FedEx Q4 FY18 Earnings Call Transcript – June 19, 2018

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

Good afternoon, and welcome to FedEx Corporation's fourth quarter earnings conference call. The fourth quarter earnings release, stat book, and earnings presentation slides are on our website at fedex.com. This call and the accompanying slides are being streamed from our website where the replay and slides will be available for about one year.

Questions are welcome through our e-mail address which is ir@fedex.com. When you send your questions, please include your full name and contact information. Preference will be given to inquiries of a long-term strategic nature.

I want to remind all listeners that 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 the press releases and filings with the SEC. Please refer to the Investor Relations portion of our website at fedex.com for a reconciliation of the non-GAAP financial measures discussed on this call to the most directly comparable GAAP measures.

Joining us on the call today are Fred Smith, Chairman; Dave Bronczek, President and Chief Operating Officer; Alan Graf, Executive VP and CFO; Mark Allen, Executive VP, General Counsel and Secretary; Rob Carter, Executive VP, FedEx Information Services, and CIO; Don Colleran, Executive VP, Chief Sales Officer, FedEx Corporation; Raj Subramaniam, Executive Vice President, Chief Marketing and Communications Officer, FedEx Corporation; David Cunningham, President and CEO of FedEx Express; Henry Maier, President and CEO of FedEx Ground; and Mike Ducker, President and CEO of FedEx Freight.

And now Fred Smith will share his views on the quarter.

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

Thank you, Mickey. Welcome to our call to discuss earnings for the fourth quarter and the full year and our outlook for FY19 and beyond. We're very proud of the financial and operational results FedEx delivered in FY18, and let me congratulate our more than 425,000 team members worldwide for a job very well done indeed.

FedEx Express posted solid revenue growth and is making good progress towards improving operating income by $1.2 billion to $1.5 billion in FY20 versus FY17. At FedEx Ground modernization and optimization are paying off in more efficient handling, the increasing growth of business-to-business and e-commerce shipments.

FedEx Freight margins are increasing due to an improved industrial business environment and a better balance of volume, pricing, and capacity. Our leading-edge technologies now allow our customers to conveniently pick up, drop off, or ship at approximately 60,000 locations nationwide in the United States.

FY18 was a year of opportunity and, quite frankly, challenges - anticipated and unexpected - and FedEx emerged more competitive than ever. We're committed to increasing our margins, earnings, cash flows, and returns while investing for long-term profitable success. We believe our shareowners, team members, and customers will reap the benefits of this approach by creating sustainable, differentiated advantages.

In all my years at FedEx, I have never been so optimistic and so sure of our strategy and our ability to deliver an exciting future. Having said that, we do remain concerned, however, about threats to diminish the free flow of goods among countries. Trade is a two-way street, and FedEx supports lowering trade barriers for our customers, not raising them.

Finally, let me extend the best wishes of the corporation, the board, and all of our teammates, and most importantly from me personally to FedEx Freight President and CEO, Mike Ducker, as he retires this summer. This will be Mike's last call.

Mike has been our partner for more than 43 years and he always answered the call when asked to lead in each new opportunity. Whether in Europe, Asia, or in the Americas, Mike has been truly the model of our People-Service-Profit philosophy, and I must tell you he is one of the most outstanding leaders and executives that I have ever seen in any field. So, Mike, you're retiring with our best wishes and we're going to miss you, but since you only live right down the road, we'll see you a lot. So, here's to you, Mike.

So with that, let me turn it over to Alan for his comments.

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

Thank you, Fred, and good afternoon, everyone. For the quarter, adjusted earnings were $5.91 per share, up 41% year-over-year, driven by tax benefits and improved operating results that are covered in the earnings release. Our adjusted consolidated operating margin was 11.5%. All three transportation segments achieved the fourth quarter operating margin targets that we provided last quarter.

Turning to the full year, we finished the year with an adjusted EPS of $15.31. That's up 27% year-over-year. We invested more in our people to share some of the benefits of the U.S. Tax Cuts and Jobs Act by advancing our annual pay increases for certain U.S. hourly workers to April 1 from the normal October date for 2018.

Our capital expenditures were $5.7 billion, or 8.7% of revenues. We repurchased 4.3 million shares for approximately $1 billion in FY18. In FY18, we contributed $2.5 billion to our tax-qualified U.S. domestic pension plans.

Regarding pensions, I would like to take a few minutes to explain the effect the new pension accounting rules will have on our financial results for FY19. Going forward, only the pension service cost will be included in operating expenses. All the other elements that make up total pension expense will now be classified as other non-operating expenses including the year-end mark-to-market adjustment.

For example, in FY18, our total pension expense excluding mark-to-market and other pension adjustments was $224 million while our service cost was $812 million. So while there is no impact to net income from these new rules, they will negatively impact our operating margin by about 90 basis points. Of course, prior years will be recast to conform to these new rules, so there will be no year-over-year impact once we have an apples-to-apples comparison starting in the first quarter of FY19.

Since our primary pension plans are fully funded under ERISA, contributions will not be required for the foreseeable future. As a result, most of the service cost expense is really a non-cash item. That has a material effect when modeling our cash flows. While no cash contributions are required in our primary U.S. pension plans, we will make voluntary contributions during FY19 but they will be at a much lower level than the $2.5 billion we contributed in FY18.

I would also like to comment on the pension de-risking transaction we executed in Q4 to remove approximately 20% of our pension liabilities from the balance sheet through an annuity purchase with MetLife. This $6 billion transaction was the largest single transaction in our history and it represents a win for both our shareholders and our retirees. This event follows a long line of de-risking activities including plan design changes and special lump sum settlements all designed to reduce the volatility of our pension liabilities and further strengthen our balance sheet.

For FY19, FedEx is targeting revenue growth of approximately 9%. We are also targeting the following before year-end mark-to-market retirement plan accounting adjustments and excluding TNT Express integration expenses: an operating margin of approximately 8.5%, remember that's being reduced by the service cost; an earnings of $17 to $17.60 per diluted share; additionally, we are anticipating an effective tax rate of approximately 25% prior to year-end mark-to-market retirement plan accounting adjustments, which is higher than our FY18 effective tax rate due to tax benefits from transactions and TCJA impacts that will not reoccur during FY19. We expect our FY19 cash tax rate to be lower than the U.S. statutory rate of 21% due to the favorable capital expensing provision created by the TCJA.

Cash flows will improve as earnings grow. For FY19, depreciation and amortization is expected to be approximately $3 billion, so FedEx will generate very strong cash flows. Capital spending is expected to decline slightly to $5.6 billion, or about 8% of projected revenues.

Our TNT integration expenses are projected to be $450 million, and we expect voluntary contributions to our primary pension plans in FY19 to be significantly lower than FY18. Last week we announced that we are boosting our FY19 dividend by 30% to $0.65 per share per quarter.

We are confident that we will achieve the operating income improvement at Express of $1.2 billion to $1.5 billion in FY20 versus FY17 assuming moderate economic growth and current accounting and tax rules.

And now Raj will provide more color for our forecast and our strengthening position in the marketplace.

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Thank you, Alan. I'll open with our economic update and outlook and then discuss our revenue performance and business conditions in each segment and provide some commentary on broader industry trends and our growth priorities.

The economic outlook remains very favorable. The U.S. industrial sector has shifted into higher gear, and capital spending is expanding. Consumers are benefiting from a strong labor market and tax cuts are supporting incomes. Overall sentiment remains near multi-year highs.

Globally, the structured three-speed world is becoming visible again after a couple of years of synchronous global growth. While the U.S. accelerates, the Eurozone and Japan are slowing, and the emerging world continues to post the fastest rates of growth. On balance, we expect another year of strong global growth as economic momentum runs at a healthy pace. Sound fundamentals remain in place to underpin sustained growth in global manufacturing and business investment.

The next few slides show details of revenue, volume, and yield performance by transportation segment. It is clear our pricing strategies that allow us to grow volumes and increase yields across the portfolio show continued success.

For our U.S. Domestic Express business, revenue and yield increased 4% and 3%, respectively. Excluding the impact of fuel, yield per package increased 1%. FedEx Express international export package revenue increased double digits by 10% in Q4 primarily due to a yield increase of 10%. Excluding fuel and exchange rate impact, yields increased 3%.

Ground segment revenue also saw double-digit growth at 12% in Q4 with volume and yield each up 6% continuing the strong volume growth from Home Delivery and balanced volume and yield growth in commercial. Excluding fuel, yield per package increased 5%. At FedEx Freight, revenue per shipment increased 8% mainly driven by our revenue quality efforts. Excluding fuel, revenue per shipment was up 6%. Revenue per shipment growth is driven by stronger weight per shipment and ongoing emphasis on revenue quality improvements.

Let me now discuss some exciting new enhancements to the FedEx portfolio that will help drive our growth in FY19. First, we believe that the realignment of FedEx Trade Networks that we recently announced is a very positive step for FedEx. It allows us to leverage the vast array of capabilities including air and ocean forwarding, supply chain and fulfillment services, cross-border capabilities, 3D printing, and customized transportation solutions across the full global portfolio of FedEx.

In effect, FTN becomes the force multiplier for our business as our customers benefit from the differentiated solutions for their supply chain needs. E-commerce continues to grow rapidly around the world and we continue to enhance our global portfolio to offer market-leading capabilities on a global scale. During the last quarter, we acquired P2P Mailing Limited, which provides unique last-mile delivery options to more than 200 countries and territories. P2P further expands the capabilities of FedEx within the Cross Border e-commerce market segment.

We've also experience significant growth in the usage of FedEx Delivery Manager platform especially in the last year. Total new Delivery Manager enrollments were up 50% year-over-year during FY18. We have been expanding FedEx Delivery Manager internationally and are now in 42 countries representing 75% of the world GDP. Additional new countries in the Middle East, Asia, and Latin America will be added in FY19.

E-commerce also brings significantly more returns, and we have expanded our returns technology to enable e-tailers and consumers with unique visibility, flexibility and efficiency for our returns management through our FedEx Office locations.

We continue to enhance customer's access to our services with additional FedEx Office locations including the first 50 new FedEx Office locations inside Walmart stores opening in time for the upcoming peak season.

We anticipate adding a total of 500 FedEx Office locations inside Walmart stores over the next two years. The FedEx OnSite program continues to expand with Walgreens and other retail partners, and we already have almost 11,000 package pickup locations in the U.S. This program is all about convenience and brings FedEx ever closer to consumers.

We, of course, are deep into our preparations for the upcoming peak season and we will announce more specific plans and expectations for the peak season in the upcoming months. We are proud of the close collaboration with our customers and the detailed forecasting processes that we use. The final results in peak 2018 were a 99% match to our forecast, which allowed us to very effectively prepare and position people and operational resources and ultimately deliver outstanding service even on the busiest days of the holiday season.

Let me now turn the call over to Dave Bronczek for his remarks. Dave?

David J. Bronczek
President & COO, FedEx Corp.

Okay. Thank you, Raj, and good afternoon to everyone. We are proud to report record Q4 adjusted operating income of $2 billion for FedEx Corporation, which is up $255 million year-over-year or 15%. As Alan just said, we told you last quarter we expected operating margins at all three transportation operating companies to improve for the fourth quarter, and they all did. At FedEx Express, fourth quarter adjusted operating profit hit a record $1.1 billion, up $129 million year-over-year, or 13%, and their adjusted operating margin was double-digits at 11.5%.

FedEx Express segment revenue growth was driven primarily by our international business, and we had excellent growth in both international and U.S. freight services, which helped drive better profitability.

As you saw in the release, we are continuing to improve the efficiency and the reliability of the air network with additional orders for new aircraft that will replace older, less efficient aircraft. The deliveries of the additional 767s will begin in FY20 and the deliveries of the additional 777s will begin in FY21. The reliability of our air fleet has improved significantly and will continue to improve in this next phase of the fleet modernization program.

Now with respect to the TNT integration, I am happy to say that at the two-year mark, the integration is accelerating and that significant expansion in our network dramatically improves our global capabilities and our competitive posture.

On June 1, we continued the integration of our world-class global sales teams. Our sales teams will be fully integrated in FY19, this year, of course, one year ahead of our original schedule. The technology and operational capabilities to provide us with the ability to flow packages between the legacy TNT and FedEx systems is progressing as planned to allow us to flow volume to the lowest cost or the highest service FedEx Express network in FY19. That's this year.

In June, we launched Economy Express one-day transit service in 175 lanes in Europe. These lanes were previously operated on a two-day transit time commitment. This is a significant step in demonstrating the power of the TNT European road network and a tangible example of the benefits of our integration for our customers. Customers will benefit from more speed, more value, more coverage, and, of course, more choice with all of these changes. The successful integration of TNT and FedEx Express remains a key driver of the FedEx Express FY20 operating income improvement target of $1.2 billion to $1.5 billion over FY17's results.

Now, FedEx Ground also achieved record fourth quarter operating profit of $832 million, up $125 million year-over-year, or 18%, with double-digit percentage growth in revenue and an operating margin of 17.3%. We are improving revenue quality through a balanced approach to volume and yield growth. We reduced our long-term capital plans for FedEx Ground to much better match capacity expansion with pricing and volume growth. We're optimizing and modernizing in many areas to drive greater profitability.

FedEx Freight's fourth quarter operating profit was also a record profit of $175 million, up $45 million and an amazing 35%. Freight's operating margin was 9.4% exceeding all the guidance that we gave you in the last quarter. FedEx Freight continues to show improvement in revenue and profitability as our pricing strategies drive revenue growth while investments in the network dramatically improves safety and lowers our costs.

We are very pleased with the Freight's performance in FY18, look forward to continued success in FY19. So in FY18, we made progress towards our goals of increasing earnings, margins, cash flows, and returns while dramatically enhancing customer service, and we expect to do the same thing in FY19.

And with that, I'll turn it back over to Mickey Foster.

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

So now we'll answer the questions that were submitted.

QUESTION AND ANSWER SECTION

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

I'll be the QB here giving the ball off to various people to answer these questions. The first one is from Helane Becker and Ken Hoexter of Cowen and BofA Merrill Lynch, respectively. Could a trade war interrupt global growth or is world trade too entrenched to allow for any disruption? So I'm going to ask Dave Bronczek to take this on. If we get a lot of other questions about this, perhaps we'll talk a bit more of it at the end since it was such a topic of conversation on the business shows all day long. Dave?

David J. Bronczek
President & COO, FedEx Corp.

Okay. Thanks, Fred, and thanks, Ken and Helane. It's a great question. We believe global supply chains, especially those of high-value items are well-established and will be very difficult to disrupt. We are hopeful that amenable solutions, of course, to trade policy issues will be found. However, our global assets are at such a large scale now, it is relatively easy for us to reposition our networks really all around the world should any trade patterns evolve. So hopefully I helped answer your question.

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

So question number two, this is from the Associated Press. Are U.S. customers seeking expedited imports of items from China that will fall under new tariffs on July 6? Raj?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

So we have not seen any changes in the U.S. customer behavior directly related to these new tariffs. Now this is not really surprising especially since the commodities in question make up only a very, very small portion of our U.S.-China revenues.

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

Ken Hoexter again. Are tech sales a leading indicator you still watch for Asia-U.S. exports? So the same line of questioning here, Raj.

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Yes, Ken. The answer to that question is yes, technology sales is clearly one of the key indicators that we monitor that is very highly correlated to Asia-U.S. exports. Now you have to back out some of the noise that cell phone product cycle an underlying trend. And in recent months, industry investment in technology, capital goods have really helped underpin the ongoing growth in Asian exports.

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

So here's a question from David Vernon of Bernstein and Kevin Sterling of Seaport Global. How is the tightening truck transportation market impacting demand and cost at each FedEx segment? Dave Bronczek?

David J. Bronczek
President & COO, FedEx Corp.

Okay. Great question, David. Demand continues to be very strong by the strength of industrial production, as Raj mentioned earlier, in consumer demand. However, to give you a little bit of color and background for this, I'm going to have the three opco presidents starting maybe with Henry and then Mike at FedEx Freight and then David who has probably the least effect to give their points of view and their comments on it. So, Henry?

Henry J. Maier
President & CEO, FedEx Ground

Thanks for the question, David and Kevin. At FedEx Ground, 100% of our transportation is purchased as it has been for 33 years as the company has contracts with all entities providing transportation services, most importantly our contract service providers, but you might also be surprised to know we also have contracts with rail truck load and, of course, the United States Postal Service. These relationships support the company to access virtually unlimited options in the market and drive our industry-leading flexibility to scale our transportation needs as customer demands warrant.

Michael L. Ducker
President & Chief Executive Officer, FedEx Freight, FedEx Corp.

Yeah, I'll just add that we're seeing very strong demand for our services in the Freight sector. We remain focused on disciplined growth and margin expansion while providing the best service in the industry. As a proof point, our fourth quarter results were perfectly balanced with 8% growth on average daily shipments and an 8% revenue per shipment growth. And again, while the robust industrial production number is most closely correlated with the LTL market, we really expect a particularly strong IP growth during the first half of FY19. So that translates into a good growth and shipments.

David L. Cunningham, Jr.
President & Chief Executive Officer-FedEx Express, FedEx Corp.

Good day. This is Dave Cunningham representing FedEx Express. We have not experienced any issues with securing third-party trucking load.

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

Does FedEx believe that the growth of e-commerce has changed the seasonality of the global air freight market? If so, how are you adjusting? This is David Campbell of Thompson Davis. Raj?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

David, yes indeed, global e-commerce is increasing, but you have to remember that the vast majority of the pounds that we carry are business-to-business shipments, and as such, seasonality still continues to follow traditional patterns. I think more importantly perhaps is the fact that Dave Bronczek mentioned earlier that the scale of our network is combined with the capacity that we have deployed on commercial carriers that's so huge now that it makes it relatively easy for us to flex capacity as required by market demand.

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

How much of the $400 million impact from the cyberattack should we assume comes back in FY19? Have you fully recovered all TNT share losses? I'll ask David Cunningham and perhaps Don Colleran to deal with that issue. David?

David L. Cunningham, Jr.
President & Chief Executive Officer-FedEx Express, FedEx Corp.

Thanks, Fred, and thanks, Scott. You can see in the results that we experienced year-over-year double-digit revenue growth in our international package and freight services this past quarter. While higher rates were certainly a major contributor, we're also seeing solid year-over-year growth in freight traffic, a piece of our product portfolio that expanded significantly through the addition of TNT. Again, the recovery of the business over the past several months has been remarkable and we certainly owe major thanks to our sales, customer service, and IT professionals who've done an outstanding job of recovering from this attack.

Donald F. Colleran
Chief Sales Officer & Executive Vice President, FedEx Corp.

Thank you, David. Just like to add a comment to that as well. We greatly appreciate the loyalty that our customers have shown us as we went through this difficult period. And as you noted, I'm also glad to mention that we resumed year-over-year growth in the impacted segments of that business.

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

So here are three questions for FedEx Ground we'll give to Henry. Question one, how much can you grow FedEx Ground volumes without adding more facilities? Helane Becker of Cowen. Second, what level of FedEx Ground margins are possible over the long term? Jairam Nathan of Daiwa and David Ross of Stifel. And how much is left to do for full ISP model conversion? From David Ross of Stifel. Henry, can you member all of those?

Henry J. Maier
President & CEO, FedEx Ground

Yeah, I think I can, Fred.

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

Okay.

Henry J. Maier
President & CEO, FedEx Ground

Thanks. First of all, thanks for the questions. In terms of adding volume, I would say our investments in automation and technology have led us to have the most automated package sortation network in North America, if not the world. And that's enabled us to be able to flex our capacity as needed based on market dynamics, and probably the best example of that is how we handle record volumes each year at peak.

Concerning margins, we expect to continue to deliver strong volume and revenue growth driven by the trends that everybody here today so far has talked about by e-commerce. We're intently focused on modernizing and optimizing the Ground network to drive profitability, and we continue to look for ways to maximize asset utilization by leveraging existing capacity and automation.

In terms of the ISP model conversion, we expect to be done sometime in the late calendar 2019. We recently announced that we were accelerating that process. Thanks for the questions.

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

Will the IMO 2020 changes in marine fuel standards impact demand and pricing in the air freight markets? David Vernon of Bernstein. Raj?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

David, it's a bit too early to tell at this point. It's great to see that thanks to IMO 2020 that the marine fuel sulfur will be reduced, which should be positive for the global environment. While the implementation will probably raise fuel prices, then we'll have to see what kind of material impact this has in the air freight demand. It's too early to tell. But please note that thanks to our growing FedEx Trade Networks' ocean business, we are very close to any pricing developments and in a perfect position to optimize transportation solutions for our customers. Thank you, David.

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

So a couple of questions on Freight. Why are FedEx Freight annual margins not double digits in such a strong LTL environment? And are any investments restraining current margins? David Ross of Stifel. And are you interested in getting into heavy goods last-mile? Will that be through your LTL or package division? Scott Group of Wolfe Research, and David Vernon of Bernstein has a similar question. So let me ask Mike Ducker to answer both of those questions.

Michael L. Ducker
President & Chief Executive Officer, FedEx Freight, FedEx Corp.

All right. Thanks, David. First of all, we're pleased with the profit and margin performance during FY 2018, and I would like to give a shout out to our teammates for their great performance. Our operating income improved by 33% and the margin by 120 basis points. If you take that on a quarterly basis, for Q4 it was 35% and 130 basis points.

Now while we're pleased with that, we're still not satisfied with those results. Our goal remains sustainable double-digit margins, but we're not going to compromise our continued investments, which we believe are critical for our future growth and preparedness. So we continue to invest in technology that will prepare us better for the rapid modernization of supply chains and to ensure we maintain a market-leading position.

The second part of the question for David Vernon at Bernstein, we already deliver significant volume of goods through both FedEx Ground and FedEx Freight, the last-mile goods. So as demand grows for those shipments, we believe FedEx is uniquely positioned on reach and flexibility of our networks to provide outstanding service even for those larger and heavier deliveries. Specifically for LTL, e-commerce is and will create opportunities for us. And while we see opportunity in that large growing market, we do have plans to leverage those trends to support margin expansion.

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

So a question for Raj, can you detail the issues at FedEx Supply Chain and the turnaround plans? Jairam Nathan at Daiwa and Kevin Sterling at Seaport Global. Raj?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

All right, Jairam and Kevin, yeah, we have covered this issue in our May 29 8-K disclosure and we are accelerating our efforts to streamline and standardize our operating model and upgrading our technology. These actions will not only increase our flexibility and service for our customers, at the same time it also improves profitability through lower operating expenses. As I mentioned in the opening, we are very excited about the realignment of FedEx Trade Networks, which will act as a force multiplier for our entire business.

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

Let me just add to that. I mean, we don't have any systemic problems at FedEx Supply Chain. We have an excellent group working on there. Basic issue about the goodwill impairment was simply that we had two cell phone repair contracts, one that went to a different business model, a warranty type model where they didn't repair them anymore, they just gave new phones. And the second, the customer decided to split the business for strategic reasons. So we've got a lot of stuff in the pipeline and Supply Chain will do fine.

On a related area, there's a question about why we moved FedEx Trade Networks out from under FedEx Express. Raj basically mentioned this, but I thought I would just add some color on this. Basically FedEx Trade Networks is now doing things for all of the opcos. FedEx Trade Networks is the largest customs broker in the United States. They clear things for FedEx Ground going across the NAFTA borders. We're moving more sea freight and that sea freight is going into the FedEx Freight network by putting the other specialty operating companies together. As Raj said, we believe that it'll be a force multiplier across our opcos, and we felt it was a better fit there.

Now I have to tell you we have a sort of a model for that what we did with FedEx Office, I mean, it has been a fantastic contributor to our operating companies doing all kinds of value-added services, and I'm sure that will be the case with the new FedEx Trade Network with Custom Critical and Supply Chain and Forward Depots and Cross Border as integral parts of it.

So now we turn to a number of financial questions related to capex. We have one from Ravi Shanker. Given the new planes and the ongoing hub expenses, is it fair to assume that capex will increase in FY20 and beyond from FY19 levels? And I'll ask Alan if he will take that.

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

Thank you, Fred. We're going to continue to grow our revenues and continue to grow our cash flows. And as we see opportunities to invest whether it's expense, capital, or acquisitions that is going to increase the long-term value of our company, we're going to do that.

Obviously, we benefited greatly from the TCJA tax rate and 100% expensing for the next five years. That obviously makes capex investing less risky. Although in the case of the aircraft, that was certainly not the driver when you're presented with opportunities to make asset acquisitions at a really good price and those that are driving tremendous productivity improvements and operating expense reductions. We need to make those moves.

So our capex is going to spike up in FY20 and FY21 mostly as a result of Express. We are significantly reducing our outlook for capex at Ground. We won't build a hub for a long time. Ground has many innovative and in some ways revolutionary cost reduction programs under way right now, all of which involves sweating assets, improving productivity, and lowering costs. And the same thing at Freight. So it will be easily managed. I won't say that we'll be able to stay at the 8% level but it will be very easily managed and covered with our cash flows, and we'll still have excess cash flow.

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

So in the same vein, David Vernon wants to know, as EBITDA and cash flows go up faster than the rate of capex, which is what we've been telling is going to happen here for a significant period of time -- and what's our free cash flow projection for this coming year, Alan? Do we put that out there?

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

No, we're not going to put that out there because we have a different definition of free cash flow.

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

Okay.

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

But our EBITDA will be very strong particularly if you consider the service cost with pension. But this is one of my favorite subjects at FedEx. The whole concept that you're driving at is capital allocation. I think we've done a tremendous job with that in the past. We're balancing it, I think, very effectively with returns to shareholders.

I'll just remind you that since FY14 we bought back 70.5 million shares for $10 billion at an average price of $147. And based on where it's trading today, I'd say that's a pretty dang good move. We just increased our dividend 30% more. We hope to continue stock buyback and continue dividends. We've managed our pension very effectively. It's now over fully funded from an ERISA standpoint. So we'll continue to do what we've been doing, and we'll be balancing our opportunities and our total shareholder returns. And I suspect we will be improving our credit ratios as we go along.

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

So that basically answers David Vernon's question about what should investors expect FedEx to do with the resulting ramp in free cash flow. What percentage of your overall domestic package revenue is now B2C, are B2C margins improving? Scott Group, Wolfe Research. Raj?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Well, we don't provide specific breakdown of B2C revenue or margins, but you have to remember that the B2C e-commerce is still relatively a small percentage of our total global revenues. Now having said that, you all know it's a relative fast-growing segment, and we are very excited about the capabilities that we have put in place to grow this business profitably.

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

So there's a question from Ken Hoexter of BofA Merrill. Can you review the total cost of integration since acquisition? And what's left after 2019? Do the benefits outweigh the cost yet? And then Matthew Reustle of Goldman Sachs asked a similar question. After the $450 million in TNT integration expenses in 2019, will you still have $150 million of integration expenses in 2020? Alan?

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

So we're now a little bit past two years of day one with TNT, and we've earned a tremendous amount. Recall we also suffered a very nasty cyberattack a year ago almost coming up on a year anniversary. And so our integration expenses are going to be a little bit higher than we had originally thought, but that's not bad at all because we'll be tightening our defenses from a cyber-standpoint, and we're going to invest more than that than we had anticipated. But the results will be a much more productive and much more flexible IT network.

Additionally, we have found additional productivity enhancers as we go through the integration that are going to really increase our returns substantially. I have to say FY19, when we're going to step up to about $450 million worth of integration, is a very big year. We have great plans in place. We're off to a good start. And this is a key year for us in terms of integration after 2019. We'll have somewhere around $250 million to $300 million left in FY20, but that'll be around the edges. I think the meat on the chicken is going to be the current fiscal year that we're in.

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

Chris Wetherbee of Citi asked, do you expect new aircraft orders to add to total company capacity or will total airless stay flat as old planes are retired? Dave Bronczek, David Cunningham?

David J. Bronczek
President & COO, FedEx Corp.

Yeah. Let me start off by saying the great thing about these airplanes is we can just completely replace old planes like the MD11s, take them out of international and bring them back to the United States and move the MD10s out. We can totally do that and we've done mostly that. We've added very few incremental planes along the years here. On the other hand, if we continue to see strong growth like we're seeing now, we could use them to add capacity. So we can hold and just replace or we can grow and add the capacity that we currently have. So, with that David Cunningham?

David L. Cunningham, Jr.
President & Chief Executive Officer-FedEx Express, FedEx Corp.

I think Dave covered it well. The only thing I would add is that we continue to modernize our global network resulting in improved reliability, reduced emissions, and greater operational flexibility.

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

So Matthew Reustle of Goldman Sachs asked, can you still achieve 10% corporate operating margins long term with the pension accounting changes? The answer to that question is yes, and our goal is to have operating margins at the corporate level and at the opco level and the teams.

Here's one from outside of last-mile delivery, which I'd take it as the term that's being applied to the heavy and hard to handle. Raj, is that right?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

No, I think it's technology that...

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

Oh, technology. Okay. Are you seeing any increase in competition? Can technology disrupt your mode? Or are hard assets the barrier to entry? Matthew Reustle Goldman Sachs. Raj?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Matthew, well, FedEx is still arguably the most extensive global delivery network probably in the history of transportation. And when you combine that with our technology and human assets, it's hard to conceive of a scenario where technology alone could be a disruptor.

I mean, there's definitely a trend in popular press to get carried away by the conversations around technology being the answer to every question. But the real, real answer is how we combine technology with physical and human assets that provide the value proposition that our customers are seeking. If you haven't already done so, I would highly encourage you to watch our short video on the subject at fedex.com/dream.

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

So, Raj, while we've got you on the skewer here, Scott Group wants to know and Kevin Sterling, when do you think the Post Office will meaningfully raise rates? Is this a risk for you?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Well, Kevin, I don't think we can speculate on what USPS might or might not do. However, we do believe that the cost of last-mile delivery will continue to increase in the years to come, which will be an opportunity for FedEx.

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

So a question from Bascome Majors of Susquehanna and Helane Becker of Cowen. Are customers coming to you to discuss UPS strike contingency plans? How much of UPS volume could you accommodate if there is a strike? Dave Bronczek?

David J. Bronczek
President & COO, FedEx Corp.

Yes. Obviously, it's a timely question. However, we never actually comment about our competitors' issues or their business considerations. I do want to say something that's very important for our customers though. We will continue to provide outstanding service for our customers. We have capacity. Only then and only then, if there's additional capacity, if there is a need, would we consider other alternatives for other customers. We will take care of our customers first like we always do the way we ramp up for Christmas peaks and so forth. We can handle it, and we're going to take care of our customers.

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

So we've got a question from Scott Schneeberger of Oppenheimer for David Cunningham. Could you please cover economic trends you're witnessing in Europe and how they are impacting your business?

David L. Cunningham, Jr.
President & Chief Executive Officer-FedEx Express, FedEx Corp.

Well, as we talked earlier, we've seen a good growth in productivity in our results in the fourth quarter, and we continue to expect to see the same.

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

Could you please discuss FedEx progress in gaining share with small and medium-size customers? Also from Scott, so, Raj, would you or Don Colleran take that on?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Well, Scott, thank you for that question. We do not break out the segment performance, but what I can tell you is that we're making tremendous progress in the small and medium segment, and FY18 was particularly a very good year, it's a banner year, in fact. We have a fantastic value proposition around the world and really strengthened by the acquisition of TNT and which allows our commercial team which I believe is second to none to win more business every single day. As you can hopefully tell, we are very pleased with the results so far and we expect to accelerate our progress in the segment in the years to come.

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

Raj, how about FedEx Fulfillment Service from Brian Ossenbeck, how about an update on that?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Well, Brian FedEx Fulfillment now has two major fulfillment centers, as you know, operational in the United States, and that business continues to grow as we sign new customers, especially small and medium-size e-commerce companies who are really looking to scale their business. We continue to enhance our offering to include additional marketplace integrations, better inventory management, analytics, and so on. And customers are responding very well to the service as FedEx Fulfillment gives them more flexibility to focus on what they do best while FedEx can focus on the supply chain needs.

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

Brian also asked -- and you might as well take this, Raj -- what's needed to facilitate a higher utilization rate of your retail and OnSite network for customer pickups and returns versus a residential stop? Raj?

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Well, as I mentioned to you earlier, we are thrilled to have almost 11,000 convenient locations in the U.S. for customers to pick up their packages today. The three factors that drive it, first obviously is convenience. And we are right there. Locations are open later in the evening. 700 of them are open, in fact, 24 hours.

The second issue is around porch piracy. The recent surveys show that 75% of online shoppers were concerned about porch piracy and 45% have a package either stolen or known someone that has had their package stolen. So those are two very important factors.

The third one probably over the medium to long term is that, as I mentioned to you, the cost of last-mile continues to increase. These locations will not only become a convenient location but it'll also become economic value for our customers.

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

We have a couple of questions here about Ground efficiency and the MetLife program. They've been asked and answered otherwise. A question about the recent rally in oil prices. Could it push some shippers to lower service levels with fewer guarantees? Raj, do you want to...

Rajesh Subramaniam
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Yeah. Well, Brian, I don't think so. I don't think that's going to be the effect. But again, having said that, we have a full portfolio of offerings including FedEx Trade Networks that allow us to optimize our offerings to our customer needs.

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

So from Brian Ossenbeck of JPMorgan, what does the next chapter of technology and innovation look like? How close to commercial viability are the recently disclosed tracking sensors, blockchain involvement, and small drone test flights? So, Rob Carter, you want to talk at least about the first two of those?

Robert B. Carter
EVP FedEx Information Services & CIO, FedEx Corp.

Yeah. Sure. Well, the impact of innovations in the connected world, whether it's the Internet of Things and sensor-based logistics, mobility, blockchain, autonomy, all of those things are accelerating across the enterprise. If you look at sensor-based logistics and the announcements and capabilities that we have shown in our new Bluetooth low-energy sensors, that's resulted in a huge number of patent filings and really is a viable technology in and of itself today. What takes some time to roll though is the infrastructure and Wi-Fi networks and rolling stock and an aircraft in order to marshal all those sensors as they operate in the world. And in the back-end systems, they're needed to handle that volume of data.

With regard to blockchain, we're quickly seeing blockchain capabilities moving towards production primarily through our involvement in BiTA, the Blockchain in Transport Alliance, with now hundreds of participating companies. FedEx Freight is leading the charge there and are chairing the committee on standards for BiTA, and we have several applications that are working their way forward.

And then lastly with regard to drones, drones are still really specializing in observation and inspection with sophisticated optics and their ability to look at aircraft and airframes. That's a very advanced capability that we're already using today. But things like lift and range are limiting their use in transport although we are testing them in some of our larger ramp facilities to deliver parts to mechanics and things of that nature.

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

So Alan just mentioned that integration costs will be higher than initially expected. You're saying higher than the $1.4 billion guidance from last year. How much? Scott Group of Wolfe Research. Alan?

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

I'd say right now based from what we're seeing, it's more like $1.5 billion, about a $100 million more. If we find additional opportunities, we'll keep you posted on that, but those are opportunistic as opposed to it's costing us more than we thought.

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

I think that's all the questions that we have. There's one here from Ravi Shanker about Tesla semis. I think we'll defer that. We haven't gotten them yet. We are looking forward to testing them. We test a lot of different things from a lot of different vendors. But, Mickey, that completes all of the questions, so I'll turn it over to you.

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

Thank you. In closing, we continue to evolve our earnings call format to enhance your long-term strategic understanding of FedEx Corporation and to make the most effective use of our time with analysts and investors. Beginning with the first quarter earnings call in September, we plan to streamline the process and improve the focus on our integrated strategies and consolidated financial results.

Remarks by the management team will be brief so we can concentrate on answering as many of your strategic questions as possible. To address those questions on an enterprise basis, the company call participants will be Fred Smith, Dave Bronczek, Alan Graf, Mark Allen, Rob Carter, and Raj Subramaniam.

We will also file our 10-Q and post recurring supplemental information simultaneously with our earnings release to offer investors more context and details around the financial and operating results rather than addressing those on the call. And also to address as many topics of interest as possible, we will consolidate similar questions. We are confident these changes will optimize the time with our investors.

Thank you for your participation in the FedEx Corporation fourth quarter earnings conference call. Feel free to call anyone on the Investor Relations team if you have additional questions about FedEx. Thank you very much.