

FedEx Q1 FY25 Earnings Call Transcript – September 19, 2024

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

During our Q&A session, callers will be limited to one question to allow us to accommodate all those who would like to participate. Certain statements in this conference call may be considered forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Such forward-looking statements are subject to risks, uncertainties and other factors that 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.

Today's presentation also includes certain non-GAAP financial measures. Please refer to the Investor Relations portion of our website at fedex.com for a reconciliation of the non-GAAP financial measures discussed on this call to the most directly comparable GAAP measures.

Joining us on the call today are Raj Subramaniam, President and CEO; Brie Carere, Executive Vice President and Chief Customer Officer; and John Dietrich, Executive Vice President and CFO.

Now, I will turn the call over to Raj.

Rajesh Subramaniam

President, Chief Executive Officer & Director, FedEx Corp.

Thank you, Jeni, and good afternoon. Our results reflect the challenging Q1 demand environment, which was weaker than we expected, particularly in the US domestic package market. Looking at our performance on a year-over-year basis, there are several factors at play. Weakness in the industrial economy pressured our B2B volumes, particularly in the US.

We saw increasing demand for our lower-yielding services, and some of this demand increase was driven by a shift in customer preference worldwide from priority to deferred services. And we continued to execute on structural cost reductions via DRIVE, which partially offset revenue and expense pressure. That said, we now expect the cadence of DRIVE-related savings throughout the year to increase sequentially by quarter. And we had one fewer operating day in the quarter.

Notwithstanding this difficult quarter, with the actions we are taking, we remain confident in the trajectory ahead. We are on track to deliver the \$4 billion of savings through DRIVE in FY 2025 compared to the FY 2023 baseline. We have recently implemented significant new pricing actions relating to both demand and fuel surcharges, which will benefit us in the coming quarters.

We're making significant progress on our network transformation. We're prepared for the expiration of the U.S. Postal Service contract, and we are continuing to roll out Network 2.0. The implementation of Tricolor, which is the redesign of our global air network, is well underway. The demand changes we're seeing in the market make Tricolor an even more instrumental element of our longer-term strategy to increase flexibility of our network, lower our cost-to-serve and grow in new profitable markets.

Taken together, our network transformation actions will drive improved profitability by unlocking efficiencies, improving density and creating a more flexible network. This will strengthen our competitive position, while simultaneously supporting our objectives for improved profitability and returns.

Our innovative data-driven solutions are also supporting our transformation and enabling a better experience for our customers. Additionally, our seamless transition to One FedEx at the start of Q1 allows us to operate more efficiently and effectively as we implement our strategies.

Accounting for these factors, our updated expectations for the remainder of the fiscal year and our Q1 performance, we are narrowing our FY 2025 adjusted EPS outlook range to \$20 to \$21. John will provide more color on the underlying assumptions shortly.

DRIVE has evolved from a targeted transformation network to being the foundation for how we work across the enterprise. In the first quarter, we achieved \$390 million of DRIVE-related savings. Breaking this down by category, approximately \$90 million came from our surface network, \$160 million from our air network & international, and \$140 million from G&A.

Our surface operations focused on efficiency in linehaul planning. In air & international, we maintain focus on transforming our network, while maximizing staff efficiency at hubs and ramps. In Europe, we further optimized in-station processes. Within G&A, we continued to improve the efficiency of our IT function. We also continued our transition from a regional-based procurement support model to one that's centralized and organized by spend category. We are collaborating across sourcing, finance and the businesses to drive cost out.

Looking ahead, we expect our quarterly DRIVE cost reductions to build quarter-over-quarter throughout the year. Within our surface operations, we'll keep focusing on the end-to-end efficiency initiatives, including optimizing our rental fleet and maximizing rail usage. In the air network & international category, a majority of our savings in the remainder of the year will come from Europe. While we realized some Europe savings in the quarter, most of our Europe-related DRIVE savings was skewed towards the second half of FY 2025 as we achieve efficiency and productivity improvements across the region.

I'm encouraged by the progress we're making in Europe, improving service levels, reducing churn and winning new business despite difficult market conditions. We continue to expect \$600 million of cumulative DRIVE-related savings from Europe, which will help us exit the year with a better-performing European business. Across the air network, more broadly, we'll maintain our focus on managing our fleet and broader air operation efficiently. And within G&A, we'll continue to optimize functions globally with a focus on IT and outside vendor spend.

In the first quarter, we continued to introduce Network 2.0 in select markets. Canada, which is our biggest network optimization yet is well underway. On completion of Canada's rollout in early calendar year of 2025, nearly 200 facilities across the US and Canada will be handling consolidated and integrated ground and express volume. Optimizations will resume post-peak, and continue to ramp into FY 2026.

As we have shared before, we're taking a coordinated and deliberate approach to maintain and enhance customer service, while also applying learnings from each rollout to later integrations. For example, we're optimizing pickup and delivery operations to best leverage existing assets and resources, including facilities, equipment and team members. We're also now looking at geographic markets more holistically rather than by location-by-location. This enables us to consider volume and customer mix across an entire market.

Our strategy is working. We continue to see roughly a 10% reduction in pickup and delivery costs in markets where we have fully rolled out Network 2.0. Service levels in these markets are meeting or exceeding our network average. We're also leveraging new technologies to facilitate high-quality service.

For example, we recently launched what we call the Shipment Eligibility Orchestrator. This is an innovative internal decision-making engine that leverages machine learning to dynamically route packages in real time. For Network 2.0, one application of this tool ensures that we direct high priority healthcare and time-sensitive shipments to designated couriers trained to handle them. Shipment Eligibility Orchestrator is an evolving learning platform where we're adding new use cases by the day.

In the first quarter, we also successfully piloted our new Hold-to-Match solution, which optimizes last-mile delivery cost. It does this by holding early ground stops when another package is destined for the same stop the following day. We will do

this while ensuring an on-time delivery for all packages. Hold-to-Match is increasing stop density and will help lower our cost-per-package. We look forward to expanding the capability throughout the year.

And this month, aligned with our mission to make supply chain smarter for everyone, we announced a strategic alliance investment with Nimble. Nimble is an AI robotics and autonomous e-commerce fulfillment technology company. FedEx Supply Chain will use Nimble's cutting-edge fulfillment systems to streamline our operations, further penetrate the global e-commerce market, and unlock new opportunities for customers.

As we shared last quarter, we're conducting an assessment of the role of FedEx Freight in our portfolio structure. The assessment is well underway and on track to be completed by the end of the calendar year, all while we continue to deliver safe and reliable service to our customers.

Before I close, I would like to congratulate Mark Allen, our General Counsel and Secretary on his upcoming retirement. During his distinguished 42-year career at FedEx, Mark has served as an instrumental counselor and a business partner. FedEx has benefited from his strong business acumen, unassuming leadership, and vast international experience. We thank him for his service.

I'm excited to welcome Gina Adams into her new role as General Counsel and Secretary of FedEx effective September 24. Gina joined the company in 1992. Since 2001, she has led Government and Regulatory Affairs. Gina brings extensive experience addressing many of the most important issues facing our company and advocating for policies that support our customers and our industry. I know her expertise and insights will be invaluable as we continue to transform FedEx.

I also want to take this opportunity to thank the entire FedEx team for their hard work and dedication as we transform our network, prepare for peak, and deliver for our customers. I remain confident in the value creation opportunities ahead as we focus on growing revenue profitably, reducing our structural cost and leveraging the insights from our vast collection of data.

Now, let me turn the call over to Brie.

Brie A. Carere

Chief Customer Officer & Executive Vice President, FedEx Corp.

Thank you, Raj, and good afternoon, everyone. Despite a challenging demand environment, our team continued to deliver high-quality service to our customers. They are drawn to our distinct advantages, including our industry-leading weekend delivery, robust portfolio, and daily weekday delivery in rural areas that the competition simply can't match. Our value proposition continues to attract customers in high-value segments such as healthcare, and small and medium business. In the front half of the calendar year 2024, we continued to gain profitable market share in the United States and around the world.

Let's review first quarter top line performance by segment on a year-over-year basis. At Federal Express, revenue declined 1%. This was driven by one fewer operating day and a mix shift towards deferred services. Slightly lower US domestic average daily package volume was offset by higher international export package volume. Yield remained positive, driven by higher base rates and fuel surcharges, with growth partially offset by a tapering of international export demand surcharges.

At FedEx Freight, revenue declined 2%, driven by reduced weight per shipment and priority shipment, lower fuel surcharges, and one fewer operating day. Revenue per shipment, however, was up 2%, demonstrating our continued focus on revenue quality. We continue to lead the LTL market in total revenue share while maintaining a great revenue per hundredweight.

Turning now to volume trends by service during the quarter. Volumes were pressured, led by weakness in the US market partially offset by international growth. Across US domestic express services, volumes declined 3% due to a weaker B2B demand environment. Ground volumes were slightly higher driven by a targeted FedEx Ground Economy growth strategy. We continue to focus growth on customers who have both a FedEx Ground Economy and a FedEx Ground Home Delivery requirement. This improves both total yield and customer profitability.

International export package volumes increased 9% in the quarter driven by International Economy, which is largely consistent with recent quarterly trends. At FedEx Freight, both weight per shipment and average daily shipments declined 3%. We attribute some of this weakness to a shift of heavier freight to the truckload market due to the excess truckload capacity and associated lower rates.

And as a reminder our contract with the United States Postal Service expires later this month and we will be making network adjustments post-expiration. During the quarter, we continued to meet our service commitments with revenue near contract minimums as we expected.

We are operating in a very competitive but still rational pricing environment. Against this backdrop, we maintain our focus on revenue quality and continued to grow the yield in the first quarter, but at a lower rate than we expected especially here in the United States.

At Federal Express, package yield increased 1% overall, driven by US priority and international domestic. Yield for our ground services came in roughly flat driven by growth in lower-yielding residential volume. As expected, the combined International Priority and International Economy parcel yield declined primarily due to the tapering of demand surcharges.

At FedEx Freight, revenue per shipment was up 2% as we continued to lean into our revenue quality strategy. Lower weights and decreased fuel surcharge revenue due to the lower fuel prices partially offset strength in base yields. Overall, the LTL pricing environment remains disciplined and rational.

Importantly, we announced several pricing actions that we expect to improve yield in the coming quarters. Last week, we shared plans for our 5.9% general rate increase effective in January. We expect a high GRI capture this year. We have increased our US and international fuel surcharge tables and announced new demand surcharges which take effect in the coming days and weeks. The broader approach to demand surcharges reflects the requirement to cover our incremental peak cost to deliver an outstanding service during the holiday season.

Looking at FY 2025, we now expect revenue to grow at low single-digit rate. We previously expected low to mid-single-digit revenue growth this fiscal year. At the midpoint of our outlook range, we expect the demand environment to moderately improve as we move through the year driven by slight recovery in the industrial economy, e-commerce growth, and low inventory levels. We anticipate some improvement in the pricing environment skewed toward the second half of the fiscal year. We also expect modest improvement in the US domestic ground parcel volume, with the year-over-year increase growing particularly in the back half of the fiscal year.

We expect LTL shipments to inflect positive later in the fiscal year and our outlook assumes continued strength in Asia export volume demand. The current environment increases our conviction that the market requires a provider with a portfolio with both express and deferred parcel and air freight solutions. Our Tricolor strategy positions us to evolve our international business as the market shifts, while delivering these services more profitably.

In Q1, we established the international network design, and we will continue to optimize our operations to improve profitability. Planned enhancements include both operational and pricing changes, which will drive increased density per flight, lower last-mile cost, and improved international dimension capture.

As part of this strategy, in Q1, we launched our new FedEx International Deferred Freight service, which has a slower transit time than International Economy freight. We will use this extra time to both build dense skids and increase the proportion of volume that is trucked to its final destination.

Looking ahead to peak, I am particularly excited about the great service we will deliver for our customers. This holiday season, consumers will have improved visibility to their shipments via real-time map view. And just in time for peak, we will launch our Picture Proof of Delivery Attempt which will provide customers with a picture of a door tag in the event of a missed delivery. This feature will bolster communication about the delivery attempt and elevate the customer experience.

In closing, I am proud of our team's hard work and dedication during a difficult quarter. I am confident our pricing actions, our distinct service advantages, and of course, our world-class team will position us incredibly well as we head into peak.

And with that, I'll turn it over to John to discuss the financials in more detail.

John W. Dietrich

Executive Vice President & CFO, FedEx Corp.

Thank you, Brie, and good afternoon, everyone. As Raj and Brie both mentioned, our first quarter results reflect a more challenging environment which pressured Q1 profitability despite our ongoing progress to reduce structural cost through DRIVE. I'll start with a Q1 adjusted operating income bridge to help explain the quarterly dynamics on a year-over-year basis.

Our first quarter results were negatively affected by soft revenue trends, with a global decline in priority volume and growth in deferred volume. This dynamic pressured our results twofold. First, it constrained yield growth, with total package yield up 1% year-over-year, almost 1 percentage point lower than we expected. Yield was most constrained internationally, with added pressure for more volume and lower-yielding services and reduced demand surcharges.

Second, the increase in International Economy volume was the primary driver of the \$124 million increase in purchase transportation expense at Federal Express. In addition, we had one fewer operating day in the quarter resulting in an approximately \$170 million headwind.

We were able to partially offset these headwinds in normal inflationary cost pressures with about \$390 million of structural cost savings from DRIVE. As Raj mentioned, we now expect quarterly DRIVE-related savings to build throughout the year. So, while our Q1 DRIVE results were solid, they were below our expectations from a timing standpoint and will increase sequentially through the remainder of FY 2025. All these factors combined resulted in an adjusted operating profit decline of \$382 million.

Moving to a breakdown by segment. At Federal Express, adjusted operating profit decreased \$337 million year-over-year, with \$150 million of the decline due to one fewer operating day. The remaining \$187 million reduction was a result of the reduced flow-through associated with the revenue softness and the shift toward deferred service offerings, partially offset by DRIVE savings.

Increased demand for International Economy and higher rates were the primary drivers of higher purchase transportation costs. Taking the revenue and associated costs together, International Economy growth provided a modest benefit to profitability. We expect International Economy profitability to continue improving as we execute on Tricolor.

Additionally, we were expecting to achieve higher revenue and profit flow-through from US premium services in Q1, which did not materialize. As a result, we are adjusting our US domestic network to reflect the softer demand environment.

At FedEx Freight, while operating profit was down \$43 million, nearly half this decline was due to one fewer operating day. Lower weight per shipment and decreased priority volumes continue to be headwinds, partially offset by base yield improvement.

In light of our Q1 performance and the current demand environment, we are narrowing our FY 2025 EPS outlook range. We now expect \$20 to \$21 in adjusted EPS for FY 2025 compared to the prior range of \$20 to \$22. At the top end of our range, we assume an improvement in the pricing environment and the industrial economy. At the low end of the range, we assume the pricing environment continues to be very competitive, and the industrial economy remains challenged. As Brie shared, we now anticipate our revenue growth rate to be in the low-single digits.

Regarding our expected earnings cadence for the remainder of the fiscal year, the U.S. Postal Service contract termination headwind will begin in Q2 as expected. We plan to reduce our daytime flight hours by approximately 60%, with the majority of that reduction taking place in October.

We anticipate a negative effect in Q2 from the timing of Cyber Week, which shifts into Q3 this fiscal year. Overall, from an EPS perspective, we expect lower-than-normal seasonality in Q2 and better-than-normal seasonality in the fiscal second half. Supporting this cadence are ramping DRIVE savings that we are confident we will deliver in the quarters ahead.

Turning to our updated full-year operating income bridge, which shows the year-over-year operating profit elements embedded in our full-year outlook. This bridge now reflects adjusted operating profit of \$7 billion which is equivalent to \$20.50 adjusted EPS, the midpoint of our outlook range. For revenue, net of costs, which now includes variable incentive compensation, we expect \$100 million headwind, reflecting our lower revenue projection and the shift in the volume mix dynamic I mentioned earlier.

We now forecast a \$500 million headwind from international export yield pressure, up \$100 million from our prior expectations due to lower-than-expected base yields and the mix shift to International Economy. We still expect about \$300 million headwind from two fewer operating days, one that was in Q1 and one that will be in Q4. And lastly, we anticipate a \$500 million headwind from the U.S. Postal Service contract termination.

And as I just mentioned, we remain confident in our ability to offset these headwinds with \$2.2 billion from incremental DRIVE savings. Further supporting this revised outlook is our commitment to revenue quality, including our latest demand surcharges, which are broader than they have been historically, and fuel surcharge table adjustments, as Brie mentioned.

For the full year at the segment level, we continue to expect adjusted operating margin expansion at Federal Express. At FedEx Freight, assuming the challenging revenue environment persists, we now anticipate a modest decline in operating margin. At the midpoint of this new outlook range, we expect to deliver 15% adjusted EPS growth.

Moving to capital allocation, in Q1, capital expenditures were \$767 million. We are on track to invest \$5.2 billion in CapEx for FY 2025, which is flat versus FY 2024, and we still anticipate strong adjusted free cash flow this fiscal year. We'll be allocating capital to the highest-return segments of our portfolio, and we remain committed to improving our ROIC. Supported by our healthy cash on hand and strong adjusted free cash flow, we completed \$1 billion in stock repurchases in Q1 and plan to repurchase an additional \$1 billion in Q2. Overall, I remain confident in the transformation initiatives underway, which will translate to improved profitability in FY 2025 and beyond.

And with that, let's open it up for questions.

QUESTION AND ANSWER SECTION

Operator: The first question today is from Brian Ossenbeck with JPMorgan. Please go ahead.

Brian P. Ossenbeck

Analyst, JPMorgan Securities LLC

Hey. Good evening. Thanks for taking the questions. So, just wanted to see if you could give a little bit more color on the negative mix shift. It seems like it's pretty pervasive, but maybe a little bit in the US and also some international, and why you think you can push through additional demand surcharges, fuel surcharges and the GRI. So, maybe you can square those two together because it don't seem like it's a constructive environment to keep on raising prices at that level. Thank you.

Brie Carere

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

Good afternoon, Brian. It's Brie. Thank you for the question. So, from a pricing perspective, obviously, we look at our entire and our collective pricing strategy in each individual component. But then of course, holistically, we have been studying kind of the market and the yield and we're very confident in the capture rate from the GRI that we anticipate in January. From a demand surcharges perspective, I think we have two different factors that we're looking at here.

One, we did make the change for the demand surcharge for the domestic market from an e-commerce perspective. As we have kind of talked about over the last couple of years, demand surcharges are necessary to improve the profitability and make sure that we deliver the outstanding service that customers expect because, of course, this is the most important time of the year for retailers, and this year, we had to make a shift in addition to using demand surcharges for the customers that drive the peaking factors, we had to have a more widespread distribution. But we really are still emphasizing on the customers that drive the increase, so we're very confident on the capture from a demand perspective.

And then fuel, obviously, when we look at the total yield or customer spend from an international perspective, we think that this is the right mix and the right approach to make sure that we are growing our yield. We still believe that the international service at FedEx is just a great value, and so we're very confident from a capture perspective.

When we look at, to your point, the demand distribution, I would say from an international perspective we knew that there would be, the demand surcharge in international would behave a little differently than the peak surcharges here in the United States and we had anticipated that. And it was actually there was more pressure there in first quarter.

We do anticipate that pressure to taper as we go through the year. And what do I mean by that? We can see the strength still in the Asia export market and we can see the stickiness on demand surcharges, so we've made some changes there. So, we do expect that that will improve through the year. So, I think that kind of gives you just how we're thinking about the pricing and the mix shift.

Operator: The next question is from Jordan Alliger with Goldman Sachs. Please go ahead.

Jordan Alliger

Analyst, Goldman Sachs & Co. LLC

Yeah, hi. I was wondering, you talked about the lower-than-normal second quarter EPS seasonality. Can you give some sense for order of magnitude below normal? And how do you define normal, is it like a percentage of typical full-year earnings? And I guess following that, what gives confidence on the sharp second-half ramp? Is it more the economy? Is it mix? Is it B2B coming back? Thanks.

John W. Dietrich

Executive Vice President & CFO, FedEx Corp.

Yeah, thanks, Jordan. It's John. And we're really not in a position to give quarterly guidance, but what I can share with you is our expected cadence. So, regarding our expected earnings cadence for Q2, as we talked about, we're going to

experience the U.S. Postal Service contract termination. That will be a headwind that begins in Q2. And we also anticipate a negative effect in Q2 from the timing of Cyber Week, so that's going to push into Q3.

So, overall, from an EPS perspective, we expect lower-than-normal seasonality in Q2 and better-than-normal seasonality in the fiscal second half of the year. And to your question, supporting our view on this, is the ramp-up in DRIVE savings, as well as the revenue actions, really tangible meaningful revenue actions that Brie talked about. So, that's why we're focused on certainly the whole year, but that upside in the second half. Thank you.

Operator: The next question is from Jonathan Chappell with Evercore. Please go ahead.

Jonathan Chappell
Analyst, Evercore Group LLC

Thank you. Good afternoon. John, kind of sticking with that theme. You noted the \$390 million in DRIVE in the first quarter was lower than what you anticipated. So, can you help us understand why that fell short of your first quarter target? And if you're not – and if you can't give the cadence quarterly from here, at least how much is going to be back half-weighted? What gives us the confidence that the \$2.2 billion is still attainable, when coming off a quarter when the quarterly target couldn't be hit?

John W. Dietrich
Executive Vice President & CFO, FedEx Corp.

Yeah, thanks, Jonathan. Look, we had a lot of positive momentum coming through Q4 of last year, last fiscal year, and into the first quarter. And as many of you may have heard me say in the past, with regard to these DRIVE initiatives, many of them over-deliver, some of them under-deliver, some of them produce on time, some perhaps a little later in time. What I can tell you is there's a very robust drive process and we feel very strongly that while we're pleased with the \$390 million that we delivered, we would have liked to have seen more based on that positive momentum, but we're committed to the \$2.2 billion for the fiscal year.

And I'll just also refer to the \$1.8 billion from last year, we laid that marker down and we delivered on it. I personally, as well as other members of the senior team, sit on the DRIVE initiative sessions which occur every week. So, that's really what gives me the confidence, seeing the progress, seeing the commitment of the teams, and frankly, the strong pipeline of initiatives that are delivered every week. And so, it's an evolving exercise, but at the same time, we're committed to those numbers. Thank you.

Operator: The next question is from Tom Wadewitz with UBS. Please go ahead.

Thomas Wadewitz
Analyst, UBS Securities LLC

Yeah, good afternoon. Wanted to ask you about some of the pressure from purchase transportation costs that were up quite a bit. I think you alluded to them being driven somewhat by International Economy growth. So, I mean, I guess the question is, is there something that's a little bit wrong right now with International Economy that you're not making money with it or it's just like calibrated wrong, because it seems like that's part of the problem with PT going up? So, yeah, how do we think about IE and also the equation for PT expense to be more manageable and less of a drag on margin? Thank you.

John W. Dietrich
Executive Vice President & CFO, FedEx Corp.

Sure. Thanks, Tom. So, yeah, as mentioned, the purchase transportation cost did increase. And really, there are three major drivers of this absolute expense increase. And first, I'll note that the PT included \$130 million of year-over-year

increase which was from higher freight forwarding revenue in our Logistics operating segment and this increase in purchase transportation expense was directly related to increase in revenue at Logistics. So, that's the first element.

Second, with regard to Federal Express, most of our PT spend is related to our contracted service provider pickup and delivery, surface linehaul spend both in the US and internationally, and the remainder at FEC is driven by air commercial linehaul. So, in the ordinary course, it's important to note that this is a \$4.7-plus billion dollar spend line item and the ordinary course increases of – in our rates amounted to about \$140 million of PT expense increase. That was partially offset by the efficiency gains, and of course, one fewer operating day. So, that's the second element.

And then finally the third, the \$120 million of PT expense was additional commercial air linehaul capacity, which ties in with your point on the International Economy, as well as some investment in Tricolor, but what I can say is that those volumes were contributory to the year-over-year profit. So, little pressure on margin, but they were contributory and not loss-making. So, hopefully, that gives you some clarity on that.

Operator: The next question is from Daniel Imbro with Stephens. Please go ahead.

Daniel Imbro
Analyst, Stephens, Inc.

Yeah, thanks. Good evening, guys. Wanted to ask one on the FedEx Freight side. So, you guys have been closing locations for a little while. You closed some more here in 1Q. I guess how are you thinking, John, about capital deployment towards that segment and actually reinvesting into growth? And then as it relates to the strategic review, but I'd understand by year-end, we'll get the update. But what are the factors you guys are still digging into as you decide what the best decision for this asset over time? Thanks.

John W. Dietrich
Executive Vice President & CFO, FedEx Corp.

Sure. Thanks for that question. Yeah, with regard to Freight, it's absolutely part of our capital investment program and our plans, as I mentioned in my remarks. We're looking to invest in those areas of the business that's going to provide the best ROIC, and Freight is certainly one of them. We feel really good about our investment on the air side in our fleet.

And in fact, that spend is coming down and that allows us some capital to deploy into some of the other areas of the business and Freight is absolutely one of them. So, well, stay tuned on terms of the details on that, but from a capital standpoint, we're going to continue to manage our capital intensity.

I think from my perspective on a year-over-year basis, that's a really good news story. We saw both flat expectations year-over-year, as well as some sequential reductions from Q4 of last year. And so, facilities are definitely a part of it. It's all part of our integrated plan on One FedEx and Network 2.0 as well.

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

Hey, Daniel, it's Brie. The only other thing that I would like to add is I just wanted to make sure there wasn't an assumption in that question that we were constraining growth at FedEx Freight because of capital allocation. That is not at all the case. Obviously, it is a tough freight environment right now, but Lance, John, and I are very committed to profitably growing the FedEx Freight portfolio and we feel really good about our value proposition. So, we are looking always for dock door expansion in the right markets, and [indiscernible] (00:38:41) right place from a growth perspective.

Operator: The next question is from Chris Wetherbee from Wells Fargo. Please go ahead.

Chris Wetherbee

Analyst, Wells Fargo

Hey, thanks. Just as we're thinking to try to calibrate a little bit appropriately here, John, maybe if you could help us on the second quarter. Just is there enough in terms of the walk as you move from 1Q to 2Q for earnings to be up sequentially, I guess, would maybe be the first question. And I guess maybe for Brie, just very quickly on the pricing side. Obviously, some big peak season surcharges that have come, have been announced so far, I guess. How do you think about sort of the compliance or capture rate around that and any sort of early indications you're having from your customers on the likelihood of them kind of coming to fruition?

John W. Dietrich

Executive Vice President & CFO, FedEx Corp.

Yeah, thanks, Chris. I'll take the first part of that and then turn it over to Brie. Yeah, but on a sequential basis when we talk about the revenue actions and the pricing actions that Brie talked about, coupled with the DRIVE savings that we expect and are committed to, yeah, we see definitely the opportunity for sequential quarter-over-quarter profit improvement.

Brie Carere

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

Hi, Chris. From a demand surcharge perspective, obviously, we've got several years of track record and also our large customer peak surcharges are already pre-negotiated, so I feel pretty good from a capture perspective there.

We have, to your point, changed methodologies a little bit. I think we've been conservative in our estimate on the capture right there and that is reflected already in the range provided. So, I think we've got the right balance. I am optimistic about the capture because I think customers do understand that there's a lot of pressure on the network especially this year, if you think about the shopping period for this year, there's five less shopping days which means there's three less operating days. And so, it really is a condensed peak period and I think our customers understand that, and therefore understand the broader approach from a peak demand perspective.

Operator: The next question is from Stephanie Moore with Jefferies. Please go ahead.

Stephanie Moore

Analyst, Jefferies LLC

Hi. Good afternoon. Thank you. Maybe taking a step back here, looking at the quarter. Clearly, some challenges outside of your control really that you called out, impacting the top line and kind of the full-year expectations. But as you kind of look at the performance of the quarter, given it was a bit more of a challenging top line environment, still saw a pretty material impact to overall earnings, kind of going quarter to quarter here, 4Q to 1Q.

So, as you think about your ability to kind of flex your network and adjust to maybe some of these challenges that can pop up intra-quarter, how would you kind of rate your performance? And if you think back, is there something that should have been done differently? DRIVE savings, you have again called out, but just as again you can flex your network, maybe just some insight there would be helpful. Thanks.

John W. Dietrich

Executive Vice President & CFO, FedEx Corp.

Yeah, thanks, Stephanie. It's John. Yeah, no, it's a great question. And I think the team does an excellent job of monitoring the demand trends and adjusting as best we can. Pretty dramatic changes, though, when you talk about the mix shift that we experienced. And the volumes were there. Volumes were, for the most part, pretty strong. And when

you're operating such an expansive network, it takes a little bit of time to adjust, but we're looking at that every day and, frankly, every week and making schedule adjustments.

And frankly, as we look forward here, and as part of the winding down of the Postal Service contract, I think we're going to have some additional flexibility to continue to create the network of the future, which is going to allow for some additional efficiencies and flexibility. So, we're optimistic about that, but when, again, you're talking about a large network, it's tough to flip a switch, if you will, but I think the team does a great job of monitoring that and adjusting.

Operator: The next question is from Brandon Oglenski with Barclays. Please go ahead.

Brandon R. Oglenski
Analyst, Barclays Capital, Inc.

Hey. Good afternoon, and thanks for taking my question. Raj, I guess if I listen to the call only, it sounds like DRIVE is working, FedEx One (sic) [One FedEx] is well underway, the Tricolor initiative is supposedly delivering profitable market share. And I guess it's kind of just feeding off that last question. The reality is this is one of the lowest-profit first quarters that we've seen since maybe 2009.

And EPS is very much run-rating well below your full-year range here. So, I think it's really hard to get credibility with investors with these types of numbers and with costs that are actually up, even though supposedly DRIVE is underway. So, I don't know, can you just give us some concrete examples of what's going to change? I get it, the post office contract is going away, think taking down daytime flying is a step in the right direction. But incrementally, how do we get to that much higher earnings run rate?

Rajesh Subramaniam
President & Chief Operating Officer, FedEx Corp.

Well, thank you, Brandon, for the question. I will just start by saying yes. This point that we just talked about before, the soft industrial economy is clearly weighing on the B2B volumes, and it was definitely much weaker than we expected, and we have to make adjustments accordingly. And as you know, shipments linked to industrial production are our highest-yielding and the most profitable.

At the same time, e-commerce is resetting and starting to grow again and we're also seeing some modest improvements in global trade. So, the dynamics of the profile of our traffic changed. Having said all this, we're absolutely focused on what we can control, and this is the mantra that we have preached over the past two years, and we have got real good success that we have demonstrated over several quarters.

We have a very, very deep sense of urgency in executing our structural cost reduction programs. You can take that to the bank. We have revenue quality initiatives that Brie talked about. We have profitable growth opportunities that we are lining up as well, and everything, I mean everything, is now being done with the rigor and the discipline of DRIVE. This is a proven method of success, and I'm very confident that our execution will get us to support our FY 2025 guidance.

I'm going to turn it to John to talk about specifically some examples on the DRIVE side, and maybe Brie on the growth side.

John W. Dietrich
Executive Vice President & CFO, FedEx Corp.

Sure, Raj. Thank you. So, again, across the board, as we look at surface operations, for example, we're going to continue to optimize our staffing and enhance efficiencies across all our segments, frankly. And the implementation of some of our technology tools is going to facilitate not only present day, but also as we look forward into Network 2.0. It's going to be a key element of that.

On the air network, we're looking at the entire network. I mentioned what we're able to do once we're relieved of the Postal Service flying, but our air network, there's more we can do in Europe, there's more we can do internationally. And matching the size of aircraft, the gauge of aircraft with the demand profiles, there's a lot of great work being done there.

Europe is another area where we're going to be able to have, as Raj mentioned in his initial comments, some opportunity there, and leveraging not only the DRIVE initiatives but, as Raj mentioned, it's a significant ground operation there and we're leveraging the expertise of what we do exceptionally well here in the US to facilitate and continue to improve what we're doing in Europe. And then the progress we're making on G&A is significant, as we're bringing the op cos together, just from a procurement standpoint.

I mentioned IT. There's a lot of great work being done, of which there's more to do, but we're getting benefit from leveraging our scale on procurement and centralizing that, and just a whole number of initiatives that are going to contribute to the rest of the year as well as delivering on the \$2.2 billion.

Brie Carere

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

Brandon, the only thing that I will add, as we talked about kind of the plans that we have for demand surcharges as well as the fuel surcharge table changes, both the domestic change and the international change, not all of this was planned or in our original assumptions come June, so that is additive. The impact there absolutely is impact in Q2, but the majority of the impact will happen in Q3 given just the distribution of peak and then, of course, our GRI, so that gives us great confidence because we can forecast this with a lot of granularity.

And then I think just additive to what John said, as we look at our European pricing strategy, as I've talked about, we are taking a lot of our tools and capabilities from the US into Europe to improve their profitability and their pricing capture. Dimensional capture is significant for Europe because, remember, they do have a sizable intra-European freight business; and getting all dimensional capture both there and large package for parcel is incredibly important to that business. And you can see some of the discipline improving. The international domestic yields did improve and, of course, that is a big part of the Europe business. So, I'm very confident in not only what we've announced, but some of the things that we have coming for Europe.

Operator: The next question is from Jason Seidl is with TD Cowen. Please go ahead.

Jason H. Seidl

Analyst, TD Securities (USA) LLC

Hey. Thank you for taking my question. How should we think about the overall macro? I mean, we've seen a very weak industrial environment. You guys seem to point to a weaker parcel volumes and then even a trade down. I guess, what's in your assumptions going forward for the overall macro? And then, as a follow-up, if there is a strike on the East Coast ports and Gulf, how could that potentially impact any air freight volumes you might see?

Rajesh Subramaniam

President & Chief Operating Officer, FedEx Corp.

Okay. Thank you, Jason, for the question. Clearly, this quarter, the industrial economy is weighing on our B2B volumes, and the S&P US manufacturing PMI dipped 1.7 points to 47.9, is the lowest reading of the year. And at the same time, e-commerce is resetting and starting to grow again. As of Q2 CY 2024, e-commerce was 16% of retail sales, which is up from 15.8% in Q1. And the same – and also, we are also seeing modest improvement in the global trade data. The trade was up 1.8% year-over-year in June, and bringing the growth for H1 CY 2024 to 0.9%. So, this has been the one out of Asia.

To give you some idea, the magnitude of the Fed rate cuts yesterday signals the weakness of the current environment. Now, we're not assuming a significant comeback on the industrial environment in the rest of this calendar year. We're cautiously optimistic that industrial production will moderately improve in the second half, but we are dialing in pretty low growth expectations at this point because of the environment we are seeing.

Once again, let me just say this, that we remain focused on what we can control, and that is really critical for us, and the actions we're taking on executing on our structural cost savings, our revenue initiatives and growth initiatives are absolutely critical; and we are confident we'll deliver on the guidance that we give you.

John W. Dietrich

Executive Vice President & CFO, FedEx Corp.

And, Jason, if I could. You had asked about the port disruption, and my experience is any time you have some port disruption, it generally favors air freight, so we'll be watching that closely, and keep you posted on that.

Operator: The next question is from Conor Cunningham with Melius Research. Please go ahead. Mr. Cunningham, is your phone on mute? Move on to the next question, Scott Group with Wolfe Research. Please go ahead.

Scott H. Group

Analyst, Wolfe Research LLC

Hey. Thanks. Afternoon, guys. I'm in the airport, so sorry about any background noise. Raj, I know we're not through the review yet for LTL, but maybe just what are the puts and takes, the pros and cons, if you can say or do you feel like it's more or less likely that you move forward with the sale or spin? And while we're on the just topic of like strategic reviews, is there a point where you think about strategic options for the Europe business if we can't get back to profitability?

John W. Dietrich

Executive Vice President & CFO, FedEx Corp.

So, Scott, I'll take the first one. As Raj mentioned in his remarks, the assessment is well underway and we're on track to complete it and communicate the outcome of that by the end of the calendar year.

Rajesh Subramaniam

President & Chief Operating Officer, FedEx Corp.

Okay. And on Europe, let me just say this much. Europe is a top priority for the executive team, and we have a long runway of profit improvement there. In fact, the entire Exec Committee was in the continent in June to show support for the team.

Our focus is on capturing profitable share while at the same time improving its cost profile. In fact, in FY 2024, we saw the financial performance in Europe improve year-over-year. You're seeing improvement in service levels, the commercial execution, driving profitable share gains, and the service levels have been highest in the past three years.

Now, as we've just talked about before, Europe is primarily a ground and freight business, and as we have shown in the US, we know how to run a very profitable surface network, and we're taking these learning from the US and applying it to Europe.

Over the past few months we've done an incredible amount of work in designing the right physical and technological solutions to enable the streamlined flow of packages and pallets across our intra-European road network, and now this is being put into action, and our US domestic service executive management team is directly involved and intricately involved in the optimization of the European surface network. So, with that, we're going to drive improvement in Europe. Again, manage the DRIVE process.

We'll improve the station and hub efficiency. We'll optimize the linehaul and last mile density. We will continue to improve on our G&A and back-office savings, as we talked about in our incremental pricing for European freight products, and you put in place there a revised organizational structure, which added expertise on the US surface team. We are confident of this now in Europe, and we are expecting improvement of \$600 million over FY 2023 as part of DRIVE. And we're confident that with our leadership in place, with Wouter at the helm. So, thank you for the question, Scott.

Operator: The next question is from David Vernon with Bernstein. Please go ahead. Mr. Vernon, is your line on mute?

David Vernon

Analyst, Bernstein

Hi. Sorry about that. I was in an airport, just trying to keep the background noise down. So, John, if you think about the cadence of earnings for the remainder of FY 2025, 60, 90 or so, can you give us a sense of how much of that is front versus back-end loaded?

And then I know you can't really talk much about beyond the fact that the Freight review is ongoing, but there's been some discussion in the market about whether the Freight margins, as they're reported with intercompany costs would be similar to what they might be kind of coming out if it was a standalone business. Can you just talk conceptually whether the intercompany costs that are charged to the Freight business right now sort of accurately reflect what the burden might be if you had to equip it with a sales force, for example? Thank you.

John W. Dietrich

Executive Vice President & CFO, FedEx Corp.

Yeah, Thanks, David. Yeah, I'm not going to comment further on Freight. There's a comprehensive assessment taking place that takes all those things into account, and we look forward to reporting back on that.

Now, with regard to the cadence, as I said, we're expecting Q2 to be, from a seasonal standpoint, below seasonality, and it's going to be back half sequentially. We're going to see continued improvement through the year. And that includes our DRIVE initiatives as well as our profitability initiatives. So, thank you.

Operator: The next question is from Bruce Chan with Stifel. Please go ahead.

Jizong Bruce Chan

Analyst, Stifel, Nicolaus & Co., Inc.

Hey. Good evening, everyone. You made a couple of mentions of the strong Asia export volumes. Could we just maybe level set on how much of that is coming from big two or three Chinese e-comm players and how you're thinking about volumes heading into the peak season?

And then maybe just a follow-up. If we think about these players taking down a lot of capacity during peak season and maybe pushing air freight costs upwards, what's the sort of net impact here with Tricolor? I'd imagine that there's some tailwind to the purple tails, but maybe there is continued PT pressure on some of the other colors. So, just maybe some thoughts on how we should think about that.

Brie Carere

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

Hey, Bruce. It's Brie. I think I've got it all. So, as we think about Asia export for the rest of the fiscal year, we are expecting sort of continued strength based on what we saw in Q1 from a seasonality, yes, of course, we'll have some seasonal improvement in the peak period coming out of Asia, but we think that the volumes will remain very similar kind of seasonally throughout the year.

With regards to the big two, we have very productive relationships with them, however we also been very strategic and making sure that the relationship is mutually beneficial. What do I mean by that? Obviously, these are two massive shippers coming out of the Asia market, and we have found, I would say, small opportunities to work together relative to our overall Asia business.

So, I mean, we're really happy with the relationship. They are accretive. But we have really focused on the parts of their business where they do need speed and/or where we have available capacity coming into the United States. So, we're happy with these relationships. They will not be a significant growth driver for us, and we're not planning on that. We also do not see any sort of material risk coming out of peak as a result either.

And I guess I should say, from a Tricolor perspective, just the last part of your question, we absolutely expect that improved Tricolor optimization that John has covered earlier will continue to improve all of our international margins. We really have to think about the Tricolor being the right strategy for the entire international system form as we anticipate that deferred volumes will continue to be the largest growth driver in the industry.

Operator: The final question today comes from Ken Hoexter with Bank of America. Please go ahead.

Ken Hoexter
Analyst, BofA Securities, Inc.

Great. Thanks for squeezing me in at the end. I guess, maybe just there still seems to be a bit of confusion based on a lot of questions coming in. Just on the margin outlook, right, so if you're – well, I guess one sequentially. John, you did say it's going to be up both sequentially and year-over-year, right? I think you threw the two things together.

But, Raj, I guess, if we're talking about 5% combined margins now, is the economy service a negative margin business that is dragging you down? If international is still losing money, does the \$600 million you're talking about get you to break even versus peers at 20%? Maybe you can talk about kind of where does this go once, you're done with the DRIVE savings, before Network 2.0, but what is the flow through that we can kind of expect on a net basis.

John W. Dietrich
Executive Vice President & CFO, FedEx Corp.

So, Ken, I'll start with that. I believe I said sequential, I don't believe I said year-over-year, so just that one clarification. So, again, we're not going to be providing quarterly guidance, but for modeling purposes, we're anticipating Freight margins to be down for the full year due to the challenging US domestic industrial economy, and we do anticipate adjusted FEC margins to be up for FY 2025, driven by DRIVE and the recent pricing actions, which will support profitable growth.

Rajesh Subramaniam
President & Chief Operating Officer, FedEx Corp.

And let me just add, Ken, that the items that you just talked about and let me just recap. With the Network 2.0 coming into play, in the horizon we're talking about in the next couple of years, improvements that we're seeing in Europe and that'll continue on, the Tricolor will be a huge advantage as we restructure the system. These are all accretive to the FedEx story as we move forward here, and so as we complete the \$4 billion of DRIVE savings in fiscal 2025, we still have significant drivers of profitable expansion for FedEx in even in this year and for some time in the future.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Raj Subramaniam for any closing remarks.

Rajesh Subramaniam
President & Chief Operating Officer, FedEx Corp.

Thank you very much. As you know, we faced a very difficult quarter, marked by weaker-than-expected demand environment. However, because of the execution focus that we have, I remain confident in the value creation opportunities ahead. We are focused on delivering structural cost reductions through DRIVE and executing our network transformation plans, and these efforts will lead to a more flexible, efficient and intelligent network.

Once again, let me thank the FedEx team members for their hard work and dedication in delivering outstanding customer experience as we prepare for the peak season. And thank you all for your time and attention today.