for supplemental capacity related to inventory management, which is driving some of the investments they are making in transportation. Large retailers have long had their own transportation capabilities, primarily to enable movement and positioning of inventory across their store and fulfillment locations.

While recent stories and reports of a new entity competing with the three major carriers in the United States grabs headlines, the reality is it would be a daunting task, requiring tens of billions of dollars in capital and years to build sufficient scale and density to replicate existing networks like FedEx. It's also important to note that no one FedEx customer represents more than approximately 3% of total revenue. Additionally, other than the Postal Service, no single customer represents more than approximately 3% of revenue for FedEx Express, FedEx Ground, or FedEx Freight. We manage these relationships carefully to ensure we don't become overly dependent on any one customer.

We expect these industry trends and dynamics to accelerate this coming holiday season and will continue to affect the industry year-round. FedEx is well positioned to provide innovative solutions and to meet this growing demand. Now I'll turn it over to Alan Graf.

Alan B. Graf, Jr.
Executive Vice President & CFO, FedEx Corp.

Thank you, Mike, for that excellent report and good afternoon, everyone. We had a strong quarter with adjusted earnings of $2.51 per diluted share up year-over-year more than 23%. Adjusted consolidated operating margin increased to a healthy 9.2% versus 8.3% last year. These record earnings proved once again the success of our strategy to manage our portfolio of services to achieve enterprise results and it's important to remember this strategy does not always translate into each segment's individual earnings and margin performance. We expect our fiscal 2016 adjusted earnings to be up 20% to 22% over last year as we continue to benefit from our execution of the profit improvement program at Express. Our positive financial momentum should continue into our upcoming fiscal 2017 where we expect continued solid growth in earnings and cash flow.

This quarter, there were three expense adjustments within corporate, eliminations and other. First, during the quarter, we reached agreements in principle to settle all of the 19 cases on appeal in the multi-district independent contractor litigation. The settlements will require court approval. We recognize a liability for the net expected loss related to these cases and certain other pending independent contractor related proceedings of $204 million, or $0.46 per diluted share. These disputes involve a contractor model which FedEx Ground has not operated since 2011. This is good news because, assuming the necessary court approvals are obtained; it resolves all of the remaining multi-district litigation cases. We are defending contractor model cases that are no longer -- that are not or no longer part of the multi-district litigation. These cases are in varying stages of litigation. We do not expect to incur a material loss in these cases.

Secondly, net expenses related to the settlement of a U.S. Customs and Border protection matter involving FedEx Trade Networks were $69 million, or $0.15 per diluted share. Thirdly, our pending acquisition of TNT Express had an operating income impact of $23 million and EPS impact of $0.06 per diluted share.

Turning to the segments and starting with our star, Express, Express had an outstanding quarter, as operating income climbed 51% and operating margin increased despite lower revenues. Let me repeat that. Operating income climbed 51% and operating margin increased despite lower revenues. Who does that?

Express operating margin was 9.1%, up 320 basis points versus last year and is the best third-quarter margin in Express segment history. The increase was driven primarily by yield management, U.S. domestic volume growth and ongoing benefits from the profit improvement program. Express is efficiently managing volume increases in eCommerce and at the same time, continued softness in international volumes. The profit improvement program that we announced in 2012 continues to improve revenue quality, increase productivity, and constrain expenses.

Turning to Ground, Ground saw unprecedented demand with volumes increasing 11%; however, Ground's operating margin declined. The 390 basis point decline in operating margin was primarily driven by five factors. One, 190 basis points from the change in SmartPost revenue reporting and the inclusion of GENCO results. Two, 60 basis points from higher costs, driven significantly by peak season demand that exceeded both volume and package size expectations, as Mike discussed. Third, 60 basis points from higher self-insurance reserves. Fourth, 30 basis points from increased purchased transportation rates for line haul and fifth, 30 basis points from network expansion costs.

As Mike said, we are evaluating several Ground pricing initiatives to balance our revenue and costs and increase margins. In addition, over the next two years, we are spending additional capital at Ground to expand needed capacity to support both commercial and eCommerce growth, including non-conveyable annexes designed to more efficiently handle those packages that do not fit on our sortation equipment. As Fred mentioned, we expect Ground to return to mid-teens margins in the fourth quarter.

At Freight, Freight continues to adjust to a very challenging LTL market. Freight segment operating results decreased primarily due to salaries and employee benefits expense outpacing revenue growth and revenue growth was negatively impacted by lower fuel surcharges and weight per shipment. We have been installing dimensional scanners to more accurately cost and price shipments. Freight currently has 45 dimensional scanners in their operation today, with another eight slated to be installed by the end of the fiscal year. These dimensional scanners pay for themselves in less than a year and are an important part of our yield improvement program. We also expect Freight's productivity to continue to improve in Q4 as well as throughout 2017.

From an outlook standpoint, we expect our solid earnings growth to continue in the fourth quarter from the execution of the profit improvement program and from improvements in our Express and Ground segments due to volume and yield growth. We are updating the lower part of the range for our adjusted FY16 earnings guidance to $10.70 before year-end mark-to-market pension accounting adjustments. The new range of $10.70 to $10.90 represents adjusted EPS growth of 20% to 22% year-over-year.

Our outlook excludes certain legal costs as well as any TNT integration costs or results. Our expectations for earnings are dependent on several external factors, including fuel prices and moderate growth in the global economy. The capital spending forecast for the fiscal year is now $4.8 billion, which is higher than our previous forecast due to increased investments in FedEx Ground as we continue to expand the network in anticipation of continued high growth.

FedEx is strongly committed to delivering long-term value for our customers, shareowners and team members. In January we completed the 15 million share repurchase program authorized in September 2014 and announced our most recent stock repurchase program of up to 25 million shares of FedEx Corporation common stock. Since FY14, FedEx has returned over $8.3 billion to shareowners through the repurchase of over 60 million shares and during the past two years has increased its dividend by 33% and 25%, respectively. Our strong balance sheet, profit and cash flow performance give us the flexibility to initiate this stock repurchase program while continuing to execute our strategic growth initiatives.

In the near term, we are planning a debt offering, the proceeds of which are expected to be used for general corporate purposes, including share repurchases and the prepayment of certain tax-exempt debt. We intend to fund the acquisition of TNT Express with cash from operations and proceeds from a planned debt offering in the fourth quarter, which we plan to launch shortly after the other debt offering. We will evaluate assessing the euromarket for the TNT funding. The lowered Moody's rating was expected -- that we expected will have a de minimis impact on our upcoming financings.

Regarding the TNT acquisition, we completed several steps during the third quarter, including unconditional approval by the European Commission of our intention to acquire TNT and TNT's announced agreement to sell its airline operation to comply with rules governing foreign ownership of European airlines. We had many questions submitted by analysts on the TNT acquisition, many of which we cannot answer in detail at this time. I will say that FY17 will be a year of investment and integration and beginning in FY18, I am expecting TNT to be very accretive to earnings. The TNT acquisition is expected to expand our global portfolio, particularly in Europe, significantly lower our cost to serve our European markets by increasing density in our pickup and delivery operations and accelerate our global growth.

More than 20 FedEx and TNT operational and geographical teams are planning to make the transition as smooth as possible for customers and team members to position FedEx for long-term profitable growth. We remain confident that we will close the acquisition in the first half of calendar year 2016 and we were very pleased with TNT's recently reported improving operating performance. When approved, this landmark acquisition is expected to bring over 50,000 new team members to our ranks and significantly improve our global competitive position.

In closing I am extremely proud of the FedEx team for its impressive efforts. Our financial momentum should continue into FY17 where we expect continued solid growth in earnings and cash flow. Thank you for your attention and I'm now going to turn the meeting back over to Fred, who will start the Q&A.

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

Mickey, why don't we take -- we covered most of the internet answers in my remarks, Mike's remarks and Alan's remarks. There are a couple of others we'll get to but I'll let Mickey moderate at this point in time for the other ones. I'd point out we will plan to spend about 45 minutes on the Q&A or until we run out of strategic questions. We're not going to replow a lot of ground that we have done in the past here because it just wastes everybody's time. Mickey?

A. Mickey Foster
Vice President - Investor Relations, FedEx Corp.

The first question? We're ready for the first live question.

Operator: Thank you. [Operator instructions.] We'll move first to Chris Wetherbee with Citi.

Christian Wetherbee
Analyst, Citigroup

Hey, thanks. Good afternoon. Wanted to think about sort of a bigger picture strategic question for the Express side of the business. So far the profit improvement plan has been very successful and you're hitting your goals. As you think about the next sort of three years, excluding TNT for a moment, how do you think about sort of the capital intensity and the asset intensity of that business? Does there come a point where there's an opportunity to maybe do more business with fewer assets in the air and sort of leveraging sort of the supply dynamics within the air cargo market? Want to think about the bigger picture trend for Express going forward. Can you feel more confident using third-party aircraft and how we should think about that?

David J. Bronczek
President & CEO, FedEx Express

Thanks for your question, Chris. Thanks for your comments about our Express team has done a great job. The answer to your question is we have a great fleet modernization plan that actually takes us out a lot of years and we continue to replace the old planes with the new 767s and the 777s and quite frankly, we've actually already been doing things like you suggested, using third-party lift where appropriate around the world and that's been very beneficial and very profitable, obviously.

I think on top of that, our FTN, our FedEx Trade Networks organization and their strategic part of our business around the world on ocean shipping with the air freight shipping and obviously the priority express shipping, you can see that we will continue to grow our profits and our margins and -- for a long, long time. Quite frankly we've got our network right in the sweet zone right now, executing on all cylinders. So I think that to answer your question, we probably could look at opportunities to add more into our capacity if we needed to. The great thing about what we've done is we can flex up or down and we've appropriately done that, so we're always looking for opportunities to grow our profits and grow our margins and if that appears to be the case, we'll go forward with that.

Operator: We'll move to our next question from Allison Landry with Credit Suisse.

Allison Landry
Analyst, Credit Suisse

Thanks. Good afternoon. Following up on your comments regarding capital spending, looking out a couple of years to FY17 and FY18, how should we think about growth in capex at Ground versus Express, exclusive of any impact from TNT?

Alan B. Graf, Jr.
Executive Vice President & CFO, FedEx Corp.

Allison, this is Alan. You need to think about capex exclusive of TNT being at $5 billion or a little bit over for the next couple of years and most of that increase is going into the Ground networks. We have about 100 projects under way right now that we hope to get finished before next peak, a broad brush across the country, two new hubs, all the things are going to be automated. I'm sure Henry can add a little bit to that, but easily affordable. The actual number will be higher because we're going have to invest in TNT. TNT had been underinvested in and we'll have more to tell you about that after we close. Henry?

Henry J. Maier
President & CEO, FedEx Ground

Allison, we have on tap for this year two hubs and 19 automated satellites which will bring us up to over 100 -- I think the exact number is 103 automated facilities out of a network of about 550 by the end of the year. That's what's driving the majority of our capital spend.

Operator: Thank you. Our next question will come from Tom Wadewitz with UBS.

Tom Wadewitz
Analyst, UBS

Yes, good afternoon. Thank you for the question. I appreciate all of the comments at the beginning, Fred. It's helpful to get that perspective. On the Express, your various comments are pretty upbeat about how you're ending the year with Express margin and I think you said 12% in fourth quarter. Would you reconsider kind of what you might be able to get to in Express margin over the next several years? Is there any framework for what might be a path forward?

Is it -- you've talked about 10% in the past. Is this something that we ought to think about 11% or 12% on a full-year basis? Just wondering if you could frame that kind of additional momentum and how we might think about that the next few years in Express? Thank you.

David J. Bronczek
President & CEO, FedEx Express

Well, thanks, Tom. I appreciate your feedback and I remember, you were there when we announced our profit improvement plan and I'm really pleased to say that we're hitting it and exceeding it. The momentum actually is carrying us into the fourth quarter and it will carry us into next fiscal year. It's in every area. Quite frankly, we have a DNA now in our Company. We've right sized the Company. We've got the right cost structure in place for our people and our airplanes and our whole network around the world. TNT, as Alan mentioned before and Fred, is going to be fantastic going forward.

But I think the answer will be obvious. The answer is we continue to grow our profits and our margins. You can see it in the fourth quarter; we're at 12%. Obviously double-digit margins are right on us now and we continue to grow into that going forward. Without being too much more specific than we already are, which we've been more specific than we usually are, yes, you can see very strong double-digit margins at Express going forward.

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

This is Fred Smith again. Let me reiterate what I said at the opening of my remarks and the end of the remarks. We anticipate FedEx Corporation's margins, returns, cash flows, and EPS to increase over the foreseeable future, so obviously with Express and then Ground as our biggest operating companies, that should basically answer your question. Regarding the item on the fleet, I think that it's important to note that FedEx Express is operating 20 less airplanes today in 2016 than we were in 2013. Now part of the reason we're able to do that is because the airplanes are much more reliable. We don't need as many spares and not as many in maintenance integrals and of course we are always trying to make our assets sweat more and use assets productively, whether they are ours or someone else's. That's an integral part of what we do as well.

Operator: Thank you. Our next question will come from Kelly Dougherty with Macquarie.

Kelly Dougherty
Analyst, Macquarie Capital

Hi, guys. Thanks for taking the question. Just wanted to maybe turn to Ground a little bit. Any better sense you can provide about the profitability, the improvement potential that could come from the SmartPost integration, maybe how long of a process this will take, if it's something that we'll start to see no noticeable difference in FY17? I know the goal is mid-teens gross margins and you talk about that for the next quarter, but kind of from a full-year basis, just wondering if you could walk us through how and when we get there.

Henry J. Maier
President & CEO, FedEx Ground

Hi, Kelly, this is Henry Maier. Thanks for the question. I think it's important to point out here that we are totally focused at FedEx Ground on long-term profitable growth. We have a number of initiatives under way right now that over the long-term will fundamentally change the way we operate FedEx Ground. Let me share a couple of them with you.

There are network changes under way that integrate commercial and residential networks and position us to increase our operating days and continue to enhance our service. We are making a number of operating adjustments that enable the cost effective and productive handling of the increased volume of large, non-conveyable packages. We are also investing in technology that supports operating one consolidated Ground network which, prior to our announcement last September, we had two. We are also transitioning our U.S. pickup and delivery service providers national to a single operating agreement that enables increased service capacity and improves operational flexibility for these independent businesses.

Now these investments, which vary in timetables but should be essentially complete by the end of -- I'm sorry, prior to FY21, will have a short-term impact on margin but will ultimately drive cost out of the network, enabling Ground margins to return to historic levels. We continue to believe that we are uniquely positioned to succeed in this new eCommerce world.

Operator: Thank you. Our next question will come from David Ross with Stifel.

David Ross
Analyst, Stifel Nicolaus

Yes, good afternoon. I just wanted to turn to FedEx Freight for a second. The shipment growth accelerated nicely, up 7% in the challenging period for the LTL industry, but margins weakened. Just wanted to get a little bit more color, Mike, in terms of what's behind that, in terms of how much was related to fuel, was it an intentional move to not push the price lever as much to get the volume in, or what else was going on there?

T. Michael Glenn
Executive Vice President - Market Development & Corporate Communications, FedEx Corp.

Thanks for the question. This is Mike Glenn. The success that we had in growth was primarily driven by our sales activities in the small and mid-size customer segment. Our sales team is executing crisply and bringing the kind of growth that we're looking for. The primary driver, absent fuel and the lower yield per shipment or revenue per shipment, was lower weight per shipment. I'll turn it over to Mike Ducker to comment further.

Michael L. Ducker
President & CEO FedEx Freight

Yes, David. Mike Ducker and I'll just reiterate the excellent job done. Most of that growth came in the small and medium sector. In the first half of 2016, we had anticipated volume growth that really didn't materialize, so we found ourselves overstaffed in certain geographies. Through a combination of that sales success Mike just talked about and reduced staffing through attrition, we've now better aligned our staffing to volume levels.

We're in balance and we've got significantly improved network efficiencies going forward. A lot of that was input cost on salaries and wages and benefits versus the volume that we had at first part of the year. Now we're operating in balance. Service levels are the best in many years. We're focused on yield improvement, productivity improvement and better capacity management in the future.

Nate Brochmann
Analyst, William Blair & Company

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

Fred Smith here. I mentioned that we covered most of the internet questions in the prepared remarks. There were a couple that didn't fit, one of them from Nate Brochmann of William Blair; we all likely agree that same-day delivery is a relatively small market today and likely will be even in the future. What is FedEx doing to prepare or partner with local delivery/final mile firms if the market turns out to be larger than expected? Mike?

T. Michael Glenn
Executive Vice President - Market Development & Corporate Communications, FedEx Corp.

Nate, FedEx currently offers same-day delivery in 23 markets and we've seen volume growth in key segments such as retail, eCommerce, healthcare, and others. FedEx SameDay City plays an important role in our eCommerce suite of services and customers are responding well to the uniformed professionalism of our business model. Having said that, it still represents a niche offering and a very small percentage of our overall portfolio but we are able to scale when demand dictates.

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

Nate also asks a question about FedEx Ground and the productivity of our independent service providers. I think Henry answered that just a moment ago, so we'll move on to one by David Ross of Stifel: China has been grabbing a lot of headlines in recent months. Please discuss the importance of China's economy to the FedEx Global Express network. Dave Bronczek?

David Ross
Analyst, Stifel Nicolaus

David J. Bronczek
President & CEO, FedEx Express

Thanks, Fred, and thanks for the question, David. Obviously, China is very important to us but they're not more important than all of the rest of the world and they are a part of the rest of the world for us. There's a lot of multi-national companies that are in China that we do business with in China and exporting out of China so I would say that we're always watching how the economy is in China but it's not causing us any problem or any concern right now because our customers there are, for the most part, multi-national customers.

Ravi Shanker
Analyst, Morgan Stanley

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

There was also a question from Ravi Shanker of Morgan Stanley about Amazon's building out some of its own capacity. I think that was answered in its entirety by Mike's remarks. Tell me, queue yourself up, Ravi, if that's not the case. Now we'll take another question from someone on the line.

Operator: Okay, and our next question comes from Ken Hoexter with Merrill Lynch.

Ken Hoexter
Analyst, BofA Merrill Lynch

Sorry about that. Thanks, Fred and team, for a great, great job on the quarter but maybe you could talk a little bit, Alan, on TNT. I know you want to wait until it closes but can you talk about the process here? Does the appeal slow the potential on closing? Is there a timing we should expect on the China decision? And then maybe you can talk about, in terms of synergies, when we can kind of expect to see the level and amount as you talk about what's going to go into 2018 and the benefits you get from that.

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

This is Fred Smith. Let me ask our General Counsel, Christine Richards, to comment on the first. Regarding the second, since it has not been approved, I think unfortunately we need to wait on making any comments about that until the transaction has closed, but we'll make sure we do that, assuming that it does close in the first call after that. Chris, if you'll speak to the legal issues?

Christine P. Richards
EVP, General Counsel & Secretary, FedEx Corp.

Ken, this is Chris Richards. Thank you for the question. I'm very pleased to report that we have obtained a tremendous number of competitive approvals from the last call and at this point in time we have unconditional approval in Australia, Brazil, Chile, Columbia, the European Union, Israel, Japan, Namibia, New Zealand, Russia, Singapore, South Africa, Taiwan, Turkey, the Ukraine, the United States and Vietnam. We are completing the process and have review pending in Argentina, China and Korea. We also have an appeal of the unconditional approval in Brazil, which was an expected appeal. It is a part of their normal process and we are very confident that we will close the acquisition of TNT in the first half of calendar year 2016 with all necessary regulatory approvals.

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

We'll take live questions again.

Operator: Thank you. We'll move next to Rob Salmon with Deutsche Bank.

Rob Salmon
Analyst, Deutsche Bank

Hey, good afternoon, guys. With regard to the omni-channel retailing, I'm curious which network that's running through when you're getting the from store-to-home. I would imagine anything that's going intra-store is running across the B2B network, probably predominantly in Express but was hoping to get a little bit of perspective related to which respective network it runs through and the impact to return on invested capital and revenue per unit would be really helpful.

T. Michael Glenn
Executive Vice President - Market Development & Corporate Communications, FedEx Corp.

This is Mike Glenn. Regarding our metro service capabilities, we have a variety of services. We have Express service for the premium packages that require a specific delivery time. We have Ground services that can serve metro areas. We also have SmartPost services that can serve metro. So we have a variety of services to meet that need. I should also mention SameDay City, which is operated by our FedEx Office team, also has the capability to serve metro store-to-home delivery. We have a wide variety of service capabilities and we are well suited to participate in that market segment.

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

This is Fred Smith speaking. Let me again remind the people that follow FedEx that our services are a portfolio which are broadly used by customers. I think I'm correct; well into 90% of our customers, Mike, use Express and Ground. Over 70% use Express, Ground and Freight and I think based on the e-mails and the comments that I get on the internet, every man, woman and child in America uses FedEx Office.

Again, our job is to try to improve earnings, returns, cash flows, and we have told you that we are confident that we can do that. I think a little bit on this call, not so much as in the past, if you attempt to try to dissect FedEx into a sum of the parts analysis, you're going to get surprised. I mean, we buy airplanes because they increase earnings, cash flows, and returns over a period of time. We add automated Ground facilities because they do the same thing.

There's no motivation inside FedEx to do anything other than to achieve those results at the corporate level and sometimes we decide to be aggressive in one segment because we're achieving our corporate goals. You've seen that with the Ground numbers when we were responding to the post-2008 crash in Express and fuel prices running up to $147 a barrel. We launched the profit improvement program and a lot of the corporate results were funded by the outstanding performance of Ground. Now we're doing a lot of things over on Henry's side of the house and as Express margins and returns are expanding, we are able to do that, still buying a lot of stock and pay for a significant acquisition. It's important to keep that in mind when you're asking these questions.

Operator: Thank you. Our next question comes from Ravi Shanker with Morgan Stanley.

Ravi Shanker
Analyst, Morgan Stanley

Thanks. Good evening, everyone. Fred, thanks for addressing my e-mail question, Amazon. Just one follow-up on omni-channel. Can you give us an update on your Monday residential service trial? How many cities so far? Have you expanded it to any new cities and what have you learned from trial so far?

Henry J. Maier
President & CEO, FedEx Ground

Yes, thanks, Ravi. It's I guess safe to say that the six-day pilot we ran in Tennessee this year was an unmitigated success. We have plans to expand it later this summer and we're looking very hard at whether or not we just run this network six days a week year-round. We get much more turns out of the assets. I think Dave mentioned making the assets sweat. Well, we certainly do that.

I think the other thing that's important people on the call to understand is that while we talk a lot about peak, eCommerce buying behavior is really shifting to a peak-like look year-round. We're extremely heavy on Monday because of the eCommerce orders that flow in and are fulfilled over the weekend. I think long term, I think a six day a week operation is probably the best operation to run because these eCommerce stores never shut down. I think we're well positioned there.

Operator: Thank you. Our next question will come from Scott Group with Wolfe Research.

Scott H. Group
Analyst, Wolfe Research

Thanks. Afternoon, guys. Alan, wanted to follow up a little bit on the guidance. If I plug 12% Express margins for the fourth quarter into the model, it feels like there's some upside potential to that $10.70 to $10.90 range. Any offsets that we should be thinking about to keep us within that range? I know you made some preliminary comments on FY17, but can you give any kind of more color on what you kind of consider solid earnings growth if you think we could be in that 10% to 15% long-term guidance that you have?

Alan B. Graf, Jr.
Executive Vice President & CFO, FedEx Corp.

Well the guidance is the best that I can do. I missed so many quarters that now we're back to a quarterly guidance here in the fourth quarter. You never know. Fuel prices are ticking up a little bit and so that could possibly work against us on a year-over-year basis, so we're watching that very carefully. There could be what happens at the end of the year and with aircraft maintenance, we think there might be a little bit of risk of that as well. We're watching all these very carefully but I'm pretty confident in that range and that's why we cut the bottom of it off. Mike told you about how we've lowered, substantially, our expectations for the economy in 2016 and so we're keeping our eye on that as well. Having said that, I'm not guaranteeing we're going to hit that -- inside that range because my track record has not been very good on a quarterly basis.

Jeff Kauffman
Analyst, Buckingham Research

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

Fred Smith here. We have one internet question from Jeffrey Kauffman, the Buckingham Research Group, on the TPP Trans-Pacific trade agreement: while the agreement reached seemed a reason to celebrate, it seems that popular politics seems to be voting down free trade in this election season. What does TPP mean to FedEx? Does Management view the risk of TPP not being approved increasing. Can you please provide an update?

Well, I don't think there's any question about the fact that TPP is going to be harder to pass given that the leading Republican and Democratic candidates for President of the United States are against it. Free-trade and opening markets has been American policy since 1934 when Roosevelt and Hull passed the Trade Agreement Act that overturned the absolutely disastrous Smoot-Hawley tariffs. Those were two Republicans that in 1929 -- or 1930 put in a lot of tariffs to protect America. Trade contracted by 66%.

The Roosevelt-Hull action in 1934 turned it around, but there's no questions those tariffs created -- was a big part of the cause of the Depression. So after the war, one of the first things that Hull, still there, and Roosevelt, before his death, worked on was the International Trade Organization, and along with the IMF and the World Bank. They couldn't get it passed so they instead came up with this framework called the General Agreement on Tariffs and Trades, called GATT, and seven times they expanded trade until the World Trade Organization was put in place back in the 1990s.

The thought that trade has not been a great thing for the world and America is absolutely belied by facts. Now, have been there mercantilists? Of course there have, Japan and China in particular. But to lump in all trade with the trade practices of a couple of trading partners is like putting leeches on you and bleeding you the way they used to do during the old days and think you're going to get better. It's a self-inflicted problem.

In the case of Mexico, the NAFTA agreement has added hundreds of billions of dollars to U.S. business which is traded with Mexico. Yes, we do have a modest trade deficit with Mexico but the benefits of trade are always disbursed. Lower iPhones, lower TVs, lower priced t-shirts, lower automobile costs, on and on down the line, which makes everyone's standard of living better, whereas the pain is always localized, like the unfortunate Carrier air conditioner shutdown in Indiana that's being so prominently talked about.

Now TPP, it should be noticed and everybody makes a big thing out of the fact it's a 54,000 page document or something like that. What it does in the main is to reduce 18,000 tariffs on U.S. goods. It helps us a lot and I hope as we get into the general election the profound benefits of free trade over many, many decades can be understood and the mercantilist practices of people who are not comporting to the WTO dealt with on an individual basis. We think that it's much more difficult to get TPP passed, but I can promise you we are going to work as hard as we can to make sure people understand these issues.

A. Mickey Foster
Vice President - Investor Relations, FedEx Corp.

We'll just take another question from a live -- from live on the call.

Operator: Thank you. We'll move to Brandon Oglenski with Barclays.

Brandon Oglenski
Analyst, Barclays Capital

Well, good evening, everyone and thanks for taking my question. Again, congrats on the growth. It's tough to come by here for most other companies. Fred or Mike, can you guys help us understand here, because this might be part of the confusion or part of the problem looking at Amazon. As we have more and more omni-channel distribution and as Amazon puts fulfillment centers closer to the consumer, has there been a length of haul reduction in the average eCommerce shipment or is it by far still a regional distribution model? If we do go to more local type distribution, how does that change where you see the capital priorities for FedEx? Or maybe it's not even shifting that way?

T. Michael Glenn
Executive Vice President - Market Development & Corporate Communications, FedEx Corp.

Well, I think Amazon's strategy is clear. The more distributions facilities they put up, the more they would like to be close to the end consumer which by definition makes more deliveries on a local basis. Having said that, all the conversation about new entrants into the local delivery market, I mean there are hundreds and thousands of local delivery companies in every market in the country delivering parcels. All you have to do is Google local delivery and you'll come -- I'm not sure where you live, but Google that and the city where you live and you'll find hundreds of companies that deliver parcels on a local basis every day.

That's not the market that FedEx competes in on a day-to-day basis. We run a broad global network. Having said that, as I mentioned before, no single customer represents over 3% of our total revenue, so we're not exposed to any one customer and we try to manage our business so that we don't get over exposed in that regard. We're well positioned for growth long-term and as I said, Amazon is a good customer. We expect them to be a good customer long-term.

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

Fred Smith here. Let me refer you to my friend David Abney's remarks after their last quarterly results. He was on CNBC, did a great job and he pointed out that the essential thing in the delivery business is route density and revenue per delivery stop. That is why he said virtually the same thing that we have said that in all likelihood, the primary deliverers of eCommerce shipments for the foreseeable future will be UPS, U.S. Postal Service and FedEx, because input costs, even though you might have a local operator of the thousands that Mike talked about are trumped by the delivery density and the revenue-per-stop characteristics of the big carriers.

Remember, we are not delivering from 50 fulfillment centers or 100 stores or 60 stores. We have the capability to pick up, transport and deliver an item from 95% of the human beings on the planet, much less every business in the world, within one to two business days, door-to-door, customs cleared. That's known as Metcalfe's law. Everybody understands us in the telecommunications business. It's the number of nodes on the network squared. If you run a hub-and-spoke system, it's N times N minus one.

So whether you're a big box retailer or you're an e-tailer that puts their fulfillment centers, which is a surrogate for the store and delivers the items individually or has you come into the store, the economics are the same. It's network density and revenue per delivery stop that are the determinant of who’s going to deliver these packages in the years to come. The Postal Service delivers to 140 -- 154 million addresses every day and so light-weight eCommerce packages are perfect for the Postal Service because they can put them in with the mail and deliver them to residences. That's why Parcel Select, as they call it, is partnered with FedEx SmartPost, UPS SurePost, Amazon, Direct Injection and another group of smaller competitors in the so-called consolidator space. It's that misunderstanding that the drivers are network density and revenue per delivery stop that have lead to a lot of the misunderstanding about the future evolution of the markets.

Okay another question from -- live question?

Operator: Yes, we'll move to Matt Troy with Nomura.

Matt Troy
Analyst, Nomura

Yes, thanks. I was wanting to look at the Express segment. The rate of growth in the overnight premium product almost doubled versus your year-to-date rate. Was just curious, is that more tied to the urgency around peak season? Are you seeing a shift back in behavior by consumers that's more sustainable to the premium products?

T. Michael Glenn
Executive Vice President - Market Development & Corporate Communications, FedEx Corp.

We had strong demand for overnight services in peak season. Obviously, that is certainly the case as you get closer to Christmas Day and that was a key driver for that.

Matt Troy
Analyst, Nomura

Okay, thank you.

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

Let me take a couple of internet questions here and then Mickey can tie it off with one or two questions from -- live questions. John Barns asks about DIM pricing. I think we pretty well covered that. You want to –

John Barnes
Analyst, RBC Capital Markets

T. Michael Glenn
Executive Vice President - Market Development & Corporate Communications, FedEx Corp.

Well, John, let me just say that FedEx implemented DIM pricing last January, therefore the third quarter last year only had two months of impact of the new dimensional weight pricing while this year had three months in the impact so there was one difference in terms of month. Dimensional weight pricing, obviously, is the standard in the industry and I will say that I think it's had a very positive effect on customers in terms of how they view their packages and the package size. There's still a long way to go on that, but certainly there -- we made a lot of progress in that regard. I think you also had a comment about are you concerned about driving customers to find alternative or non-traditional sources of parcel capacity? I'm not aware that there are any viable non-traditional sources of parcel capacity, especially in peak season so we certainly don't see that as an issue.

Allison Landry
Analyst, Credit Suisse

Art W. Hatfield
Analyst, Raymond James

Frederick W. Smith
Chairman, President & CEO, FedEx Corp.

Allison Landry asks some questions about Parcel Select. I think that I answered that in the longer-winded answer I gave about route densities and revenue per delivery stop. Art Hatfield of Raymond James: do you currently see any new regulatory headwinds on the horizon either here in the U.S. or overseas? Art, this, along with bad trade policy and bad tax policy, is why we are seeing low GDP growth rate and why global GDP has slowed down in global trade. I cannot tell you the onslaught of regulatory issues that we deal with every day here. It's in every possible crevice of the organization, from Department of Labor to the FAA to protectionist policies camouflaged as security regulations overseas.

If you don't try to stop these things, the natural course of events is they come on the bottom of the ship like barnacles. That's happening and that's why we have low growth rates. Bad policies on taxes and regulations in Europe, in the United States, in China, in Japan, and unless those things turn around you're going to continue to have low growth rates. Mickey, you want to finish it up?

A. Mickey Foster
Vice President - Investor Relations, FedEx Corp.

Ok just one or two more questions and then we'll finish.

Operator: We'll move to the next question from Kevin Sterling with BB&T Capital Markets.

Kevin Sterling
Analyst, BB&T Capital Markets

Thank you. Good afternoon, gentlemen. In LTL volumes, you saw nice volume growth. Are you seeing more growth on the economy side or the priority side? How much is improved rail service helping economy grow?

T. Michael Glenn
Executive Vice President - Market Development & Corporate Communications, FedEx Corp.

We had balanced growth between the two services, so there was no material difference there.

Kevin Sterling
Analyst, BB&T Capital Markets

Okay, thank you.

Operator: That does conclude our question-and-answer session. At this time, I'll turn it back over to Mickey Foster for any final or additional remarks.

A. Mickey Foster
Vice President - Investor Relations, FedEx Corp.

Thank you for your participation in FedEx Corporation's third-quarter earnings release conference call. Feel free to call anyone on the Investor Relations team if you have any additional questions about FedEx. Thank you.