

# FedEx Q2 FY09 Earnings Call Transcript – Dec. 18, 2008

## FedEx Q2 FY09 Earnings Call

---

### Operator

Good day everyone and welcome to the FedEx Corporation second quarter earnings conference call. Today's call is being recorded. At this time I will turn the call over to Mickey Foster. Please go ahead.

---

### A. Mickey Foster

*VP – Investor Relations, FedEx Corp.*

Good morning and welcome to the FedEx Corporation second quarter earnings conference call. I'm Mickey Foster, Vice President of Investor Relations at FedEx Corporation. The earnings release and 25 page Stat Book are on our Web site at fedex.com. This call is being broadcast from our Web site and the replay and podcast download will be available for approximately 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 and a follow up so we can accommodate all those who would like to participate.

I want to remind all listeners that FedEx Corporation desires to take advantage of the Safe Harbor provisions of the Private Securities Litigation Reform Act. Certain statements in this conference call 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. To the extent we disclose any non-GAAP financial measures on this call, please refer to the Investor Relations portion of our Web site at fedex.com for a reconciliation of such measures to the most directly comparable GAAP measures.

Joining us on the call today are Fred Smith, Chairman, President and CEO; Alan Graf, Executive Vice President and CFO; Mike Glenn, Executive Vice President, Market Development and Corporate Communications; Chris Richards, Executive Vice President, General Counsel and Secretary; Rob Carter, Executive Vice President FedEx Information Services and CIO; Dave Bronczek, President and CEO of FedEx Express; Dave Rebolz, President and CEO of FedEx Ground; and Doug Duncan, President and CEO of FedEx Freight.

And now our Chairman, Fred Smith, will share his views on the quarter followed by Alan Graf. After Alan we will have questions and answers.

---

### Frederick W. Smith

*Chairman, President & CEO, FedEx Corp.*

Thank you, Mickey. Good morning, ladies and gentlemen, we appreciate your joining today's conference call to discuss FedEx quarter two FY09 earnings. FedEx financial performance is increasingly being challenged by some of the worst business conditions in the history of our company. But we've been managing costs and taking full advantage of market opportunities and our service levels are at record highs.

We expect, however, that economic conditions will remain very difficult through calendar 2009 and today we're announcing additional actions we believe are necessary to offset weak demand, to protect our business and help minimize the loss of jobs. We believe these steps are necessary and will require shared sacrifice from the top down and across the FedEx workforce.

I'm very confident our team, as it has done many times in the past, will do whatever it takes to keep FedEx competitive. And I firmly believe we will emerge as a stronger, more vibrant company when the economy improves, as I'm sure it will.

During the first half of fiscal year '09 FedEx managed to produce solid financial results primarily due to three factors — one, a steep decline in fuel prices; two, gaining additional volume as a result of DHL's pull out from the U.S. Domestic market; and three, the outstanding customer service delivered by our team members who every day live our Purple Promise, stated simply, "I will make every FedEx experience outstanding."

As we near the conclusion of our busiest time of the year I'd like to take this opportunity to extend my utmost appreciation to our team members around the world for their dedication in going literally and figuratively that extra mile to deliver the holidays to our customers.

Earlier this year in anticipation of continued economic weakening, FedEx began a program of cost management activities to minimize job loss and position our company for long-term growth. We grounded certain aircraft and reduced flight and labor hours, fuel consumption and maintenance costs. We reconfigured route structures for greater efficiency and productivity. We instituted a hard freeze on all hiring except for mission-critical positions. We cut discretionary spending and, because we believe there should be a strong relationship between pay and

corporate performance, we eliminated all bonus and variable incentive compensation payouts representing hundreds of millions of dollars in FY09.

As we all know, the global economic downturn continues, and we are in some degree uncharted territory as uncertainty in the marketplace continues. We cannot predict exactly how it will unfold. The actions that we're unveiling today are aimed at minimizing loss of jobs in the company and better positioning FedEx for long-term and future growth. These measures are expected to reduce costs by an additional \$200 million in the remainder of FY09 which ends May 31st and by about \$600 million in FY10. Overall our cost reduction efforts should total more than \$1 billion in the current fiscal year.

The actions that we're announcing today include permanent reductions in compensation from the top down, beginning January 1, 2009. In this regard my salary will be reduced by 20%; our other senior executive officers by 7.5% to 10%, depending on position. And all other officers and United States salaried exempt personnel will take a 5% reduction.

We will eliminate merit-based salary increases in calendar 2009 for U.S. salaried exempt personnel. And we will suspend our 401(k) company matching contributions for a minimum of one year, effective February 1, 2009. We will find new ways to reduce costs for all the goods and services we buy across the company. We will make purchasing a more strategic activity.

We are streamlining and simplifying internal processes, within FedEx Services particularly, and focused on our information technology functions especially. We aim to reduce duplication, overhead and nonessential costs. We reduced capital spending plans for this fiscal year from \$3 billion at the start of the year to currently estimated at \$2.4 billion for FY09.

I'd like to be clear however, we will not do anything to compromise our outstanding service levels in return for short-term gain and, in fact, we're redoubling our efforts to improve on even our high service levels that we're able to provide our customers today.

We'll continue to balance the need to control spending with the opportunity to make investments with high returns. For example, yesterday, December 17th, the first FedEx Express test flight arrived at our new Asia-Pacific hub in Guangzhou, China which will officially open now on February 6th. It will be the largest FedEx facility of its kind outside the United States, overtaking our large facility even in Paris and Europe, and it represents a US\$150 million capital investment. It will be the heart of our APAC operations which are integral to our long-term growth strategy.

Tested time and again, FedEx has proved its strength, resilience and ability to successfully adapt. In the FedEx culture we see adversity often as an opportunity to strengthen our competitive advantage. I am highly confident in our business model and our team members' ability to focus, be strong and give it their best during these challenging times. I can tell you we remain very thankful for their commitment, passion, loyalty and, most of all, understanding.

As we move forward I am optimistic we will gain market share even in a declining market and add new customers in light of DHL's decision to pull out from the U.S. domestic market. We will continue to position FedEx to take full advantage of market conditions when the economy rebounds, and it will rebound at some point, I'm quite sure of it. We'll continue to provide the highest levels of service to our customers, service levels that they have come to expect when the FedEx brand is on the service.

Let me remind all of you that procrastinate that there is still time for those last-minute shoppers to have their gifts delivered in time for the holidays. In fact, you may ship as late as Tuesday, December 23 for FedEx Express delivery before Christmas.

Now before I turn it over to Alan Graf let me digress to say that one of the reasons that we are so confident in our future and in our current situation is because of the hard work put in by Alan and his team and the CFOs at our operating companies over many years to build an extremely strong balance sheet and great liquidity. And with that financial strength we enter these challenging times with great confidence and I'd now like to turn the floor over to Alan.

---

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

Thank you, Fred. Good morning, everyone. I'm going to try to give you a little bit of color on what we saw in the second quarter, which was frankly different than what we had expected when we had previously had our first-quarter discussion with you; and then give you what little we can see about the second half in terms of our revenue expectations and talk a little bit about our cash flows for the rest of the year.

As you know, global economic conditions deteriorated further in the second quarter of 2009 — fiscal 2009 — and continued to negatively impact our revenue and earnings growth rates. We experienced continued softening in demand for our services, particularly our FedEx Express and FedEx Freight services, due to declines in industrial production and consumer spending. Shipping volumes for our transportation segments declined year-over-year in the second quarter and remain below prior years and at levels as we began our historical peak shipping season.

Let me give you a little bit of a trend analysis by segment to give you an idea of just how weak the second quarter was. In the first fiscal quarter of 2009, U.S. domestic express volumes declined 5% year-over-year. In the second quarter that number slipped to 8% of the decline year-over-year. In terms of International Priority at Express, we were about flat in the first quarter of fiscal 2009 versus 2008 and that slipped to a decline of 7% in the second fiscal quarter of 2009 versus the previous year.

While we had been growing at FedEx Ground in our first fiscal quarter, 4% year over year, we saw a 1% decline in the second quarter year-over-year. And the same story at Freight, where our less than truckload shipments had been growing at 4% our first fiscal quarter, but declined by 2% in our second fiscal quarter year-over-year. So an accelerating negative volume trend throughout the quarter.

In terms of yield, we did see weight decreases that were negatively impacting our domestic express and IP yields and, of course, IP yields were further negatively impacted by exchange rates during the quarter as a result of the strengthening dollar. Ground yields, however, were positively impacted by rate increases and extra services and performed very well.

During the second quarter rapidly declining fuel costs and a timing lag between such declines and adjustments to our fuel surcharges provided substantial offsetting benefits to the decrease in volumes, particularly at FedEx Express. The average price of jet fuel during the second quarter of fiscal 2009 was 26% lower than the average during the first quarter of fiscal 2009, while the fuel surcharge only decreased quarter over quarter by a nominal amount. That substantial benefit to our earnings in the second quarter will not continue in the second half.

As Fred mentioned in response to weak business conditions, we took actions in the first half of fiscal 2009 to lower our cost structure such as eliminating variable compensation payments, implementing a strict hiring freeze, making significant volume-related reductions in labor hours and line haul expenses, and reducing personnel and facilities at FedEx Freight and FedEx Office.

In addition, we have exercised stringent control over discretionary spending and we have rationalized our networks by adjusting routes and equipment types, temporarily idling equipment, consolidating facilities and deferring facility expansions to match current demand levels. Fred detailed the additional actions to further reduce costs that we will be taking in the third quarter.

Now turning to the outlook — we frankly expect the difficult global economic environment will worsen in

the second half of fiscal 2009, and we obviously have reduced our earnings forecast accordingly. Weak economic conditions in the U.S. have spread to Europe and Asia and ongoing weak global economic factors are expected to further reduce demand for all of our transportation services in the second half of fiscal 2009. We don't believe we have reached the bottom of industrial production or consumer spending on a quarter-over-quarter basis at this point.

With the exception of volumes at SmartPost, shipping volumes in our third quarter, which includes our historical peak shipping season for our package business, are expected to be particularly weak and well below prior-year levels. While we expect to benefit in the long term from the exit of DHL from the U.S. domestic market, we cannot predict the extent of such additional volumes under present economic conditions. We do not anticipate year-over-year GDP growth to turn positive until the fourth calendar quarter of 2009 at the earliest.

We have provided a wide range earnings estimate for the second half of FY09. We have extremely limited visibility as we forecast base volume erosion from weak economic conditions in express and ground package traffic offset by increases in that traffic from customers switching to FedEx from DHL, and the elasticity at Express of significant lower fuel surcharges.

This lack of visibility to revenue, combined with the fact that any additional cost reduction we may take beyond those we announce today would only impact the fourth quarter and beyond, precludes us from providing a meaningful third-quarter forecast.

For the remainder of fiscal 2009 we will continue to balance the need to control spending with the opportunity to make investments with high returns, such as in substantially more fuel-efficient Boeing 757 and Boeing 777 freighters. Although we have pushed back our 777 delivery schedule, we will continue to invest in critical long-term strategic projects focused on expanding our global networks and broadening our service offerings to position us for stronger growth when economic conditions improve.

And lastly, let me point out that our cash flow from operations remains strong and we expect to end the year with \$1.5 billion of cash on the balance sheet, even after retiring a \$500 million debt maturity in April. And with that we'll be happy to take your questions.

---

## Operator

(Operator Instructions). And we'll take our first question from Ed Wolfe with Wolfe Research.

---

**Ed Wolfe**

*Analyst, Wolfe Research*

Thanks — good morning. Alan, can you talk a little bit about the impact of DHL in terms of which products are you mostly seeing the volumes? You noted in the release and talked about SmartPost. Where else are you seeing more versus less of the DHL volumes? And over time, what do you see as the pricing potential, if you could talk about that, from DHL?

---

**T. Michael Glenn**

*Executive Vice President, Market Development & Corporate Communications, FedEx Corp.*

Ed, this is Mike Glenn. Clearly DHL's decision in the United States has presented a unique opportunity and one that we began planning for many months ago. Early in the stages we saw actually a higher level of ground volume coming on; it seemed to be the first to activate and then that balanced itself out and actually skews now a little bit more towards express. SmartPost has also benefited significantly as the result of DHL's decision, but it's very difficult to predict how this will settle out.

Because our average yield per transaction is much higher than what DHL was carrying the traffic at, it will be — it will take some time for us to see how this volume settles in the various modes. And I don't think we'll have clear visibility to that until after the holidays. So, we'll just have to wait and see how the mix of traffic settles out in the various networks, because I think that could be skewed to some degree by the holiday and Christmas season.

---

**Ed Wolfe**

*Analyst, Wolfe Research*

In the results, it seems like your Ground results when you take out fuel feel much better than your Express results. Is some of that — is that driven by seeing the Ground earlier at DHL or is that just the nature that there's more fixed cost at Express than Ground?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

It's definitely some of both, but mostly the latter. As I said, we were — when we talked to you at the end of our first quarter we weren't expecting the sort of decline accelerations that we saw in the numbers that I mentioned to you on the trends. And so with the size of the fixed cost network that we have at Express, chasing that decline in revenue down with cost reductions takes us longer.

We will get there and we are, as I said, we've done quite a few things already and we have more levers if we need to pull them. At the same time we don't want our service levels to do anything but improve, which we think is one of the keys for our longer-term success. So, we're behind at Express in terms of getting our cost structure in line with the amount of revenue that we're seeing, but we will catch back up.

---

**Ed Wolfe**

*Analyst, Wolfe Research*

Thanks. I'll get back in line. Thank you.

---

**T. Michael Glenn**

*Executive Vice President, Market Development & Corporate Communications, FedEx Corp.*

Ed, let me respond to your pricing question because I failed to address that. Clearly we see some opportunity here. We're going to take a very disciplined approach to pursuing this opportunity. It would be very easy to be caught up in volume attainment and market share gains. That's not the approach that we're taking. We're taking advantage of the opportunity and going to make sure that it benefits FedEx Corporation.

---

**Operator**

And thank you. We'll take our next question from David Ross with Stifel Nicolaus.

---

**David Ross**

*Analyst, Stifel Nicolaus*

Good morning. Can you first talk I guess about with fuel being so low these days if you're rethinking potentially hedging?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

No. All I have to do is look at the wreckage of the last year of all the airlines who did and that's an easy one to answer.

---

**David Ross**

*Analyst, Stifel Nicolaus*

Okay. The next question is just on the Freight segment. If you could talk a little bit of the difference between the national LTL piece and the regional LTL piece and how they fared during the quarter?

---

**Douglas G. Duncan**

*President & CEO, FedEx Freight*

This is Doug. Both grew market share, although the market share gains at the national side are stronger than the ones at the regional side. So I think we did very well in the marketplace. The problem is the whole market is chasing declining volume which is really showing up on the yield side, which is where the biggest problems are.

---

**Operator**

And we'll take our next question from Donald Broughton with Avondale Partners.

---

**Donald Broughton**

*Analyst, Avondale Partners*

Morning everybody. We saw the worst decline in margins in Freight. Doug, is that a function of you continuing to try and grow out the infrastructure on the national basis? Is it more a fixed cost basis than the other businesses? What exactly would you attribute that to?

---

**Douglas G. Duncan**

*President & CEO, FedEx Freight*

Donald, I think it's more the industrial economy got hit early. The trucking industry — the freight industry — was pressured starting back late '06 with the housing decline in growth and then as we begin to sell fewer cars in this country, so the industrial side has put the freight business under pressure for a number of years.

Now, we've mitigated that because we've been growing market share across those years, but now you lump the decline and the consumer economy on top of that. So, I think the trucking market was weak to begin with and now we're going into this global recession. So I think the yield side of it is really hurting. When you look at our unit costs, we've kept those roughly in line with the volumes that we've seen. But the yield is the side of the house that is causing all the problems.

---

**Donald Broughton**

*Analyst, Avondale Partners*

Fair enough. On the fuel line, I certainly know that you got pinched by a larger number than this in recent quarters as fuel was going straight up into your — in your face. But my back of the envelope math says

there was an after-tax \$200 million benefit from the falling price of fuel. Is that close or do I need work — need to find a new envelope?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

I would just say that the language that I gave you was very carefully crafted. I will read it again because I wrote it down — adjustments to our fuel surcharges provided substantial offsetting benefits to the decrease in volumes, and obviously that's not going to continue with where we are. I will say jet fuel has not declined as much as Gulf Coast oil prices have at this point, so there could be a little bit more decline in the price of jet fuel going forward. And as far as what's going to happen with oil prices we believe with the weakness in the economy they're going to stay at these levels, at least during our third quarter. And so we won't see that benefit in the third and fourth quarter as we enjoyed in the second quarter.

---

**Operator**

Thank you. And our next question comes from Jon Langenfeld with Robert W. Baird.

---

**Jon Langenfeld**

*Analyst, Robert W. Baird*

Good morning, Alan, thanks for laying out the progression quarter to quarter. If we look at those numbers, is it safe to assume that you left the quarter at a meaningfully lower rate? So for instance International Priority down 7% for the quarter, can you give us any sense for what it was in the last month of the quarter?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

Now, this is one of the things that's reducing our visibility a bit in that most of our traffic in the various cohorts and modes saw sequential year-over-year worsening during the second quarter with the exception of SmartPost, which has grown straight through the roof because it's such a terrific service and, oddly enough, domestic express.

Now, the reason domestic express did not have a sequential decline during the quarter is that you have to go back to the previous year when we had a very strong September and fuel prices were still very low and did not start to increase until late September / October timeframe. So we had a very tough comp in the month of September year-over-year. That's part of it.

Secondarily, the rumors about DHL and then the announcement by DHL didn't stimulate volume in September as it did in October and November for domestic express, particularly in November. So that didn't have a sequential decline. But as I said in my opening remarks, in December and here going into the second half we just see a lot of weakness.

---

**Jon Langenfeld**  
*Analyst, Robert W. Baird*

Okay, good color. And then on the international side, I know that area is more fixed cost structure than maybe the domestic express side, but can you talk about some of the cost initiatives you have there to vary it with the volume contraction?

---

**David J. Bronczek**  
*President & CEO, FedEx Express*

Yeah, this is Dave Bronczek, Jon. Obviously the drop-off in the second quarter for international was very large for us. So our very big network across the globe, we're able to scale it down through line-haul reductions without affecting our customer service whether it's in intra-Asia, across the Pacific, across the Atlantic or here in the United States while we're delivering international packages. So we've dropped our jet fuel consumption for example by 7%. These are significant numbers for us.

---

**Operator**

Thank you. And our next question comes from Peter Jacobs with Ragen MacKenzie.

---

**Peter Jacobs**  
*Analyst, Ragen MacKenzie*

Good morning, gentlemen. Could you start by giving a little bit more color around the decline in volumes in the International Priority business? I guess regions that you might have seen the most pronounced declines. And also could you talk about if there's any fuel surcharge mechanisms there as well that are similar to what you have in the States?

---

**David J. Bronczek**  
*President & CEO, FedEx Express*

This is Dave again. Primarily Asia Pacific and U.S. international export back to Asia are the two areas that have the most significant decline. Europe quite frankly did well for us. The surcharge applies around the world for us at FedEx Express.

---

---

**Peter Jacobs**  
*Analyst, Ragen MacKenzie*

I was wondering because I guess the yields stayed — or declined quite a bit in International Priority while they held up in the domestic. And I understand the yields holding up if I understand that right in the domestic business was a lot due to the timing of the fuel surcharges and you got some benefits there perhaps. But the international yields were down pretty good. So could you help me understand that a little bit?

---

**David J. Bronczek**  
*President & CEO, FedEx Express*

They're not down as much...

---

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

Actually International yields improved on an absolute basis year-over-year but that was largely fuel surcharge. And the same is true in U.S. package — there was an absolute increase year-over-year and that was largely fuel surcharge. Our weaknesses were in rates.

---

**David J. Bronczek**  
*President & CEO, FedEx Express*

One other component obviously, we have much more domestic international that has a little bit lower overall yield than the intercontinental.

---

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

That's true.

---

**Operator**

Thank you. And our next question will come from Tom Wadewitz with JPMorgan.

---

**Tom Wadewitz**  
*Analyst, J.P. Morgan*

Yes, good morning. Alan, I know there's not a lot of visibility and you've given — the wide range reflects that. But can you give us any kind of a broad sense of at the high end and the low end what your volume

expectations might be if you talk about domestic express volumes or IP volumes, just kind of how bad and how good things could be at the two ends of the range in any broad terms?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

Tom, let me first — I think this is an important point to make. The range that I've given is a low and a high forecast, it's not a best and a worst. Best and worst would imply certainty that we're going to get inside that range and I am not by all — any means saying there is certainty that we're going to hit within that range.

Tell me how many packages went through the Wilmington hub at DHL last night and I can give you a better idea of how much of that we're going to get in the second half as they go out of business in January, that's number one. Number two, tell me how weak or strong industrial production is going to be in the first calendar quarter of '09 and that would help. So it's — the range is our best guesses of what could be an economy that quits declining so rapidly and more traffic from DHL versus one that continues to decline and we don't see as much from DHL.

---

**Tom Wadewitz**

*Analyst, J.P. Morgan*

Okay — let's see. I guess a different topic then, and maybe a question for Fred. There's I think some concern that as you've got the new Congress and the new administration coming in that there would be — some of the union friendly legislation would come to the forefront. Obviously you as a very large transport company that's nonunion except the pilots would potentially have an increase in unionization risk if some of that legislation gets traction. Can you give a sense of how you view that risk and some of the things that you do that even if that passed that would kind of prevent the risk of unionization in Express or LTL?

---

**Frederick W. Smith**

*Chairman, President & CEO, FedEx Corp.*

Well, tell me first what legislation that you're specifically referring to.

---

**Tom Wadewitz**

*Analyst, J.P. Morgan*

Well, I guess there would be two things that I would think of. So presumably the employee free choice would be something that would be brought up again.

And then I guess the provision that was put in the prior FAA reauthorization about taking Express out of Railway Labor would be something else potentially that could come up in 2009.

---

**Frederick W. Smith**

*Chairman, President & CEO, FedEx Corp.*

Well, let me give a broad brush answer and then ask Christine Richards, our General Counsel, who also manages our Federal Affairs unit under the able leadership of Gina Adams in DC to comment.

Regarding card check, I think the opposition to card check is so broad and so deep in American industry that all we can do is to say we do not think that that is good public policy. And in particular I think the mandatory arbitration provision would be very ill advised, particularly at this time, where you take the management of a business out of the hands of management and labor who understand the business and put it in the hands of an arbitrator who may or may not understand the business.

So we strongly oppose it, but we are just one of many people in that regard. Under the Railway Labor Act provision, we've said repeatedly that it is extremely bad public policy. FedEx Express has been a Railway Labor Act carrier since its inception; it was one of the key elements in the formation of the Company, the integrated Air/Ground network. That issue was challenged in court. The ruling in the Ninth Circuit Court in California was very clear in the court saying that FedEx Express is exactly the kind of integrated transportation system that Congress intended.

And so we would hope that that provision would not see the light of day or, at the very least, if they want to examine the Railway Labor Act they ought to do it in the cold light of day and have a bill and have hearings on it and deal with the public policy issues which were developed over 138 years. I mean, this is a very long-standing issue and why the Labor Act was put in place and it is certainly not anti-labor because 70% of the people under the Railway Labor Act are represented. So we would strongly oppose that.

I guess the final thing I'd say before asking Chris to comment, the main thing about FedEx is the fact that we have always had I think our priorities right, we understand the most important folks in this organization are not the people you're talking to, they're the people you deal with everyday out there picking up and delivering our shipments and delivering that Purple Promise.

So we've tried to do right by our folks, to be fair and forthright with them and I hope the actions that we are taking today demonstrate that as well. So we believe that our current focus is correct and obviously the

unions have the right to try to organize our folks and it's their right to decide on that if that's what they want. But we think that our formula for success has been pretty good over the past 35 years. Now I'll ask Christine to talk specifically about any legislative issues because she knows them better than I do.

---

**Christine P. Richards**

*Executive Vice President, General Counsel and Secretary, FedEx Corp.*

Thank you, Fred. I think what we anticipate is a broader dialogue, particularly with respect to the Employee Free Choice Act, amongst all the constituencies that would be impacted by that Act. As it is considered in the context of the economic times that we're facing in the U.S. and globally, any major change or disruption that would potentially negatively impact the ability of employers to move forward with offering jobs and growing their businesses poses a pretty broad risk to the country's economy at this point in time.

And we expect the dialogue on that bill to be extremely broad. And as Fred said, there will be many voices in business who will be pointing out the weaknesses of the bill. As you watch the hearings with the automotive manufacturers, you hear a lot of criticism of decisions that management made in the years running up to the current situation.

Fred is right, the mandatory arbitration provision in the Employee Free Choice Act would take away from management the ability to make the right decisions and to offer employment packages that ensure the long-term stability of companies. An arbitrator who has no vested interest except as the arbitrator in the matter would be making decisions that could impact the benefits to be received by the employee, and more importantly the value to the company and to the shareholders of the enterprise as a long-term going concern. So that part of the bill is particularly troubling to us.

On the Railway Labor Act changes, we expect to see the kind of initiatives we have. We are fully supportive of having a dialogue and hearings on that matter so that people can better understand why that bill, why that statute is in place to permit entities that run national and international networks to continue to operate those networks without interference by a disruption in one particular locale.

We hope we can have a situation where we have that dialogue, and we look forward to working with people on both sides of the aisle as Congress convenes after the first of the year to move the country forward.

---

**Operator**

Thank you. And our next question will come from Robert Pickels with Manning and Napier.

---

**Robert Pickels**

*Analyst, Manning & Napier*

Good morning. My question I guess is for Fred and anyone else who has been there a long time and managed through a lot of these cycles. I'm just curious what some of the similarities and differences are between what we are experiencing today versus the early 90s or back in the early 80s or in the 70s, and what you're doing that's the same and what's different, and what challenges you might be experiencing in this particular downturn?

---

**Frederick W. Smith**

*Chairman, President & CEO, FedEx Corp.*

Well, I think it has been commented upon by many, many people. This is obviously the most significant economic challenge that the United States has had, certainly in the period of time than I've been in business. And I think simply put, it is a massive deleveraging. I personally believe that the root cause of this is the fact that the United States in particular has had policies, particularly tax policies, in place which incited the growth in the financial sector at the expense of the industrial sector.

Now the best indication I can give to you of that is that in — let's say the economic problems in the early 80s, 25 years or so ago, financial activities represented about 15% of the reported profits of U.S. industry. By 2007, I think — it may have been 2006 — but about 25 years on, the financial sector was generating 32% of all profits. The deductibility of interest which incents people to leverage up, with probably the ultimate example being the private equity sector.

While equity is taxed very significantly and capital is taxed very significantly means that the companies that employ the blue-collar workforce can't invest to the extent that they need to invest. And one of the things that we have advocated very strongly in addition to lowering the overall corporate tax rate is to expense capital, and that is a policy that President-elect Obama and his team could put in place that has no downside. Because if you can incent business to invest, all you are doing is to defer the tax. And what you do from the industrial sector is you mitigate the risk of making those investments.

And I have asked scores of CEOs over the last few weeks if such a policy was put in place, would in fact they bring forward productivity-enhancing or

technology-based investments that they are deferring just like we are. I said in my comments we've reduced our capital from \$3 billion to \$2.4 billion. Well, if we could make capital investments and get the money back in the year they were made, it makes our workforce more productive and about \$0.70 on the \$1.00 accrues to the blue-collar workforce.

Now why am I going into this rather long explanation? It's because unless and until the tax policies of the United States move more towards encouraging industrial activity and away from leveraging either personal or corporate, we're going to have a massive deleveraging that of course is underway at the moment. Now how long that takes leads to the uncertainty that both Alan and I mentioned, and it is taking place. People are deferring the purchase of automobiles, housing is not being purchased — those are the two biggest consumer purchasing decisions that people make.

So it's going to have to run its course and I don't think that a stimulus package that simply encourages people to consume or a check in the mail, like the stimulus package last summer, may have the intended effect. Because people may well use that money to continue the deleveraging process. So stimulation on the industrial front I think has much more potential and, again, it's like the sleeves off your vest because if people don't invest the government loses nothing.

Corporate taxes are only about 15% of the revenues the government gets and if we make increased capital investment and get to write it off in the year that it's made, again, it's simply a deferral because then the Federal Treasury is a partner and our capital investment from that point forward as long as that investment is made. And the only way to make blue-collar folks wealthier is investment in productivity enhancing equipment, the training and the infrastructure that goes to support them.

So I think that things will definitely turn around. I think the country and the economy will be on much more solid footing when it comes out. And of course it's clear that all of the central bankers have learned the lessons of the Great Depression in that they're providing great liquidity and great stimulation out there. But I just hope the policy makers will remember that it's the industrial sector that provides those high-value added jobs and put more focus there in appropriate tax policy.

---

**Robert Pickels**  
*Analyst, Manning & Napier*

Thank you.

---

**Operator**

Thank you. And our next question will come from Art Hatfield with Morgan Keegan.

---

**Art Hatfield**  
*Analyst, Morgan Keegan*

Thank you, morning everybody. Hey Alan, just real quick back to your earlier comments about cost chasing down revenue. If revenue were to — or volumes were to stabilize how far behind are you on that at the Express unit?

---

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

Not that far. So, that's part of the reason the range is so high, that if it would stabilize, then I think the actions that we've taken are the actions that we would need to take and that will start to catch up. If they continue to deteriorate there's a likelihood we'll have to take additional cost actions to chase that. But there is an underlying amount of economic activity that's continuing and that requires transportation. And so it's just a question of when that stabilizes is when I can give you a better answer.

And then to put a little color on what's different this time, we have — this company is so much bigger with so many different operating models and subsidiaries. I mean, we're in the retail business at Office. We didn't have an LTL business the last time we had a severe downturn. And we have a wonderful operating model at Ground. And Ground, while it may not be on a growth plane at the moment, it certainly could be, even in this economic environment because the value that's being provided there is so great.

And then lastly, we have a wonderful management team and operations out there. They don't need me to tell them what to do, they're already doing it and telling me what they're doing. And that's one of the great advantages of having long-term tenured senior management here is they know exactly how to get the costs out and they're doing it on their own. So I'm not displeased with our cost performance, we just — we just got caught with a faster decline in traffic than we had been planning.

---

**Art Hatfield**  
*Analyst, Morgan Keegan*

Understood. I guess it's fair to say then the comments that Fred made with regards to service that if things turn, and someday they will, you don't get caught in a

situation where you are chasing to get people added where need to be so that service doesn't suffer?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

Absolutely Art. You know, we think when it turns back up it's going to be pretty dang rapid because there's no inventory out there, supply chains are very shortened right now. And so, when the demand goes up we'll be in a position to perform extremely well. And obviously we lost one of our competitors in the business and I think our service superiority had a lot to do with that.

---

**Art Hatfield**

*Analyst, Morgan Keegan*

Thank you.

---

**Operator**

Thank you. And our next question will come from Justin Yagerman with Wachovia.

---

**Justin Yagerman**

*Analyst, Wachovia Capital Markets*

Hey guys, thanks for taking my questions. I was curious, Doug, at Freight are there any LTL customers that are coming to you guys right now making contingency — contingency plans for large carrier bankruptcies? And I guess, are you picking up market share from weaker capitalized players as carriers — as customers are scared about financial health of some other carriers out there right now?

---

**Douglas G. Duncan**

*President & CEO, FedEx Freight*

Justin, we've been taking market share for quite some time and continue to do so in both our regional network and our national network. Obviously in the national network we — we're kind of new to the long haul party with an improved value proposition, we just have better service than everybody else and we've been growing market share on that value proposition.

I would tell you recently we've had an awful lot of customers come to us concerned about the future, especially in the long haul sector, and I think we picked up quite a bit of market share because people are nervous about what's going on in the market. I think that's also occurring in the regional market which is why we continue to grow market share there as well. So I think both things are working in our favor.

As you know, the LTL business is a pretty fragmented business, we have lots of competitors and I think it's highly likely that capacity will come out of this industry because, as I said before, we've — this industry has been under pressure for two years now. So, as that happens I think we're well positioned to help customers out and between the service that we provided and the brand of FedEx I think we've positioned ourselves to be the first call made when somebody gets concerned about supply chain disruptions.

---

**Justin Yagerman**

*Analyst, Wachovia Capital Markets*

Thanks. And I guess a follow up on a different topic — Alan, can you give us what the oil estimate is that's in — for crude as a price per barrel that's in your current guidance? And then along those lines, you guys have been on the forefront of giving discounts on fuel surcharges in a few of your divisions and is there any thought given the lower fuel environment that we're in currently and the challenging yield environment that we're in currently to potentially taking back some of those discounts and being more market rate in terms of where you are on fuel surcharges competitively?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

I did mention in my opening comments one of the things that we're looking at is the elasticity, if there is any, at domestic express for these rapidly declining fuel surcharges which right now are going to be at most 2% in February. I noticed oil is trading at \$38 and change at the moment. We have a higher number than that in our outlook, but it's not enough to make a material difference at the moment. And as far as pricing goes, believe me, it's very complex, it's very fungible and since it's so hard I'm going to let Mike answer it. (Laughter)

---

**T. Michael Glenn**

*Executive Vice President, Market Development & Corporate Communications, FedEx Corp.*

Well, let me state on the front end that our sales team has done a wonderful job in managing the fuel surcharge and I'm very proud of their efforts in that regard. They've been very disciplined in their approach and we have an extremely high attainment rate of the fuel surcharge. Having said that, there are some instances in dealing with some customers where it's in FedEx's benefit to discount the base rate versus the fuel surcharge and vice versa. So we look at every one of those to ensure what is in the best interest of FedEx Corporation long term, but our

attainment rate in the fuel surcharges quite high, so we've done a very good job in that regard.

---

**Operator**

And our next question will come from Adam Longson with Morgan Stanley.

---

**Adam Longson**

*Analyst, Morgan Stanley*

Good morning. Can you give us a sense of where capacity utilization sits now in the domestic air network and how much you could really rationalize out of that without affecting service?

---

**David J. Bronczek**

*President & CEO, FedEx Express*

This is Dave, Adam. We have — we're pulling down capacity in the United States. We're rationalizing our capacity to our volumes here in the United States. Of course we have an ability to quickly move the network back up if we needed to. So we're watching it carefully, we're adjusting our cost with our revenue. Of course, the wildcard in it is when international pops back up into our U.S. networks again. So we — we're managing it very carefully.

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

We've got plenty of room over Christmas though if you need to buy those last-second gifts.

---

**Adam Longson**

*Analyst, Morgan Stanley*

Fair enough. And just a quick follow-up, changing topics. As strange as this sounds, are there any assets out there that are now much cheaper to acquire that you once decided against maybe acquiring for price reasons?

---

**Frederick W. Smith**

*Chairman, President & CEO, FedEx Corp.*

Well, you know, let me — this is Smith here. Let me just say — reiterate what I said before Alan took over. We have a very strong balance sheet and when times are bad there are always great opportunities that come up. And as I mentioned, we look at this to some degree as a huge opportunity. I can't think of anything right off the top of my head that I'd be willing to talk to

you about, but, I mean it would... (laughter) All kidding aside, but we have the balance sheet to do whatever were to arise.

But, your question did bring something into mind that I don't think that people have quite appreciated about FedEx, and hopefully it's being demonstrated now. Over many, many years we have built a system which can flex both ways. A part of the way we've done that is to have a huge part of our compensation, certainly at the management level, to be variable in nature. I mean we, we clearly have personally experienced that to the benefit of the Corporation. As I said in my remarks, that's as it should be.

Our personnel systems out in the field, going back to Art Hatfield's comments, in all of our operating companies, allow us to flex up and down, sometimes not quite as fast as we would like on the down side, but we certainly can flex up on the up side with no risk to service. And, as I said in my remarks and Alan mentioned in his, that's something that we would not put at risk and we're running at the highest service levels we've ever had and intend to improve them even further.

But the other thing is we've managed our asset structure and our network design which allows us to flex things. In our air fleet, for instance, we buy some new airplanes, we buy some used airplanes, we plan to have airplanes that are in the fleet that are fully depreciated or nearly fully depreciated so that we can flex them and that's what Dave's doing in his operation right now.

So we can go one way or another. We have lots of cost levers still to come if we need them, as Alan mentioned. But it's because we've built them in over a long period of time and hopefully people are recognizing that now. And I'm very proud of the way we've built up that capability and, again, worked so hard to build a strong balance sheet which makes this troubling times to be sure but, as was mentioned a moment ago, an opportunity as well.

---

**Operator**

Thank you. And we'll take our next question from Gary Chase with Barclays Capital.

---

**Gary Chase**

*Analyst, Barclays Capital*

Good morning, everybody. Alan — wondered if you could maybe give us a sense of is there any way to size what kind of volume were you expecting when you sized the network for this quarter? So you noted the deceleration month over month and obviously we can see the numbers quarter over quarter. What level

were you prepared for and how much did volume disappoint you factually in the fiscal second quarter?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

I don't know if it was disappointing. I mean, we're a — we're in the same boat as everyone else with the weakening economy and I think, as we've said, we are taking market share even in the declining market across the board. We've got some great stories. I think the Ground numbers are terrific. SmartPost is growing unbelievably and it's an unbelievable service. So in that regard I don't know that we're disappointed.

What we are doing is preparing, as all great companies do, to come out on the other side stronger and a better and more nimble competitor than we were going in. So, while we've grounded or temporarily parked a few more airplanes and deferred some CapEx and reduced hours and all those kinds of things, it's just more of that than we otherwise would have.

So we'll have to see how we come out in the first couple of weeks of January as DHL completely shuts down their operation and whether some of the stimulus things in Washington start to take hold with the 0% funds rate and all that to see where we are. But as I said, we did hit our range that we gave you at the end of the first quarter, but it was because we had a large benefit from fuel that offset the declines that we saw in our revenue.

---

**Gary Chase**

*Analyst, Barclays Capital*

I guess I was just thinking, Alan, obviously given a new volume reality you've announced a new round of cost reductions. So you're saying that you're taking additional action because volumes have changed. Is it safe to say that when you were first looking and planning your network for the fiscal second quarter you were anticipating a volume level that was more consistent with what you had in the fiscal first?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

We were anticipating we were going to have some year-over-year declines at Express but not to the extent that we had. But as Fred mentioned, we are able to flex down, we just can't catch it up in the immediate quarter and very near term. And an important point that Fred made is that some of these actions that we're taking here on the compensation front across the board are to preserve jobs and keep our service levels high so that we have those well-

trained people in place so when this turns we're in a better position than everybody else.

---

**Gary Chase**

*Analyst, Barclays Capital*

Can then — can I just ask you to quickly clarify, you say \$200 million in savings this year, \$600 million next in 2010 — is the \$600 million incremental to the \$200 million? In other words, is it an \$800 million run rate or is it a \$600 million?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

No, the \$600 million would be more of an annualized number, the \$200 million is basically the impact to the second half. The \$600 million is an incremental to the well over \$1 billion that we've already reduced. And we have, again, on the downside we have other levers we can pull, and on the upside I think we're really well positioned if we get one.

---

**Operator**

Thank you. We'll take our next question from Helane Becker with Jesup & Lamont.

---

**Helane Becker**

*Analyst, Jesup & Lamont*

Oh, thank you very much, operator. Hi, everybody. Alan, on — just a couple of things, for an example your pension contributions. Can you just address how the changes you're making in the cost reductions and the changes in the market will affect contributions for fiscal '09 calendar year?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

Well, we have, as you know, a May 31 measurement date on the balance sheet and we'll just have to see what market conditions are at that point in terms of what the discount rate for our liabilities would be, what the market value of assets will be and any other changes that we may or may not make to the plan. And that will then determine what our contributions and expense are in fiscal '10.

We've made almost a half billion of contributions this year and anticipate no further contributions to the plan. I'll remind everybody that we are a very young company and the demand on our pension plan on a monthly basis from a cash flow standpoint is basically

immaterial due to size of the plan. So it's strongly funded from that standpoint.

---

**Helane Becker**

*Analyst, Jesup & Lamont*

Okay. And then, are there any non-cash charges you would have to take or that you'll talk about in the second quarter 10-Q as a result of the reductions you're making, the \$1 billion?

---

**Alan B. Graf, Jr.**

*Executive Vice President & CFO, FedEx Corp.*

We are having no impairment or non-cash charges in the second quarter.

---

**Operator**

And thank you. That does conclude our Q&A session for today. I'll turn the call back over to you, Mr. Foster.

---

**A. Mickey Foster**

*VP – Investor Relations, FedEx Corp.*

Thank you very much for your participation on the FedEx second-quarter earnings conference call. And please feel free to call anyone in the Investor Relations team if you have any additional questions. Thank you very much.

---

**Operator**

And that does conclude our conference for today. Thank you for your participation and have a wonderful day. You may now disconnect.