

FedEx Q4 FY09 Earnings Call Transcript – June 17, 2009

FedEx Q4 FY09 Earnings Call

Operator

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

A. Mickey Foster

VP – Investor Relations, FedEx Corp.

Good morning and welcome to FedEx Corporation's fourth quarter earnings conference call. I am Mickey Foster, Vice President of Investor Relations. The earnings release and 26-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 release and filings with the SEC.

In our earnings release, we include certain non-GAAP financial measures which we may discuss on this call. Please refer to the release available on our Web site for further discussion of these measures and a reconciliation of them to the most directly comparable GAAP measures. To the extent we disclose any other non-GAAP financial measures on the call, please refer to the Investor Relations portion of our Web site, at fedex.com, for reconciliation of such measures to the most directly comparable GAAP measures.

Joining us on the call today is Fred Smith, Chairman, President, and CEO, currently in Paris representing the Company at the French American Business Council. Joining us on the call here in Memphis, 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 Rebholz, 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. And after Alan, we have questions and answers.

Frederick W. Smith

Chairman, President & CEO, FedEx Corp.

Thank you very much, Mickey. And good morning, ladies and gentlemen. Thank you for participating in today's conference call to discuss FedEx's financial and operational performance during the fourth quarter of fiscal year '09 and our outlook. Of course we faced the most difficult economic conditions in our Company's history and in fact the most difficult economic conditions that the modern world has seen since the end of World War II over the time period that represented FedEx's FY09.

While the severe global recession continues to throttle somewhat FedEx's growth, we do see signs of stability as the rate of decline appears to have leveled off. In this regard, declines in FedEx Express International shipments appear to have bottomed and are at levels similar to last quarter. How long this bottoming out process will take and how strong the recovery will be remains of course uncertain. We believe however, the worst of the recession is likely behind us.

We remain optimistic about a turnaround beginning later in calendar 2009, though corporate caution in managing inventory and spending could be a limiting factor and push it out a little bit later. There appear to be three macroeconomic trends paving the way for a recovery.

First, inventory to sales ratios are starting to moderate, which we believe will lead to restocking later this year even if the economy remains at current levels. Second, broad financial conditions in the stock market and credit markets are improving. And third, the latest manufacturing, housing and consumer confidence surveys show positive signs and global trade figures have improved sequentially.

At FedEx, we built our Company to be resilient with the ability to flex our networks up or down as economic conditions and volumes shift. We know that

business by its very nature goes through cycles, so we must be able to adapt quickly and we certainly have. In FY09, the recession led FedEx to undertake even more significant measures of cost containment to protect our Company, to preserve jobs within our Company and to position our Company for future growth.

In the fourth fiscal quarter, as you probably know, we adjusted our workforce to better match our volumes consistent with previous announcements. We decided at FedEx Express to permanently remove a number of aircraft and park others to optimize our express network in light of weak economic conditions and the expected delivery of newer, more fuel-efficient aircraft. And finally, we are centralizing many customer support functions to deliver a simpler and seamless experience to our customers. We believe these steps, together with earlier strategic activities, have positively positioned FedEx to take full advantage of the rebound in the global economy.

I would like to commend our team for its personal commitment to the Purple Promise and as most of you know, the Purple Promise is very simple: "I will make every FedEx experience outstanding." Our service levels because of this effort continue to be very high across the entire enterprise and we are very proud that in May, FedEx was rated as number one in customer satisfaction among express delivery companies for the 12th consecutive year by the highly regarded American Customer Satisfaction Index. We believe this is proof positive that while management is committed to reducing costs, we will not compromise our outstanding service levels.

Although Chris Richards can comment on these in greater detail later if you have questions about them, I do want to call your attention to two court decisions this past quarter regarding FedEx Ground, defending its successful business model that allows independent owner operators to run their own small business and deliver best-in-class customer service for economical ground package shipping. These decisions validate our long-standing position that FedEx contractors are independent service providers and small business owners.

In this respect, FedEx Ground won a United States Court of Appeals decision that said these contractors are independent business owners, not employees, and are thus outside the jurisdiction of the National Labor Relations Board or NLRB. A jury in the Superior Court of the state of Washington also affirmed in a verdict that FedEx Ground's single work area contractors operating in the state of Washington are independent business owners and not employees.

I know also that many of you have questions about developments in Washington, DC and in Congress relative to the Railway Labor Act and any change to it and its implications for FedEx Express. The FAA Reauthorization Act was recently approved by the House of Representatives and included a provision which we think is highly anti-competitive and would unfairly benefit one company, UPS, while targeting another company, FedEx. UPS is working this issue hard in concert with the Teamsters.

Now, let me give you a little historical perspective on this and I think my credibility here should go unchallenged since I founded FedEx in 1971 and we began operations in 1973 and one of the innovative concepts about Federal Express was that it was an integrated air/ground system. As a consequence, it has always been a Railway Labor Act carrier.

Now, the Railway Labor Act carrier status did not come by accident. The Railway Labor Act is legislation that was passed in 1926 after half a century of labor strikes in the rail industry, and covered initially railroads and express companies, with airlines being added in 1936, the year after Congress passed another labor act which would evolve into what we now refer to as the National Labor Relations Act.

The Railway Labor Act has two very important features. One, it requires system-wide bargaining units and it certainly is not anti-union in any respect as over 70% of the employees covered by the Railway Labor Act are represented by collective bargaining agreements versus about 8% of the private employment sector under the National Labor Relations Act.

The second major feature of the Railway Labor Act is that it requires the government to give permission to either labor or management to strike or to lock out. The purpose of the Railway Labor Act is to keep large commercial enterprises serving the public interest or the arteries of commerce, as they were called when the Act was passed in 1926, open for the public benefit. Clearly FedEx Express, with its enormous network of interconnected hubs and hundreds of airplanes and tens of thousands of vehicles is prototypical of the type of enterprise that Congress intended to cover by the Railway Labor Act.

So it's not surprising that in 1991 at the end of years of litigation questioning this status, the Ninth Circuit Court of Appeals affirmed the fact that FedEx Express was correctly organized under the Railway Labor Act and, to paraphrase the decision, was exactly the type of integrated air/ground system that Congress intended to operate under the Act.

In concert with the decision regarding Federal Express, other litigation concerning United Parcel Service was concluded in 1996 at the DC Circuit Court of Appeals and found, in contrast, UPS was correctly under the NLRB because they had combined their air and ground packages when they attempted to set up a company to compete with FedEx. And that since the majority of their packages were ground packages in that network, and since the company had been, since its inception, covered under what we would now refer to as the National Labor Relations Act, or it had been since 1935, that they were alternatively correctly covered under the NLRA. Of course, their air carrier operations is an RLA operation.

So this single-interest legislation would overturn two court decisions without one word of testimony from the millions of customers who depend on the FedEx network, and not surprisingly we object very much to the effort to do this and have opposed it vigorously in Washington and hope the Senate will in its wisdom work this legislative effort.

I would like to also point out that FedEx Express provides highly competitive wages and benefits. FedEx Express is committed, along with the other FedEx companies that are governed alternatively by the National Labor Relations Act, to a work environment that supports direct and open communications among all our employees. And as a result of those efforts, we have gained a well-earned reputation as a great place to work around the world and we have been repeatedly recognized for workplace excellence by a variety of third-party experts.

Now in conclusion, as we begin FY10, I would like to take this opportunity on behalf of our senior leadership team to thank the tens of thousands of other FedEx team members around the globe for their dedication and perseverance during one of the toughest years in our history. I am particularly proud of the strong balance sheet we have developed over the years and the measures that we have taken that have given us the flexibility to weather an economic challenge of this magnitude. I firmly believe FedEx will emerge a stronger, more profitable Company poised for future growth when economic growth resumes.

And in this respect I can think of no better person to comment further on the financial aspects of FedEx than our Chief Financial Officer, Alan Graf. Alan?

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

Thank you, Fred, and good morning everyone. Since our last meeting, we lost our good friend and colleague Jim Clippard, our former Vice President of Investor Relations. The Silver Fox was a class act in every respect and please join us in taking a moment in memory of Jim.

(Pause)

Thank you. This morning we released our fourth quarter results, and we are very proud of our accomplishments that were achieved in a brutal economic environment. We took tough cost control actions, which will not only help us weather the current storm, but will also make us stronger in the long run and provide us with great upside cash flow and earnings leverage when the economy turns up.

We earned an adjusted \$0.64 a share, which is on the high side of the range of \$0.45 to \$0.70 we provided you in March, excluding one-time charges. And quite frankly, the economic environment ended up being much worse in the quarter than we thought when we gave you that range. Our cost management and productivity and customer service levels were able to offset a substantial amount of the \$2 billion revenue shortfall we had in the quarter versus last year's fourth quarter.

The revenue decline is mostly attributable to lower volumes at FedEx Express and FedEx Freight, reduced fuel surcharges, lower shipment weights and base rate pressure in a very competitive pricing environment.

Looking first at the FedEx Express segment, we saw revenue decrease 25% to \$4.8 billion from \$6.4 billion last year; 21% decrease in U.S. domestic package revenue with yields down 19% and volume down 2%. And the yields were down 19% because of the decline in the fuel surcharge as well as rates and weights for package. This is also despite the fact that DHL exited the business.

Express saw a 27% decrease in IP package revenues, with yields down 17% and volumes down 12%. In the case of the yield decline, we held rates fairly well but fuel and exchange rates were the major cause of those declines. We also had a 30% decrease in freight revenues at Express, with pounds down 20% and yields down 12%. Overall, the operating loss including \$260 million in aircraft-related charges and severance programs was \$132 million versus income of \$426 million last year.

Looking now at the Ground segment, revenue decreased 1%. That was a 1% decrease in ground

yields with flat volume — excellent performance. And although we had a 27% decrease in SmartPost yields, the volume there was up 65% and so was its profit. Operating income was flat at \$203 million, and the margin increased to 11.9% versus 11.8% last year. FedEx Ground average daily volume was 3.3 million, with FedEx Home Delivery growth offsetting the commercial decline. And again, this includes market share gains from the exit of DHL from the domestic market.

At FedEx Freight, revenues decreased 28% to \$948 million from \$1.3 billion last year. The LTL average daily shipments decreased 17% and the LTL yields decreased 11%. Here the story was mixed, as the decline in yields in the regional network were almost all related to the fuel surcharge where in the National network, the fuel and base yields both declined in a very brutal market. Weights were also down 2% per shipment.

Operating income decreased to a loss of \$106 million versus income of \$99 million last year and that loss includes a \$90 million impairment charge related to the Watkins goodwill. LTL average daily shipments were down 17% to 68,400 from 82,000 last year in the weakest LTL markets in decades.

And at the Services segment, revenue decreased 13% to \$478 million on lower copy product revenues. Fourth-quarter results for FedEx Services include an \$810 million goodwill impairment charge related to the acquisition of Kinko's, now known as FedEx Office. This charge was not allocated to the transportation segments, as the charge was unrelated to the core performance of those businesses.

Turning back to the corporate results for the year, I think it is important to note that we were operating cash flow positive for fiscal 2009, and at the end of the year, we had \$2.3 billion in cash and debt of \$2.6 billion. That is referencing back to Fred's comment about our strong balance sheet. During 2009, we reduced CapEx from our original business plan by \$700 million, and used most of that to make an additional contribution of \$600 million to our qualified U.S. domestic pension plan in the fourth quarter. That's in addition to the \$483 million we contributed to in September.

The very important note here is that our principal U.S. domestic pension plan is overfunded as of May 31, 2009. We did recognize a \$1.2 billion charge to equity via comprehensive income for the market losses our pension plans incurred during fiscal 2009.

Let me turn my attention now to fiscal 2010 where we have provided you a first-quarter range of \$0.30 to

\$0.45 a share, as we face strong economic headwinds versus a year ago, as well as rising fuel prices. June and July fuel surcharges were set in April and May and with fuel prices now substantially higher, the impact of rising fuel prices will have a substantial drag on our first quarter earnings. However, if fuel prices stay in the range that they are, that should even out during the rest of the fiscal year.

I do not have enough visibility on when the economy will turn up, nor can I predict fuel price volatility for the fiscal year, and therefore cannot provide a meaningful fiscal year '10 earnings forecast for the full year at this time.

We believe that we will be poised for growth beginning in the second half of our fiscal year when the comparables are not as difficult as the first half. We expect year-over-year GDP growth to turn positive in the first calendar quarter of calendar 2010. Our number one objective for FY10 is that we intend to remain operating cash flow positive for the year.

Lastly regarding pension, expenses will be up \$125 million versus 2009 for the entire year, but that is a substantially lower amount than we were anticipating back in early March when the markets hit their bottom. We anticipate making contributions of approximately \$850 million to the U.S. qualified plans this year and those are in my forecast for operating cash flow positive. CapEx will be in approximately the same range as last year, about \$2.6 billion, and that includes \$1.1 billion at Express for more efficient 757 and 777 aircraft.

That is the end of my comments, operator, and we are ready for questions.

Operator

(Operator Instructions)

We will take our first question from Jon Langenfeld with Robert W. Baird.

Ben Hartford

Analyst, Robert W. Baird

Good morning, this is Ben Hartford in for Jon this morning. I guess if we could just start on the domestic side, can you talk a little bit about the core pricing environment? I know it's difficult to get down to, but can we kind of strip out fuel and talk about what core trends were like throughout the quarter?

T. Michael Glenn

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

Ben, the pricing — this is Mike Glenn. The pricing environment certainly is competitive and that's not unusual when there is capacity in the market during recessionary periods. We certainly see more aggressive pricing on an account-by-account basis, but our hope is that as the economy starts to improve, we will see stabilization of that environment, we will see an improving pricing environment where we are certainly competing on value and not so focused on competitors trying to fill up networks.

Ben Hartford

Analyst, Robert W. Baird

Okay, and then moving over to the cost side, you know, if we take that \$1 billion that you had outlined three months ago, what is the run rate that you realized this quarter and how much of that cost take-out do you view as permanent take-out versus costs that are going to have to return to the business when volumes improve?

David J. Bronczek

President & CEO, FedEx Express

Hey Ben, this is Dave Bronczek. I'll start off at FedEx Express. You probably have seen it in our numbers but our expenses were better year-over-year excluding one-time costs by 21%, almost \$1.3 billion in Q4 year-over-year. Obviously we've done a lot of things that are permanent in our cost structure. We have replaced — we've eliminated some aircraft, we've parked some aircraft. We've made some headcount reductions across the board. We are anticipating the same kind of performance in FY10.

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

As to what's permanent and what's not, we have a tremendous amount of leverage at Express and Freight, where if we get the turn that we think we might in early calendar 2010, we can take a lot of that additional revenue to the bottom line with very little limited incremental variable cost added. So we should see significant cash flow and earnings leverage from that. Even at Ground, we are anticipating increased productivity and a further tightening of that network as it grows during fiscal 2010.

Ben Hartford

Analyst, Robert W. Baird

Okay, great. Thank you.

Operator

Thank you. Our next question comes from Peter Jacobs with Ragan MacKenzie.

Peter Jacobs

Analyst, Ragen MacKenzie

Thank you. I guess the first question I would have is in the FedEx Freight segment. You talked about — you mentioned that you are seeing a difference in the regional and national carriers. Could you just talk about some of the dynamics that are playing out and why you saw the base rates fall in National but they were holding up in regional. Anything going on there?

Douglas G. Duncan

President & CEO, FedEx Freight

This is Doug, a couple of things there. Customers tend to negotiate how they want. Some of it is in the fuel surcharge, some of it is in the base rate, so I would caution you not to use too much of the breakdown because you really need to look at the total yield number because that's the way the customers look at it and that's the way we manage it.

The other thing in the National network, when we acquired that company, they were highly concentrated in the electronics markets and other markets that had very high yields and we've done a great job of penetrating the more industrial markets where our regional company already had a big base and that in fact had lowered the class of the freight, not necessarily the profitability, but it shows up as a yield decline, basically a mix change versus just a straight yield decline.

So I think we've managed yield quite well. I think we've got a great value proposition that has been accepted in the marketplace at FedEx National, but it is overcapacity and the pricing is very aggressive in that market.

Peter Jacobs

Analyst, Ragen MacKenzie

Okay, thank you. Alan, could I just ask you a quick question please?

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

Go ahead.

Peter Jacobs
Analyst, Ragen MacKenzie

You talked about the principal U.S. pension plans being overfunded. I think that's what you said, but then there was a charge to equity in comprehensive income. Could you explain that? I'm a little confused on why there would be a charge if the plans are overfunded. Is there other parts of the pension that you had to take the charge for?

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

Well, we made contributions significantly higher than what we had expensed and following SFAS 158 and the rules of accounting, you have to make up the losses through comprehensive income, which is exactly how we did it. And you will see that in the footnote in the packets you have today and you'll read more about it in our 10-K, which we will file next month.

Peter Jacobs
Analyst, Ragen MacKenzie

So does that theoretically then get reversed or does that — is that just something you are going to have to live with even though you continue to make the contributions and the plans are overfunded?

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

Well, since what we've booked were really unrealized market losses, if you can predict what the market will be May 31, 2010, I can answer that question. Hopefully they will. Hopefully they will, but that's the world we live in with this mark-to-market snapshot for a long-term pension plan with the short-term volatility in interest rates in the markets. So yes, it's very complicated accounting. Unfortunately, that's what we have to live with.

Operator

Thank you. Our next question comes from Donald Broughton with Avondale Partners.

Donald Broughton
Analyst, Avondale Partners

Good morning, gentlemen. If you could help me, Doug, the question really is, is how much capacity does FedEx Freight have if and when a major competitor leaves the playing field? How much capacity do you have and how much of that market share is possible for you to grab in the jump ball that would follow?

Douglas G. Duncan
President & CEO, FedEx Freight

Well, we are in a great position to take on additional capacity. The cost-cutting that we have done has been smart. Our FTEs for the quarter was down about 17% but our headcounts are only down 7%. We've retained the bulk of our driving force which is the tough positions to fill when the volumes come back. We have continued to go down some of our construction projects that are needed in certain key areas where we are constrained capacity. We opened a 135-door facility in Houston last week, a brand-new 252-door hub in Columbus earlier in the quarter.

So, we have continued to protect the network. We haven't given up any coverage. We have phenomenal service. We protected the drivers so that we have them at hand to handle additional tonnage. So I think we are very well positioned for that and we would like to see the industry get to more normal capacity.

Donald Broughton
Analyst, Avondale Partners

But would I be overly optimistic to suggest that you are really only running at 70% of your current — of your possible capacity at current volume levels?

Douglas G. Duncan
President & CEO, FedEx Freight

I don't know that I've got a good percentage number to give you on that but given what we see as the possibilities of consolidation in the marketplace, I think we are in great shape to handle our fair share of what may come our way.

Operator

Thank you. Our next question comes from Helane Becker with Jesup & Lamont.

Helane Becker

Analyst, Jesup & Lamont

Thank you very much, operator. Hi, gentlemen. Thank you for taking my question. So maybe, Fred, you could comment on this since you talked at great length about the FAA reauthorization bill. If the Senate doesn't get it and the bill passes similarly to that House version, can you just talk about how that affects FedEx going forward and how we should think about that if it doesn't work out that it just dies a natural death?

Frederick W. Smith

Chairman, President & CEO, FedEx Corp.

Well, I think the most important thing that would happen, Helane, is that we would have to be much more cautious in our investment in the Express business. The reason I went through that historical litany was to try to explain why the Congress passed the Railway Labor Act to begin with. From the end of the Civil War through World War I, and Woodrow Wilson almost nationalized the railroads over this issue, the Congress tried four times to bring stability to the rail industry and repeatedly customers were bankrupted and products were not able to get to the market and so forth because of local labor disputes. That's why, after the war, the Congress passed this grand compromise recognizing that there were three seats at the table and not just two.

It wasn't just labor and management. It was labor and management and the public interest. So no Railway Labor Act carrier, whether it's one of the major airlines or the railroads could possibly continue to invest in the assets necessary to run these integrated networks if in fact it reverted to the pre-1926 environment where the FedEx Express network could be shut down by a local labor dispute in Oakland or Memphis or Newark or Chicago or whatever the case may be. And that is precisely why when we exercised our option on these new 777 airplanes, our Board of Directors had to exercise an appropriate amount of prudence and make those orders cancellable if this action took place.

So it would significantly change our ability to make the kinds of investments that, as many people have noted, changed the world — the FedEx invention of the modern express industry. And as I said it would —

if this happens it would overturn two court decisions that say the industry is organized correctly. And as you know, we do not, like UPS, combine our air express networks and our ground networks. We think that this gives us a competitive advantage because our ground network is focused on highly reliable low-cost ground packages and our Express network is focused on very high service expectation express packages shipped to 220 countries around the world.

So it would materially change our business model to the detriment of the public interest. And, you know, the rhetoric about this thing is quite frankly absurd that the situation at UPS exists because UPS made the decision to organize the way they did, thinking that it would give them a competitive advantage against FedEx. They then tried to put their operations under the Railway Labor Act, which we supported by the way, and then that was taken to court.

And the court said no, you made your bed, now lie in it. You tried to put air express packages in predominately a ground package network, which was then and I might add by definition is a monopoly. They have over a 60% market share. So all of these facts we've tried to get across to the Congress, but it would change our business model. We would have to be much more cautious.

What wouldn't change is the focus we put on our employee relations. We have a great team. We try to be fair and equitable with our folks, and that wouldn't change at all. We respect their right to have third-party representation if that's what they choose. Our pilots did that. We have very good relations with our pilots. So that's the best answer I can give you, it would just change the fundamental nature of Federal Express, which has been, as I said, a Railway Labor Act since its inception and was based in part on my experience in the Marine Corps of an integrated air/ground network. That's why it has been so successful.

So it is an attempt to quite frankly advantage UPS and disadvantage FedEx by making our operations susceptible to local disruptions, which again is exactly why the Congress passed the Railway Labor Act in 1926.

Helane Becker

Analyst, Jesup & Lamont

Right, well didn't you set up FedEx to be separate ground and air for specifically this reason?

Frederick W. Smith

Chairman, President & CEO, FedEx Corp.

I didn't — it was not set up to be separate ground and air. It was set up to specifically be an integrated air/ground system and that issue was litigated and the courts found that it was in fact exactly what the Congress intended when it set up the Railway Labor Act. So it was always a Railway Labor Act operation.

Operator

Thank you. Our next question comes from Gary Chase from Barclays Capital.

Gary Chase

Analyst, Barclays Capital

Good morning, guys. Just a quick cleanup one for Alan and then a question on cost. When you said you expected to be cash positive, that's obviously after CapEx or at least I assume that. And could you also clarify, did you say the pension contribution would be \$132 million? Was that the expected number?

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

The increase in expense that will run through the P&L for our pension plans is \$125 million. The contributions to the qualified plans will be \$850 million, which is less than fiscal '09, but will be more than what we will expense. And when I say operating cash flow positive, that includes CapEx. That includes that contribution to the pension plan. It does not include any debt refinancing or debt paybacks which we have about \$650 million of debt to repay during fiscal 2010. But of course we have \$2.3 billion in cash so we haven't made any decisions in that regard.

Gary Chase

Analyst, Barclays Capital

Okay, then more importantly in past releases you've identified upwards of \$2 billion in savings that you think you can take out of the operation as you scale it down. Is there a way to think about how much of that is already in the numbers, what we saw in the fourth quarter and how much of it we should expect to spool up during the course of fiscal '10?

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

That's a question that's going to play out during the year. We have hiring and wage freezes, basically across the board. We have suspended our 401(k) contributions. If the economy turns up and we start to see the growth that we think we will get, we will start to repair those reductions. And if we don't, we won't. So we are going to manage the heck out of this year just like we did in 2009. But again, let me just stress, we have a tremendous amount of leverage in these networks at the moment because the drop in volumes has been so precipitous.

There are additional — on the downside — there are additional things we can do cost-wise if the economy goes south from here. So we are not locked in to where we are either way. We have flexibility but we have a lot of leverage.

Operator

Thank you. Our next question comes from Tom Wadewitz with J.P. Morgan.

Tom Wadewitz

Analyst, J.P. Morgan

Yes, good morning. I wanted to ask you first on the volume side, the express, domestic express down 1.7% in the quarter, was actually down a bit less than what we saw year-over-year in third quarter I think down 3%. Is that just additional DHL coming in or did you see certain areas improve slightly? I guess could you give a sense of where you see Express volumes going forward, whether it's weak for a while or whether you see some early indications of that improving a little bit?

T. Michael Glenn

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

Tom, as we discussed on the last call, we were very successful taking DHL volume that was available to the marketplace. We were able to obtain greater than our fair share in all segments where we were competing. So there's some of that which also has a negative impact on yields because as you — as I'm sure you know, the DHL volume tends to be lighter and more concentrated in large customers, so you see both a customer mix issue there as well as an average weight per package issue there that affects the pricing.

Having said that, we did see some improvement in the quarter but as we've said for a long time, we don't

anticipate seeing the domestic express market as a significant growth opportunity going forward. We see that market as relatively mature. But having said that, it's important to understand we manage the Express network is a global network. The investments we make in the U.S. are all part of a global network, so that's the way we look at it on a global basis, not really as a domestic opportunity.

Operator

Thank you. Our next question comes from Art Hatfield with Morgan Keegan.

Art Hatfield

Analyst, Morgan Keegan

Thank you and thanks for taking my questions this morning. First, kind of a broadly-thinking one. You addressed the issue of excess capacity and the LTL environment. If things kind of play out as you expect over the next few quarters and we do start to see GDP growth in Q1 of 2010, how long and what level of GDP growth do you think we need to see before you kind of see a balance between supply and demand in the express industry?

Douglas G. Duncan

President & CEO, FedEx Freight

Art, this is Doug. In the LTL space, if you go back and look, we actually began the decline earlier than the general economy because of the housing crunch that began in 2006. So you can actually see a decline in the overall trucking business starting in the fourth quarter of 2006. So we got in it kind of earlier than the general economy. My gauge is that the whole economy, the whole industry is down a little better than 20% since its peak of 2006 and I don't think we're going to have the kind of GDP growth that's going to get us back to that capacity quickly.

So I think the growth will be moderate from a very low base and because of that I think you're going to see capacity come out of this industry in pretty good chunks because I just don't think it's sustainable in this economic climate.

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

Art, this is Alan. I know you know this, but I will just take the opportunity. Industrial Production year over year has been down for seven consecutive quarters

and some of those were double-digit declines and LTL is very sensitive to industrial and housing. So there's no — unless a lot of capacity comes out, it's going to take quite a while for the capacity that's out there to get filled back up.

Art Hatfield

Analyst, Morgan Keegan

What about these issues on the express business side?

David J. Bronczek

President & CEO, FedEx Express

Hey Art, this is Dave. Alan had already mentioned this and Fred did too, but I think it's important to point it out, our international number, which of course as Mike commented, is our global number as we look at international and domestic, improved sequentially, which is very important for us. It shows signs of stability. Asia improved. Europe improved. Latin America improved. And overall, we improved quarter-over-quarter, so that's a very good sign for us.

We mentioned that last quarter as well. And as we've all talked about, if we see signs of that improvement going into the first calendar quarter, that would be very positive for us. And by the way, as you would know, there's a lot of capacity that has come down throughout the world in the express and airfreight markets and we see that as an opportunity as well.

Operator

Thank you. Our next question comes from William Green, Morgan Stanley.

Adam Longson

Analyst, Morgan Stanley

Good morning, this is Adam Longson in for Bill Greene. Alan, given how difficult the economy is, I have got to believe that your sales team is probably doing everything they can to retain business and help customers and inevitably that means you will get requests for discounts. As the CFO, how do you balance the need to maintain pricing integrity with concerns about maintaining market share if some of your competitors get aggressive on price? What are some of your thoughts on pricing this year?

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

I'll go and then I will let Mike go. First of all, we've got the most awesome sales force in the world. I'm very proud of them. Really working hard. We are not in the market share gain for market share sake. We are certainly taking market share at Ground very consistently year after year after year and, you know, we just made an 11.9% margin, so obviously we want to continue to do that.

There is business that we're willing to walk away from and that we do. We have certain lane advantages. Competitors may have certain lane advantages but at the same time, it's a competitive environment and we want to maintain cash flow positive and build long-term shareholder value, and that means we can't take every price deal that is offered to us. I will let Mike talk about it.

T. Michael Glenn

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

We have a process which we manage these opportunities on a weekly basis called the Revenue Management Committee, which has representatives certainly out of Alan's office, senior executives out of the finance organization, the legal organization and of course the key operating companies are represented either by the CEOs of those operating companies or an executive vice president. We review each one of these opportunities on a weekly basis. We have a very clear understanding of the impact that pricing decisions have on the Company both at the OpCo level and the corporate level. And I think if you take a look at our yield performance in a very difficult market, we have outperformed the market when it comes to yield management.

So, we will continue that disciplined approach to managing price. As I indicated, I'm very hopeful that, as the markets improve, that we'll see certainly more stability and improving yields and more competing on value as opposed to focusing on filling up networks. So we will continue to use that very disciplined process that's worked well for us in the past and again hopeful that we will see some more stability in pricing going forward.

Operator

Thank you. Our next question comes from Chris Ceraso with Credit Suisse.

Chris Ceraso

Analyst, Credit Suisse

Thanks. Can you hear me?

A. Mickey Foster

VP – Investor Relations, FedEx Corp.

Yes.

Chris Ceraso

Analyst, Credit Suisse

Okay, great. Can you just maybe give us a high-level breakdown of the change from fiscal first quarter of '09 to your guidance for fiscal '10 on some big buckets? How much is the fuel headwind? How much would you attribute to volume and yield? We know that it's maybe \$0.06 of pension and then on the other side, how much is — are you getting back from cost savings?

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

All of the above. I mean the fuel surcharge is going to be significantly different in FY10's first quarter than FY09's. And the economic environment is light-years different. So obviously those are the two big hitters and we can't get it all back in cost year-over-year at this point because we have, as I said, leverage in the networks. We would've had to take them down further and tighten them even more, which we think would have been a very big long-term mistake.

And certainly we are not going to disinvest in service. In fact, we are investing in our service levels to keep them as close to 100% as we can. So, it's all of the above. Fuel is definitely substantial. Quantifying it is of course a non-GAAP analytic process, which includes price negotiations, fuel burn, weight per package, all of those kinds of things in there. But we are just going to see more of the same in Q1 of 2010 that we saw in the last part of fiscal 2009.

I want to clarify my Industrial Production comment. When I said seven consecutive quarters, that includes we believe that it will be down each of the quarters two, three and four of calendar 2009, so all the way through calendar 2009 that will be seven consecutive quarters by the time we get to December 31.

Operator

Thank you. Our next question comes from Ken Hoexter, Merrill Lynch.

Ken Hoexter

Analyst, Bank of America/Merrill Lynch

Great, good morning. Can we just run over the impairment charge for a second? You took \$1.2 billion out and that included \$810 million for the Services, \$260 million Express, \$90 million for Freight and then you said \$10 million was in the Freight number as well for severance. What is the other \$35 million attributed to?

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

Well, big round numbers, the goodwill impairments are \$900 million, the asset impairments are \$200 million, severance all throughout FedEx Corporation is \$46 million. Lease penalties, aircraft mod cancellation, lease abandonments and others are the rest. And that gets you to \$1.204 billion to be precise. The tax effect is \$128 million and that gets you to the \$1.076 billion precisely as the impairment charge total.

Operator

Thank you. Our next question comes from David Ross with Stifel Nicolaus.

David Ross

Analyst, Stifel Nicolaus

Good morning, gentlemen and Chris. First question on the Express price competition in the U.S. You said that was driven due to the excess capacity but is it being driven more by the shippers putting their freight out for rebid or more by competitors just going in and chasing freight?

T. Michael Glenn

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

Well, again I think you got to — it's a little difficult to take out the DHL noise from the Express rates because as I mentioned, DHL was a more aggressive price competitor and also they tended to have lighter weight packages concentrated with larger customers, which results in lower yields per package. While FedEx was able to take that traffic at a significant

premium to where UPS was — excuse me — where DHL was carrying it, it still was lower than our average yield per transaction. So, there is certainly the DHL noise in there.

Having said that, you do see aggressive pricing on an account-by-account basis. It tends to be where capacity is available and that's not unusual in these economic times. You also see a lighter average weight per transaction as traffic tends to shift from one network to another in order to control costs.

I would say there's a slight increase in terms of companies that are rebidding traffic in order to take advantage of these opportunities in the recessionary times, but nothing outside the norm that again you would expect to see in this environment. I think the bigger issue affecting the yields was the DHL mix of traffic that came into our system, again albeit FedEx took it at much higher yields than DHL was carrying it and the change in average weight per transaction.

But, you know, it's about what we would expect to see in this environment, but we are very hopeful that that will stabilize and the environment will improve significantly as the economy improves.

Operator

Thank you. Our next question comes from David Campbell with Thompson Davis & Co.

David Campbell

Analyst, Thompson Davis & Co.

On the Internat— (garbled) front business, can you see gains in market share because of DHL's loss of domestic capabilities?

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

David, you are breaking up there but I think the question was — are we seeing gains in international business around the world as a result of DHL — DHL's departure from the express business here in the U.S.? The answer to that question is yes. For the same reason that we run the Express network as a global network, customers view that competitive networks in a similar fashion and when you take the U.S. out of a global network, it obviously creates a lot of issues in terms of the value that a company can bring to a competitor in terms of leveraging and managing their supply chain.

So, we have seen some opportunities there. I think those are picking up as we again move through — move into the new fiscal year and our sales team is doing a great job working with customers to help them with their supply chain. So there is no question that DHL's departure from the U.S. is creating opportunities around the world.

Operator

Thank you. Our next question comes from John Mims, BB&T Capital Markets.

John Mims

Analyst, BB&T Capital Markets

Hey, good morning, guys. Alan, can you talk about the fuel — your guidance for next quarter and how sensitive that is to fuel? Is there a high or low water mark if oil was to jump to 80 or fall to 60 where you would blow through the top or the bottom of that range?

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

Well, you could definitely blow through the top or bottom of that range based on fuel spikes up or down. Again, remember as I mentioned, we have already set June and July surcharges from the April and May pricing environment, which was substantially lower than what we are paying at the moment. So if it stays where it relatively where it is as I said in my earlier comments, then I am much more comfortable with that range than if it is volatile and volatile either way because it's the volatility and the lag that hurts us on a quarterly basis.

In the long run, there are a lot of other factors. How much does a fuel surcharge create mode shift? So many factors that are involved in it — it's much more judgmental. But right now because of this run-up, it's having a substantial drag on what our first-quarter earnings otherwise would be. At the stage where it is, we should get most of that back in quarters two, three and four.

Operator

Thank you. Our next question comes from Ed Wolfe, with Wolfe Research.

Ed Wolfe

Analyst, Wolfe Research

Thanks, and good morning. Two quick questions. First, can you talk about May and June trend for IP and U.S. Express package volumes relative to minus 12.3 and minus 1.7 for those two in the quarter? And also if Congress goes through the reclassification of FedEx under the RLA, what steps, Fred, do you plan to take to help prevent organization? I'm guessing there are things you can do to make sure that doesn't come to fruition if the law goes against you.

David J. Bronczek

President & CEO, FedEx Express

Ed, this is Dave and then I will throw over to Alan. In that 12.3 in Q4 obviously sequentially, Asia improved, if that's your question, and so did Europe. That's very important for us going forward. Overall, as I mentioned before, all of international all up improved from Q3 to Q4. So we are optimistic as we have said now several times that as the year goes forward, halfway through the year we start seeing an upside in the positive territory.

Alan B. Graf, Jr.

Executive Vice President & CFO, FedEx Corp.

Sort of Ed, very broad brush, in Express, the domestic express volumes are going to be basically flattish for the year and pretty consistently in each quarter. IP is going to stay down because the comps are just so tough compared to year ago when we were doing significantly better. We had only a slight decline in our first fiscal quarter of 2009 in IP. It was almost flat, so that should begin to get better and mitigate and as we turn into the 2010 calendar year, I expect to be back on a growth plan in IP again assuming that our assumptions that I've told you about the economy and having year-over-year GDP growth actually come to fruition. With that, I will turn the other question over to Fred.

Frederick W. Smith

Chairman, President & CEO, FedEx Corp.

Well, Ed, I might want Dave Bronczek to talk a little bit more about this but, fundamentally we would not change anything that we are doing in terms of the culture of FedEx Express. We have always been very team member oriented. We have system-wide bidding rights. People can start as a cargo handler in Ohio and advance as high in the Company as one can go. In fact I think that's the short form career statement of

Dave Bronczek, the CEO of FedEx Express. Many of our people started that way.

So we have a very strong corporate culture, very people-oriented, so I don't think we would do anything in that respect. As I said before, we recognize and respect our employees' rights to have third-party representation. We just have worked hard to make sure that we — that they don't feel that that's necessary, and that's true in our Railway Labor Act company, FedEx Express. That's true in our National Labor Relations Act companies, FedEx Ground and FedEx Freight.

Now having said that, as I answered the question with Helane, there is no Railway Labor Act carrier, whether it is a major railroad or a major airline or a major express company like FedEx, that could possibly invest the levels of capital that we have invested in this business if it was subject to a local labor dispute. And that's just not hypothetical, I personally have called almost every one of the CEOs of every one of the railroads and air carriers and confirmed that that was the case.

So over time it would change our approach to the business. I think it would certainly change the way the network evolved and managed. Certain facilities would probably over time be scaled back. Others wouldn't be. As I said, the contract with Boeing, our Board required that the exercise of the option be subject to this change. And in the time when Boards of Directors in the financial sector have been roundly criticized for a lack of risk management, it would have been absolutely imprudent for our board to approve a multibillion-dollar purchase of assets which will be highly productive in our Express network. But if in essence we became overnight because of a preemptory change in the law, despite as I said the 150 years of history in this matter, then we go from being an integrated air/ground express company, which did change the world of commerce, to in essence an airfreight forwarder with an airline. That's a very different proposition than Federal Express is today.

Dave, do you want to comment further on it?

David J. Bronczek
President & CEO, FedEx Express

Yes, Fred, and thanks for the question, Ed, because it gives me a good opportunity to thank my Express management team. In the history of Federal Express and of course now FedEx Express, we have always had an employee survey which goes back 25 years. And as tough as the economy has been and as tough

as the actions that we have had to take have been with all the communications, we have never had a higher — never — survey feedback than we had this year. In fact in almost every category the surveys went up across the United States.

That is the case across the world by the way as well, but unbelievable progress in that. The employee morale is exceedingly high. We have great support from our teammates. They understand the issues that we are facing and I am very, very proud of all of them. So thank you for the question, Ed.

Operator

Thank you. That will conclude today's question-and-answer session. I would like to turn the conference back over to Mr. Mickey Foster for any additional or closing remarks.

A. Mickey Foster
VP – Investor Relations, FedEx Corp.

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

Operator

That does conclude today's conference. Thank you for your participation.