

## FedEx Q1 FY23 Earnings Call Transcript – September 22, 2022

### **A. Mickey Foster**

*Vice President, Investor Relations, FedEx Corp.*

Good afternoon and welcome to FedEx Corporation's First Quarter Earnings Conference Call. Before we begin, we want to recognize our SEC 8-K was filed earlier than planned due to a technical issue. The first quarter earnings release, Form 10-Q and stat book are on our website at [fedex.com](https://www.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.

We 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](https://www.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 Raj Subramaniam, President and CEO; Mike Lenz, Executive Vice President and CFO; and Brie Carere, Executive Vice President and Chief Customer Officer.

And now, Raj will share his views on the quarter.

### **Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

Thank you, Mickey, and good afternoon, everyone. I'd like to start today by acknowledging our preannounced first quarter earnings results and updated outlook we provided last week. Our network capacity did not align with the demand we experienced as the quarter progressed, but as communicated last week, we have taken swift actions to address what's within our control. Getting costs out rapidly is my priority, and today, I will outline why I'm confident in our ability to drive improved performance and profitability through aggressive cost actions.

Before providing more details around these actions, let me briefly discuss what happened since we last spoke to you in June. We saw a decline in our volumes during the first quarter, which accelerated in the final weeks. Our softening volumes in Asia and the US were predominantly due to the economy, while the shortfall in Europe was both economic and service-related. Therefore, we had costs in the system for volumes that didn't materialize.

While we immediately took action, savings from these cost efforts lagged the volume decline due to the scale of our operations. As a result, while revenue was up 6% year-over-year, these dynamics translated to volumes being down year-over-year at all our transportation segments. The volume decline directly impacted our bottom line, driving total company adjusted operating income down roughly 18% year-over-year.

Now, what matters most is what we are doing about it, and this brings me to our aggressive and decisive plan to reduce costs. I'll speak to you – or I'll speak to our actions in two parts: first, our fiscal year 2023 steps to immediately reduce costs; and second, our Deliver Today, Innovate for Tomorrow transformation strategy to permanently reduce costs and optimize our network.

Starting with fiscal year 2023, we are prioritizing cost actions to generate \$2.2 billion to \$2.7 billion of savings, of which, about \$1 billion will be permanent. Taking each key contributor in turn, at FedEx Express, we expect to drive \$1.5 billion to \$1.7 billion in savings this fiscal year. The largest single expected contributor in fiscal 2023 will

be the changes we are making to our express air network as we cut global flight hours. This reduction includes 11% of planned specific daily frequencies, 9% of transatlantic daily frequencies, and 17% of daily frequencies in the lane between Asia and Europe.

As volumes deteriorated later in the quarter, we began making these structural changes to our network. The impact of these initial changes will be fully realized in October, and the benefit of our continued actions will steadily increase throughout the fiscal year. We are also evaluating additional reductions to be implemented post-peak.

Further, we're taking steps to enhance our ground efficiency, including reducing routes, hours, vehicle rentals and other on-road expenses. For example, in Europe, we are altering ground network routes to improve productivity, leading to a reduction of approximately 11% of routes in the UK and 12% in Germany.

Now, turning to FedEx Ground, we expect savings in Ground to be \$350 million to \$500 million in fiscal 2023. Our approach to cutting costs in Ground primarily centers around rationalizing our operations. We are consolidating sorts which will reduce costs while maintaining service, and have canceled several planned Ground network capacity projects. And as mentioned last week, we're also reducing select Sunday operations in over 170 stations. Mike will provide more details on our capital plans shortly.

The final components of our expected fiscal 2023 savings will be from overhead expenses as we right-size our overall cost structure. These actions include our plans to close nearly 140 FedEx Office locations and at least 5 corporate office facilities. Additionally, FedEx Services have stopped all non-critical projects. In total, our overhead reduction actions including, FedEx Services, will contribute \$350 million to \$500 million.

We realized nearly \$300 million in cost savings from these actions in Q1 and expect approximately another \$700 million in Q2 for the remainder of the fiscal 2023 savings realized during the second half of the year.

The second part of our cost plan is focused on permanent reductions. And we have launched DRIVE, a program supporting our Deliver Today, Innovate for Tomorrow strategy introduced in June. DRIVE is how we execute on that strategy. Our team has already started implementing cost reductions into this program, and this will ultimately enable Network 2.0, a long-term end-to-end optimization of our network.

Sriram Krishnasamy, our newly appointed Chief Transformation Officer, will facilitate DRIVE and continue reporting directly to me. In total, we expect to take out an additional \$4 billion in costs related to DRIVE by fiscal year 2025.

To be clear, these are incremental to the fiscal 2023 savings I just outlined. These transformational changes will lay the foundation for Network 2.0, which will create an additional \$2 billion benefit over the long term.

In closing, we are focused on actions we can control as we stabilize our near-term performance and execute against our long-term strategy. I'd like to sincerely thank our highly motivated team for their hard work and dedication to deliver upon the Purple Promise.

Now, let me turn it over to our Chief Customer Officer, Brie Carere, to discuss market trends that underpin our outlook and our commercial strategy in some more detail.

**Brie A. Carere**

*Chief Customer Officer & Executive Vice President, FedEx Corp.*

Thank you and good afternoon, everyone. As Raj discussed, during the first quarter, manufacturing, global trade and consumer spending decelerated particularly late in the quarter and certainly more than we anticipated. As a result, our first quarter volumes were lower than we forecasted.

Our current expectations for 2022 US GDP growth and US industrial production forecasts have declined by about 100 basis points since June. Data shows that US consumer spending has slowed as inflation remains a challenge. Further, consumption is skewed toward services, demonstrated by the fact that in June, excluding auto, the real retail inventory-to-sales ratio fully recovered to its pre-pandemic level.

From October to June, the real inventory-to-sales ratio, excluding automotive, increased 14 basis points, which was the fastest gain over an 8-month period in the 25-year history of the series. Also, real retail sales, including auto, after growing 4.6% and 10.8% in calendar year 2021 and 2022, respectively, are now down 3.1% year-over-year through July and are pacing to have the worst decline since the Great Recession.

Turning to our transportation businesses, I'd like to spend a moment on the dynamics occurring within FedEx Express, and most specifically, in Asia and Europe. Starting with Asia, our results were impacted by macroeconomic weakness. Our lower demand is consistent with the broader market, with ocean and air freight rates under pressure in recent weeks.

A good indicator of how quickly the market changed in Asia is to review the spot rates coming out of Hong Kong and Shanghai. In June and July, spot rates were between 20% and 40% higher year-over-year, respectively. In early August, these rates fell to single digits, and by the end of the month, Shanghai had plummeted to a 10% decline year-over-year, while Hong Kong rates were flat. Through June, which is the latest data available, we have had small market share gains in our Asia region.

In Europe, the economy was weaker than we anticipated and service further pressured our results. Our network integration was successfully completed in March, but it is an incredibly complicated effort to combine two individual networks of this scale. Throughout the quarter, we continued to refine our standard operating procedures to improve service levels and create momentum across our European division.

Moving now to FedEx Ground, revenue growth was driven by higher yield from higher fuel surcharges, base rate increases, and improved volume mix. Despite volumes being lower than anticipated, we've held market share in the United States.

FedEx Ground has strong service levels, best-in-market transit times and an exciting new picture proof-of-delivery capability. We are ready to deliver for peak. We will remain nimble in leveraging peak surcharges to balance demand and the capacity of our network as we monitor volume trends.

And at FedEx Freight, momentum continues to build. The Freight team delivered another strong quarter marked by 21% revenue growth. The team continues to drive disciplined execution, focused on revenue quality and profitable share growth.

For the company overall, we continue to execute our revenue quality strategy and pursue business that provides attractive yields. We continue to deliver new pricing capabilities, and we've taken recent actions to stay wellpositioned relative to the market as we approach peak. We have maintained a brisk pace for re-pricing contract for the renewals and continue to negotiate strong increases.

We just announced a 6.9% general rate increase this coming January in our response to inflationary pressures on our costs. We also announced our new remote area surcharge and peak residential pricing in the United States.

In Europe and Asia, we will launch a new handling surcharge as well this January. In August, we implemented international fuel surcharge table adjustments for Asia, Europe, the Middle East and Africa. Fuel surcharges are an important pricing tool. We rigorously monitor fuel prices to ensure that we are appropriately positioned relative to the market.

We're moving with speed and agility to reposition our business model for today's operating environment. As you heard from Raj, we have great opportunity to align costs with volume levels. We are committed to doing this while executing against our commercial strategy and delivering for our customers.

Importantly, we're still focused on the longer-term opportunity growing in high-value segments, driving improved service quality and, of course, delivering an outstanding customer experience. I am really pleased with how our teams have responded in this dynamic environment, and we are well-positioned to deliver during the upcoming peak season. Service is strong, and we have a fantastic value proposition.

With that, I'll turn it over to our Chief Financial Officer, Mike Lenz.

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

Thank you, Brie. While revenue was up 6% for the quarter, profitability was challenged, with operating income down 18% on an adjusted basis; and adjusted operating margin down 150 basis points year-over-year.

At Express, adjusted operating income declined 72% due to lower average daily package and freight volume and increased expenses, as cost reductions lagged volume declines. These factors were partially offset by yield management actions, including higher fuel surcharges. Package yield, including fuel, grew 16% year-over-year.

Turning to Ground. Operating income increased 3% primarily due to yield improvement and home delivery volume growth. Yield, including fuel, grew 12% year-over-year. These factors were partially offset by higher operating expenses, driven by increased purchased transportation and other operating expenses.

Freight delivered another strong quarter, with operating income increasing over 67% as the Freight team continues to execute. This was driven by yield management actions, including higher fuel surcharges. Yield, including the surcharges, grew 27%. This was partially offset by higher salaries and employee benefits as well as lower shipment volumes.

To address the changed environment, we're focused on what's within our control and moving with urgency to take cost out of the network. Our team is operating with speed to identify cost-saving opportunities and accelerate their implementation.

The \$2.2 billion to \$2.7 billion fiscal 2023 savings we're targeting are relative to our initial plans heading into the year. The majority of this year's savings will come from Express, where the demand change has been most pronounced. We expect about \$1 billion of our fiscal 2023 savings to be permanent in nature, with flight reduction as the largest component, along with corporate and back-office costs. These permanent cost reductions were not part of the Deliver Today, Innovate for Tomorrow strategy we shared in June, which is about how we structurally optimize our networks. These reductions are directly related to flexing in a changed environment with a view to build back differently in the future.

As Raj mentioned, we remain committed to the profit improvement objectives we shared at our June Investors Meeting. We have launched efforts to accelerate initiatives, identify incremental opportunities, and implement metrics to track progress under the DRIVE program.

So next, I'll give more details on the targeted \$4 billion savings by fiscal 2025 enabled by DRIVE. About \$1.4 billion of the total will come from the FedEx Express operating expenses. Four largest areas of opportunity we are actively advancing are: first, restructuring the air network by reducing routes and more efficiently deploying crews, aircraft and commercial linehaul; next, optimization of sort, surface linehaul and on-road design to improve

efficiency, asset utilization and service; next, driving efficiencies in Europe, as we've discussed previously; and lastly, harmonizing global clearance processes to lower cost.

About \$1.1 billion of the total will come from FedEx Ground operating expenses via dock productivity initiatives, network and linehaul efficiencies, and reduced liability costs. And approximately \$1.5 billion will come from shared and allocated overhead expenses, led by procurement savings, back-office automation and infrastructure modernization, increased deployment of digital self-service, and further consolidation of shared service functions.

Moving to our capital spending plans, we've reduced our forecast for capital spend for fiscal 2023 to \$6.3 billion compared to our prior \$6.8 billion forecast. We're intensely focused on allocating capital to the most attractive ROIC initiatives.

Our liquidity remains a source of strength as we ended the quarter with \$6.9 billion in cash. And based on our cash flows and liquidity, we remain committed to our capital return strategy including our plan to repurchase \$1.5 billion of stock in fiscal 2023. We expect to purchase \$1 billion in the second quarter.

Our capital return strategy reflects our confidence in our business despite the headwinds we're currently navigating. We have significant flexibility to maintain our balanced capital allocation and preserve a resilient balance sheet.

Now, turning to second quarter guidance, while we continue to drive aggressive cost reduction actions, we expect business conditions to remain challenging in the second quarter. As a result and consistent with the update we provided last week, currently expecting revenue of between \$23.5 billion to \$24 billion in the fiscal second quarter and adjusted earnings per share excluding costs related to business optimization and realignment initiatives of \$2.75 or greater in the second quarter.

For the remainder of the year, while we are not providing guidance given current uncertainties, our plan is based on an expectation that the weak trends we saw in late Q1 will persist across our major geographies. This is embedded in our guidance for the second quarter and driving our cost takeout initiatives for the fiscal year.

Longer term, we remain committed to our fiscal 2025 targets for operating margin improvement, return on invested capital, and capital intensity that we shared with you in June. We're leaning more heavily into cost actions to get to those goals.

The start of the year presented greater-than-expected challenges, but I can assure you that we are moving with urgency to address these pressures while remaining focused on creating long-term value by prioritizing revenue quality, expanding margins, and elevating financial returns through profitable growth and reduced capital intensity.

And with that, we'll open it up for your questions.

## QUESTION AND ANSWER SECTION

**Operator:** And we will take our first question from Tom Wadewitz with UBS. Please go ahead.

**Thomas Wadewitz**  
*Analyst, UBS Securities LLC*

Yeah, good afternoon. I wanted to see if you could maybe give us some more perspective on some of the biggest cost reduction actions and just kind of your level of confidence on the execution. It seems like, I guess, parking the planes and taking out capacity is something you've done in prior downturns, but perhaps rationalizing sorting

centers seems like a new thing in Ground. And I guess the labor markets, maybe it's a little tougher to take labor market if you think you might need it back. So, I just wanted to see if you could give maybe a bit more detail on your visibility to those cost actions and kind of how they come through. Thank you.

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

Sure, Tom. This is Mike. So, you're correct in observing that the biggest order of magnitude of the cost reductions is from flexing down the air network. So, that will come into play particularly as we move through into the second half of the year as the flight reductions take effect in October and into November.

So, at Ground, you spoke of the facility and sort rationalization. What that does for us is as volume fell down below expectations, that leads to inefficient linehaul because load factors down and so, thus, you're running x – more linehaul than you need for the volume you have. So, by consolidating sorts and rationalizing facilities, that's just an example of how we can optimize against the lower volume.

I'd also highlight that within the capital spending projections, we have deferred a number of planned Ground facilities and we actually canceled a few that were literally about to initiate. So, we are moving quickly on this and fully acting to realize the full potential there.

So, we have clear plans to get at all of these. I have a long list and they all add up to a very solid number, and the team's focused on execution.

**Operator:** We will take our next question from Brian Ossenbeck with JPMorgan. Please go ahead.

**Brian P. Ossenbeck**

*Analyst, JPMorgan Securities LLC*

Yeah, hi. Maybe just more a basic question. Raj, can you just talk about the – I guess, the reason why this is only a FedEx issue, at least at this point in time? Why haven't peers called this out? They all seem to sound like things are actually working pretty well in their favor, at least not nearly as much of a falloff as you've highlighted. So, maybe you can just address that and why you waited a week to talk about the costs which we're all waiting for? And then just because of the significant downdraft in Express, can you give us some recent stats in terms of just how quickly it fell and how September is shaping up?

**Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

Okay, let me start, and then Brie can talk about some of the trends you're seeing. Listen, I can't comment on what our competition is seeing or not seeing. All I can say is the trends that we are seeing in the marketplace, and we want to get out ahead of this. And listen, the whole – at the end of the day, the macro is going to ebb and flow. It's really the activities that we do that matters at the end of the day, and we want to take control of what we can control. And that's why we are being very aggressive on our cost actions. And again, we'll let the economic environment, the things that we don't control, it'll do what it'll do. We'll just – we'll focus on the issues that we can control and primarily on the cost side.

I'll let Brie talk about the revenue trends.

**Brie A. Carere**

*Chief Customer Officer & Executive Vice President, FedEx Corp.*



Sure. Thanks, Raj. Brian, just to kind of reiterate what we – well, I know we had a lot of opening comments, but when we look at kind of the background, we really did break things into three categories. In Asia-Pacific, we absolutely believe that this is a market trend and not a FedEx trend. As I mentioned, our market share studies, they are a little bit of a lagging indicator, but we do see that through June in our Asia-Pacific region, we actually gained market share. And that's why I shared those spot rates and how quickly the market changed in August. And we do believe the entire market is experiencing that in Asia.

In Europe, similar story from an economic perspective. We think that the economy got worse throughout the quarter. We, however, acknowledge did not have the improvement in service in the quarter that we had expected. We actually saw some plateau in service level, so that was a FedEx issue. And as Raj mentioned, we're working on it furiously and actually feel good about the momentum there from a service improvement.

And then here in the United States, as I mentioned, through June, we can see that we've held market share. If you actually look from a nuanced perspective, I would say that the one nuance within the domestic performance is that from a FedEx Ground economy perspective, we have prioritized revenue quality and so we have let some volume go. That was very conscious. And we have seen that kind of persist throughout the quarter.

So overall, we do think that the entire market is experiencing what we had from a macroeconomic perspective. And then for Q2, you've got the revenue range, and I would say that September is right in that range.

**Operator:** We will take our next question from Brandon Oglenski with Barclays. Please go ahead.

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

Hey, Raj, and team. Thanks for taking my question. And definitely appreciate the new cost plans, but maybe we're going about this all the wrong way because there's been plenty of cost improvement plans in the past at this company that just haven't delivered. So, can I ask a pointed question? Have you done a product review? Like, what is not working in the last 20 years that's driving lower profitability in your network relative to your competitor? Is there a certain product or customer or a region that just isn't working?

And I can tell you from the outside looking in, TNT seems to have been an unmitigated disaster here that just isn't delivering because you guys are calling out European losses again. And then from our perspective as well, dual Express and Ground pickup and delivery networks, I get it, I know that Express and Ground have different dynamics. However, your asset efficiency is literally half that of your nearest competitor, which is unionized, if I might add. So, I guess, why not use this downturn to put more concrete plans in place to exit markets or regions that aren't working? And the billion dollars in permanent cost-out, obviously a step in the right direction but I guess, how can you address the deficiencies in the network as you see them?

**Rajesh Subramaniam**  
*President, Chief Executive Officer & Director, FedEx Corp.*

Well, thank you, Brandon. I think we are absolutely fully committed to taking cost – the cost levers out. We talked about in three buckets, fiscal year 2023, the \$2.2 billion to \$2.7 billion with the – for cost takeout here. We're talking about \$4 billion between 2023 and 2025. And then in the Network 2.0 of \$2 billion after that.

So, those are significant numbers. We are confident in these numbers. We have identified domains with targets. We have people who are focusing on run the business and people focused on transform the business, and we are using cutting-edge technology and some of it is already coming on live here. And all of this is in motion as we speak to deliver value as quickly as possible. So, we are confident. We are committed and this is definitely the focus of the entire team.

As far as TNT is concerned, since you asked that question, you've got to go back and look at the – little bit of history here. There's a portfolio gap that we had in Europe that our competition has been in Europe since 1974 and it took – it's a very important business and profitable business for them. We had to fill that portfolio gap. Now, has the integration gone exactly the way we thought it would? No, because we had the cyberattack. We had COVID. We had all kinds of things in the middle. But the integration is now complete, and that part of it is done. We had – the service issues are getting better, and we have in our portfolio to sell in Europe that's unmatched and sales is getting on the front foot.

So, this is the starting point, if you would call, and that's why we're confident of the improvements that Europe is going to deliver for us over the next two or three years.

And again, on the issue of Network 2.0, it's very easy to say, yeah, put it together and look at the numbers. Yes, that's great. But the complexity of – from a technology perspective, from facilities perspective, other issues is far greater. And most importantly, we have \$4 billion of in-network efficiencies we can get relatively easier than that. And, oh, by the way, we're building technology that'll enable us to get to Network 2.0. So we think it's the right sequence.

**Operator:** We will take our next question from Jordan Alliger with Goldman Sachs. Please go ahead.

**Jordan Alliger**

*Analyst, Goldman Sachs & Co. LLC*

Yeah, hi. Sort of a question for you in light of what – what could you have done different in the quarter? I guess the magnitude of the Express drop-off was so sharp and I guess that clients decelerated. But I'm just curious, like, how did it catch you so off guard? How do you protect against that in the future? And I would have thought that with the contractual customers you've had, you might have had more of a heads-up that this deceleration was coming. So maybe you could talk to that. Thank you.

**Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

Let me talk about timing. And then, maybe, Brie, if you want to add about what you saw from the customers. But, yeah, volume did drop off quite suddenly towards the end of the quarter. As you know, we have a complex system form in which multiple constituencies are on that. And there's a time lag between the actions we can take on reducing the linehaul network. And that's all it is. So as I said in October, you will see the full benefit of those takedowns.

In terms of customer trends, I don't know, Brie, if you want to add anything more?

**Brie A. Carere**

*Chief Customer Officer & Executive Vice President, FedEx Corp.*

Yeah. What I will say is that from a customer perspective, our customers are incredibly sticky. And what we experienced, especially in August, both in Asia and here in the United States is two things, is their demand actually wasn't there and our customers missed their own forecasts.

So I think from a customer relationship perspective, we are working with them furiously to help them manage the difficulties that they're experiencing in their own business. But from a customer stickiness perspective, this is absolutely a reduction of demand within their own business, not a share loss implication.



**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

Yeah. Jordan, this is Mike. We also are very intently focused on identifying these variable costs and shortening the time span in which we can realize the reduction there. So, again, there's a span and continuum across different lines of business and nature of cost, but we are intently focused on shortening that horizon.

**Operator:** We will take our next question from Helane Becker with Cowen. Please go ahead.

**Helane Becker**

*Analyst, Cowen & Co. LLC*

Thanks very much, operator. Hi, team. So just kind of wondering if you could be more specific on flights that you're reducing and parking aircraft to get to this 1.6-ish billion-dollar number. Like, how should we think about the trade lanes that are going to be impacted and maybe the number of aircraft that are going to be on the ground? Or do you change your Boeing delivery schedule?

**Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

Let me hit the trade lanes first, and then we'll go to aircraft. I think we have taken down 11% of transpacific daily frequencies, 9% of transatlantic daily frequencies, and 17% of daily frequencies in the lane between Asia and Europe. And we will continue to look at it and we'll see what needs to happen post-peak, depending upon how the volume levels hold. Mike?

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

Yeah. Helane, in taking that down, we're maintaining connectivity and service in the network. But there's lower volume, so we need less lift. So as a result, we identified the opportunity to park aircraft just as we have demonstrated in the past. So the equivalent of about eight narrow-bodies is what we will be idling temporarily. And so, as you can appreciate that, that defers maintenance spending that we otherwise would have had and, of course, you save the operating cost of not flying. So we'll continue to take that approach for how conditions unfold.

**Operator:** We will take our next question from Chris Wetherbee with Citi. Please go ahead.

**Chris Wetherbee**

*Analyst, Citigroup Global Markets, Inc.*

Hey, thanks. Good afternoon. I guess I wanted to understand the process of the cost-outs particularly this year. So I think you guys mentioned that \$300 million of cost savings is in the fiscal first quarter, another \$700 million is realized or expected to be realized in the second quarter. So that's about 40% or so of the full year, yet the results are running at a level that is about half of what we expected just a week or so ago.

So is this the kind of run rate we should expect as we move into the back half of the year with that extra \$1.2 billion to \$1.7 billion of costs coming in, or is there improvement? I guess I'm just struggling, particularly with the second quarter with the \$700 million of cost savings relative to EBIT for the total company, which may be in the neighborhood of \$1 billion or a little bit north of that.

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

Okay. Chris, so this is Mike. Let me take that in two parts. First, you asked about the second quarter in that. So as we emphasized, we saw the downturn in the demand in the latter part of Q1. And as we expect those trends to persist through all of Q2, while we've accelerated or we'll realize more of the cost savings in Q2 as you highlight, we also have three full months of that step-change in demand that occurred late in Q1. So that certainly pressures Q2 margins.

As we go through the year, the savings build and we expect then that the pressures relative to Q2 will mitigate as we go through the – be less as we go through the year.

**Operator:** We will take our next question from Ken Hoexter with Bank of America. Please go ahead.

**Ken Hoexter**

*Analyst, BofA Securities, Inc.*

Hey. Great. Good afternoon. Just before I get to the question, I just wanted to understand why you chose to launch your Q&A with CNBC versus hosting a conference call? Just wanted to understand the philosophy of what we can expect of the message going forward and how you plan on distributing it. And obviously, you had technical issues today, but just to try to understand why you chose that route in getting a message out.

But my question is how do you solve the festering Ground contractor issue? It seems like you talked about purchased transportation cost scaling. You mentioned in your statements you've pulled some networks. Some have turned their routes in. It seems like – seems like there's really deep concern. Is there opportunity to use this kind of, I don't know, whether the cost savings or something to change the structure there to resolve some of these issues that the contractors seem to have? Thanks.

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

Hey, Ken. This is Mike. First, as it relates to your question about the pre-release, so we felt that was appropriate for the circumstances. It's consistent with market practices and, quite frankly, allowed us to use more time today to be talking about how we're going to address it and our future plans.

**Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

As far as the perceived issues on the Ground side, let me just assure you, first of all, that the service levels at FedEx Ground are now reached pre-pandemic levels and we are very well-positioned for peak. The 6,000 contractors, we have 96% of them have signed the peak incentive program, and to put that in perspective, it is running ahead of where we were last year.

So a lot of those were in the media. They're all much more of a perception issue than reality, and we are wellpositioned for peak. And we have the support from our team.

**Operator:** We will take our next question from Amit Mehrotra with Deutsche Bank. Please go ahead.

**Amit Mehrotra**

*Analyst, Deutsche Bank Securities, Inc.*

Thanks. Hi, everyone. Mike, I just wanted to ask about the cost-out initiatives this year, and if it's a gross or net number? Because obviously, the company has a \$90 billion cost structure. If it's not net, \$2.2 billion to \$2.7 billion, it may sound like a lot, but if you have 3% inflation on that number, it wipes out the entirety of the cost savings. So, I want to know how you think about that, if that's a fair or unfair way of characterizing it. And then just very simply, are Express profits going up from here in the fiscal second quarter, or are they going down from here? If you can just answer that as well. Thank you.

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

So, Amit, first, as we've said, the \$2.2 billion to \$2.7 billion is relative to our cost plans that we had coming into the year. Now, as you rightfully observe, we, as everybody else in the world, is experiencing unprecedented levels of inflation and so that absolutely impacts our base costs. I guess the best way I could characterize it for you is on a absolute cost basis, the first quarter is the largest of the absolute year-over-year increase. As we move through the year, that will mitigate as the cost initiatives take traction here, and that will offset the cost inflation down the road.

I'm sorry, what was the second question?

**Amit Mehrotra**

*Analyst, Deutsche Bank Securities, Inc.*

Well, if you're just giving me a chance to follow up on that and then – the second question was if Express profits are going up from where we were in the fiscal first quarter, the 1.7% margin, or even just absolute profits, are they going up, or are they going down in the second quarter?

And the way you characterize the answer just now, it just seems like there's still no – if inflation offsets the gross cost takeout, then basically, all of the revenue decline prospectively drops to the bottom line. And so, I just wanted to understand how you – if you agree with that or how you think about that.

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

No, it wouldn't drop to the bottom line because of the actions we're taking. We're reducing costs to adjust to a lower demand environment. So while that doesn't leave us at the expectations that we highlighted that we outlined in June, it's certainly the case that we're significantly mitigating that as we go through the year.

As it relates to Express, I would – as I highlighted earlier, the demand downturn, particularly in Asia-Pacific and Europe, occurred late in Q1. So, Q2 will be – will see margin pressure again at Express not dissimilar to what we experienced in Q1. But the structural initiatives really gain hold at Express as we move through Q2. So if you think about the overall cost-outs, Express has more as we move through the year because of the timing of the big elements there.

**Operator:** We will take our next question from Jack Atkins with Stephens. Please go ahead.

**Jack Atkins**

*Analyst, Stephens, Inc.*

Okay. Thank you for taking my question. So I guess, Raj, going back to the comments you made earlier about the team, do you feel like you've got the right senior team in place to lead FedEx into the future? There's a clear lack of outside talent on the senior executive committee. Your largest competitor has really benefited from bringing in some outside talent over the last five or so years. Do you think it would make sense for FedEx to do that as you look forward to really put in some best practices and help drive improved profitability returns? It seems like that's sort of a missing element to the story here.

**Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

Jack, I think I'm very, very confident in the team that we have. There's a lot of experience here. We have several new players in place. The team is very, very excited. Obviously, we'll look at external talent. We already brought in external talent on several areas of this company. So, we're not averse to that at all. It's just that we have a very, very good team, Jack, and I'm very confident that we can deliver.

**Operator:** We will take our next question from Jon Chappell with Evercore ISI. Please go ahead.

**Jonathan Chappell**

*Analyst, Evercore Group LLC*

Thank you. Good afternoon. Brie, I wanted to ask you about the service challenges that you referenced. Just want to make sure, is that strictly in Europe? We're now six months past the finality of the integration of TNT. Are you confident that those service issues are behind you?

And then, the final thing, as you think about cost cutting across all of the regions, is there a risk that cost cutting could exacerbate some of the service issues going forward?

**Brie A. Carere**

*Chief Customer Officer & Executive Vice President, FedEx Corp.*

Great question, and let me answer the second part first. The answer is absolutely not. At FedEx, one of the things we talk about a lot is quality-driven management, and core service actually costs more. And our teams are completely aligned that we are going to reduce costs and continue to improve service. And I cannot emphasize that enough that these things will move hand in hand, and we are very confident in our service at Ground as we head here into the peak season for e-commerce.

When we're talking about service in Europe, as Raj mentioned, the March integration of the airline was successful. We successfully integrated the airline. It was very complicated and we did suffer some service challenges in March. As we stood in front of you in June, we absolutely had improvement from that March point. We did expect continued improvement in July and August, and what we experienced in Europe was a plateau in that service improvement. And I want to be really specific.

When we get into Europe, the international domestic markets, when we talk about like our UK market or we talk about the France market, that domestic service is actually really, really strong. And then, when we get across Europe on the deferred service offering, it's strong. We have to elevate the service within our overnight business in Europe, and that is our number one focus from a service perspective. And yes, I am confident that Karen and her team will continue to improve there. But I just wanted to kind of give you that background of kind of where

we're at and what we're looking at moving forward. And absolutely, our entire team knows reduced cost and improved service.

**Operator:** We will take our next question from Ravi Shanker with Morgan Stanley. Please go ahead.

**Ravi Shanker**

*Analyst, Morgan Stanley & Co. LLC*

Thanks. So regarding the GRI announcement, how do you reconcile pushing through your biggest rate increase in history at a time when your volumes are falling double digits? I mean, isn't that going to exacerbate the volume decline?

**Brie A. Carere**

*Chief Customer Officer & Executive Vice President, FedEx Corp.*

Fair question. I think the answer is inflation. Last year, we had a 5.9% increase in post. And by the way, we have just an incredible insight into our pricing discipline and the market, and the commercial tools the team have are just best-in-class. So, last year we did a 5.9%. It was incredibly sticky. We had continued cost increases throughout the year. And so, we felt that the 6.9% was appropriate for this year's GRI. We will monitor postimplementation stickiness. And of course, we're constantly looking to balance the yield and the volume and make sure that we get the right volume levels from a utilization perspective. But given the inflationary backdrop, yes, we thought this was the right increase for the year.

**Operator:** We will take our next question from Ari Rosa from Credit Suisse. Please go ahead.

**Ariel Rosa**

*Analyst, Credit Suisse Securities (USA) LLC*

Great. Thanks. So Raj, if I look at FedEx Freight, it's now producing almost four times the operating income of Express. Just could you talk maybe about how you think about the sustainability of performance on the Freight side, particularly as we head into a potential downturn? And then, to what extent if we see some of the strength at Freight starting to wane, is it possible that that starts to eat into some of the gains that you might see from cost savings at the other units?

**Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

Yeah. Thank you, Ari, for that question. First of all, let me just say our FedEx Freight team has done a – continue to do a phenomenal job of both managing revenue quality and our operating efficiency to generate fantastic results. And they also form a great piece of our portfolio and also provide synergies on the cost side.

The point that you made is important because when there's a significant change when we went through the last downturn, that we're very much focused on revenue quality and efficiency. And even through the downturn, actually, the margins expanded. And so, we are very disciplined in this area and we are executing the plan. We'll have to watch how the market conditions change. Our volumes have actually, as you can see, have declined, and yet, the margins have gone up. And the team has done a fantastic job and I expect them to do that going forward.

**Operator:** We will take our next question from Bruce Chan with Stifel. Please go ahead.

**Jizong Bruce Chan**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Yes. Thanks, operator. Raj, Brie, I just want to go back to some of your earlier comments and maybe just ask it bluntly. When you think about the miss, how much of the shortfall was volume-related and how much was from those European service issues?

And maybe just to follow-up, if you can give us some color on what exactly you mean by service issues. I might have missed it, but it's not really clear to me what that means. Was it, I guess, customer attrition? And if so, can that come back? Thank you.

**Brie A. Carere**

*Chief Customer Officer & Executive Vice President, FedEx Corp.*

So, the short answer is the vast majority of our volume miss was macroeconomic. We talked about it. Kind of when you think about the miss, it really was predominantly at Express, with Asia being the largest issue. We believe that was entirely macroeconomic. And then, when we get into Europe, there was a split between service and the macroeconomic decline.

I will tell you two things. From a service perspective, when we say service issues, specifically, what we're talking about is on the Express portfolio within Europe, across the European network, is that we are not hitting that time definite mark at the level that we expect of FedEx. And so, we need to kind of increase that service commitment there.

What I will tell you is that the sales team and our customer base absolutely want FedEx participating in this market, and we have such strong indication that customers are looking for us in their portfolio in Europe. We have great relationships with large globals here in the United States and they want us as part of their portfolio in Europe. So, I'm very optimistic about the future in Europe.

**Operator:** We will take our next question from Bascome Majors with Susquehanna. Please go ahead.

**Bascome Majors**

*Analyst, Susquehanna Financial Group LLLP*

Raj, you've managed through a lot of change at FedEx since 2016. Just to mention the TNT acquisition, the cyberattack, the trade war downturn and the pandemic, a change in leadership from a founder and whatever we're going to call the cyclical reversal when we look back on it in a few years here. But as you step back and reflect, are there any management mistakes that FedEx did make? And if so, what can you learn from those mistakes to set your customers and your shareholders up for success over the next three to five years? Thank you.

**Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

Well, Bascome, I think it's an excellent question, and let me just think about this for a second. You see, when – 2016 was – we're primarily in the B2B space. And when you looked ahead at the market, we thought 90% of the growth for the next five years was going to be e-commerce driven and 10% B2B. Well, you look back now and look at that timeframe, we see almost – not 90%, but more than 100% of the growth came from e-commerce. So we actually expanded our e-commerce portfolio in a big way and expanded our operations on ground. We are very proud of the work we did in creating this portfolio of services in this timeframe.



We also did some of the most important work in the history of the company, especially with Express, by delivering vaccines and healthcare around the world and especially in the time of the great pandemic, where operating a network like ours around the world was extraordinarily complex with changing circumstances. So I'm extremely proud of the team for having executed that. So this is the timeframe we're talking about.

So what we did not anticipate, to be perfectly honest with you, was the tremendous inflation of costs that hit us squarely last year. And that was what really got us. And even with that, we had tremendous results in fiscal year 2022 from our EPS perspective, but we absorbed a lot of costs from the inflation side of the house. And then, now that we're dealing with this situation, we had to build capacity. And now, we have more capacity than we need. So could we have timed that a little better? I don't know how you're going to could calculate it. It's like you can't build half a building, can you?

So it's just – it is now we are in a position to – as we laid out at the Investor Meeting, we are focusing on the things we have control. Our focus is now on improvement of margins, improvement of ROIC and improve our capital intensity. That's what we're going to do. And this, again, the economic upturn or downturn, forget about that for a second. Let's focus on the things we can control. And that's why this tremendous cost focus and the structural costs that we are talking about, that's going to get us to these targets.

**Operator:** We will take our next question from Todd Fowler with KeyBanc Capital Markets. Please go ahead.

**Todd Fowler**

*Analyst, KeyBanc Capital Markets, Inc.*

Great. Thanks and good evening. So I just want to make sure I understand the underlying macro assumptions. Mike, is it that the trends that you saw in August that that's kind of the run rate now going into the second quarter, or do you expect some further deceleration from where we were in August? And then, is there a risk that there's contagion where we see weakness in Asia, and then that comes into the US, or just kind of how are you thinking about the geographic piece of it? And then, lastly, we typically see price follow volume. And so, is there a risk on the yield front that as volumes slow that price follows after that? Thanks.

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

Okay, Todd. So, yeah, the basic underlying planning assumptions that we are using is that the demand levels that we experienced in late August will continue through the rest of the year, and so that we're taking actions accordingly to react to that. So that's the operating assumption now. I don't have a crystal ball about contagion in that. But rest assured, we are going to be continuing to focus on the things we can control. And if we need to make further adjustments and reductions in the cost structure, we will move quickly and decisively.

**Operator:** We will take our next question from Jeff Kauffman with Vertical Research Partners. Please go ahead.

**Jeffrey Kauffman**

*Analyst, Vertical Research Partners LLC*

Thank you very much. And thank you for the guidance on the cost savings as well. I just wanted to ask, because I noticed that the other corporate and overhead part of operating income was about \$100 million higher than year ago. It costs money to park planes. And I don't know if you're furloughing pilots or you're reducing those hours. It costs money to reduce routes or consolidate sorts or shut down offices. Do you guys have any estimate for where those costs are going to be, how much they're going to be, were they running through the regular P&L during the quarter, or was that the \$100 million in incremental costs that I saw going through kind of corporate office and

other?

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

Jeff, yeah, let me just specifically address this. The \$100 million, you can put it into two pieces. We had a specific customer bad debt reserve that we booked for \$80 million at FedEx Logistics. And so, while we are pursuing legal action, it was the appropriate reserve to take at this point in time. And then, while we separate it out in terms of our adjusted earnings, there's also \$24 million of our business realignment is in that corporate other line. So maybe that gives a little more context for what's there.

**Operator:** We will take our next...

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

I guess just to clarify, as far as any other – no charges or anything that was specific to the items you were asking about.

**Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

And there's also no furlough of the pilots. That's not even a thing.

**Operator:** We will take our next question from David Vernon with Bernstein. Please go ahead.

**David Vernon**

*Analyst, Sanford C. Bernstein & Co. LLC*

Hey. Good afternoon. So I appreciate the added color on the cost savings, but reductions from baseline are kind of difficult to book as profitability. 10 weeks ago, we were looking at low-\$20 EPS number going to something in the low-30s. Is there any to think that those targets for earnings power have actually shifted as a result of what's happening in the market right now or are we just pushing those out? And does the \$4 billion of extra cost saves just kind of gets you back to that 10% margin level?

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

I think, David, the way to frame it is that we fully recognize that the external environment has changed more than we expected. So we're focused on delivering the margin improvement, lowering the capital intensity that we highlighted, but it's absolutely the case that a greater emphasis will be put on the cost reductions. And so, that's what we're highlighting here today and we have the specific initiatives and plans in place to go after that and realize that as support of the goals that we outlined.

**Operator:** We will take our next question from Jairam Nathan with Daiwa. Please go ahead.

**Jairam Nathan**

*Analyst, Daiwa Capital Markets America, Inc.*

Hi. Thanks for taking my question. So, I just had – wanted to clarify, are there any – should we account for any cash restructuring expenses or anything of that sort for these cost savings?

**Michael C. Lenz**

*Executive Vice President & CFO, FedEx Corp.*

So to clarify, for the cost savings that we've identified for FY 2023, no, there's nothing associated with that. Now previously, as we talked about the broader business optimization initiatives over a number of years, we scoped that that could be potentially in the \$2 billion range, but that is over a longer-time horizon. But the near-term cost initiatives, there is no special charge for that.

**Operator:** That concludes today's question-and-answer session. At this time, I will turn the conference back to Raj Subramaniam for any additional or closing remarks.

**Rajesh Subramaniam**

*President, Chief Executive Officer & Director, FedEx Corp.*

Thank you very much. And in closing, let me just say, it goes without saying, it was a challenging quarter. This is a real critical moment in time for FedEx to execute, and I'm very confident that we will. The actions we are taking are key components on the path to achieve our long-term targets and make FedEx stronger for a better tomorrow.

Thank you for your time today and thank you for your interest in FedEx.