FedEx Q2 FY19 Earnings Call Transcript – December 18, 2018

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

Good afternoon and welcome to FedEx Corporation second quarter earnings conference call. The second quarter Form 10-Q, earnings release and stat book are on our website at fedex.com. This call is being streamed from our website where the replay will be available for about one year.

Questions are welcomed through our email address, which is ir@fedex.com. When you send your question, please include your full name and contact information. Many of the questions we received in advance have been addressed in the remarks today, or in the 10-Q.

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 our 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 and Raj Subramaniam, Executive VP, Chief Marketing Communications Officer of FedEx Corporation.

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

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

Thank you, Mickey. Season's greetings to all. Welcome to our call. FedEx is in the midst of another record-setting holiday season, long-term investments in capacity and advanced automation are paying off in speed advantage and outstanding service during peak and year-around. We salute our 450,000-plus team members around the world for outstanding service and we greatly appreciate their dedication to our Purple Promise, which simply states, "I will make every FedEx experience outstanding."

At FedEx Ground, I think it's particularly notable, 96% of packages moved through an automated facility translating to increased efficiency and speed. During this holiday season, service is at record levels. Just yesterday, 67% of FedEx Ground packages were delivered one full day earlier than schedule, despite it being one of the busiest days in the history of our company. What's more, yesterday was the busiest shipping day ever at FedEx Office. This fall we opened two major Ground hubs with Allentown, Pennsylvania being the largest in the FedEx Ground network. Both Express and Ground hub operations in North Carolina have been recently expanded as well.

FedEx second quarter adjusted earnings per share were up 27% year-over-year and we anticipate full- year fiscal 2019 and adjusted earnings per share will increase year-over-year despite difficult global economic conditions. As our volumes and revenues demonstrate, FedEx is experiencing strong growth in the U.S. where the economy remains solid; however, our international business, especially in Europe, weakened significantly since we last talked with you during our earnings call in September. In addition, China's economy has weakened due in part to trade disputes. As a result, we have lowered our fiscal 2019 earnings guidance and are accelerating actions to reduce costs given the uncertainty of global macroeconomic trends. We're highly confident that we will achieve the benefits expected with the acquisition of TNT Express, although we will not achieve our FedEx profit improvement goal in fiscal 2019.

Voluntary employee buyout announced in our earnings release today is consistent with FedEx's People-Service-Profit philosophy and addresses three strategic issues. One, we are nearing the end of our IT modernization program project renewal which began in 2010 to transition FedEx information systems into the cloud. Legacy mainframe applications are now being rapidly retired. This is one of the largest such transitions in the history of business. Once concluded, renewal will have vastly reduced the number of FedEx IT systems while dramatically improving security, speed-to-value, reliability, flexibility, productivity, and provide new automation opportunities for our customers and many FedEx operations. The VBO will provide our team members with important career options as legacy systems and technologies are retired.

Massive integration of TNT into FedEx would be approaching its end stages, so a second rationale for the VBO is that we will not need the same number of staff positions at the end of this multi-year integration journey. And third, we believe new productivity-enhancing tools from accounting bots, legal system analytics, to predictive AI, et cetera, will allow us to operate our company with fewer staff positions going forward.

Of course, we expect overall FedEx employment to increase over the next several years, again, assuming moderate economic growth. Nevertheless, the VBO will help improve our tooth-to-tail costs. U.S. VBO is targeted to achieve an annual savings of $225 million to $275 million per year providing an approximately 18 to 24 month payback. Alan will further discuss our cost management strategy following comments from Raj and Dave.

Let me add, however, that we do not manage FedEx solely for quarterly results. In fact, as we speak, we're also currently planning for the next quarter century of FedEx's services and operations.

Let me thank David Cunningham for his valuable contributions and wish him well in retirement after more than 36 years of service, most recently as President and CEO of FedEx Express. Raj Subramaniam, a 27-year veteran of FedEx, will succeed David. He brings remarkable expertise and vision to this position, which are critical as we manage the Express business as a part of the global portfolio. Let me add, for those of you who don't know, Raj served as one of our regional Presidents during his long career. Brie Carere, who has more than 17 years with our company, will succeed Raj as Executive Vice President and Chief Marketing and Communications Officer of FedEx Corporation. Raj?

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

Thank you, Fred, and good afternoon, everyone. Let me begin by giving you our thoughts on where we stand on the economic outlook. In the U.S., growth remains solid driven by robust consumer spending and favorable conditions in the industrial sector. Internationally, economic strength seen earlier this year has given way to a slowdown. The peak for global economic growth now appears to be behind us.

Eurozone growth has slowed from 2.5% last year to under 2% in the second half of 2018 and economic growth in the UK has slowed sharply since July. The secular slowdown in Chinese economy has been exacerbated by trade tensions. Spillover effects from these tensions and the fading tech cycle have negatively impacted growth throughout Asia. Emerging Asia growth slowed from 6% in 2017 to 5.6% in Q3. World trade slowed in Q3 to just 3.5% compared to 5.3% in Q3 2017. Leading indicators point to positive but even slower trade growth near term.

Now turning to FedEx performance. We grew composite revenue, volume and yields at each transportation segment. We have been working to holistically manage base yields and surcharges including fuel. The domestic pricing environment is competitive but rational. We recently announced our 2019 GRI of 4.9% for FedEx Ground and Express shipments and 5.9% for FedEx Freight.

As per our announcement yesterday, we're expanding e-commerce delivery options for retailers with FedEx Extra Hours, a service that enables participating retailers to fulfill ecommerce orders into the evening and receive late pickups by FedEx Express with next-day local delivery and two-day shipping to any address in the continental United States. Retailers can extend evening order cutoff time by five to eight hours with some as late as midnight depending on their current order fulfillment process. FedEx Extra Hours recently launched with select customers, including AutoZone and Best Buy in multiple markets across the United States.

As e-commerce continues to drive business, we continue to invest in our extensive retail network. In October alone, FedEx OnSite expanded to more than 1,200 Walgreens-owned, Rite Aid locations, bringing the total FedEx Hold locations to more than 12,000. And, extending the saving grace once again for anyone who needs it, pickup will be available on Christmas Day at the vast majority of more than 8,900 Walgreens locations.

Further, we are encouraging our customers who have not already done so to register for FedEx Delivery Manager. This will not only alert them of upcoming deliveries, but also allow them to redirect packages to thousands of secure and convenient hold locations during the holiday season. Enrollments have grown over 72% fiscal year-to-date, a clear indication that customers are enjoying the visibility and control of their shipments.

Thanks to our outstanding team members and unparalleled network, we are experiencing yet another record peak season for FedEx. Once again, we have not applied a residential peak surcharge. FedEx delivers to millions of small and medium-sized businesses every day and we want to support these customers as e-commerce continues to grow and become a major part of their business. And that is just one of the many reasons we are doing very well in the small and medium customer segments.

We're extremely proud of the excellent service levels that we have achieved this peak season, especially given the increase in volumes. The last three Mondays were some of the busiest days in the history of FedEx, including Cyber Monday where our volume crossed 32 million packages, more than double our average daily volume. We were able to deliver all of that volume with record service levels.

With that, I would like to take this opportunity to thank more than 450,000 team members around the world who are going above and beyond to deliver this home stretch of the holiday season.

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

David J. Bronczek
President & COO, FedEx Corp.

Okay. Thank you, Raj, and good afternoon to everyone. We are very pleased with our peak service performance as Fred and Raj has already mentioned. I'd like to thank all of our team members all around the world especially here in the middle of our peak season. My comments are focused on FedEx Express today where trends worsened in the second quarter primarily due to international revenue challenges driven, of course, by international economic weakness.

While international revenue is still growing, it is not growing at the rate we expected because of the overall global economic uncertainty that Raj just mentioned. Some of the largest economies in Europe are experiencing weakness that is impacting our international business. Germany, for example, saw their GDP contract quarter-over-quarter in the third calendar quarter. Italy remains a drag on overall Eurozone growth. The unrest in France, and I was just there two weeks ago, continues to escalate and spread with yellow vest protests now inspiring similar actions in Belgium, The Netherlands, Germany, and, of course, throughout all of France. Also, the uncertainty of the United Kingdom with their Brexit issue.

Following TNT's recovery from the cyber-attack, we have seen an accelerated shift of our product mix to more freight than parcel, putting pressure on our system and of course our costs. Continued tariff and trade concerns and uncertainty in Asia are impacting our business there as well. We continue to work with our customers as they re-evaluate their supply chains.

As you just heard from Raj, the U.S. economy remains solid and we are seeing strong growth in Express deferred package volume. Our TNT integration activities continue and are in full swing throughout Europe, throughout Asia and Latin America. Following the cyber-attack, we accelerated the integration of our sales force by one full year, and to date, approximately 70% of our global sales force has been integrated, with the remainder to be completed at the end of this fiscal year. This will provide us a single point-of-contact for our customers, something they very much are looking forward to.

Further, we accelerated investments in our IT systems and infrastructure to strengthen and enhance and protect the systems we use to run our daily business. Our focus continues to be on keeping our customers at the very center of all of our efforts, while at the same time, we are integrating our two global network businesses. The stations and countries that we have been integrating to date are primarily in smaller markets and represent approximately 30% of our combined volumes. The completion of the integration in these markets is indeed important, but synergy benefits have been limited given the relative size of the volumes we've integrated. The remaining integration work is focused on our much larger, more complex, direct serve markets.

Said differently, the countries that deliver most of the benefits are weighted to the later stages of the integration due to the complexities of their business. Our businesses are heavily dependent on IT solutions for the integration. For example, these require harmonizations of our services and then corresponding redesign of our multiple customer platforms, including of course, fedex.com and our customer automation tools.

Our original integration planning contemplated the long lead time required to build these IT solutions, and accordingly, the benefits of these efforts would occur towards the end of the integration. While changes in our revenue mix and softness in volumes have impacted the timing of the realization of the financial benefits, we remain confident in the long-term value of the combination and synergies to be realized through a single pick-up and delivery network, single air and road network, back office efficiencies, and of course, mainly our revenue growth.

And now I'll turn it over to Alan Graf to give more details.

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

Thank you, Dave, and good afternoon, everyone. As Dave just outlined, since our last earnings release, Express experienced significant weakness in business conditions and a change in service mix, especially in Europe. For the second quarter, International Priority volumes were up 1%, while International Economy volumes increased 9%. International Priority freight pounds were flat, and International Economy freight pounds surged 16%. In the U.S., overnight package volumes were up 3%, while deferred package volumes increased 15%. These volume trends accelerated during the quarter, and Express operating profit was significantly below our business plan in the first half of fiscal year 2019.

To address the shifts in our business conditions, we are implementing and accelerating several cost reduction initiatives both in the U.S. and internationally. These initiatives include a voluntary employee buyout program, capacity reductions, primarily in the international airline network, limited hiring in staff functions and reductions in discretionary spending. In addition to these cost reductions, we will continue to improve our productivity through various programs, including expanding use of our technology and capitalizing on efficiencies available through the scale of our network as we integrate operations in Europe and gain market share at FedEx Ground.

We had positive results from both Ground and Freight. The Ground segment operating income surged 18% to $586 million on an 8% volume increase and a 6% yield increase. Despite the upfront costs associated with opening two major hubs and inflationary cost pressures, Ground's operating margin increased 40 basis points to 11.4%. Ground's profitability will increase as investment in our market-leading automation, coupled with large productivity initiatives, come online. We will provide more detail on our Ground strategic projects in the coming months.

Freight segment grew operating income 37%, with shipments increasing 8% and yields up 6%. Operating margin was 7.7%, up 120 basis points. Cost reduction initiatives, combined with continued profit improvements in Ground and Freight are expected to increase the long-term growth in corporate earnings and margins, improve cash flows and increase our competitiveness.

Regarding our FY19 outlook, we are projecting adjusted earnings of $15.50 to $16.60 per diluted share, down from $17.20 to $17.80. This lower guidance is due to a shift in business conditions and service mix at Express, primarily in Europe. We are no longer providing guidance for revenue growth and operating margin for FY19.

Voluntary buyout will be offered to eligible U.S. employees. Costs of this program are expected to total $450 million to $575 million and will be recognized primarily in fiscal year 2019 with the remainder in fiscal year 2020. This voluntary buyout will have estimated savings of $225 million to $275 million in FY20. We are also reviewing similar international opportunities. We are forecasting an effective tax rate of 24% to 25% for FY19 before year-end mark-to-market retirement plan accounting adjustments.

Our capital forecast remains $5.6 billion, and we are reevaluating our capital spending going forward. We repurchased nearly $1.3 billion of our shares during the first half of this fiscal year, which has reduced our year-over-year share count. As I mentioned, we are reviewing all aspects of our financial plans, including whether we will repurchase additional shares this year. As a reminder, we spent $11.6 billion purchasing almost 76 million shares over the last five-and-a-half years, resulting in the nearly 18% reduction in outstanding shares.

During the remainder of 2019, we will continue to execute our TNT Express integration plans and will be focused on integrating the largest and most complex countries, which include the largest workforces and facilities. We continue to expect the aggregate integration program expense, including restructuring charges at TNT Express through 2020 to be approximately $1.5 billion and expect to incur approximately $450 million of these costs during 2019. However, based on the timing of the completion of integration activities, including any international voluntary employee buyout program, we may incur additional integration costs after 2020. The timing and amount of integration expenses and capital investments in any future period may change as we continue to execute the integration of TNT.

We expect to realize the benefits of the TNT acquisition that were anticipated when the company was acquired, although at a more moderate pace, caused by reductions in base business levels due to increasing economic weakness during the second quarter and a change in service mix, following the NotPetya cyber-attack. As a result, we now expect the operating profit improvement goal of $1.2 billion to $1.5 billion for Express over fiscal year 2017 will not be realized in FY 2020.

Before we begin to address your questions, I recognize there's great interest on when we expect to achieve the $1.2 billion to $1.5 billion Express profit improvement and how much of it we will achieve in FY20. At this stage, I'm not in a position to give an updated forecast for the reasons that my colleagues and I have mentioned. We are intensely working on further actions and plans to enable progress towards these goals. My hope is that I can give you a directional perspective when we report our Q3 results.

Despite the rapid changes we have experienced, I am confident that we will see improved operating earnings, margins, and cash flow in FY20 versus FY19, assuming moderate U.S. domestic economic growth and no further weakening in international economic conditions.

Now I'll turn the call over to Fred for your questions.

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

Thank you, Alan. We've got a mix of questions that came in prior to the call, and then some that came in after the 10-Q was put up. So I'll go back and forth between the two to try to be fair here.

So first question, which I'll take, over the next 5 to 10 years, what are the biggest competitive threats to each division, Express, Ground and Freight? This comes from **Donald Broughton of Broughton Capital**. Donald, we don't see any large or certainly no existential competitive threats to any of the three major divisions at FedEx. We do, however see enormous competitive opportunities and we have over many years taken market share and believe we have strategies in place that will allow us to expand the available or addressable market and to continue, given the considerations that Alan just mentioned, to grow FedEx and to improve our profitability and margins and cash flows.

There's a question came in from **Jack Atkins of Stephens**. Ground margins have now expanded in three out of the last four quarters, with the heavy investment phase of Ground now behind you, is it right to think about margin in this segment expanding on a consistent basis moving forward? Alan?

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

Thank you, Jack. I think in my opening remarks I talked about how excited we are about where Ground is now, where Ground is heading. We'll have more to say about that in the months ahead, but I would say there are two things in particular. As we build scale at Ground and continue to sweat the assets that we have more efficiently, we're reducing costs at a very nice clip on a per-package basis. Compare that with what they otherwise would have been which is going to make us much more competitive in the Ground network.

I would also say the use of technology has helped us to become much better in terms of improving our densities and with scale and technology and continued improvement in density will help drive Ground's operating margins up. I'm not going to give you a percentage. I just will tell you that we believe Ground has opportunity to improve its margins over the next several years.

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

So here is a question from **Tom Wadewitz of UBS**. What is FedEx's strategy for improving the quality of packages and revenue in the TNT FedEx Europe network? Does FedEx need to cut price in order to attract premium packages back into its European network? Does FDX need to wait for the network integration to be complete before they can focus on share gain and volume growth in Europe?

So I'm going to ask Dave Bronczek to take the first part of this question, but it just so happens that we have the President of FedEx Europe here this afternoon, Bert Nappier, and Dave will turn it over to him and you can hear it from the horse's mouth, so to speak. Dave?

David J. Bronczek
President & COO, FedEx Corp.

Okay. Thanks, Fred. Thanks, Tom, for your question. I was just over in Europe and talking to the management team there. And of course, as I mentioned in my comments, we continue to grow. We continue to grow just at not the rate that we were hoping to grow, and of course with the slowing economy, that has affected our growth, but we're not shy of volume or growth. The reality is, however, that TNT, when we bought that company, they had a tremendous value proposition in their freight products and their specialty service. That actually is growing very nicely, very strong, and it's the parcel part of the business that of course is weaker for all of Europe. And so, for us, that's our focus. And I'll turn it over to Bert.

Herbert C. Nappier
President, FedEx Express Europe & CEO, TNT

Thanks, Dave. As Dave noted, the improvement of our revenue quality in Europe really is focused on the Express parcel side of the house. We are growing in that part of our business really and our strategy comes down to value proposition, as Dave outlined. We're focused on speeding up our European road network. We've got a very strong air network. We're making investments in key hub locations in Liège and Paris. And when you combine that, we're really going back to our customers with the value proposition that we think is very competitive. The economy has been a headwind in growing parcels, but what we have been able to do is grow deferred volume and freight volume very nicely with a semi-integrated business. We're about halfway through, and as we continue to integrate, you'll see the capabilities there that we need to grow in the future. So, if we can do what we're doing with the integration where it is, then we'll only be better as we go forward.

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

Okay. This is a question from **Ken Hoexter of Merrill Lynch**. Have you seen any impact from Amazon Air? Raj?

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

Ken, the short answer to that question is no. On the contrary, as you can see from our press release, our numbers do speak for themselves as we are seeing significant volume growth across our U.S. domestic parcel business.

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

So I'll just take this for me, from a short and long-term perspective, what is FedEx's strategy to counter competition from Amazon? **David Campbell of Thompson Davis**.

You know, I'm not really sure how to answer this question. I mean, we look at Amazon as a wonderful company and service, and they're a good customer of ours. We don't see them as a peer competitor at this point in time. For many reasons, we think it is doubtful that that will be the case. So we have very strong strategies, well understood by the management team. The addressable markets that we deal with are growing. And as we've said over and over again, we've grown market share particularly in the sectors we want to grow. There've been some sectors that we've chosen not to attack for a number of reasons, and that can change from time to time.

So I don't know what I can say other than what I just said. I think the prospects that this company is going to be "disrupted," which just occurs over and over again, to quote a previous statement, is fantastical. So I'll leave it at that.

Raj, could you comment on our new initiative with Walgreens and one-day prescription delivery? Does this require any investments, what are the financial impacts?

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

Okay, yes, for sure. Earlier this month, as you know, we announced with Walgreens the nationwide launch of Walgreens Express, which is really a next-day prescription delivery service available at Walgreens locations. Now, regarding the question on investment, we are simply leveraging the fact that our current FedEx OnSite retail alliance with Walgreens allows our existing operational flows in and out of those stores. And prescription deliveries will be executed by the same station making the pickup, which our Extra Hours service now makes possible.

So this is one more example of how we are committed to increasing convenience, enhancing customer experience and really expanding our service offering for our customers. And let me add, we're doing all of this in a very, very cost-effective manner.

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

I hope I hadn't given **Tom Wadewitz** [**of UBS**] two questions here and taken it. But if I have, he's a hell of an analyst. So he wants to know about the maintenance expense. How much of the Express maintenance expense in 2Q FY19 was unusual? Is maintenance expense likely to remain elevated for the next several quarters? Alan?

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

Tom, I'll try to help you out here and turn this into a strategic question because it was an anomaly in the first half. When you're in this business, you have a big fleet like ours, you have timing issues from time to time, and we had some timing issues in the first half. Second half, well, the comparisons will be almost flat year-over-year, but that's not the strategic question. The strategic question has to do with our continuing to replace our old aircraft with new, and we are continuing to do that. We're checking the pace. But having said that, it's been an integral part of how we're able to continue to hold our costs.

The maintenance aspect of new planes versus used planes is absolutely unbelievable, not just from a cost standpoint, but from a reliability standpoint. Our air ops division is doing a fantastic job. It's making a big difference in peak to have these new aircraft out here, who have dispatch reliability through the roof. So from a strategic standpoint, the maintenance cost is going to go down over time relatively to our revenues and our packages because of the newness factor.

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

So, there was a question for Raj here about his – let me just read it. It's from **Jack Atkins of Stephens**. Raj, as you step into your new role, what are some of the immediate changes you expect to bring to the seat, and what are your first priorities for Express?

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

Jack, thank you for the question. Obviously I'm very, very excited to be in this role, and my first priority is really to focus on Europe. And we have focused on the integration and focused on positive change in Europe. Having said that, we're very thrilled with some of the new value that we're creating for our customers all across the board, and look forward to continuing the growth of Express in a profitable manner.

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

So as long as we got you on the phone there, Raj, why don't you answer **Christian Wetherbee's** question from **Citi**, way up in the Northeast. Is the international Express yield deterioration driven by missed changes at TNT, or are there other factors affecting yield?

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

So, Chris, the international yields are negatively impacted by exchange rates and product mix and to some extent region mix. Those are the key factors.

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

So here's a question from **David Ross of Stifel**, which I would normally give to Raj or Dave Bronczek, but I'm going to take it, because the answer is pretty clear. For the Express changes regarding international network capacity reductions, where are these taking place? Does it involve number of flights or facilities? Will they be permanent or temporary?

So the answer to the question, David, is if I told you that, we would have to come and kill you because it would be – this is competitively sensitive obviously. We can't tell our competitors what we're going to do, but anything – you've got to recognize our networks are so big and the size of our Asia and our Pacific and our Asia to Europe and Europe to Asia networks are so extensive, we can take capacity up and down. So all kidding aside, Dave wants to jump in here. So, yeah, don't tell him.

David J. Bronczek
President & COO, FedEx Corp.

No, I won't. I could tell you that, and I've said this many times in the past, our networks are so big and so flexible we can go up and down. And obviously some – a quick example would be some of the traffic that's not flying on our purple tails right now we've consolidated. We would eliminate that cost. We've put it on our purple tails. I mean there's good examples all over the world like that. But it's certainly true that the flexibility of our global fleet and our global network lets us go up and lets us go down.

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

So **Allison Landry of Credit Suisse**, how much flexibility you have to throttle back to $5.6 billion CapEx budget, Alan?

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

We have a lot of questions regarding CapEx and airplanes and everything, so thank you for the question, Allison. And I'll try to just consolidate it into one answer, and that is obviously we're looking at everything. I would point out and there's a reason I gave you the things I gave you in my overview to call out. I mean, all that information is in the press release and you could have found it later, but we're still carrying an awful lot of things and we're still growing in terms of pounds and packages. So we're off on our yields and a lot of that is macro. So we're still going to grow this company going forward. I think we have the ability, as Fred and Dave both mentioned, to flex down if we have some sort of real big meltdown. We don't think we are going to have that happen, but we could certainly do it.

As far as our plane acquisitions and our CapEx, we have some big projects underway. Indianapolis and Memphis hubs and we've got an order book of aircraft – and we're looking at that, but we need those things for the long-term. And as Fred mentioned, we're planning for the next 25 years, and the technology that comes with those expansions and the technology that comes on the airplanes and the reliability are vital to us. So it's a balancing act. It's going to be a little bit tougher this year. We probably will slow some things down to see what happens, but at the end of the day, we still need to move forward with a majority of the programs that we've got in place.

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

So this is a question from **Lee Klaskow of Bloomberg Intelligence**. I'm going to give it to Dave Bronczek because he lived for many years overseas and in Europe and then in Canada. Is it culturally harder to have employees outside of the U.S. to volunteer for these buyout programs? You take it, Dave, and maybe Bert wants to add something to it as well.

David J. Bronczek
President & COO, FedEx Corp.

No, Fred, it's not. And I've been offshore half of my career, quite frankly, and the people over there are the same as people here. They want an opportunity, they want diversity, they want a chance to grow with the company. On the other hand, they want our people philosophy. And part of our people philosophy is if you have a voluntary buyout, they can voluntarily move forward to do it. I think that it's going to be well-received. Alan and Fred didn't mention it in their comments, but we are looking at a global part to the voluntary buyout. And of course, part of it was originally planned in the TNT integration. This is beyond that. This is much more than that. This is, of course, Europe and it's all around the world. So I think that it is part of our culture, our company's culture that our employees actually like very much.

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

So there's another question from **Tom Wadewitz from UBS** about the air network. I think we've answered that, that there's lots of flexibility in it. We don't want to give details about the percentage moved in the purple tails and that moved in underbelly. Suffice it to say our purple tail network is scheduled so it provides unmatched service. And obviously, with the lower-yielding, less service sensitive business, we have the option to either put it on our planes or put it on other carriers until we build up enough density to put another flight on the network. That's the way the system works, but it's not in our best interest to go into further detail about that because of competitive interest.

There are a couple more questions on Amazon Air, one from **Dan Ronan of Transport Topics**. What concerns does FedEx have regarding the recent expansion by Amazon Air at Northern Kentucky, Rockford International and Alliance Airports? Raj?

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

Well, Dan, as we've talked about before, we don't have any concerns. So far as you can see, our volumes in the domestic networks are continuing to increase, and we value Amazon as a good customer of ours. Thank you.

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

I think it's also important to recognize – and again there's this significant misunderstanding. The Amazon Air network is set up to move inventory within the Amazon system, which is prodigious. It's big. It moves not-in-stock and low-turn SKUs and forward-stocked items for their third-party customers who can't duplicate inventory every place. So it's scheduled differently than FedEx or UPS' system. There's a very good analysis of this that came out from **David Vernon of Bernstein**, so I'd recommend people that are interested in that to read that.

Let's see. Let me take some of the questions that came in earlier. **Scott Group of Wolfe Research**. International volumes were up 5% year-over-year and international yields were flat, so it doesn't seem to be an issue with volumes, but one's a bad pricing and bad mix. Do you think the mix issues are company-specific related to TNT or macro driven? I think Dave wants to say something about this and then Alan.

David J. Bronczek
President & COO, FedEx Corp.

I'll go ahead and start. There's no question about the fact that I made it in my comments that one of the things that TNT really did very well and we continue to do well with TNT inside FedEx is the freight product and their specialty freight product. So after the cyber-attack, that product came booming back because no one's better than we are in that product. So that product, of course, has a little bit different mix, a little bit different cost structure to it. We're focusing on our parcels as well. As you pointed out, the questioner pointed out, our volumes are growing. They're just not growing as fast as what we would like them to grow, and with the economy being depressed somewhat, we're still dealing with that. But that's the point. We're still focused on parcel and freight, and we're still growing.

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

And this came on us fast – this is Alan. This came on us fast, this mix change, and so we can adjust and we will, and one of the great things about promoting our head pricing guy to a P&L, as he now cares a whole lot more about yields at Express than he did in the past. So I'm sure that he's going to be on Brie to make sure that we get the mix back right.

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

Yeah, we've got some interesting things underway in the pallet or the freight business, we'll tell you more about in calendar 2019 but I think to some degree, it's our success in attacking the pallet business that is creating the problem. I mean, we've been aggressive in this area, and it's growing and some of the more traditional areas where we have a higher market share, it's been affected by the macroeconomic issues that have created this mix issue. But we'll have a lot more to say about it in March and June. I know that's difficult for people to follow the earnings of companies on a quarterly basis to acquiesce, I'm sorry we can't be more precise on that.

But **Ben Hartford of Baird** has the so-called [indiscernible] (00:45:01) between U.S. and China followed the conclusion of the G-20 Summit earlier this month produced any meaningful improvement in customer's volume growth expectations in 2019, particularly during the first half of the calendar year? If not, does your updated 2019 guidance assume a particularly weak February/March international volume environment during and following the Lunar New Year? Raj?

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

Ben, at this point, given what we know, we're assuming that the current softness that we're seeing continues into the New Year and that's what we assume or guess and if that changes, we'll update you in our next quarterly call.

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

So, Raj, as long as we got you at bat, what magnitude of increase in post office pricing is needed to materially affect private carrier's pricing power?

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

Well, I don't want to particularly comment on the pricing decisions of other carriers. I will just reiterate the broad point that we have made in previous conference calls that the cost of last-mile delivery will continue to go up in the years to come.

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

Let me just add something to that. It's a particular peak of mine. Many of the observers of this industry continued to misrepresent the total package market by double counting the postal packages, many of which are given to them for direct injection by FedEx SmartPost, UPS SurePost, and Amazon Direct injection. So that is the so-called parcel select service, which has been in place since 1997. It was originally designed for only items that could be placed in a mailbox, if you go back and research it, and that could be put in one of the right-hand jeep delivery vehicles. Of course, the Postal Service has expanded that and as e-commerce has grown, the packages have gotten large, which has created its own set of dynamics inside the Postal Service. So many times you'll see, well, FedEx is going to handle this many packages from peak and UPS is going to handle this many packages from peak, and the Postal Service is going to handle this many packages from peak, a lot of the postal packages are actually FedEx SmartPost and UPS SurePost. Yeah, that's not the case for Priority Mail of course which is a Postal Service in the end product or first class package service, which was introduced a year ago as I recall.

It was moved, a package product that was previously in the regulated non-competitive sector over into the competitive sector to give the Postal Service more pricing freedom but those are like the small craft packaging you get prescription drugs in or small cosmetics or vitamins or something like that. So this is not well reported and it's something for people who follow the industry to be careful about. The Postal Service, put a different way, as we've said many times has very little in the way of upstream network capabilities. And so when people talk about the industry as FedEx, UPS and the Postal Service, it leaves out that significant issue of the Postal Service's network capabilities.

So, Dave Bronczek, did FedEx win a LTL business when a competitor declined to accept shipments for a brief period recently? **Keith Schoonmaker of Morningstar**.

David J. Bronczek
President & COO, FedEx Corp.

Let me just answer the question by saying that we always look in terms of how we can handle a customer if we have extra capacity. In this case, when one of our competitors was having some difficulty, we did, and we moved it in our network because we knew we could provide outstanding service. So our FedEx Freight team did a great job of handling that. In that case, we did take that part of the business.

I do want to go back, Fred, if it's okay with you, to a question earlier about China that Raj answered. It is true that our customers are talking to us daily about possibilities of weakness, softening in China, just potentially for the future. And the good news for us with our customers is we have such a broad array of our portfolio between our ocean, between deferred shipping, our Express, of course, shipping, so we've been talking to our customers. There is a concern out there that has been raised. We've been able to talk to our customers about any number of different possibilities, keeping the business inside FedEx. And I wanted to make that extra point, Fred.

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

Excellent. Let me go back to a question from **Donald Broughton of Broughton Capital**. I'm going to ask Raj to speak to this. With TNT solidifying your position in Europe, are there plans to expand the service offerings in Asia, or is the next great opportunity somewhere else? Raj?

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

Well, Donald, Bert and Dave have talked a lot about Europe, so – but outside of Europe, TNT has fantastic ground networks in Middle East, in Asia, in Latin America. And when you combine those networks with FedEx's unmatched intercontinental air system, we now have a unique network that allows us to offer new value to our customers in a very, very cost-effective manner. And this allows us to now target multiple large international market segments, and we are very well positioned to expand these service offerings, including Asia, as you point out. For instance, the largest air cargo lane in the world is Asia to Europe. With the capabilities that we just talked about, we are now extremely well positioned to win in this market segment that I just talked about.

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

So let me add to Raj's comments. I was down in Southeast Asia recently. Raj happened to be with me, and I think he will agree the Southeast Asian road network we have is just unmatched. Our position in Singapore, we have a wonderful regional hub there that's among the most productive in the FedEx system. We just began a flight from Singapore down to Sydney, and they were doing extremely well. Our sales and marketing people have done a great job putting that capacity on.

So we have, as I've said earlier, strategic plans where we think we can attack a larger Express addressable market and can grow FedEx even in a low-growth environment. Now, as we've said repeatedly today, obviously, when you have a change that comes on you as fast as this did, it's hard to react to it.

But I have a very timely question in that regard from **Helane Becker of Cowen** that said, over the next five years, is it possible that while the rhetoric from politicians continues to be protection-focused, companies will ignore it and continue to grow internationally?

So, let me answer that question from a broader perspective. The most important thing that is different about today than has ever been true in the history of the world is billions of people and more being added every day are equipped with a personal order entry device, a mobile telephone, and you can now access the goods of the world and see them, compare shop, and with the services we provide, you can get the landed cost of the item from FedEx Cross Border and have it delivered in one to two business days to virtually any business or any person on the planet.

That's never been the case before. And so you have this tremendous bottom-up business ecosphere today that we're right in the middle of, and I think the profundity of that will, in the end, create the demand on an ongoing basis just like it has been for time immemorial for human beings wanting to travel and trade. This type of bottom-up commerce is completely changing the politics, for instance, in Africa and in parts of Latin America, which often have been politically mismanaged. But now, people are not as dependent on the patriarchal or the corrupt political class.

This is very, very important, and I'll just conclude by saying most of the issues that we're dealing with today are induced by bad political choices, I mean, making a bad decision about a new tax, creating a tremendously difficult situation with Brexit, the immigration crisis in Germany, the mercantilism and state-owned enterprise initiatives in China, the tariffs that the United States put in unilaterally. So you just go down the list, and they're all things that have created macroeconomic slowdowns. The good news is, with a change in policy, they could turn it around pretty quick, too. So, fundamentally, we think trade will continue to grow.

We have a question here about stocking. No question, a lot of stocking took place across the Pacific in advance of the 1st of January. And so as Alan, I think, mentioned, I mean we're rigged for silent running here on the submarine. We think that the first quarter we'll see some ripple effects of that. But China is a manufacturing powerhouse. Just look in today's Wall Street Journal, there's fantastic groups of charts that show that. So I think, hopefully, the political folks will get it right and trade growth will resume. Sorry for the longwinded answer, but you can't just give a pithy one-liner and realize what our perspective is without talking about it in greater depth.

Here is a question from Helane [**Helane Becker of Cowen**] about the market share on the TNT cyber-attack. I think we covered that adequately, no? Anymore?

David J. Bronczek
President & COO, FedEx Corp.

We did.

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

Okay. All right. So I hope that was adequate for you, Helane. Raj, talk a bit about the large structural shift you've observed in B2B and B2C shipping patterns over the past three to five years and how you feel the business is prepared to respond to these dynamics going forward? **Todd Fowler, KeyBanc**.

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

Thanks, Todd. The first thing I want to mention here is that roughly 75% of our business is driven by B2B transactions. And our infrastructure and value proposition we've put in place over the last 40-plus years that stand us in very, very good stead as we continue to reliably serve our customers. Now, having said that, as you all know, the e-commerce market continues to grow roughly 3x to 4x the pace of traditional retail. And for instance, just in this calendar quarter 2018, e-commerce sales grew 14.5% year-over-year in the U.S. And that drives a lot of innovation for companies like us, as we leverage our existing infrastructure to create even more value for our customers.

And again, it should be noted that the core offerings that we have, FedEx Home Delivery, FedEx SmartPost, and others are integral for e-commerce, and we are building on that strong foundation to enhance our regional infrastructure to launch new services like FedEx Extra Hours, FedEx Fulfillment and so on. And it should be noted that more than 80% of our U.S. population is now within five miles of a FedEx Hold location. We are also making great progress on the digital front, with FedEx Delivery Manager, which I mentioned earlier. Also on a global basis, once again, we are leveraging our core, our unparalleled network. There's a lot of focus on the last-mile. But don't forget, the first few thousand miles. When you combine our network with the FedEx Cross Border solutions, you can quickly see how we are becoming a force in the fast-growing cross-border e-commerce space as well.

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

Let me take one real quick here. Have you seen any manufacturing move out of China to other Asian countries in light of the tariffs? **Kevin Sterling of Seaport**.

You know Kevin, when I was out in Asia a few weeks ago, there's a lot of talk about that and they're on definitely some significant growth in Vietnam and Thailand and Indonesia, but China is working very hard to go upstream on the value chain, which again the charts in today's Wall Street Journal show. So I don't think there's going to be any wholesale move the manufacturing out of China and I don't think it could be done even if people wanted to do it, but markets adjust over time. So we do see it along the lines that I just mentioned to you.

So **Matthew Russell of Goldman Sachs** wants to know, can you please differentiate the drivers to your 2019 EPS cut? Is it entirely macro? To what do you attribute to higher growth and lower-yielding products? Alan?

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

We talked about this quite a bit. Let me just maybe cap it off by saying that the reduction in the range for this year is entirely macro. It's entirely Express, and it's entirely revenue. It came on us fast. We're going to adjust to it, make it back up. During the second quarter as I mentioned, Freight and Ground performed admirably. Both those entities continue to improve their margins. They're taking advantage of technology and scale; you're going to keep hearing more about this. Very excited for those two entities about what's ahead for them. So we'll get back on track here but we want to make sure you understood exactly what happened and the differences between now and where we were at the September call.

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

So, Dave Bronczek, please discuss the expected benefits from the decision to lease about 900 electric trucks in the long-term. What percentage of the fleet could be electric? Why is leasing versus owning them preferred? **Todd Fowler, KeyBanc**.

David J. Bronczek
President & COO, FedEx Corp.

Okay. Great. Thank you, Todd for the question. Of course, we're always looking for ways to improve our sustainability and efficiency in all of our vehicles, whether they're on the road vehicles or in the hubs. In this case, we worked with Ryder and Ryder actually is a risk mitigator for us quite frankly. More than 3% of our fleet in the United States will be electric. We hope it's more than that. So far the tests are coming in very favorably. So I think for all the reasons that you would suspect, the carbon emissions, the fuel savings, the efficiencies, it's proving to be very good so far for us.

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

So let me add to that, two things. One, part of the rationale for this acquisition is that this is required by California regulations, and second, these are Chinese vehicles. Chanje is I think the way we pronounce the manufacturer name. They look to be terrific. You need to recognize that China, by law, requires all large, heavy, public vehicles to become electric in the next few years. So they are the market leader in buses around the world in the automotive sector, not so much success but in these heavier vehicles. So we're excited about getting these Chanje vehicles into the fleet. As Dave said, it was a good way to do it for us, Chanje and Ryder.

Let's go to Raj from **Jairam Nathan of Daiwa**. As automation levels increase across the industry, operating leverage increases as well, how do you think it affects pricing discipline among industry players over the long-term?

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

Jairam, I'm not sure how best to answer that question other than to say that our pricing environment continues to be competitive but rational and is hard to predict how it's going to evolve, but I expect it to remain rational in the near future.

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

So, Raj, now we've got you on deck, let me squeeze a couple additional answers out of you. So please discuss the progress of FedEx Supply Chain within FedEx Trade Networks. **Scott Schneeberger of Oppenheimer**.

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

Yeah, thanks, Scott. We're making very good progress in FedEx Supply Chain. We have brought in both very strong FedEx and external leadership to the organization and a renewed focus on growing the business and that's paying dividends already, with a number of new customer wins and also a very healthy pipeline for future opportunities. At the same time, we're also standardizing our offerings and driving efficiencies in the business, which will improve our profitability.

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

So keep swinging here, Raj. Do you have plans to expand SameDay offering beyond your current 30-city footprint? **Kevin Sterling of Seaport**.

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

Actually, Kevin, the SameDay City is currently offered in 33 U.S. markets, covering 1,800 cities, and it is used by customers as a crucial tool in their business for an increasingly diverse set of industries. I want you to be aware of, the healthcare, retail, business services, manufacturers, and so on, and it plays an important part in the e-commerce suite of services that we offer, as shippers particularly respond to the uniform professionalism of our business model. And we are very happy with the way our daily volume is growing. It's growing at a healthy rate, and we expect to continue the growth rate in 2019.

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

So **David Vernon** [**of Bernstein Research**] asks are ISPs seeing any increased cost pressure as competition for labor heats up, is there any difference in the rate of inflation between line haul and pickup and delivery. Alan?

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

Thanks for the question, David. Let me just say that our ISPs are great. They do an unbelievable job. We're very proud to be their partners. Certain markets are experiencing some higher labor costs due to increased competition for people, and it affects the service providers both line haul and pickup and delivery, as it does in any other business. So they're one of the many factors that we take into consideration. Each ISP agreement is unique and negotiated. And we, as I mentioned in my opening remarks, we do have some inflationary pressures at Ground, but because of their great productivity and technology, they are overcoming those and driving their margins up.

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

So, Dave Bronczek, please describe any similarities, dissimilarities, you are witnessing between the current environment in your FedEx Freight business versus the prior peak period. **Scott Schneeberger of Oppenheimer**. David?

David J. Bronczek
President & COO, FedEx Corp.

Okay. Thanks, Scott for your question. John Smith and his FedEx Freight team have done a fabulous job. Our peak, right now, is booming. As Alan mentioned, we're up 8% year-over-year. Revenue's almost the same, total revenue. So the pounds are way up. I would tell you that in spite of the pounds and in spite of the volumes – and we have a daily call with my operating presidents, they'll be mad when I say this, our service levels have never, ever been higher in Express, in Ground and in Freight. So there's a lot of similarities from peak to non-peak even though our volumes are very strong.

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

So we've got two more questions here of the ones that have been given to me. So if you've got any problems with, we didn't get your questions, get after Mickey Foster, not me or Dave, or Alan or Raj, so. There's a question from **Brian Ossenbeck of JPMorgan**. How has the pilot program for heavy home good deliveries progressed so far? If you expanded, would this service take packages shipped with FedEx? Or would it be incremental volume?

Let me just say this before I ask Raj to weigh in on this. It's important for people on this call to understand there's the oversized market and there is the heavy hard-to-handle market. Oversized market is basically handled by FedEx Ground, where there has been, over the last five or six years a substantial growth in that sector, and Ground is responding to that by doing some unique things with sortation, automated robotics that handle these types of things. You're going to hear a lot more about it. On the heavy hard-to-handle items – and Brian, this is for both business and residential, not just one – these are items that require a dock height truck, a lift gate, dollies to move it, and they generally require movement over the threshold into the office of the building. We've just started offering that as a FedEx Freight product, FedEx Freight Direct, and you'll hear a lot more about it. But Raj will give you the state of play here.

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

Yeah, as Fred mentioned here, the heavy hard-to-handle market is one of the fastest-growing segments in e-commerce, and it represents roughly a $10 billion market opportunity. And the customer response to FedEx entering the market has been quite positive, and it will represent a new revenue stream for us as we go forward.

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

All right. Raj, this is a clean-up question here, because I don't want any complaints about anybody on this call that we didn't answer any question that you might have fully. How do you see the push towards one-day shipping by the e-tailers affecting capacity? Can USPS handle last-mile delivery for one-day shipping growth, or does it fall on FedEx and UPS? **Jairam Nathan of Daiwa**.

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

Thanks, Jairam, for the question. I can't answer what USPS might do or anybody else. We can just say that the push is no surprise for us, and we are well prepared not only the impact of capacity but also the cost to serve. The global infrastructure, the technology, the capabilities and knowledge that we have and to compete in this business is quite extraordinary as we leverage off our base to build this. Now you asked specifically about e-tailers, but I also want to make a quick comment on traditional retailers. When you combine the store infrastructure of retailers with our logistics infrastructure, it allows retailers to offer a compelling value proposition for orders received late in the day. And the launch of our FedEx Extra Hours is clearly a very, very positive step in this regard.

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

So, thank you for your participation in FedEx Corporation's Second Quarter Earnings Conference Call. Feel free to call anyone on the Investor Relations team if you have any additional questions about FedEx. Thank you.