

FedEx Q3 FY21 Earnings Call Transcript – March 18, 2021

A. Mickey Foster

Vice President, Investor Relations, FedEx Corp.

Good afternoon, and welcome to FedEx Corporation's Third Quarter Earnings Conference Call. The third quarter Form 10-Q, earnings release, stat book as well as our economic forecast are on our website at fedex.com. This call is being streamed from our website, where the replay will be available for about 1 year.

Joining us on the call today are members of the media.

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 the call to the most directly comparable GAAP measures.

Joining us on the call today are Fred Smith, Chairman and CEO; Raj Subramaniam, President and COO; Mike Lenz, Executive VP and CFO; Mark Allen, Executive VP, General Counsel and Secretary; Rob Carter, Executive Vice President, FedEx Information Services and CIO; Brie Carere, Executive Vice President, Chief Marketing and Communications Officer; Jill Brannon, Executive Vice President and Chief Sales Officer; Don Colleran, President and CEO of FedEx Express; Henry Maier, President and CEO of FedEx Ground; John Smith, President and CEO-elect of FedEx Ground, and Lance Moll, President and CEO of FedEx Freight.

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

Frederick W. Smith

Chairman, President & CEO, FedEx Corp.

Thank you, Mickey. First, I want to say how immensely proud I am of our FedEx team members. Since our last earnings call, they've completed an historic peak season. And using the power of our expanded 7-day a week FedEx Ground operations, our team handled record-breaking volumes throughout the holiday shipping season. They also worked diligently to clear the backlog caused by the recent severe winter weather in the U.S., a 50-year event. They worked night and day to move the backlog quickly and as safely as possible. This includes the many team members who typically perform other duties and volunteered their time to help. We're sincerely grateful to them and to our customers for their understanding as we navigated the effects of these massive winter storms.

Our team members are continuing to move the world forward with the delivery of COVID-19 vaccines, related ingredients, and supplies throughout the U.S., Canada and more than 20 other countries around the world. We did a great job on these vaccines during the weather event, too. FedEx is prepared to transport now vaccines to more than 220 countries and territories for as long as necessary to help eradicate COVID-19.

As part of our responsibility to be good stewards of the planet, earlier this month, we announced our bold strategy to achieve carbon-neutral operations globally by 2040. To help reach this goal, we focused our strategy in 3 key areas: vehicle electrification, which we've been involved in for over a decade; sustainable energy; and carbon sequestration - natural carbon sequestration. In this regard, importantly, our plan includes a pledge to help establish the Yale Center for Natural Carbon Capture. The center will build on the Yale legacy of the school and the environment of world-class research and education to develop measurable carbon capture solutions with an initial focus on helping to offset greenhouse gas emissions equivalent to current airline emissions. Findings will be published and shared so that

businesses, industries and governments globally can benefit from this work. As reflected in this quarter's results, continued execution of our strategies is producing strong earnings growth and margin improvement across our company. We expect demand for our unmatched e-commerce and international express solutions to remain high for the foreseeable future.

I'm exceedingly optimistic about the future of FedEx, and again, very grateful to our team members for their hard work. I'd also like to thank Henry Maier, President and CEO of FedEx Ground, who is retiring at the end of July after more than 35 years of dedicated service at FedEx. We'll have much more to say about Henry on our next earnings call in June.

Let me now ask Raj, Brie and Mike to provide their comments, after which we will take your questions. Raj?

Rajesh Subramaniam

President & Chief Operating Officer, FedEx Corp.

Thank you, Fred, and good afternoon, everybody. Q3 was a strong quarter of growth for FedEx. Despite challenging circumstances, the team performed exceptionally well through the biggest peak season in our company's history. This included delivering nearly half a billion holiday packages, transporting the first shipment of COVID-19 vaccines here in the U.S. and increasing collaboration across operating companies.

Our results speak for themselves. In December, we achieved the highest monthly totals in our company's history in both revenue and operating profit. Results in December were different than previous years. We better maximized our available capacity and, as Brie will cover in a moment, better aligned prices to incremental costs. Peak 2020 was unlike any peak experience before and sets a new standard for future peak seasons.

As Fred mentioned, our operations were impacted by last month's severe winter weather throughout the United States. Mike will expand more on the scope and unique nature of these storms. And I'm sure many of you have seen reports in the last couple of days, which illustrate the impact these storms had on the overall U.S. economy, including retail sales and manufacturing output. We implemented numerous contingencies to mitigate the impact, including adding sorts, line haul and collaborating across our network to assist in the recovery. I'm very proud of the team for managing through this very challenging situation.

Now speaking of the team, we announced that Henry Maier will retire this summer and named John Smith, former President and CEO of FedEx Freight, his successor. Lance Moll, former SVP of Operations at FedEx Freight, has been promoted to CEO, and we're pleased to have all these 3 gentlemen on the call today.

Now turning to FedEx Ground. The outstanding margin improvement for Ground in Q3 highlights the success of our ongoing strategic initiatives and investments to improve efficiency and reduce costs associated with the last-mile, even amid record residential volume levels. These investments continue to pay off.

Let me share 3 examples. Number one, we saw a meaningful improvement in last-mile efficiency as service providers improve their stops per hour 21% year-over-year in Q3. Number two, the average cost per stop decreased by 12% year-over-year. And number three, we maximized our assets, expanding to 7-day operations and integrating Ground Economy, or formerly FedEx SmartPost, reduced our fixed cost per package by 4% year-over-year. We remain very optimistic for continued profitable growth at Ground.

Collaboration between operating companies continue at an unprecedented rate in Q3. This month marks the 1-year anniversary of the launch of last-mile optimization, which allows us to flex our networks to increase delivery density for residential, rural and deferred packages. LMO will expand to 6 more markets effective May 1, increasing to 63 markets in total and covering 2/3 of the U.S. GDP. Additionally, FedEx Freight has delivered more than 1.75 million shipments for Ground so far this fiscal year. This time last year, Freight had yet to deliver a single Ground shipment as increased support for Ground kicked off in May of 2020.

Finally, turning to FedEx Express. Our global network is moving COVID-19 vaccines, ingredients and supplies as we speak. It has been a coordinated orchestration of our physical and digital capabilities. At FedEx Express, we expect elevated pricing for at least the next 12 months. We know, however, that these prices are not sustainable in the longer term, and we will flex our networks appropriately as commercial capacity returns into the market. In addition, we will continue to improve our efficiency by executing last-mile optimization and transforming our European business.

In Europe, momentum continues with the physical integration of the TNT network. We recently announced our Europe restructuring program, and we are progressing with local consultations as planned and in accordance with local market regulations. April will be a big month as we prepare to roll out a set of new service capabilities for our customers, which Brie will provide more detail very shortly here. We'll complete their integration in spring 2022, which will bring the physical network integration to a close. Our Paris hub will be our main Express hub in Europe with Liege serving as Indy does in the U.S. as our second largest European air hub. We remain focused on optimizing the network and strengthening our capabilities to drive upside in Europe for years to come.

In closing, FedEx remains committed to delivering long-term profitable growth. We have the network, the strategy and the right team in place as we build upon the exceptional results we have seen so far in fiscal year '21. With that, let me turn it over to Brie.

Brie Carere

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

Thank you, Raj. Good afternoon, everyone. In the United States, we are seeing strong growth and momentum. The U.S. domestic parcel market is expected to grow to 101 million packages a day by calendar year 2022, with e-commerce contributing 86% of total U.S. market growth. E-commerce as a percentage of U.S. retail sales was approximately 21% in Q4 of calendar year '20, significantly above the pre-pandemic level.

We remain excited about the diversification and evolution of the e-commerce market. Some of our largest retail customers reported e-commerce growth rates in the high double and even triple digits through 2020. As the U.S. reopens, we recognize the potential for a short-term deceleration in e-commerce shopping. However, we are very confident that e-commerce, as a percentage of retail, has a long growth runway.

Turning now to peak. It certainly was the "Shipathon" we predicted, a peak upon a peak. We had tremendous growth with almost 500 million packages delivered and 19% year-over-year ADV growth. To the global sales and marketing teams, I could not be more proud of your execution and the momentum you have created.

FY '21 parcel volume growth remains strong, supported by a portfolio of e-commerce solutions growing at double digits. Of particular note, our FedEx Ground 7-day-a-week residential delivery service is one of the fastest-growing services in e-commerce with 70% volume growth in Q3. Overall, year-to-date average daily volume growth remains strong for all customer segments. However, our U.S. small and medium segment grew 35% through the end of February.

In FY '21 Q3, FedEx total U.S. domestic residential package volume mix was 70% versus 62% a year ago. With the increase of residential packages in our networks, we're focused on improving yield and product mix. In FY '21 Q3, we increased FedEx Ground Economy yield by 35% and overall U.S. domestic residential yields by 15% year-over-year. It's important to note FedEx Ground is formerly FedEx SmartPost. While e-commerce is the key driver of the overall growth, in January, our U.S. enterprise B2B volume was at pre-COVID levels.

Turning to our U.S. revenue quality strategy. We continue to actively pursue yield management, product and customer mix strategies. Our primary focus is ensuring large customer pricing aligns to their volume distribution. We continue to manage capacity at FedEx Ground, prioritizing our highest yielding SAM segment as well as our premium home delivery product. As we plan for peak of fiscal year '22, our peak surcharges will continue to play a critical role.

Turning now to international. Global air cargo capacity remains down 20% year-over-year as of January. And we expect air cargo capacity to remain constrained through the end of calendar year 2021. We expect passenger capacity to recover between 55% and 75% of its pre-COVID level by the end of calendar year 2021 with a full recovery not anticipated until '23 or '24.

From a demand perspective, APAC outbound has recovered to pre-COVID, while Europe outbound is expecting a partial recovery by the end of 2021 and a full recovery sometime in 2023. With these projections, demand trends will continue to favor freighters and integrators. We are confident in our ability to maintain elevated yields for at least 12 months. With e-commerce driving significant growth internationally, we will increasingly utilize peak surcharges in our international business. Finally, we are executing commercial strategies to maintain and grow our incremental volume as capacity recovers. Intercontinental performance continues to be very strong. Our total international express yield per pound has again seen impressive double-digit year-over-year improvements in all key markets. Our B2B volumes are recovering to pre-COVID levels in Europe and are fully recovered in Asia, while our overall growth is fueled by significant B2C volumes.

During our fourth quarter, we will dramatically enhance our European portfolio. As stated on previous calls, with the completion of the road integration last May, our European road value proposition already gained significant improvements. Our customers have been accessing the unparalleled TNT European road network. In Q4, we will introduce an enhanced Europe-to-the-U.S. value proposition, providing an industry-leading next-day service to the U.S. in twice the number of origin countries currently offered. In addition, we will be launching our new FedEx International Priority Express service, giving our European customers 2 premium services within Europe, offering customers choice between overnight by noon and overnight by end of day. We will be rolling out these new service capabilities to our customers over the coming months.

We will also launch FedEx International Connect Plus from Europe to the United States to Asia and within Europe, providing the service across more than 200 lanes. FedEx International Connect Plus, or FICP, has been designed with features of service targeted to reduce the cost to serve while delivering an outstanding customer experience and is specifically targeted to support our e-commerce customers. The new European transportation portfolio is brought to market through a refreshed and modern online shipping application that has already rolled out in Europe and across 143 countries globally. In summary, we have great momentum coming out of Q3.

And with that, I'll turn it over to Mike for his comments.

Michael C. Lenz

Executive Vice President & CFO, FedEx Corp.

Thank you, Brie, and good afternoon, everyone. FedEx delivered significantly improved financial results during the quarter as we met the challenges of rising demand and limited capacity during our peak season and overcame severe winter weather in February.

Adjusted operating profit increased 120% and adjusted operating margin increased 210 basis points, primarily due to strong volume growth in U.S. domestic residential package, a 41% increase in FedEx International Priority package volume, led by Asia and Europe; and solid execution of our revenue management strategies in the face of increasing demand across all our transportation segments. These gains were partially offset by 4 noteworthy factors. First, higher variable incentive compensation expense of \$485 million, including a \$125 million special bonus for global frontline team members at FedEx Express; second, lower revenues and higher costs due to significant weather events that reduced operating income by an estimated \$350 million; third, the estimated impact of having 1 fewer operating week day, which was approximately \$150 million; and lastly, consolidated direct COVID-19-related cost of approximately \$60 million, which does not capture the many accommodations we continue to make across all our operations for the safety of our employees and to comply with various regulations and guidelines.

Given its significance, I want to add further context around the adverse weather impact. First, we always anticipate and have contingencies for demand and operational impacts during our fiscal third quarter, which spans the most active winter weather months. The mid to late February events, in particular, impacted many parts of the country, but were historic throughout the south-central corridor of the U.S. The snow amounts in Memphis had not been seen in over 50 years prior to the founding of FedEx and, when coupled with a record-tying 9 consecutive days below freezing, had a significant impact on our operations, as Fred and Raj mentioned.

Our Indianapolis and North Texas Express hubs were impacted as well. Demand was deferred as significant portions of the U.S. population were impacted by the various weather events. Of the \$350 million estimated impact, \$240 million was at Express, \$85 million at Ground and \$25 million at Freight. Despite that, the Express segment reported adjusted operating profit of \$514 million with an adjusted operating margin of 4.8%, up 260 basis points, driven by significant volume growth in both international export and U.S. domestic package as well as higher international priority yields. In the quarter, Express absorbed \$340 million higher variable incentive compensation expense and was on pace to deliver record third quarter operating profit prior to the February weather.

FedEx Ground had an exceptional peak and third quarter, growing operating margin 270 basis points over the prior year to 8.8%. Operating income of \$702 million was the highest third quarter in FedEx Ground's history. Yield grew 11%, while volumes were up 25%, resulting in 37% growth in revenues, which more than offset headwinds, including increased payments to our independent service providers, higher labor rates and higher variable incentive compensation of \$70 million. As Raj and Brie highlighted, our commercial and operational initiatives are yielding and will continue to yield profitable growth at Ground as we capitalize on the e-commerce opportunity.

Turning to FedEx Freight. Operating income increased 5% despite the impact of increased variable compensation and the weather. Freight continues to post excellent results with their focus on revenue quality, aligning their cost structure with current business levels and improving operational efficiencies. Freight also provided critical peak season operational support to both Ground and Express.

Our effective tax rate was 15% for the quarter due to tax benefits of \$108 million, resulting from a tax rate increase in the Netherlands applied to a deferred tax balances and associated with a \$300 million voluntary contribution to our qualified U.S. pension plans.

Now turning to what's ahead. While there remains a degree of uncertainty as we begin to see progress in combating the pandemic, we are projecting full year adjusted earnings per share of \$17.60 to \$18.20 compared to \$9.50 adjusted EPS in FY '20. We expect our effective tax rate prior to the year-end mark-to-market adjustment to be between 21% and 22% for the full year fiscal '21. We expect higher revenue, operating income and operating margins on a year-over-year basis at all our transportation segments in the fourth quarter, which does include 1 additional operating week day. These forecasts assume continued recovery in U.S. industrial production and global trade, no additional COVID-19-related business restrictions and current fuel price expectations. With this forecast, we expect higher variable incentive compensation expense in the fourth quarter as we plan to reward our employees for their achievements this year. The year-over-year increase is expected to be slightly higher than the third quarter, excluding the \$125 million special bonus I mentioned previously.

Earlier, Fred mentioned our sustainability initiatives, and we will record our \$100 million pledge to Yale University in our fourth quarter results. For Express, in the fourth quarter, there will be no benefit from the reduction in the aviation excise tax from the CARES Act, which expired on December 31. In addition, Express maintenance costs will be higher year-over-year in the fourth quarter as we execute on our flexible air fleet strategy. Just over a year ago, we shared with you plans to temporarily park the equivalent of 7 MD-11s. Given the increased demand, we are efficiently adding needed capacity for our customers by investing in maintenance expense to utilize aircraft from temporary storage. As of now, we plan to have no temporarily parked MD-11s prior to next peak season. This illustrates our ability to flex capacity up or down in a financially efficient manner in response to changes in the market.

Our capital spending focus remains on strategic investments that will reduce our cost structure, improve our efficiency and increase our capacity to profitably meet market growth demands. Our FY '21 CapEx forecast is now \$5.7 billion due to changes in the timing of aircraft payments as well as the acceleration of FedEx Ground capacity initiatives.

That projects to roughly 6.9% of expected revenue, which is the lowest level in over 10 years. While we have not finalized our FY '22 plans, capital spending will increase as we invest in capacity and proceed with investments in replacement capital previously deferred. That said, I anticipate CapEx as a percentage of revenue will be 8% or less, which remains less than our historical capital intensity. We will provide more specifics in June.

Looking at liquidity on the balance sheet. We ended the third quarter with \$8.9 billion in cash and cash equivalents and on Tuesday, renewed our \$2 billion 5-year credit agreement and \$1.5 billion 364-day credit agreement. The key aspect of our capital allocation strategy moving forward will be strengthening our balance sheet and repayment of outstanding debt. Given our strong cash flows and liquidity position, we are evaluating potential transactions to reduce and refinance existing debt. The timing of any transaction will be based on market conditions, and we would incur costs related to these transactions which may be material.

I'll close by reiterating I have great confidence in our ability to build on the successes we have had this year as we execute our plans to generate sustainable long-term growth in earnings and cash flow.

And with that, we can move to the question-and-answer session.

QUESTION AND ANSWER SECTION

Operator: And first, we'll go to Chris Wetherbee from Citi.

Chris Wetherbee

Analyst, Citigroup Global Markets, Inc.

Maybe I want to start on the Ground side and understand, I guess, first, around Ground pricing, so significant progress has been made so far. But I wanted to get a sense of where you think you are in the process of repricing this product up for the service that you're offering and ultimately, the demand of the market right now. And then maybe as we think about how's that and mix may impact margins as we move forward, say, into fiscal '22, clearly, we've moved very heavily overweight towards B2C over the course of the last 12 months. But as B2B grows, it maybe even takes a little bit of market share. How should that play through your Ground margins?

Brie Carere

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

Thanks for the question, Chris. It's Brie speaking. From a yield strategy perspective, we still believe we have opportunity from a mix perspective. As you saw this quarter was probably the most dramatic -- or not probably, was the most dramatic movement we've been able to make from a product perspective. You're going to see that shift throughout this year as capacity -- we anticipate capacity throughout this calendar year will be constrained. And as a result, as I mentioned, we've got to prioritize our SAM growth. You heard 35%. It's the best segment performance we've got from a small perspective. So we're going to prioritize that. It will continue to work our yields up. In addition to that, the FedEx Economy product is something that we are very focused on, and it will add dramatic yield upside from here out. Henry?

Henry J. Maier

President & CEO, FedEx Ground, FedEx Corp.

Chris, let me take the margin question. First of all, in Q4, we expect teens to -- margins to be in the teens. But let me speak to how we see the business beyond that. First, we believe there's considerable operating leverage still to be realized in this business. Strategic initiatives will help ensure the right packages are on the right sort, on the right day for

on-time delivery. They also ensure that overnight sorts are reserved for next-day volume, enabling the right balance of sort capacity in the network. These are critical capabilities for a 7-day network operation. We're also implementing dynamic scheduling tools to match sort staffing headcount more closely to volumes, thereby improving dock productivity and our dock expense. And we're rolling out capabilities for certain upstream volume in the network to bypass station sortation and transfer directly to delivery vehicles, freeing up valuable station capacity. None of these initiatives require brick-and-mortar. They're possible through industry leading technology, AI and machine learning and are developed using a safe agile framework and tools.

So with all of that, in my view, as we continue to transform the FedEx Ground business, FedEx Ground's best days are still ahead of her.

Operator: And next, we'll go to Ken Hoexter from Bank of America.

Ken Hoexter

Analyst, BofA Securities, Inc.

Let me switch over to Express. And I guess if you exclude the weather impacts, the 4.8% goes up to maybe upper single digits in terms of margin. Maybe you could talk about the return of B2B on the Express side, same thing that you were just talking on Ground. Maybe you were talking about pricing starting to disappear in 12 months. So how do you look at this business? Do you see it transitioning back to double-digit margins? Or is there some structural change that keeps that at the single-digit levels?

Brie Carere

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

Ken, it's Brie. I'll start with the pricing and the yield element and then turn it back over to Don and Mike. From a yield perspective and from a B2B, as we mentioned, as of January, here in the United States, our B2B volume was back to pre-COVID level. The mix within the B2B wasn't what historically we have seen. It was obviously heavy health care, heavy retail, heavy tech. We have not seen it fully come back in automotive and industrial. So we think that there's some upside there. When you look at the B2B volume outside of the United States, at a whole holistic level, we're back, but Europe is not. So we see there still opportunity intra-Europe and intercontinental outbound from Europe. The European team has done a phenomenal job of shoring up volume, but it is B2C volume that they've shored up that gap with. So I still think that there is some B2B upside coming out of Europe still.

From a yield perspective, we're feeling pretty confident in our yields throughout this calendar year from an international express as well as a domestic express. There is pressure on the yield from a weight perspective because the e-commerce mix will continue to increase outside of the United States at Express. So overall, we're quite comfortable from a yield growth and opportunity perspective for the next 12 months. And I'll turn it over to Mike.

Michael C. Lenz

Executive Vice President & CFO, FedEx Corp.

Yes. Chris, as I said, this is Mike. We -- certainly, in the fourth quarter, we'll see margin gains at all 3 of the transportation segments. You can't get to the guidance that we put out there without that falling into place as well as the other context I gave you. And we're highly confident we can build on the momentum here with the strategies and the plans that have been outlined, but we're not going to be giving forward margin expectations. We'll have more to say about our outlook for '22 in June. Don?

Donald F. Colleran

President & CEO, FedEx Express, FedEx Corp.

Yes, Mike and Brie, just to add a few things to your comments. One is, I think Raj had mentioned in his prepared remarks about the strength of the quarter. And it was a strong quarter for us, highlighted by the best December we've had in the company's history, and on track to provide that same level of performance for the quarter until the weather hit. Now this is not a comment about would have, should have, could have, but it really is one to highlight the strong fundamentals that exist in the Express business right now. We're extremely confident of the fundamentals that we'll continue to deliver into the fourth quarter as evidence of what we've seen. We had \$1.9 billion of revenue growth in that quarter. I thank our excellent sales team around the globe and the wonderful job that the Express operating unit did in terms of monetizing and turning that into a strong performance.

And as it relates to what we're seeing from a yield perspective, I agree, obviously, with Brie's assessment. We're seeing some fundamentals in our international business that are quite clear to us in the short, medium and maybe in the longer term. When inventory levels remain low, supply is soft and demand is very strong. And we think that demand is going to even increase as the stimulus checks come into the marketplace. So we think if you look at it in terms of a trifecta, those fundamental economic issues that we have should continue to benefit us, especially in our international business going forward.

Operator: And next, we'll go to Allison Landry from Credit Suisse.

Allison M. Landry

Analyst, Credit Suisse Securities (USA) LLC

Sorry I was on mute. Just digging a little bit more in terms of the Ground revenue per piece and specifically on Q3, Brie or Henry, could you maybe talk about or break out the contribution to the yield -- of the yield equivalent that came from base price versus the peak surcharges and then mix? I guess what I'm trying to think through is how to best think about the sequential yield change in Q4. Normally, I think it's up about 4%. But obviously, maybe the peak surcharges fall off, you have some incremental surcharges in place. So just looking for a little bit of context in terms of breaking out the contribution of the different pieces there.

Brie Carere

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

Allison, from a pricing strategy perspective, obviously, the vast majority of our volume is on highly complex contractual agreements. And so it's quite difficult to streamline and break that out for you right now. But what I will tell you is from a Q3 perspective, you saw really us very much focused on our FedEx Ground Economy product. We know the spread between the FedEx Ground Economy and our FedEx Ground Home Delivery product.

That yield spread, historically, has been too wide. So we are very focused on prioritizing capacity at the higher-yielding home delivery product. And so you're going to see 2 things happen. You're going to see us give more capacity to home delivery at the higher yield, and you're going to see us increase the yield throughout this calendar year, both through peak surcharges as well as through GRI strategies and, quite frankly, just contractual discussion. So that's really our focus is closing that gap, prioritizing capacity for home delivery and making sure we've got capacity for our small and medium customers.

Allison M. Landry

Analyst, Credit Suisse Securities (USA) LLC

Okay. And just any color on what sort of the peak surcharge impact was in Q3 from a dollar perspective or a percentage perspective?

Brie Carere

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

We're not going to give that out at this time, Allison.

Operator: And next, we'll go to Jack Atkins from Stephens.

Jack Atkins

Analyst, Stephens, Inc.

Great. So Mike, I guess maybe this one is for you. When I think about the fourth quarter implied guidance, historically, you see a fairly significant ramp in earnings from the third quarter to the fourth quarter. And when you normalize for the weather and the lower tax rate, your guidance -- implied guidance is for maybe a 17% increase in earnings from third quarter to fourth quarter. Typically, it's 50% to 60%. So I'm just curious if, maybe, if you can walk us through some of the puts and takes there? Is it a factor of just the broader economy? Is there just some conservatism in general? Just can you help us think through the implied fourth quarter guidance and why you wouldn't see more of a normal seasonal ramp there?

Michael C. Lenz

Executive Vice President & CFO, FedEx Corp.

Jack, I'm not going to get into decomposing all of the puts and takes that come into seasonality. I guess I would refer back to when I mentioned an effective tax rate for the year of 21% to 22%, that implies a higher tax rate in Q4 than our -- typically, you can rule of thumb for a full year. The statutory federal rate is 21%, 3% or 4% for state and other. So 25% on a kind of normalized basis. But as we've mentioned on the call, we have had about \$300 million of discrete events through year-to-date in Q1 to 3. So I think when you kind of normalize for that and look at our underlying operating performance there, it is a very strong Q4, and I'll leave it at that. I talked about some of the other elements that will play into Q4 earlier, so I won't rehash those. But I think when you are able to piece it all together, it will be a very solid operating Q4.

Operator: And next, we'll go to Jordan Alliger from Goldman Sachs.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Question. When you think beyond the fiscal fourth quarter of this year and into the next fiscal year, you start getting to some difference in tougher volume comps, especially in Ground. Is your expectation, though, that with e-commerce continuing even at a decelerating pace that you could still grow your overall volume levels year-over-year?

Brie Carere

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

I guess the short answer is yes. We're anticipating that the market growth, 90% of the market growth is going to come through e-commerce. We've got a long-term outlook at more than 10% CAGR from an e-commerce perspective. So the short answer is, yes. And Mike, I'm sure, would like to add something.

Michael C. Lenz

Executive Vice President & CFO, FedEx Corp.

Yes. Jordan, I just will throw a lot of numbers at you. But as Brie mentioned, we went from 62% to 70% residential mix, and FedEx Ground's margins were up 270 basis points. So I think that speaks to how we plan to execute on the continued growth of e-commerce.

Frederick W. Smith

Chairman, President & CEO, FedEx Corp.

And of course, we will be giving an FY '22 earnings forecast in June. That has been something that's not been available during the pandemic from a lot of companies. But with the forecast that Mike just gave you for the fourth quarter, you can anticipate a full year FY '22 range at our June call.

Operator: And next, we'll go to Brandon Oglenski from Barclays.

Brandon Oglenski

Analyst, Barclays

Mike, can you talk to the outlook -- you said CapEx is going to be below 8% of revenue and (inaudible) on these projects because I think you mentioned accelerating some of the Ground investments?

Michael C. Lenz

Executive Vice President & CFO, FedEx Corp.

Brandon, you broke up a little bit, but if I understand asking about the CapEx references. So as we said, volume grew 25% at Ground. And so as we came through December, evaluating and looking at what's ahead and the opportunity there, we see that as opportunity. Also, if you look at our -- when you get the chance to look at the stat book in terms of the maintenance CapEx, you can see that our facilities and vehicles, we deferred a lot of that this year. So there will be some amount of those that going forward as well. So we'll be -- we'll certainly give you more specifics on that when it comes to June.

Brandon Oglenski

Analyst, Barclays

Yes. Mike, I guess I was asking, like in the longer-term context, what are the type of returns (inaudible) these projects?

Michael C. Lenz

Executive Vice President & CFO, FedEx Corp.

I think the question is about returns. You broke up again. I will say with very absolute confidence that all of these investments we're making will generate a solid return on investment, just as the investments we've made in the last few years are showing results today.

Operator: And next, we'll go to Amit Mehrotra from Deutsche Bank.

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

And Henry, I was hoping I could ask you about Ground margins, if that's okay. I think the key question and discussion point we've all had is the long-term outlook for Ground margins given the secular shift to B2C and the density challenges that obviously come with that. I mean you guys have made incredible progress on pricing and operations. I'm just wondering if you can update us -- you gave a little bit of it last quarter, but hoping you can update us on what you think the sustainable margins for Ground -- the Ground business are on an annual basis and when do you think you can get there. And just related to that, you guys called out \$350 million of weather. I was hoping you could talk about what the attribution to Ground business was from that number.

Michael C. Lenz

Executive Vice President & CFO, FedEx Corp.

Amit, this is Mike. As I said in my remarks, \$85 million of the weather was Ground. Again, we've said we're giving you fourth quarter guidance. We'll have more to say about future outlook in -- for FY '22 in June. But we're very confident of our ability to build on the momentum of generating increased returns and profitability at Ground.

Amit Mehrotra

Analyst, Deutsche Bank Securities, Inc.

Can I ask it another way then since it's the same question. And the spread between pricing costs in Ground was in excess of 300 basis points per package. As B2C recovers, is there any reason why the spread between price and cost per package should moderate over the next 4 to 5, 6 quarters?

Henry J. Maier

President & CEO, FedEx Ground, FedEx Corp.

Well, I think the last 2 quarters, we've given you some guidance on what we've seen unit costs do as we move through the pandemic and we move through the shift in the mix of our business. Obviously, we're going to lap some of those results, but we've had significant reductions in our unit costs as we've gone through the last year as a result of many of the strategic initiatives we've outlined here, and were in, frankly, in Raj's comments. We continue to see considerable operating leverage in the business, and we would expect margins to improve over time.

Operator: And next, we'll go to Tom Wadewitz with UBS.

Thomas Wadewitz

Analyst, UBS Securities LLC

Yes. Let's see. I wanted to -- I think one of the questions that seems to come up is concern about potential to have some of that strength in international rates that's beneficial for Express, that eventually, some of that profitability is going to go back as past device-based comes [back]. And presumably, that's out very quickly and that you retain a portion of it. I wanted to see if you could give us a sense of the potential offset from your cost initiatives. Those numbers, if you look at a couple of years, are they potentially in the same magnitude? And I'm thinking in particular of integration of some of the B2C shipments for Express and Ground, but that's helpful on the cost side and potentially TNT and maybe you have other things in mind.

Rajesh Subramaniam

President & Chief Operating Officer, FedEx Corp.

So Tom, this is Raj. I'll address it overall. Obviously, it's not possible to give out the numbers by the individual items that you just talked about. However, we -- let me address it broadly by first saying that the capacity in the commercial carrier -- passenger carriers, we don't expect it to come back in the next 12 months, maybe more, and we expect the premium to remain for that period of time. Even if it does come back, we have the opportunity to flex it, flex our networks. We can -- and that is -- we have demonstrated that capability to flex up. And we'll be able to flex it down as needed and they become our partner networks to move deferred traffic.

Thirdly, there's a lot of activity that's going on to continue to improve margins in FedEx Express. Transformation in Europe was one, expansion of last-mile optimization is another and very solid activity. So we feel very confident about our future of our Express around the world. I don't know, Don, if you want to add anything more to that?

Donald F. Collieran

President & CEO, FedEx Express, FedEx Corp.

I think you hit it, Raj. But clearly, we have a playbook on margin -- improving margin expansion in both our domestic and international business. I think you touched upon it. I did in my earlier comments about why we're confident over the medium term that the supply and demand curve works in our favor. Capacity is light, and we think it will continue to remain that way. Until people start traveling again on an intercontinental basis, we don't think that happens for the next 12 to 18 months because of the various levels of quarantine restrictions that are in all parts of the globe.

We're working and monitoring -- I would want to highlight that you didn't talk to was our last-mile optimization plans and the impact that, that has on our margin. I think our Chairman says, density is our destiny. And as we can continue to improve the density in the ether of our networks, it's very much margin accretive. We're celebrating the 1-year anniversary coming up on last-mile optimization, working very closely with Henry and his team. And we're driving a significant amount of volume through the Ground network. And that -- those numbers are accelerating on a sequential week-over-week, month-over-month basis.

So there's a lot of leverage that we can pull in our business, the European transformation, the domestic transformation. We have multiple playbooks in play as we speak to continue with our margin improvement and expansion.

Frederick W. Smith

Chairman, President & CEO, FedEx Corp.

Let me add something to that. The LMO initiative benefits in 2 ways: one, it takes lower-yielding residential packages and deferred packages and rural packages out of the Express network, allowing the Express system to concentrate on the high priority B2B and the verticals, particularly those that require ancillary services like SenseAware ID, which is on every single box of vaccines that we're now delivering. I mean it's almost been flawless, the execution of that. And you can count on your hand the number of issues with the number of vaccines we've delivered in the millions. And so Express is able to be more Express in the B2C and the less dense areas, more cost effectively serve. So it's not just one side. It helps on both sides, which is what Don mentioned about the density, because as we get more residential packages that are not express in nature, time definite or something that somebody needs in a residence that Express has to deliver, it helps Ground's density, its cost, its asset utilization.

And I think one of the things that I listen to these calls, the last call, we had 13 questions on Ground margins. I don't know. We're not going to have 13 this time, but we've probably got half a dozen so far, wouldn't that be close? So one of the things that's hard for us to communicate to this group, Henry has mentioned, is the fantastic effect of this technology that we've been rolling out. We don't advertise it all the time, but Rob and his team and some of the fantastic work we have going on in other ways, that's why the confidence level is so high that we can achieve these things in the future. So what

you all want us to do is to give it to you in a quarterly forecast and so forth, but some of the numbers that Raj laid out there for you, I mean, they're stunning in the productivity improvements. So I think it's important to look a bit at the bigger picture of some of these things.

And finally, I'll say, we have a plan to improve Express margins with a lot of passenger capacity in the marketplace and a plan to improve it without a lot of passenger in the market. It's not an either/or situation. And so those are the 2 recurring questions that come up in these calls. The e-commerce are going to go back because everybody -- the pandemic is over, and your margins aren't going to get better, and you're not going to do well in Express because the passenger is coming back. Those are inherent in most of the questions, these last 2 calls. Both of those are wrong. So I felt I had to step in finally. I've tried not to answer any questions, but you're going down the wrong rabbit hole on both of those areas.

Thomas Wadewitz

Analyst, UBS Securities LLC

I think if I can just offer one more thought. I think it's just like the magnitude, it seems like they're pretty big programs and pretty favorable. So I think my question was just trying to understand if you're going to give us a sense of the magnitude at some point. But they may -- I mean what you're doing, it makes a ton of sense and seems to be a big factor in the results. So anyway, just -- thanks for all the good perspective on it.

Operator: And next, we'll go to Duane Pfennigwerth from Evercore ISI.

Duane Pfennigwerth

Analyst, Evercore

I guess that rules out asking 7 more Ground questions. Just a couple for me. How much of that \$350 million is cost versus volume pushed out into this quarter?

Michael C. Lenz

Executive Vice President & CFO, FedEx Corp.

Well, I will tell you, most of the \$350 million was revenue related. We did have incremental costs at Express for, of course, beyond normal expectations for de-icing and snow removal, additional labor costs, and then I think a couple of you have noted that we had a significant event with one of our facilities in the Netherlands there as well with the roof collapse. So that is a cost that was in the number as well. But principally, it is revenue from that, and I'll let Brie talk about the overall evolution of where we are now.

Brie Carere

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

Yes. I guess the best way to think about March is the fundamentals are back. So we're very confident. If we take February out, our fundamentals look a lot like they did in January. B2B is strong. SMB is back. Ground in good shape. So it was February revenue, but we feel very confident about the fundamentals in March.

Duane Pfennigwerth

Analyst, Evercore

And then just a quick high-level on vaccine distribution. I wonder if you could talk about any surprises versus your initial expectations, either the level of activity you've seen and which segment is being utilized?

Donald F. Collieran

President & CEO, FedEx Express, FedEx Corp.

Yes. Thanks, and it gives me an opportunity to brag on the team a little bit. So I guess if there's anything that's surprised me and it shouldn't have is how amazing the team is it that provided this exemplary service. Richard Smith and his organization have done yeoman's work to make sure that these vaccines move through our network. As Fred said, an extremely high level of efficiency, a handful if that shipments that did not meet service.

I think what's important to note, though, when we talk about the vaccines, is really not the raw in absolute numbers that move in our network. In the grand scheme of things, when you look at almost 20 million packages a day moving through our network, this represents a very small portion of that. But what is important to note is a profound impact that these shipments have when they get to destination. And it really just validates our purpose, and it's one we take very, very seriously. The amount of lives that we potentially save, the amount of people we put back to work, the amount of small businesses that reopen, the borders that can reopen back to normal levels. That's really the story on that vaccines, and that's what we're most proud about.

So I guess the surprise that really shouldn't have been is the amazing work that our team has done to galvanize and be energized around this purpose. And they take that purpose very personally. Get up every morning thinking about the mission that we have to get these vaccines to market so we can get them in folks's arms. So I couldn't be more proud of the team in the way that brought these vaccines to market globally. So thanks for asking that question.

Rajesh Subramaniam

President & Chief Operating Officer, FedEx Corp.

Yes, let me also jump in on that. I couldn't wait to -- this is one of the most important work that we have done. And to do the work, to be honest, we need a network. And by that, I mean, you'll be able to pick it up in any one part of the world and deposit in any other part of the world in a couple of days. That requires a network. And only a couple of people can actually do -- a couple of companies can actually do that, and we do that very well.

But you also tied to it, the technology component, the SenseAware ID that Fred talked about that we rolled that out last year, I mean, it was perfectly timed for the vaccines to provide unprecedented visibility. And we also launched FedEx Surround last year, which provides the AI and ML predictive capability of what is going to happen. You put it all together, we have the best service possible. And as the Chairman pointed out, extremely low level of failures. So again, we are very proud of this work and continue to do our part in ending this pandemic.

Operator: And next, we'll go to Allison Poliniak from Wells Fargo.

Allison Ann Marie Poliniak-Cusic,
Analyst, Wells Fargo Securities, LLC

Just wanted to circle back on the new service capabilities that you talked about within international. Is there a way to help us understand or quantify sort of the market, who you're expecting to sell, what drove the development of those products? And any thought on sort of mix? I'm assuming it would be sort of a better mix business for you longer term. Any thoughts there?

Brie Carere

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

Sure. So I think when you think about what we're going -- what we have going on in the fourth quarter, we really actually have 3 kind of expansions from a service perspective. We will have -- actually, we do have the fastest intra-European ground network as we completed the TNT ground network integration. That will provide growth, both from a B2B

perspective as well as a B2C perspective. So we are absolutely looking to take share intra-Europe, and we see that with the fastest network in Europe. We're confident we can do that.

When you think about the intercontinental, we actually, today, have the leading value proposition from Europe to the United States, and we're going to double that. So we are going to have a dramatic advantage over both UPS and DHL. We're adding 9 origin countries. So it's going to allow us to really expand both our B2B share as well as our B2C share outside of the major markets in Europe.

And then third, as we're talking about FICP, the same story outside of the United States is playing out everywhere in the world with more than 85% of our parcel growth opportunity coming in e-commerce. And we did not have an international product that really had the right features of service for serving this massive growth opportunity. And we are under-penetrated. Full disclosure, we are behind both DHL and UPS in this market today so we see there only upside.

When you think about FICP, its features of service are different from our core B2B products in a couple of ways. Number one, we've changed the clearance capabilities. So we now have low-value clearance capabilities, or what we call type 86, which makes it a lower cost entry for the customer. We are automating our clearance capabilities, which reduces the cost to serve. We are changing the terms and conditions on the number of attempts that we will make at the last mile. And of course, we're rolling out retail access points in Europe as well so that we can provide that access directly to retail, again, lowering the cost to serve.

So in all 3 of these segments, we believe we've got market share upside. But probably most specifically, on the overnight service to the United States, it's a B2B play. On FICP, it's a rapidly growing opportunity for e-commerce. I hope that helps clarify.

Operator: And next, we'll go to Scott Group from Wolfe Research.

Scott H. Group

Analyst, Wolfe Research LLC

So Mike, I just had a few questions for you. You've been highlighting incentive comp the last few quarters. If we have more of a normal earnings growth year next year, is more of a normal incentive comp headwind, is that -- that's my question. Then the corporate elimination volume has grown to like a run rate of about \$1 billion a year. I think there's been a bunch of COVID losses in there. Is that something that should start to normalize to be less of a loss in the future?

Michael C. Lenz

Executive Vice President & CFO, FedEx Corp.

Well, Scott, one thing that I would mention in the corporate unallocated line, as we've mentioned previously, FedEx Office results are in there and the print-related revenue, while ADV is up spectacularly at FedEx Office, the print-related revenue is significantly impacted by the pandemic. So as we start to come through that, we would anticipate we'll see some improvement there.

On the variable comp, I guess what I would say to you in that is we wouldn't anticipate that to be a headwind looking at FY '22. I hope that helps.

Operator: And at this time, I'll turn it back to management for closing remarks.

A. Mickey Foster

Vice President, Investor Relations, FedEx Corp.

Thank you for your participation in FedEx Corporation Third Quarter Earnings Conference Call. Please feel free to call anyone on the Investor Relations team if you have additional questions about FedEx.
Thank you very much.