FedEx Q2 FY18 Earnings Call Transcript – December 19, 2017

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

Good afternoon and welcome to FedEx Corporation's second quarter earnings conference call.

The second quarter earnings release, 31 page stat book and our 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. Written questions are welcome via e-mail. Our e-mail address is ir@fedex.com. When you send your question, 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 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 Vice President and CFO; Mark Allen, Executive Vice President, General Counsel and Secretary; Rob Carter, Executive Vice President, FedEx Information Services and CIO; Don Colleran, Executive Vice President, 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 & CEO, FedEx Corp.

Thank you, Mickey. Good afternoon and welcome to our webcast and conference call to discuss second quarter earnings. Strategic execution by the FedEx team and a stronger global economy drove improved financial results and we believe we are well positioned for profitable long-term growth. Alan will provide further insight and our outlook.

FedEx is on track for another record holiday shipping season and we're pleased to say the outstanding service around the world and across our portfolio during the second quarter has continued into December. We plan year around to meet the intense challenges of the peak season as average daily volumes can more than double with heavy demand for residential e-commerce deliveries.

Most important, let me thank the more than 400,000 FedEx team members around the world for their outstanding efforts to keep our Purple Promise which is simply stated: "I will make every FedEx experience outstanding." It has become increasingly clear to all of us that trust and reliability matter to customers when they choose who will be delivering packages to their doors. Size, reach, speed, and reliability of our networks and the strength of the FedEx brand have great value around the world. Raj will have more to say about peak and macroeconomic trends.

We're very proud of the progress the FedEx team has made in recovering from the effects of the cyberattack at TNT. Let me express our appreciation to the thousands of FedEx professionals who worked around the clock and tirelessly to mitigate this unprecedented event. Dave will update you in his discussion of overall global operations.

We expect yield and volume growth at all of our transportation segments will support revenue and earnings growth in the second half of fiscal 2018. Our plans remain on target to improve operating income at the FedEx Express segment by $1.2 billion to $1.5 billion in fiscal 2020 versus fiscal 2017 and our goal remains to increase earnings, margins, cash flows and returns and we are confident that we can do so.

We're encouraged by the Tax Cuts and Jobs Act legislation advancing in Congress at this very moment. This legislation offers pro-growth, pro-business tax reform solutions that will power the economy, increase business investment, expand job opportunities and enhance incomes and improve U.S. competitiveness.

We, at FedEx, hope all of you have a wonderful holiday season and now let me turn the call over to Alan.

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

Thank you, Fred, and good afternoon everyone. Our adjusted earnings per share for the quarter was $3.18, up 15% from an adjusted $2.77 last year. This year's and last year's quarterly consolidated earnings were adjusted for TNT integration expenses of $0.33 and $0.18 per diluted share respectively.

As-reported and adjusted second quarter earnings this year reflect the estimated negative impact from the TNT cyberattack of $0.31 per diluted share. Results from the quarter improved primarily due to higher base rates, volume growth and a favorable net impact from fuel at each of our transportation segments.

Second quarter results also include a tax benefit of approximately $80 million or $0.29 per diluted share from foreign tax credits associated with a dividend paid from our foreign operations. Our effective tax rate was 32% for the quarter and 35.4% for the first half.

Turning to the segments and starting with Express. Adjusted operating income increased 11% to $813 million driven by revenue growth, a positive net impact from fuel and continued cost efficiencies. Adjusted operating margin improved 20 basis points to 8.7%. The cyberattack at TNT impacted our as-reported and adjusted results by an estimated $100 million for the Express segment, primarily from loss of revenue due to decreased shipments in the TNT network.

As we noted last quarter, we are accelerating portions of our TNT integration as a result of the cyberattack. TNT integration expenses for the second quarter were $96 million for Express and are included in the GAAP results. Despite the challenges from the cyberattack, total international average package volume increased 5%.

At Ground, operating income increased 12% to $521 million and operating margin increased to 10.6%. Operating results improved due to revenue growth, partially offset by higher purchase transportation, network expansion and staffing costs as well as increased self-insurance reserves. Ground continues to work on further restraining costs.

At Freight, operating income increased 34% to $118 million driven by a 7% increase in LTL revenue per shipment. Freight's operating margin improved 120 basis points year-over-year to 6.7% as revenue quality initiatives continued to benefit results.

For FedEx Corp., we are increasing our FY 2018 forecast due to enhanced revenue quality, solid demand trends and our success in restoring business impacted by this summer's cyberattack. We expect to see improved financial results in the second half.

Yield and volume growth at all of our transportation segments are expected to support revenue and earnings growth in the second half prior to any mark-to-market benefit plan adjustments. In addition, we are implementing various cost reductions at Ground for the remainder of FY 2018. We expect ongoing but diminishing financial impact from the cyberattack in the second half of fiscal 2018 in the form of lower revenues.

The earnings forecast before year-end mark-to-market pension accounting adjustments and excluding expenses related to TNT Express integration and certain first quarter FedEx Trade Networks legal matters is now $12.70 to $13.30 per diluted share for FY 2018. This forecast assumes moderate economic growth, current U.S. tax laws, and continued recovery from the cyberattack.

Our capital spending forecast for FY 2018 is still $5.9 billion, although this may increase if the Tax Cut and Jobs Act is enacted. The TNT integration continues spanning over 200 countries. By the end of FY 2020, we plan to have combined pickup and delivery operations at the local level, one global and regional air and ground network and consolidated operations, customs clearance, sales and back office information technology systems.

We now expect the integration expense over four years to be approximately $1.4 billion including restructuring charges. Approximately $450 million of that expense is expected in FY 2018. Our estimate for the integration expenses has increased due to our acceleration of the integration process and additional investments to move TNT information technology, operations and commercial infrastructure to a FedEx platform.

In addition, we have identified new opportunities to improve our integrated business capabilities for greater profitability in periods beyond FY 2020. A portion of the incremental integration expenses relates to establishing a new international corporate structure so that we may leverage synergies to maximize our international profitability ultimately benefiting our effective tax rate.

We remain committed to our target of $1.2 billion to $1.5 billion in additional operating profit for the FedEx segment in FY 2020 versus FY 2017, which includes TNT synergies as well as base business and other operational improvements across the entire global FedEx

Express network. This target assumes moderate economic growth, current accounting rules and U.S. tax laws and continued recovery from the cyberattack.

Our effective tax rate forecast is now 33% to 34% before year-end mark-to-market pension accounting adjustments. We have lowered the upper end of the range. None of our forecasts reflect any potential changes from tax reform.

So turning to tax reform, I know there are a lot of questions about possible changes for us as a result of that, so let me cover as much as I can. We welcome the possibility of lower corporate tax rate, a territorial tax system and 100% expensing of qualifying capital if these provisions are signed into law. Any capital acceleration for FedEx would primarily be for replacement of equipment and technology. If tax reform is enacted, we expect our uses of cash from tax savings would include optimizing CapEx to capture the benefits of 100% expensing to further grow the business and create even more upward mobility for our team members, funding our pension plans beyond our current forecast, increasing the dividend as our Board may approve, continuing our stock repurchase program at our current modest levels and investing in M&A where it makes sense.

As Raj will discuss U.S. GDP could increase materially next year as a result of the U.S. tax reform. If this occurs, we would likely increase capital expenditures and hiring to accommodate the additional volumes triggered from this incremental GDP growth. If the Tax Cuts and Job Act is enacted as set forth in the Joint Conference Report, we estimate our earnings per share could increase by $4.40 to $5.50 per diluted share for FY 2018 before mark-to-market year-end pension accounting adjustments, primarily due to the revaluation of our net deferred tax liabilities. This range also includes an estimated $0.85 to $1 per diluted share due to a lower tax rate on fiscal 2018 earnings for last five months of fiscal 2018.

As we have stated many times in the past, we would like to see a level playing field for corporate taxes. This tax reform bill will go a long way in making U.S.-based corporations more competitive globally.

We have delivered great service levels again this peak, thanks to our careful forecasting and planning that results from working closely with our customers to manage record-setting seasonal volumes and also thanks to the dedication of hundreds of thousands of team members all over the world that make this happen.

Now, I will turn the call over to Raj.

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

Thank you, Alan, and good afternoon, everyone. I'll open with our economic update and outlook and discuss our revenue performance and business conditions in each segment and provide some commentary on broader industry trends and enhancement to the FedEx portfolio.

We see moderate growth in the global economy. Our U.S. forecast is up slightly on solid current momentum. Consumer confidence is at a 17-year high and solid PMI readings show the industrial sector is expanding. Passage of U.S. tax reform could add materially to next year's U.S. GDP forecast. Globally, our world GDP forecast for this year and the next reflects the best growth since 2011 with a synchronized global upturn supporting trade volume growth.

The next few slides show details of revenue, volume and yield performance by transportation segment. Overall, it's clear that our pricing strategies allow us to grow volumes and increase yields across the portfolio and are succeeding in doing so. For our U.S. Domestic Express business, revenue and yield increased 6% and 5% respectively. Excluding fuel surcharge, the yield per package increased 3% due to our continued focus on revenue quality. Despite the impact of cyberattack at TNT, FedEx International Export Package revenue increased 7% year-over-year in Q2 and yield increased 4%. Excluding fuel and exchange rate impact, yields declined slightly.

The Ground segment revenue saw a double-digit growth of 12% in Q2 with volume and yield up as well as e-commerce continues to drive growth. Excluding fuel, the yield per package increased 4%. At FedEx Freight, the revenue per LTL shipment increased 7%, mainly driven by our revenue quality efforts. Excluding the impact from fuel surcharge revenue, the revenue per LTL shipment was up 5%.

Turning to peak, I wanted to provide some very exciting updates. As Fred mentioned, we are proud of the terrific service we have provided even on some of the busiest days in the history of FedEx. We continue to experience many of the trends that have been growing in recent years, the increased demand for larger heavier packages and heavy demand on Mondays. Thanks to the close collaboration with our customers, we're able to plan and engineer our networks and provide excellent service.

I'd like to take this opportunity to thank our more than 400,000 team members around the world who are continuing to work hard to deliver the holidays during the home stretch of the season. Our team members are the best in the business and they're always focused on one thing, delivering an outstanding experience for our customers.

As e-commerce continues to grow, customers are looking for new options for access to FedEx. This year, we have dramatically increased our retail access with approximately 8,200 locations added to the FedEx OnSite network with well-known retailers, including Walgreens. Customers can drop off pre-labeled FedEx Express and FedEx Ground shipments or returns. They can also redirect shipments to hold at a FedEx Office or a FedEx OnSite location for pick up.

We now have a convenience network of over 10,000 locations, including Walgreens, Kroger, Albertsons, FedEx Office and other participating locations. And for those procrastinators, here's a saving grace, pick up is now available on Christmas day at the vast majority of more than 7,500 Walgreens locations. Our presence has never been stronger during peak than it is today.

We also encourage customers to use FedEx Delivery Manager options to direct packages to thousands of secure and convenient hold locations. Enrollments have almost doubled year-over-year and the percentage of residential deliveries being delivered to FedEx Delivery Manager enrollees have almost doubled as well.

We also have a unique strategy for peak pricing this year, where we are not applying an additional peak surcharge to all residential packages, only oversized packages or packages that require additional handling. This strategy was different from others in the marketplace, but we felt it is important to be mindful of our small and medium customers. Obviously, peak is not over but we have seen very good traction with the small and medium customers and we will continue to monitor and measure to inform our pricing decisions for the next year's peak season.

Once again, we are very proud of the results across the portfolio in the second quarter and the outstanding service provided so far this peak season. We believe we are well positioned for the remaining days leading up to Christmas and look forward to helping the holidays arrive once again for our customers around the world.

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, everyone. I also want to thank all of our more than 400,000 team members for their dedication year around and especially in these days leading up to Christmas. These team members are working right now. They're on the road, they're in the air and they're probably at your doorstep delivering the holidays around the world. We are proud to report improved financial and operation results driven by strength across the FedEx portfolio.

This success results from incredible collaboration among sales, marketing and operations. Operations, of course, is our front line. Picking up, sorting, delivering packages all over the globe, but FedEx has some of the smartest minds in the industry in sales and marketing, working with our customers every day all year long, constantly innovating our service and marketing our portfolio around the world.

First, let me start off with FedEx Express. They grew their revenues and profits, as Alan just mentioned, despite the impact of the TNT Express cyberattack. The underlying fundamentals of the business remain very strong with higher base rates and growth in the international package and freight services. Cost efficiencies are also improving. For example, we continue to see higher aircraft fleet reliability, which increases our productivity.

I'm also very happy to say that at TNT, we are seeing strong service levels and operations are back to normal after the June cyberattack. The IT recovery process is complete. We have improved our reliability, we have improved our security and we are also increasing our investments to expedite portions of the integration process.

While we have been successful in our efforts so far, restoring the full confidence of our customers is our key goal. We expect the impact of the cyberattack on our financial results to diminish in our fiscal second half. Our focus remains on service to our customers, of course, our customers' priority and hardening our IT environments.

The successful integration of TNT and FedEx Express remains a key driver of the FedEx Express FY 2020 operating income improvement target of $1.2 billion to $1.5 billion over FY 2017 results, which we are now reaffirming.

Next, FedEx Ground achieved significant growth in revenue and operating income. We're starting to benefit from the cost cutting measures we are implementing to address evolving business conditions. We are improving revenue quality and reviewing long-term capital plans to balance capacity expansion with pricing and volume growth.

From a service perspective, we are having the best peak ever at FedEx Ground. I should add we are having the best peak ever at FedEx Express and FedEx Freight. We are also pleased that Bob Henning has joined the FedEx Ground team in Pittsburgh as the CFO there. Bob's experience in strategic finance, coupled with the FedEx Ground team's immense knowledge of ground operations and the industry trends, will be instrumental as we chart our course for the future.

And finally, last but certainly not least, FedEx Freight stands out with tremendous growth in revenue and profitability as we benefit from disciplined pricing strategies and investments to improve safety and efficiency. We expect this to continue and look for this segment to have one of its best years in over a decade.

With our global portfolio, we're confident of our ability to achieve our goals, which include increasing our earnings, increasing our margins, cash flows and returns.

And with that, we'll answer your submitted questions, and I'll turn it back over to Mickey.

QUESTION AND ANSWER SECTION

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

We have some submitted questions [Technical Difficulty] (24:09) Internet.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

Okay. Mickey, let me take a few that came right in as they apply directly to a couple of the remarks that were made, and then we have a list of questions that came in before the meeting that we assigned people to answer. So Amit Mehrotra of Deutsche Bank, Tom Wadewitz of UBS and Scott Group of Wolfe all would like more clarity about Alan's comments about the increase in TNT integration expense. So, Alan?

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

I'll start, and then I'll turn it over to David Cunningham. If the concern is: are we going to get the return on the additional investment over the $800 million, the answer is clearly yes. Some of that will come beyond the FY 2020 period, as I mentioned in my earlier remarks. And you should also know that we're spending a significant amount on our tax structure that is below the line, and that will have benefits even if the new tax law passes, that will be substantial and that we never quantified for you in the $1.2 billion to $1.5 billion. So I'm convinced that we're doing the right thing here. A lot of this was as a result of the cyberattack, where we decided to move much more aggressively on hardening and turning the FedEx platforms, and I think David Cunningham and Rob Carter can add a little color to that.

David L. Cunningham
President & CEO, FedEx Express

Well, I mean, Alan, there's not a lot to add in terms of what you just said. I would just add that we are convinced that the additional spending is going to generate result well beyond the $1.2 billion to $1.5 billion in the marketplace.

Rob B. Carter
Executive Vice President, Information Services and Chief Information Officer, FedEx Corp.

The only thing I'll add and just very concisely is on the heels of the cyberattack, we've become much more aggressive about improving the security posture reliability and speeding up the integration of the technology platforms. We've been successful on all three fronts. Dave mentioned those but we're going very aggressively at moving the TNT enterprise to the more stable and reliable FedEx systems.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

Okay. That was Rob Carter, our CIO, who just spoke there. I'm not sure he said that he was entering there, but he, obviously, knows whereof he speaks. Now, we have three questions about tax cash flows and CapEx. Matt Troy of Wells Fargo about CapEx levels on an absolute dollar basis over the next three years. Will it decline? Ravi Shanker, what will the proposed tax resolution do to your free cash flow performance? Will free cash flow grow up as much as EPS? And finally, from Lee Klaskow of Bloomberg Intelligence, will FedEx recognize further foreign tax credits in the remainder of FY 2018? He asked, will it be similar to the $80 million in 2Q? Alan, why don't you answer that last one and then talk about free cash flow?

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

Okay. We don't plan to recognize any more foreign tax credits this year. Things can change, but I think we've done the plan that we need to for this point. Obviously, Matt's and Ravi's questions are related. I think that, with 100% expensing as I've said at several of the last meetings, that if we got that in a new tax law, we would likely increase our CapEx on an absolute basis. One of the most important things that we're doing in the company is our fleet, re-fleeting at Express, and, if there's a possibility to accelerate that, it's the highest return project that we have out there and it's something we would look at.

So, Ravi, I'm not sure how you define free cash flow, but in my opening comments I did mention that we plan to make additional pension fund contributions, and the way I measure it, that would be a reduction in free cash flow, although, since it's optional, some people don't count that. Having said that, it won't go up as much as EPS because of what I said about CapEx, so I hope that gives you the color that you need.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

Okay. Let's turn to some of the questions that were submitted in advance. Helane Becker would like to know about the two recent feeder aircraft that we ordered, the Cessna C408, the new airplane and the ATR 72-600 large cargo door airplanes, are they growth or replacement aircraft or both? And Ken Hoexter of Merrill Lynch would like to know how big of a CapEx program this is, so David Cunningham?

David L. Cunningham
President & CEO, FedEx Express

[Technical Difficulty] (29:02) as replacement capital and a part of our fleet modernization, our current fleet of ATRs and 208s are 25 to 26 years old and will be approaching 30 years by 2020 when we take the first deliveries. These are twin-engine aircraft with modern glass cockpits, large cargo door, which is different than the others and they're also containerized versus being bulk loaded. And so we're creating a lot of efficiency but we're also creating the opportunity to handle product to markets that we haven't been able to handle in some of the smaller aircraft to this point.

So we're very excited about this. The capital is roughly equivalent to one wide-body aircraft per year. And the orders of the aircraft that we're talking about are 408s, 50 orders and 50 options. The ATRs are 30 and 20, so in terms of the ATRs, we're talking about six aircraft per year and the 408s, we're talking about 12 aircraft per year.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

The next questions are about Ground margins, also from Helane Becker, wanting to know, does it make sense to continue to invest in long-term Ground facilities? Jairam Nathan of Daiwa, how do you see FedEx capacity to handle e-commerce deliveries? Given the stronger than expected growth this year, should we expect another expansion binge? I'm not sure we've ever binged on expansion. I think they've been pretty well planned, that's a joke. And CapEx, will it increase as growth rate surpass expectations? So I'm going to ask Henry to take both of those.

Henry J. Maier
President & CEO, FedEx Ground

Yeah. Good afternoon. Thanks for the questions. Our investments in capacity and automation over the last several years have enabled our industry-leading service, including at the busiest times of the year. And we believe reliable service is a key factor in our continued growth. However, we're approaching a transition point, where you'll begin to see us dial back network expansion CapEx as we complete certain critical capacity projects already underway. And we can do this while still effectively serving the growing e-commerce market because automation and technology improves efficiency, productivity, and utilization of network capacity.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So we have another question on Ground. What are the specific steps and financial benefits you can take to improve Ground margins to mid-teens? Christian Wetherbee of Citi. I'll just say we have all kinds of plans at Ground to improve the margins there and we're confident we can do so, but none of these tactics we'll be willing to discuss with the general public.

Is there a general range for the cost savings on delivering to a drop-off location versus home delivery? What percent of Ground shipments are going to pick-up and drop-off locations currently? Todd Fowler of KeyBanc. Raj, you want to take that?

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

Yeah. Todd, thank you for the question. We don't break out the operational cost for pick-up and delivery or percentage of volume for FedEx OnSite or FedEx Office. But as you can imagine, delivering multiple packages to a retail location is far cheaper than delivering a single package to a home. But the real key here is the advantage of FedEx OnSite is the convenience that we provide for our customers and ultimately providing a win-win-win solution for the shipper, the consumer, and for FedEx. As an example, porch piracy is a significant concern that can be allayed by this service.

Now, as I mentioned already, we have more than 10,000 FedEx OnSite locations and we are very, very pleased with the usage trends that we have seen so far. Thank you.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So, Alan, I've got one here from Chris Wetherbee from Citi about the EPS estimate for the TNT cyberattack. Alan?

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

So, Chris, you asked a question about was the $1.20 still a good estimate for the year. We've had $1.10 in the first and second quarters, but it dropped significantly from the first quarter to the second quarter, so I'm not sure it's even going to be worthy of us discussing it in the second half of the year, so that's the best answer I can give you at this point.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So, we have a number of questions now on Amazon and e-commerce from Keith Schoonmaker of Morningstar. Given the high cost of residential deliveries and capacity stress from handling peak demand, is it actually beneficial to have some customers take in house some of their deliveries, or is the detrimental effect on delivery density a stronger negative than the demand relief?

We talked about this yesterday. We're not 100% sure exactly what the question is, but let me give a broad explanation of how we deal with these issues and I think it will answer the question that you have in mind. As I've said on a number of occasions, and Dave Bronczek has gone into a lot of detail on this as has Henry Maier and Raj, the secret of our business is to, one, effectively match commercial and residential deliveries so that we don't get too far out of balance and we are achieving our profitability goals.

Now as we've just discussed, we've put a lot of bow wave expenses to improve and expand our Ground network. And as Alan has said over and over again, we anticipate those are going to have substantial long-term returns and improvements to profitability. And one of the things that I've mentioned over and over again on this call is many times it seems like some of you are trying to talk about FedEx Ground, Inc. or FedEx Express, Inc. rather than FedEx Corporation, Inc.

And by that I mean, when we're knocking the ball out of the park in one segment, we then say, perhaps, we can make some investments someplace else so that we can improve their longer-term profitability. So we deal with our opcos as a portfolio of solutions and not all of them are being run by us to maximize returns every quarter or we couldn't make these long-term investments.

So going back to the question, you've got to have a disciplined approach to the mix of commercial and residential packages. Having said that, we are quite confident that we can handle vastly larger amounts of e-commerce packages in the future at profitable rates because of the investments we've made. These automated facilities that Henry talked about, we have two major hubs coming online next year and a couple more after that. These are substantial improvements to our ability to handle this type of traffic on a profitable long-term basis.

The other thing that I would mention to you that is often missed in these evaluations or the comments about the e-commerce business, it requires a close collaboration between FedEx and our customers to choreograph these massive industrial systems during these peak seasons. We will begin literally the day after New Year's planning for next peak season. And we have very close relationships with our major customers. And I think the proof of the pudding is in the eating. Dave told you we're having an outstanding peak.

Well, that's because of the investments and the close planning we do with our customers and that's a prerequisite in this business or you will not be successful. And some of the questions seem to miss those two points and I want to reemphasize that our great service is because of the outstanding planning, long-term planning and having facilities in place. We've been off a little bit sometimes but not much, but boy, we had it right this year so far, knock on wood, and secondarily, it's managing this mix. And third, you have got to have a close collaboration with your major customers who have a lot of residential e-commerce, so you know where that traffic is coming from, you can prepare for it and handle it. So apologize for the long answer, but a lot of these questions kind of miss those key points.

So then David Vernon asked if Amazon starts competing for shipping business, how would that impact your go-to-market strategy? Obviously, we don't address hypotheticals. I'm sorry, David, but maybe Raj wants to comment about this.

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

Well, Fred, all I can add to that, I'd just say that Amazon is a longstanding customer of FedEx but, however, it should be noted that FedEx has no single customer that represents more than 3% of revenue or volume.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So Allison Landry wants to know about the addressable market for reverse logistics. Are retailers capable of handling the growth in returns and online orders? And how does FedEx plan to capitalize on this opportunity? Raj?

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

Yeah. Thank you for your question, Allison. We have estimates that say that roughly 15% of all goods purchased are returned with apparel running at about 30%. Now the business of returns continues to grow in scale and complexity especially for retailers as they are directly impacted by the amount of online consumer spending. Now from our part, the integration of FedEx Supply Chain with our existing portfolio has uniquely positioned us for success here because we provide the most robust end-to-end solutions in this growing market. And we have some very exciting developments underway that will surpass customer expectations, provide new value for both merchants and consumers.

Now in addition to all this, buying online and returning in-store continues to emerge as a core consumer preference. Now as we've talked several times, we have a vast network of FedEx Office and retail alliances like Walgreens that provide an ideal opportunity to offer consumers a convenient drop-off point for their returns.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So, Allison had a follow-on question. Do we collaborate with traditional brick-and-mortar retailers that have successful online strategies? The answer to that question is yes, and big time. And we collaborate with pure e-tailers. We deal very closely with our customers. Don Colleran, do you want to make a comment about that because it's your people that are right in there, the Solutions Group?

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

Sure, Fred. I think you've done a wonderful job explaining the process. It is a 12-month process, where we sit down with approximately our top 25 customers and put together very specific and very surgical plans. We share those with the operating companies, so there's alignment in terms of where we want to position the resources. But it's worked flawlessly this year and the operational excellence that we've experienced at the operating company level is because of the ongoing planning that we do with our top customers as well as our broader set of customers, so we feel really good about where we sit this time of the year going into the last week.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So, we have a couple of other questions here on CapEx and expensing and the part that is often missed in the conversation because of the politics involved in this situation is if the tax bill works as anticipated, there will be a significant growth in GDP. And remember that the Business Roundtable did a survey prior to this tax bill passing and 82% of the BRT membership anticipated that if it did pass that it would substantially increase their capital expenditures and 75% anticipated that they would increase employment.

Well, they're not making additional CapEx and increasing employment for any other reason than the market's growing. So, if we increase capital expenditures, as Alan said, it will be because the market is growing, we think we can make more money and increase cash flows and so forth. But there's not just any willy-nilly interest in increasing CapEx, other than for that except for one thing in the case of expensing, you increase the net present value of the returns if it is a replacement piece of capital because you get it in place earlier and you get your money right back. So, to that extent, it would be bringing the money forward and not spending it later.

It's the CapEx for GDP growth rates induced by the tax rate that is the important part of any increase in CapEx and we'll identify which is which if we do that. So you got something here, Alan, on the...

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

[indiscernible]

Frederick W. Smith
Chairman & CEO, FedEx Corp.

Okay. There was a question to Rob Carter on some software?

Rob B. Carter
Executive Vice President, Information Services and Chief Information Officer, FedEx Corp.

Yeah, this is Rob Carter. This is from Amit Mehrotra from Deutsche Bank. Please update us on SmartPost redirect initiatives. When will address-matching software be deployed? Well, that software is already deployed and is paying big dividends at FedEx Ground, where we are taking address-matching capabilities and even proximate capabilities and moving SmartPost deliveries into the FedEx Ground network, so that was deployed this summer at scale and we are experiencing the benefits. We are also planning on making available to our customers in the coming timeframe, probably next year, SmartPost Hold at Location capabilities, so you'd also be able to redirect those shipments to any of our convenient more than 10,000 locations in the OnSite network.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

Okay. So here is a question from Ben Hartford. How does FedEx's attitude towards migrating closer to the consumer via a formal retail marketplace evolve? What are the merits and drawbacks to developing marketplace and more directly linked customers' retail consumer transactions with your broad distribution network?

I think, Ben, what you're asking there is why don't we put up a marketplace ourselves? Well, we strongly believe that we should not compete with our customers and our big customers have marketplaces. So we think the value-added that we bring to the table and unmatched value-added is the portfolio of solutions and assets that we can help them fulfill their marketplace requirements, so that's our policy in that regard.

There's a question about FedEx Express' domestic China deliveries. Has the focus shifted to nearly all import/export? Keith Schoonmaker of Morningstar. David Cunningham?

David L. Cunningham
President & CEO, FedEx Express

Sure. Thank you. Our domestic business is growing and an important part of our unique value proposition in China. We're the only foreign company with a wholly-owned domestic and international business. The domestic product is closely aligned and integrated with our international import/export business. It is doing great. Our business is more focused. The domestic business is more focused on the B2B market and does not compete in the domestic e-commerce market.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So there's a question about Cross Border and international e-commerce. Matthew Russell of Goldman Sachs wants to know the secular opportunity here and what if any additional investment FedEx will need to make to best capture the opportunity? Raj?

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

Yeah, Matthew, thank you for the question. According to Forrester, the Cross Border e-commerce represents roughly 11% of the total e-commerce market in 2017, but it is growing significantly faster, roughly 1.5 times faster. And so in a sense Cross Border e-commerce may become 20% of the market by 2022 for the GMV of roughly $627 billion. But as you can imagine, this market is far more complex than our domestic e-commerce market and there are only a very, very few players like FedEx who can provide adequate capabilities.

Firstly, we can leverage our existing world-class global transportation network; and secondly, we launched FedEx Cross Border as a technology play to make Cross Border e-commerce as seamless as possible. We are extremely pleased with the progress we have seen thus far and very, very excited about the potential in the future.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

There's a question about the new Tesla truck. Mike Ducker, would you read who it came from and answer it?

Michael L. Ducker
President & CEO, FedEx Freight

It came from Ravi Shanker. And Ravi asked, are there any thoughts on the Tesla semi-truck? Have you placed any orders yet? And as you know, we already have a lot of electric vehicles operating in all across our networks. We think they've got good potential, could offer a lot of benefits when they come to market. So we've certainly evaluated the truck and should we decide to order any of those, we'll certainly make that known early.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

Yeah. I think we had people out there at the...

Michael L. Ducker
President & CEO, FedEx Freight

Grand opening.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

Yeah. We worked with Tesla and looked at the vehicles, very innovative. So a company, I mean a question from David Campbell of Thompson Davis. Hope you're doing well, David, old friend. You want to know whether the company believes that internationally, your shipment growth will continue to exceed the global rate of GDP over the longer-term. And in a related question, how should investors be thinking about a potential slowdown in the pace of growth in international air freight in 2018 as it pertains to international express results in 2018? Allison Landry of Credit Suisse. And I think David Bronczek wanted to answer this personally maybe with some color from Raj.

David J. Bronczek
President & COO, FedEx Corp.

Thanks, Fred. Thanks for the question, David. We absolutely believe short term and long term the international air freight shipments continue to grow and outpace GDP like it always used to be in the past and then it slowed down but now it is again. That's great news for FedEx because we're the biggest, most powerful air freight forwarder and global business transportation worldwide. So for us it's actually right in our wheelhouse.

In terms of slowing down in 2018, Alan talked about the tax reform bill. We think that adds a lot to air freight in a global economy and I think that's again going to be very beneficial to us.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

Dave, I think you misspoke there, meant to say the largest air cargo and air express company, not the largest air forwarder. Yes. The word just flew out. I didn't want to leave any misimpression in the audience. And, Raj, do you want to add some on that?

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

I mean, all I can add to that is that the air freight, in particular, the air express markets, they really serve the high-value, high sector part of the economy and in modern times, they've grown faster than regular GDP and we expect that trend to continue over the long term.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

They've also grown faster than the general air cargo markets over a long period of time, as well, I might add. So new technology from Ravi Shanker. Are you doing any workaround integration of blockchain in the customer operations? What impact do you think it will have in logistics and how can that be an opportunity or threat to FedEx? Rob Carter, our CIO, will answer that.

Rob B. Carter
Executive Vice President, Information Services and Chief Information Officer, FedEx Corp.

Ravi, we definitely believe that blockchain represents a significant opportunity in the custodial control and chain of control for supply chain shipments. We were and are charter members in the Blockchain in Transportation Alliance as well as the Blockchain Research Institute and we believe that going forward, the overall provenance of goods as they move around the world and the enhancement that blockchain offers to global settlement systems and payment systems offer a significant opportunity for us. So I think the answer is yes.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So there's another question here about our view on electric and autonomous trucks and specifically about our subcontractor model. Would it slow down adoption of such technologies? I mean, the answer to that is no in general, but Rob just gave an important speech that sort of represents the Company's position on this and we thought it'd be a good idea if he just repeated what he said out in Silicon Valley. Rob?

Rob B. Carter
Executive Vice President, Information Services and Chief Information Officer, FedEx Corp.

Well, first off, the general innovation of footprint that we have always has us looking at modern and innovation-oriented developments in the marketplace and certainly autonomous vehicles are among them as well as electrification. So, reality is this that autonomous vehicles are already among us and we believe that the most important things that'll happen in the near term is using technologies like adaptive cruise control, lane departure, automatic braking, all of which compositely make for autonomy offer much improved safety for our drivers and a much improved quality of life for the men and women that are on the road for FedEx out there.

So, clearly, these technologies won't stop there. There are many opportunities in the future but right now, we are using a lot of autonomy to make our teams safer and to give them a better quality of life on the road. And we're using a lot of different technologies to make sure that our sustainability efforts continue to improve the environment, and I commend you [indiscernible] our sustainability report on fedex.com.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So, Scott Schneeberger of Oppenheimer has a couple of questions. One about freight, how do you anticipate balancing volume and yield at FedEx Freight going forward if current demand environment persists? Mike Ducker?

Michael L. Ducker
President & CEO, FedEx Freight

Yes, sir. First, let me thank our FedEx Freight team for a great quarter and a great peak season too and thank you for the question, Scott. As we've all read, the current environment is strong. We have very solid business processes in place to balance volume and yield. The improved revenue quality really is the primary driver of the results in Q2 including a 34% higher operating margin.

It's a team game between operations, sales, pricing, solutions, marketing. We work closely together to not only ensure we're giving the best market-leading service, but that we get compensated fairly for it using data-driven decision-making tools in which we've invested in the past. So we believe we have great processes in place. We expect that our continued focus on revenue quality will drive operating income and margin improvement through the rest of 2018.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So we've got a couple of questions here for Henry Maier. One of them is from Tom Wadewitz, is FedEx still tapping the brakes on the pace of B2C volume growth in Ground? How much did B2C Ground volumes grow in 2Q and how much did B2B Ground volumes grow? Henry?

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

Yes, this is Raj. I would just say that we're going to – we haven't broken out the volume trends between B2C and B2B and we're not going to start in this call. All I would say is that we grew our Ground business double-digits in the second quarter, with healthy volume and yield increase, and we will continue to monitor customer-over-customer and make sure we make the right decision that balances volume, yield and profitability.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So this one's for Henry, could you please discuss strategic initiatives to accelerate growth in FedEx Supply Chain and discuss what type of growth you anticipate for this business longer term? Scott Schneeberger of Oppenheimer.

Henry J. Maier
President & CEO, FedEx Ground

Thanks for the question, Scott. We think there's great opportunities for growth across several segments in supply chain. For example, we launched FedEx Fulfillment in February to help small and medium-sized retailers, e-tailers and brands. FedEx Fulfillment has many capabilities, warehousing, fulfillment, inventory and transportation management and reverse logistics so e-tailers and retailers can focus on business itself instead of supply chain.

We also see an opportunity to further leverage our reverse logistics expertise to enhance the overall returns process. E-commerce continues to drive a high return rate and consumer preferences to return online purchases to physical locations can be satisfied by leveraging FedEx Office and other retail access points.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So we have a question from David Ross of Stifel. With international growing again, do you anticipate any flight additions in calendar 2018. I think David Bronczek wanted to make a comment and we'll pass it on to David Cunningham.

David J. Bronczek
President & COO, FedEx Corp.

Yeah. I would just say that any additions we would make are so miniscule in our big global network that it wouldn't be really worth talking about. I mean, we had capacity to meet demand all year long and as the volumes grow, we keep matching the volumes. So, our network is so big and so global now that it wouldn't show up on the radar.

David L. Cunningham
President & CEO, FedEx Express

Well, and just maybe highlight the scale of what Dave's talking about, we operate 1,600 departures, utilizing 660 aircraft every single day and we scale up and we scale down to meet demand. And so as Dave said, it will be relatively modest.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So where has hiring employees [indiscernible] been the most challenging and has it impeded operations or materially increased costs this year? Brian Ossenbeck of JPMorgan, I think Dave wanted to mention something and then we'll hand it off to Henry Maier.

David J. Bronczek
President & COO, FedEx Corp.

Yeah, thanks Fred. And thanks for the question, Brian, it's a great question, we talk about it all the time. We have no problems hiring anybody anywhere in the United States or around the world, and quite frankly it's because people love working for FedEx. We actually started a program called friends and family, so our employees when their sons and daughters come back from college, we hire them. And it's been fantastic for us and it continues to be a great program, it's not just for family members but it's also friends.

Henry J. Maier
President & CEO, FedEx Ground

Yeah, let me add, Dave, this is Henry Maier, FedEx Ground. Our investments in automated facilities coupled with geographically targeted peak wage rates have allowed FedEx Ground to maintain fully staffed facilities across the entire network this peak, we've had no issues anywhere.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

So David Bronczek, this question you're uniquely qualified to answer about the Postal Service from Brian Ossenbeck of JPMorgan. Does the recent order on market dominant products and proposed supplemental pricing authority beyond the CPI cap have any impact on FedEx?

David J. Bronczek
President & COO, FedEx Corp.

The very short answer is we do not believe so. I should add, however, that the USPS is a very good partner of FedEx and has been for many, many years over a decade now. And so we keep working the partnership and improving the service along the way.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

Is there further scope to expand non-conveyable and oversized product pricing beyond current levels? What percentage of Ground freight volumes are in this category, same questioner, Raj?

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

Yeah, Brian, the non-conveyable and the oversized packages are roughly 10% to 11% of the volume we handle at the FedEx Ground network and we've added sortation and delivery capability to handle these larger, heavier packages. As you can imagine, there are only a very few players in the marketplace who have the capability to handle such traffic. So we will continue to monitor trends and adjust pricing as needed and so that ultimately we can provide an outstanding service for our customers.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

And, Raj, you can just go into this question from David Ross. Now that SmartPost is going DIM in January, when will Freight finally make the switch to dimensional pricing away from the outdated, irrelevant NMFC pricing, David Ross of Stifel. If you'd take that and then to Mike, and Mike, when you get the microphone, Ken Hoexter wants to know about any movements or thoughts on 33-foot pups.

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

Well, David, of course we agree with you in that dimensional density-based pricing offers a much more simplified alternative to the class-based system, which is frankly outdated. We have this capability to customers if you want to choose it today, and it benefits the whole industry to move to a simplified pricing structure based on shipment size. Mike?

Michael L. Ducker
President & CEO, FedEx Freight

Yes, sir. Ken, thanks for the question. As you know, we're a – FedEx is a member, in fact, a charter member of the Americans for Modern Transportation coalition. We have in that coalition a really diverse group of shippers, retailers, and customers including UPS, Amazon, the National Retail Federation, The U.S. Chamber of Commerce, among others and we continue to advocate for these because we believe that they're safer, more efficient, you get an 18% loaded improvement out of it. It puts fewer trucks on an already taxed infrastructure and there – and we've driven more than a million miles on these on the roads, so we know that they're safer. It takes out 204 million gallons of fuel a year, 4.4 billion pounds of CO2 emissions. Why wouldn't this be good is our position, so we continue to focus on it and hopefully that tax reform moving across the goal line in the infrastructure package next it will be strongly considered and we will certainly be promoting it in that legislation.

Frederick W. Smith
Chairman & CEO, FedEx Corp.

The last question is from Ken Hoexter from BofA Merrill Lynch. It's basically about our customer sales strategy. David Bronczek and Don Colleran would both cut my throat if I told you any of the – answered this question, Ken. So I'll just say we have the greatest sales force in the – of any industrial company in the world and lots of potential new business. So with that I'll turn it back over to Mickey.

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

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