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

Good afternoon and welcome to FedEx Corporation’s fourth quarter earnings conference call. The fourth quarter earnings release 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.

Joining us on the call today are members of the media. During our question-and-answer session, callers will be limited to one question in order to allow us to accommodate all those who would like to participate. 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; Raj Subramaniam, President and Chief Operating Officer; Alan Graf, Executive Vice President and Chief Financial Officer; Mark Allen, Executive Vice President, General Counsel and Secretary; Rob Carter, Executive Vice President, FedEx Information Services and CIO; Brie Carere, Executive Vice President, Chief Marketing and Communications Officer.

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

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

Thank you very much, Mickey. Welcome to all joining our quarterly call. Fiscal 2019 was a year of both challenge and change for FedEx. We faced weakening international revenue growth driven by the slowdown in global trade, less favorable service mix of TNT Express business after the NotPetya cyberattack, and continued rapid growth of e-commerce demand. We’re very proud of our team members who are responding with positive actions and innovative solutions that will make FedEx even stronger and more successful in the future.

FedEx enters fiscal 2020 with a sharp focus on extending our lead as the premier global transport and logistics company and on making the necessary investments today to capture the significant market opportunities we see for the future. These steps include enhancing FedEx Ground capabilities, speed and efficiency; improving FedEx Express hub automation, particularly in Memphis and Indianapolis; finishing the integration of TNT; modernizing our aircraft fleet and reducing unit cost and increasing productivity, especially for e-commerce deliveries.

While these investments are long-term in nature and their success cannot always be measured immediately, we’re confident they will drive significant earnings growth and improve margins, cash flows and returns for our shareholders over the long haul.

Let me emphasize, however, that based on our current forecast of U.S. GDP growth for FY 2020, we anticipate FedEx Freight will increase earnings and margin over the period. We believe FedEx Ground will increase earnings for the fiscal year with modest, if any, margin compression from current levels despite the investments we’ve announced such as six- and seven-day per week delivery, large package capabilities, and insourcing of SmartPost.

Global trade disputes and low global growth rates create significant uncertainty for the Express business, leading us to be cautious in projecting FY 2020 earnings for this segment. The integration of TNT is now progressing at a good clip and we will see significant benefits by this time in summer 2021.
A major focus of our investment strategy, I should note, is also improve sustainability and efficiency. We intend to substantially grow our e-commerce business and are well aware improved profitability in this market requires great efficiency in delivering residential packages, and we have sound initiatives to steadily improve our cost-to-serve this market.

To these ends, for example, we recently announced in-sourcing 2 million SmartPost packages and an agreement with Dollar General for over 8,000 pickup and delivery on-site locations in sparsely populated and rural areas. Over FY 2020, we will announce several additional initiatives in this regard.

Let me also caution observers who follow FedEx and this industry to be very careful extrapolating past assumptions and trends into the future. For instance, we’ve noted repeatedly, short haul package delivery will become increasingly important as retailers ship e-commerce orders from store or local fulfillment. Hence average yields have to be matched with operational changes, not visible to most, to assure potential future profitability. Also, future developments in speeding up e-commerce deliveries and postal reform, which by the way we have supported, will likely be discontinuities in the next several years.

FedEx is uniquely positioned for long-term success and will continue to deliver a great future for our customers, shareowners, team members and the communities we serve.

Let me now turn to Raj followed by Brie and Alan, and then a brief comment by Mark Allen, and then we'll take questions. Raj?

Rajesh Subramaniam
President & Chief Operating Officer, FedEx Corp.

Thank you, Fred and good afternoon. As mentioned on the last call, our focus is long-term profitable growth that drives increased shareholder value. Fiscal year 2020 is in many ways a transition year for FedEx, as we continue to reinvigorate our business to capitalize on e-commerce growth and execute significant initiatives to reduce our cost-to-serve. In the U.S. alone, we expect the parcel market to double in size to more than 100 million packages per day by 2026.

As the market grows, so too do our capabilities and offerings. Our global network serves as the invisible backbone for the fast, easy, and reliable e-commerce experience that consumers demand today, and we continuously build upon our offerings to customers. One way we are doing so is by strategically working with retailers to enable market-leading value propositions. This includes working with Target to leverage their stores as local fulfillment centers thorough our FedEx Extra Hours offering, and giving our customers access to a multitude of FedEx drop-off and pick-up services, such as last week’s announcement with Dollar General. These are just a few examples of the ways we continue to flex our operations and network to respond to our customers. Brie will cover these capabilities among others in more detail.

It is clear that we are all-in on e-commerce. This commitment is illustrated by a number of key strategic initiatives well underway in our operating units. Just last month, we announced a number of innovative solutions for our FedEx Ground network. This includes seven day a week residential delivery, rapidly integrating FedEx SmartPost volume into standard Ground operations, and enhancing network capabilities around large package handling.

These changes directly address some of the key challenges inherent with e-commerce, namely increasing consumer expectations and managing the cost for residential delivery. Bringing the SmartPost volume into the Ground network allows us to improve density and efficiency in the last-mile deliveries. It is significant that we are engineering and enhancing the Ground network in such a way that it will be more cost-effective to deliver millions of residential packages a day directly by FedEx Ground. In fact, we expect FedEx Ground to become the low-cost last-mile provider in the industry.

The recent Ground announcement should be particularly exciting to online consumers who purchase large items like furniture, TVs and kayaks with the click of a button. We expect to have a large package operation in nearly 40 Ground facilities prior to our peak season. The vast majority of these are existing facilities and this approach minimizes CapEx and enables us to focus on placing large package handling in the more strategic locations such as near ports and railroads.
Not one element of this transformation will be possible without the investments that FedEx Ground has been making and continues to make in technology. Advancements in loading, sorting and scanning technologies will provide near real-time data. It will help optimize operations for maximizing the use of rail, improving delivery density and increasing the efficiency of handling all packages, no matter the size.

These types of technological enhancements and state-of-the-art tools are true differentiators and are being implemented all across the FedEx operations, not just FedEx Ground. FedEx Freight, for example, is in the midst of modernizing an industry that has been historically paper-based. Technology advancements like advanced forklift computers, electronic shipping labels and Advance Driver Assist Systems allow for team members to work smarter, safer, and more efficiently. This evolution of automation sets us up for continued long-term success.

At FedEx Express, we are implementing initiatives focused on lowering our cost-to-serve in the U.S. This includes rightsizing the network as we prepare for future growth. To accommodate this growth, we have launched multi-year hub modernization efforts at two of our largest Express hubs, Memphis and Indy. These investments will enable Express to handle more volume more efficiently.

Internationally, the global trade picture is less than ideal, but we are confident in our long-term position. We are rapidly moving forward with the integration of TNT. As expected, we began FY 2020 with a global sales force that’s 98% integrated, positioning us with a single face to our customers in nearly every market worldwide.

We’ve recently completed, on schedule, the rollout of our capabilities to inject legacy FedEx Express intra-European shipments into the TNT European road network. We expect to be substantially complete with the operational integration by the end of fiscal year 2020. This will allow interoperability between the TNT and legacy Express networks and in turn result in faster service for customers at a lower cost. Beyond fiscal year 2020, our work will continue with key initiatives including customer migration, air network integration and product rationalization.

The various areas I’ve touched on today position FedEx to be “future ready.” We are focused on the long-term and I’m humbled by the ongoing commitment, dedication and innovation by our more than 450,000 team members around the world.

Now, I’ll turn it over to Brie to provide more details on our macro view, revenue quality and additional growth initiatives. Brie?

Brie Carere
Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.

Thank you, Raj. Good afternoon everyone. I’ll open with our economic update and outlook and provide some commentary on broader industry trends and our growth priorities. Overall, U.S. economic growth is holding up well with real GDP growing 3.1% in the first quarter of calendar year 2019. However, the industrial sector has suffered from an inventory build up and increased trade tensions. Through May, manufacturing output was 1.5% off its December peak.

For calendar year 2019, we expect global economic growth to moderate, as the developed world sees slower growth, and both domestic and external factors weigh on emerging markets. We expect services to continue to underpin global GDP growth.

Global trade has slowed as trade frictions have exerted a negative impact on sentiments and of course the manufacturing sector. As the Chinese economy has continued to decelerate, this has also impacted other Asian markets’ export performance. China’s exports, which grew almost 10% in 2018, have barely grown this year amid heightened trade tensions with the United States.

Outlook for the European economies remains slow due to a number of sector and country-specific factors, such as disruptions in the auto manufacturing sector, social tensions, policy uncertainty, as well as uncertainty related to Brexit. In Germany and Italy, which are two important markets for us, manufacturing output, which turned negative in November, has continued to decline with April manufacturing output down 3.5% and 1.9% year-over-year in Germany and Italy, respectively.
As we have stressed before, tariffs are counter-productive to efforts that encourage business growth and expand global trade. Thankfully, however we have a large and flexible global network that allows us to adjust and meet our customer’s needs when trade issues present challenges in certain markets.

As I mentioned on the last call, we remain laser-focused on three key areas: international, e-commerce, and small business. Despite macroeconomic headwinds that I just covered, our international commercial team is poised for growth. Sales integration, as Raj has mentioned, is essentially complete. Our European network is more reliable and faster than it has ever been. We have simplified our pricing structure and opened the valve for e-commerce within Europe. We have also created new pricing programs for our Asian team to sell into Europe as well as from Europe into Asia. This is the largest trade lane in the world.

E-commerce continues to be a driving force of total U.S. domestic market growth. We are building our portfolio, network and capacity to best serve thousands of retailers in this space. And we continue to differentiate, for example, with the launch of the FedEx 7-Day service. In 2020, FedEx Ground will deliver seven days a week, year-round for 80% of U.S. GDP. This is truly a transformational move that builds upon the largest global commerce transportation network in the world to further serve the growing e-commerce market. We are already faster than the competition by at least one day in 25% of the lanes. This move will further speed up our network and allow us to continue to gain market share.

With the growth of e-commerce and consumer demand for flexible, safe and convenient delivery options, FedEx sought to provide unmatched access and create cost saving opportunities for customers. The recently announced alliance with Dollar General will provide access to FedEx services in places that customers have told us are very convenient in their daily lives. The alliance will provide more than 8,000 additional locations for customers to hold packages for pick-up and drop-off pre-labeled packages, including of course pre-labeled returns. Further, it will bring FedEx closer to the consumer than we have ever been before, within five miles of over 90% of the United States population.

Once the Dollar General rollout is complete, the number of retail locations providing staffed FedEx shipping will grow to over 27,000. We are incredibly excited that the access to FedEx services continues to improve, especially for e-commerce recipients in more rural, less populated areas of the United States.

This is a tremendous achievement, not just in increasing access, but also in creating cost saving opportunities for our customers and for FedEx. For instance, by choosing to ship packages directly to convenient FedEx retail locations, merchants can reduce costs of residential delivery surcharges. Delivery to a retail location eliminates weather-related damage or porch theft, helping to reduce customer service and replacement cost for retailers.

And for returns, drop-off at our retail locations result in higher pick-up density and drive greater operational efficiency, making FedEx even more competitive in the returns market. We have a great returns growth opportunity that our competitive retail network now opens up for us.

Across all our priorities, we continue to be very focused on revenue management. While we see a rational pricing market, e-commerce will continue to put pressure on yields with lighter packages moving shorter distances. It is important to note that contrary to the erroneous and misinformed reporting in The Wall Street Journal on June 23, FedEx has made no recent pricing changes, from no pricing changes to our strategy, and we have certainly made no changes related to any one customer. In fact, at Express, we have experienced strong growth from small and medium customers using our FedEx Express 2-day product, following a strategic pricing change we made last year, and we anticipate the growth of this successful product to continue in FY 2020. We are confident that our strategies will allow us to grow global volumes and revenues profitably.

Now let me turn the call over to Alan for his remarks. Alan?
Alan B. Graf, Jr.
Executive Vice President & CFO, FedEx Corp.

Thank you, Brie and good afternoon everyone. FedEx Express fourth quarter operating income declined, as weakness in global trade and industrial production drove a decline in our International Priority revenue. Year-over-year comparisons were also impacted by an $85 million gain on the sale of a non-core business of TNT Express last year.

To mitigate the weakness, we have undertaken several immediate cost-containment actions, including significant reductions of variable incentive compensation, limiting hiring and discretionary spending, and completing our U.S. voluntary employee buyout program. Approximately 1,500 FedEx employees have left or will be voluntarily leaving the company via the U.S. employee buyout program by the end of FY 2020. Approximately 85% of those employees departed on May 31, 2019.

We incurred costs of $316 million during the fourth quarter associated with our business realignment activities. These costs related primarily to severance for employees who accepted voluntary buyouts. Business realignment activities, including the voluntary employee buyout, are expected to benefit FY 2020 by approximately $240 million. By eliminating open positions, we expect to achieve our savings goal using less severance than we originally forecasted.

TNT integration expenses were $84 million for the fourth quarter and $388 million for FY 2019. As you heard from Raj, we are continuing to make good progress with our integration activities. At FedEx Ground, we continued to see strong e-commerce volume growth in the fourth quarter. However, FedEx Ground income and margins were negatively impacted by increased purchase transportation rates and the January launch of year-round six-day-per-week operations.

FedEx Freight closed the year with another strong quarter, despite weakening industrial production. Revenue per shipment increased 4%, operating income increased 15%, and operating margin improved to 9.9%. Below the line, our non-cash mark-to-market retirement plan accounting adjustment of a net $3.9 billion loss was driven by a substantially lower discount rate, which contributed $1.8 billion to the loss, changes in actuarial assumptions, which significantly increased the liability, and lower-than-expected asset returns.

FY 2019 capital expenditures totaled $5.5 billion. For fiscal 2020, we are targeting a mid-single digit percentage decrease in adjusted earnings per share. Our performance is being negatively affected by continued weakness in global trade and industrial production, as well as the near-term impact of certain strategic decisions we have made to sustain our leading position in a changing marketplace.

At FedEx Express, we expect earnings to be down in FY 2020, due to weakness in international priority revenue and ongoing shifts to lower-yielding services. Our strategic decision to not renew the FedEx Express U.S. domestic contract with Amazon will also be a near-term headwind, which we expect reverse to a positive in FY 2021 as we replace the lost volume and optimize the network.

Additionally, we do not expect a significant benefit from the fuel surcharge table changes in FY 2019 to repeat in FY 2020. FedEx Express will continue to implement actions to reduce cost to serve, improve efficiencies and adjust its global network to match anticipated demand. While we expect to make significant progress on TNT integration activities in FY 2020, integration work will continue in FY 2021. We expect to incur approximately $350 million of integration expenses in FY 2020 and $1.7 billion in total through FY 2021.

At FedEx Ground, we expect volume and revenue growth to remain very strong in FY 2020. However, operating margins will face headwinds from higher operating cost associated with expanding FedEx’s Ground’s delivery schedule, improving our capabilities for large packages, and other investments to significantly improve efficiency and safety as Raj mentioned.

At FedEx Freight, we expect continued improved performance as we remain focused on improving revenue quality by implementing technology solutions that will drive efficiency and further differentiate us in the LTL market. Our FY 2020 effective tax rate, prior to year-end mark-to-market retirement plan accounting adjustments, is expected to increase to 23% to 25% and will likely vary from quarter-to-quarter. In addition, our tax rate is very sensitive to international income, which may cause the rate to vary from that range.
FY 2020 capital spending is expected to be $5.9 billion. These expenditures will include FedEx Express investments in aircraft and hub modernization, FedEx Ground investments that increase our efficiency and handling large packages, and investments in technology across the enterprise that will further optimize our networks and improve our competitiveness.

All these targets assume moderate U.S. economic growth, current fuel price expectations, and no further weakening in international economic conditions. A further ramping in anti-trade measures and/or adverse changes in international trade policies and relations would likely drive additional weakness in our business.

As I mentioned earlier, a substantial decline in discount rates, changes in actuarial assumptions and lower-than-expected asset returns negatively impacted our FY 2019 mark-to-market adjustments. With that, our U.S. qualified pension plan funded status declined to approximately 90%. While we are not required to make a pension contribution in FY 2020, we are expecting to contribute $1 billion. Also, we have funded large increases in our dividend and significant share repurchase over the last several years, our stock buyback level is expected to be significantly lower in FY 2020 and our dividend remains at $0.65 per quarter.

In conclusion, management is focused on improving our near-term performance, while also positioning FedEx for long-term success. While we are adjusting cost to mitigate macro uncertainties and address the growth of e-commerce, we will continue to invest in areas that expand our capabilities and improve our long-term efficiencies. We are confident these investments will drive long-term earnings growth and improve margins, cash flows and returns.

Now let me turn the call back over to Fred to introduce the topic Mark Allen is going to discuss.

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

Thank you, Alan. First, before I do that, let me take a point of personal privilege and mention something in The Wall Street Journal article yesterday which I’m uniquely qualified to speak to and it’s the statement that I started the Express unit four decades ago to ferry shipments like legal documents and medical supplies over long distances.

Facts of the matter are that when FedEx began operations, it was specifically prohibited for private carriers to move documents of any type. That was only permitted a number of years later when there were relaxation of the Private Express Statutes in order to facilitate the fast movements of legal and financial documents. And rather than medical supplies, the company was basically put together to pick up, transport and deliver first overnight from any address in U.S. to any other address in the United States, technology packages, which was the basic market that we were serving. Of course, we then added 2Day Express. We expanded internationally, added pallets, and of course, today, we pick up and transport millions of items in the Express business on a far larger-scale, at a far, far lower price.

The biggest issue on a go-forward basis and the article goes on to say that the Express unit wasn’t built for e-commerce. The reality is it’s perfectly built for e-commerce with the exception that we have to address, as we’ve said on several of the remarks here including mine, that we have to be very efficient in delivering to residential – making residential deliveries which are an increasing part of the traffic moving through both the Ground and the Express network.

So with that clarification, let me turn now to the subject of the lawsuit that we filed yesterday. There’s been a considerable amount of misreporting on this as well. Number one, as that – that is related to the Huawei issue where we misrouted and then apologized for two packages and returned to the shipper erroneously a third. The Huawei packages were only peripherally involved in this lawsuit that we filed, and in fact, it goes back many, many years, which is in the lawsuit itself, and it concerns not contraband which many people have confused the lawsuit as concerning, it concerns import and export controls as administered by the Department of Commerce.

So we worked very hard with all kinds of law enforcement agency, as does the Postal Service and UPS, to keep certain types of items out of our networks, illegal drugs, unlicensed firearms, you could go down the list. You can go and look at the prohibited items on our website, the Postal Service. This is not about prohibited items and contraband. It is about regulations that the Department of Commerce administers, which prohibit entities, meaning companies or individuals, from exporting or importing, and that’s quite different. And in many cases, they’re either prohibited completely or they are restricted to various destinations or to various commodities or certain content.
In turn, that requires a common carrier like FedEx when one of these entities is put on the list to in essence certify and in fact get a certificate from the shipper that basically wants what’s in the package or in the shipment, and that’s the issue that we’re dealing with here. I note that Secretary Ross who I’ve known for four decades and respect and like a lot, I’m pained by the fact that he issued a statement that disagrees with our position in the litigation, but as we told the Department of Commerce yesterday, we certainly understand their job and their implementation of the trade policy of the administration, this lawsuit doesn’t speak to that at all. It speaks to the issues that our General Counsel will now tell you about. And after his remarks, we won’t have any further comments on this as we’ll let the process play out in the court.

So Mark Allen, our General Counsel, will make a statement.

Mark R. Allen  
Executive Vice President, General Counsel and Secretary, FedEx Corp.

The action that we filed yesterday in the Federal District Court in D.C. requested the government be permanently enjoined from enforcing the Export Administration Regulations against FedEx in circumstances where we have no actual knowledge that the contents of the shipment are subject to the EARs. The BIS takes the position that a common carrier like FedEx can be held liable for shipments that do not comply with the Export Administration Regulations, without requiring any evidence that the carrier had any actual knowledge of an apparent violation.

We believe very strongly that the imposition of this sort of strict liability is a clear violation of our constitutional due process rights under the Fifth Amendment. We cannot know the contents of the 15 million packages we handle daily, and whether those contents comply with the complex EARs. By requiring us to police the contents of packages moving through our global network, the government is placing an unreasonable burden on a common carrier. We’ve reached out to Commerce to let them know of our commitment to compliance. However, we hope to reach an agreement on a common sense way forward. That would be creating a Safe Harbor that essentially means if we have no knowledge of an apparent violation, the BIS will not come after us.

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

So now we’ll take your questions and we have some teed up.

QUESTION AND ANSWER SECTION

Allison Landry  
Analyst, Credit Suisse Securities

Thanks. Good afternoon. So you mentioned 2020 as a transition year for earnings, and considering the bump in CapEx, clearly it’s going to be difficult for you guys to generate cash this year. So I guess, do you expect any positive cash flow and could you help us think through the longer-term cash generation of the business as you think about 2021 and 2022? Thank you.

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

Allison, this is Alan. Yes, I do expect improved free cash flow in FY 2020. And as far as it being a transitional year, we, I think, explained it about as well as we could. If I look forward past that, I can’t predict what’s going to happen with trade, tariff, China, G20 and Brexit. So if you’ll just set that aside, that turns out well or decent. We’ve got a lot of good guys, and in 2021, we’ll have the seven-day Ground operation running at full speed. We’ll have the benefits from the full TNT interoperability. We’ll have lower U.S. FedEx Express rural and residential costs. We’ll have unbelievable improvement in Ground productivity and growth, and we’ll have continued Freight growth and improved productivity. So I think once we get through 2020, we are going to be in fantastic shape with the global macro hanging over.
As to our $5.9 billion, the company wanted to spend upwards of $7 billion. We worked very hard to push up projects, so that I think we’ll have good strategic returns, but a lot of really good things didn’t make the cut. We have a lot of opportunities here, particularly on the cost side and we’re going to attack them aggressively.

Operator: Our next question will come from Chris Wetherbee with Citi.

Christian Wetherbee
Analyst, Citigroup Global Markets, Inc.

Hey, thanks. Good afternoon. Yeah, it looks based on the guidance that you’re calling for Express to be down from a profit perspective maybe double-digits. Wanted to get a sense if you could maybe break out some of the cross currents from trade in the macro and sort of what that impact might be on the core business and try to separate that out from some of the things that you’re doing strategically with delivery as well as some of the late night pickups and maybe some of the strategic decisions you made around the customer. So if any way you can kind of parse out some of the details in sort of that guided weakness in Express would be helpful.

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

Chris, Alan again. What we’re looking at right now, as I just talked about in our fourth quarter at Express where we had International Priority revenues actually down, that’s hard to recover from in a very short period of time. Again, I don’t know what’s going to play out here on trade and tariffs, so there could be some upside for that. But at the moment I’m not seeing that.

Our load factors coming out of Asia really aren’t bad, but the yields aren’t that good and could be better. So I think the biggest issue is the macro. As far as what’s going on with Express in the U.S., it’s doing fine. I mean, we had a great growth rate in our deferred traffic, which we went after intentionally, and we’re going to get our cost structure in shape to improve the profitability at Express for that as well. So really, it’s the macro that’s the biggest hangover for what we’re looking at for FY 2020.

Operator: And next we’ll go to Jack Atkins with Stephens.

Jack Atkins
Analyst, Stephens, Inc.

Hey, good afternoon. Thank you for the time. Could you provide some more details around the steps that you’re taking to, in your words, right-size your operations to better handle e-commerce? Do you foresee perhaps further changes in the business model in an effort to gain these efficiencies such as more closely integrating your Ground and Express operations? Thank you.

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

I don’t recall who said right-size. Did you, Raj?

Rajesh Subramaniam
President & Chief Operating Officer, FedEx Corp.

Optimize.

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

Oh, optimize. Well, this is Smith here. I said in my remarks that we made a number of announcements. I don’t think anybody on this phone call knew a month ago that FedEx was going to announce seven day a week service, 8,000 Dollar
General locations, in-sourcing 2 million SmartPost packages, building a number of large package annexes to exploit that business in Ground, and then all the other things that Raj and Brie mentioned to you.

So please recall in my remarks, I basically said stay tuned, that we’ll be telling you some other things during this fiscal year. So we understand the issues involved in e-commerce and residential delivery, and Raj made the point specifically, we will be the low-cost producer in the e-commerce space for residential delivery. We’re quite confident of that from many perspectives. But we’re not prepared to tell you some of these other moves any more than we were prepared to tell you a month ago about the things that I just listed off. But there will be other things that we will announce during FY 2020 in this regard. You can count on it.

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

Scott H. Group
Analyst, Wolfe Research LLC

Hey. Thanks, afternoon. So, Alan, is there any way you can help us think about maybe the quarterly cadence of earnings? Just, obviously, we’ve got some weak trends right now, but then really tough incentive comps in the second-half of the year. Any help there?

And then maybe just, Fred, just following up on that just big picture, are there reasons why we could potentially consolidate Ground and Express networks from a delivery standpoint, and then any update you can give us on the international buyout potential?

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

That was three, Scott. So, look, as to cadence, the tax rate is going to be really spotty. I mean, we’ve got a lot of assumptions that we have to prove and get through. We’re still looking at all these pages of interpretations and regs that are coming at us left and right. We’re dealing with BEAT. You probably heard this from everybody actually following international, it’s extremely complex. So tax rate is going to be a factor in our quarter-to-quarter numbers, don’t be surprised by that.

Secondarily, again, I just can’t tell you what’s going to happen from the global economic standpoint. So that piece of it, the cadence is going to be the cadence. It’s a little bit out of our control. We’ll manage to it, but we do not want to do anything stupid and then not have the capacity that we need in the right place. So we’re watching that extremely carefully.

Domestic Ground, they’re going to have a great year. I mean, they really are. They’re going to grow fast. And if we can hold margins or get close to holding margins on this growth, with all the expansion and all the investment that they’re doing in improving productivity, they’re going to be really ready to roll in 2021. They’re going to have a great consistent year. So, that’s about all I can tell you.

The other thing is that people forget that there’s a reason that Express has a two-day service, it’s called distance. When we need an airplane, we need an airplane. The customer really decides which network makes the delivery. I think we’ve explained this over and over and over again on the margin, yes, there’s always opportunities, but for the most part, we’ve got to fly it when we have to fly it, but the customer can make that decision.

Operator: Amit Mehrotra from Deutsche Bank has our next question.

Amit Mehrotra
Analyst, Deutsche Bank Securities, Inc.

Hi, thanks for taking my question. Alan, you made the comment I think in response to Allison’s question, the free cash flow would be better in fiscal 2020. Wondering if you could just help put a finer point on that based on the macro assumptions that the company has made. And related to that, the $1 billion pension contribution, the voluntary pension contribution, I would imagine that that would be funded with new debt, given the offsetting cash savings from the PBGC insurance
premiums. And then just related to that, if you can discuss the incremental costs in fiscal 2020 associated with the seven-day delivery? Thanks so much.

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

Well, there’ll be some incremental cost associated with seven-day delivery, of course. We’ve been incurring them and we will continue to incur them, but now that we’ve gone to six-day, the seven-day leap is not nearly as significant. So those won’t be material. But they probably will likely be a headwind. But I have to say, what I’m hearing from my team is that the customers are lining up to get this seven-day, get this Sunday service and we’re going to do it very efficiently. And I think we’ll be able to start it in a very good way. So, again, I’m excited about what’s happening in that regard.

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

David G. Ross
Analyst, Stifel, Nicolaus & Co., Inc.

Yes. Good afternoon. Just back on the TNT integration expenses, the total cost of $1.7 billion is about double what it initially was. Can you just remind us what that additional expense is for and is there a difference between network integration, which you said is going to be completed in the next year, and network improvement or upgrade that need to be made to the TNT system?

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

Hey, David. It’s Alan again. Not double. I will tell you a couple of things. One is that we originally gave you a $400 million number about NotPetya. Well, that’s an old number. That’s never been updated. But it continues to be a problem for us in terms of integration, as we have to basically rebuild a system that TNT had and then integrate it with the network that we’ve got on the purple side. And it’s cost us a lot more money and slowed us down and it’s made it more complex.

The good news on that side is that the interoperability will be done by the end of fiscal year, and that’s when we can start really harvesting the benefits of that low-cost road network and flow the Express packages through it seamlessly without all kinds of double-handling and double-packaging and everything else.

Let me let Raj add to this.

Rajesh Subramaniam
President & Chief Operating Officer, FedEx Corp.

Yeah, I’ll just say that there has been tremendous momentum literally in the last few months on the TNT integration. We have the vision of interoperability by end of fiscal year 2020 and ultimately one network for air and one network for ground. It’s a lot of value to be had here. But what I want to say here is that, we’re not waiting to create value for the customers. The customer value has been created as we speak. We are speeding up lanes and our service levels are very good and the demand is strong. So I think we made a lot of progress, and the significant value in this investment, it’ll come to bear fiscal 2021 onwards.

Operator: And next we’ll go to David Vernon with Bernstein.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Hey, question for you, Fred or Raj, on the portfolio. Obviously, the expansion into the virtual kind of retail footprint with the partnerships with Dollar General, things like that, is there a point where you maybe look at the portfolio and say, why do we still have the services business? Do you need that retail footprint? Do you ever get to that point where you kind of rethink the composition of that part of the business?
Rajesh Subramaniam  
*President & Chief Operating Officer, FedEx Corp.*

I guess you’re asking about the FedEx Office. I think it plays a very important role as part of our retail network. Especially as we move forward on e-commerce, some of the premium value-added services on Hold at Location, plus return services. There are several things that we process through the FedEx Office that’s unique and differentiated. And the value is going to get even better as the e-commerce trends increase. I don’t know, Brie, if you want to add anything more to that.

Brie Carere  
*Chief Marketing and Communications Officer & Executive Vice President, FedEx Corp.*

Yeah, the only thing that I will add is, obviously, we’re very excited about the expansion of our on-site retail partnerships with Walgreens and with Dollar General. The FedEx Office retail locations bring in some of our most profitable small and medium business, because the experience they get when they’re shipping internationally, when they were shipping and they want the peace of mind of proper packaging, that is absolutely just a stellar experience and those employees just deliver a great experience. So we’re very committed to that element of the portfolio.

Rajesh Subramaniam  
*President & Chief Operating Officer, FedEx Corp.*

Yeah, and don’t forget the FedEx Office locations, the size of this FedEx Offices are really substantial, and it’s an excellent place to conduct e-commerce. And as Brie pointed out, the most profitable packages for the FedEx system comes through the FedEx Office network.

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

And we’re expanding inside Walmart stores, which is becoming a great partnership. And Brie, thanks for mentioning profitability, I loved it.

Operator:  Our next question will come from Brandon Oglenski with Barclays.

Brandon R. Oglenski  
*Analyst, Barclays Capital, Inc.*

Hey, good afternoon, everyone and thanks for taking my questions. And Mr. Smith, I really submit this question humbly as an analyst who has never run a business, but I guess at what point do we question the scale of the Express network? Because we’ve seen decade after decade of low returns, low-margins. In peak economic activity you guys can put in a pretty good return, but still never really crossing that threshold of covering the cost of capital. And on the call today, it just seems like the strategy is the same; put more capital in, optimize, but not right-size. So I guess why not a more radical look at the business? I think someone suggested to look at integrating portions of Express or Ground or maybe even going more aggressively just on the overall footprint of the business? Can you talk to that, please?

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

Didn’t you ask me this same question the last analyst call? Well, somebody else asked me a similar question. Well, look, the only way I can respond to that is, obviously, the plans and the programs we put in place were designed to create superior returns. We didn’t just decide to do it for the hell of it. In addition, it reminds me a little bit about that old adage of Mike Tyson, that everybody has a plan until they are hit in the mouth.

So one of the things that always amuses me about watching a lot of things that are written about FedEx and so forth, the competition has a vote and the economy has a vote. So clearly, we’ve been very disappointed over the last few years with
the assumptions that we made on the growth in international trade, particularly with the Trump Administration. The United States policy since 1934 with Roosevelt and the Secretary of State, Cordell Hull, was to expand international trade. And now, we have a huge dispute where the United States is basically become protectionist, defined as, I’ll make everything I need in my own borders, I don’t need to import things, and quite frankly, don’t particularly need to export them, despite the fact that 95% of the world’s population is outside the United States. So we have become a protectionist country.

We don’t agree with the Chinese position on trade either and been very vocal about that, which is mercantilism. I would like to sell to you, but I won’t buy from you on a reciprocal basis. So your question implies that we have sat around and you said “for decades” we don’t look at the business as a single segment. We’ve said that over and over again. You all deconstructed and to some degree, I sort of added in that today by making an exception saying we expected Freight and Ground to have earnings increases and margin increases in Freight, and hopefully, any compression in Ground due to the expansion will be very small.

So clearly, as we go forward and things change, if we don’t resume any kind of international growth, we would change our approach to the business. We don’t have any sacred cows here, but you also have to remember, in the Express business, as Alan said, our domestic Express business is doing fine. It’s not the issue. It’s the international business that’s having a problem for the reasons that Brie and now I am saying to you.

The good news is that if traffic and yields materialize, the conversion rate to profitability is probably in the neighborhood of 60%, because it’s a network where the incremental volume goes to the bottom line faster than any of our other activities.

In the case of TNT, I have to say, I’ve been amazed not just with the people that follow FedEx in this industry, with the amazing disinterest in the NotPetya attack. It was the largest single attack by a state-sponsored entity in the history of the world. It has put the Ukraine on its knees. The only reason that it was less of a factor to us than it was, was because of the fantastic work of our IT team that went and remediated it. Had it not been that TNT had been a subsidiary of FedEx, the company would have been bankrupt. They would have just gone out of business. So, clearly, we should have sat and waited knowing NotPetya was coming, we could have picked up the pieces. It would have been a lot easier on us.

So I think I’m going to ask Rob Carter, our CIO, to just give you a bit of color, which he was giving me the other day about the NotPetya account. To my knowledge, the only in-depth article that’s ever been written about it, I think it was in WIRED magazine. And when you read that, it’s like, oh my God, this is one of the most under-reported stories in history.

So to get to your point, of course, we want to make money in these networks, and we’ll engineer and modify them to the extent that we need to, but you’ve got to remember those two things, the anticipation of continued embrace of free-trade, which was our assumption on building a lot of this stuff, and then not assuming the NotPetya things are the two exogenous factors that we’ve been dealing with.

So Rob, you want to comment on this?

Robert B. Carter  
Chief Information Officer & Executive Vice President, FedEx Corp.

Well, this attack was a weapons-grade attack by Russia on Ukraine that utilized cyber tools that were built by the NSA and the U.S. Government. A group called Shadow Brokers stole those tools and they were turned back on the Ukraine. And the devastation to Ukraine just hasn’t properly been reported. All the airports were down. All the trains were down. Hospital systems were lost. The monitoring systems in Chernobyl that monitor what is the most infamous nuclear plant in the world were lost.

If you looked at pictures that are on the Internet of the Kiev Airport, every single screen showing the red screen of death, every point-of-sale terminal in the big grocery stores showing the same thing. Every ATM machine down in the country. This was an amazing attack, and we are thankful that our teams were certainly able to stop it at the borders of TNT. It didn’t impact the FedEx enterprise. But the devastation in the TNT technology state was considerable, to say the least. The good news for today is that this state is running significantly better than it ever has with high degrees of reliability that are positively impacting service levels for TNT and the integrated networks that are being put in place now. But Fred’s
right, this was a devastating attack for a nation state that couldn’t defend itself, and businesses like ours and many others were impacted as well.

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

Brandon, this is Alan. I just want – since the question is an important one, I just feel like I need to weigh in as the CFO. The question you asked we talk about all the time. We talk about the board level. We talk about our SMCs. Let me just add two things.

In the fourth quarter a year ago, we were almost there. I mean, we had Express running on all cylinders, and that was without TNT providing anything but a drag. So I know we can do it. I know we will do it. I’m disappointed that we haven’t done it. But I believe strongly that when we get the interoperability up and we get any kind of global trade environment that’s reasonable, that we will be successful with our international at Express.

**Operator:** Our next question will come from Helane Becker with Cowen.

**Helane Becker**  
*Cowen & Co. LLC*

Thanks very much, operator. I appreciate the time. Fred, what happened to the Guangzhou hub in this whole China-U.S. trade situation, if anything?

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

Well, there’s a tremendous trade dispute going on between China and the United States as is reported almost hourly on the business TV stations. But we’ve been a good corporate citizen in China for decades, and we are completely dedicated to compliance in China, and we have expressed that to them and reinforced it. So they audit us in Guangzhou and many other locations, and probably there have been an increase in audits as a result of this to some degree, but we’ve cooperated fully with the China State Postal Bureau and their investigation of the two misrouted packages and the erroneously returned package.

Again, we apologized to the customers. They never left our possessions. We offered to make things right, but that has nothing to do with China or Huawei. It has everything to do with the Purple Promise. We would have done that for any customer. So our Guangzhou hub is a huge part of the economy of the Pearl River basin. And so we hope there’s not going to be any further deterioration in U.S.-China trade relations.

Let me say again, just because it’s important for this audience to know about this request that we made of the D.C. Circuit Court on these export regulations. What’s really led us to do that at the end of the day wasn’t Huawei at all. It was on last Friday, there were five new entities added with these extraordinarily opaque requirements, and contrary to what you hear in the media, we don’t have to be complicit in this. It’s strict liability. If you make a mistake, if the Department of Commerce, BIS, which stands for Bureau of Industry and Security, they are empowered under their regulations, not we think based on Congressional law, but on their own regulation, to fine us or any other common carrier if what’s been represented in that shipment, even though we have a certificate saying that it complied, $250,000 per package.

So, I don’t think that’s what they intended. And as Mark said, hopefully we’re going to deal with them. But that is separate and distinct from the Huawei situation, which was three packages out of a 15 million package per day. So it’s very difficult these days to keep this in perspective, but we’ve tried to do so and we’ve had a great team in China, Karen Reddington, our President, and Eddy Chan, who runs China for us and our Government Affairs people. So hopefully we don’t have any issues there, certainly hasn’t been any operational issues to speak of.

**Operator:** Our next question will come from Bascome Majors with Susquehanna.
Bascome Majors
Susquehanna Financial Group

Yeah, hi. Thanks for taking my question here. Alan, I was curious if you could tell us how much incentive comp helped the results in 2019 on an absolute basis? I know it was $350 million through the first three quarters of the year. And how much would a target level be for that to fully come back and how much or how close to that target are you budgeting in the fiscal 2020 outlook? Thanks.

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

Hey, Bascome. We’re going to have an 8-K in July. I don’t think that’s too much of a strategic question. The AIC that we are forecasting for FY 2020 is in the guidance I gave you. And why don’t we just leave it at that and follow up with IR later?

Operator: Our next question will come from Ken Hoexter with Bank of America Merrill Lynch.

Ken Hoexter
Bank of America Merrill Lynch

Great. Hey. Good afternoon. You noted the profit growth at Ground incorporated the start-up for Sunday delivery and would still be up. Given the move of retailers for more next-day delivery from Walmart, Target to Amazon, do you see a larger shift going from Ground to Express packages and how does that change your dynamic and cost structure?

Rajesh Subramaniam
President & Chief Operating Officer, FedEx Corp.

So this is Raj. The reason we have now a full portfolio of services on transportation and other e-commerce services is to cater to all the needs of retailers and e-tailers as we go forward here. So, and to your question, when Walmart talks overnight for Walmart, well, we are the service provider for that, and we have a lot of overnight volume for that.

If you need Extra Hours, for Target, we provide that. If you need Local Zone 1 Ground delivery, we have that service as well. So my point here is that we have now a full portfolio of e-commerce delivery services along with technology and returns, and more to come as the Chairman talked about, that it is the most robust in the marketplace. So it’s really putting together the whole picture that we’re trying to do here.

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

Hey, Ken, Alan. What Ground’s working on and doing a great job of is lowering their cost structure dramatically. We wouldn’t be taking all the SmartPost packages into our own network if it wasn’t for the fact that we can do it for a lower cost than the postage. The postage is going to keep going up. We’re driving our costs down. So that’s an important phenomenon for you to understand.

Secondarily, again, the customer decides, time and distance is how we decide which network it goes into. Ground sweating its assets, it’s double turning, it’s doing all kinds of things. But it can’t make a really late in the evening pickup for next-day delivery or two-day delivery of any kind of distance and that’s when it goes to Express. So, as Raj was explaining to you, we’ve got networks to provide whatever the customer wants, and that’s the important thing. But I don’t want today to go by without people understanding, Ground is significantly lowering its unit cost and doing it very rapidly.

Operator: And next we’ll go to Tom Wadewitz from UBS.
Yeah. Good evening. Thank you for the question. Sticking on that topic, I guess, perhaps you could offer more color on what some of the actions are to significantly lower the cost structure in Ground. I guess my intuition is that in transportation, density drives cost and it seems like in the all-in on e-commerce you’re doing a number of things that will help grow the business, but could drive some dilution in your density, just more B2C packages. So I was just wondering if you could help us understand the offsets to some of the margin pressure and perhaps a little more on what you’re saying, Alan, in terms of really significantly lowering the cost structure in Ground.

I got it. I got this one. Of course, it’s density and as fast as Ground is growing and as fast as the packages are coming to them and the fact that we’re sweating the assets more, and with the technology and engineering expertise that we have, which is world-class, we can handle a whole lot more traffic, at a lot lower unit cost, and that’s a great place to be. Oh, by the way, as I want to iterate, Ground’s faster on 25% of the lanes net. Sometimes we get compared to over the peak season about how well we do versus the competition. Everybody forgets, they’re holding us to our own standards, not what all the competition does. That makes us one, two or three days faster during peak season. So I think we’re in great place and that’s how we’re doing it.

Operator: That does conclude our question-and-answer session today. And I’d like to turn it back over to Mickey Foster for closing remarks.

Thank you for your participation in FedEx Corporation’s fourth quarter earnings conference call. Please feel free to call anyone on the Investor Relations team if you have additional questions about FedEx. Thank you.