Bernstein Transcript – May 29, 2024

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

All right. Good afternoon, everyone. Welcome to the first afternoon session. My name is David Vernon. I cover transports and airlines at Bernstein. We are thrilled to have, for the first time in my 10 or 15 years covering the company, FedEx joining us at the SDC. We are in their quiet period, so they have a little bit of restrictions on some of the stuff they can talk about. We are going to get into some Q&A. I think what we're going to do here, just so you guys probably know the drill by now, we do have a digital app. If you have questions, put them in there, and I can try to work them in through the iPad if there are any.

And then what we're going to do is have Jeni Hollander from IR come up and read a couple of forward-looking disclosures. And then Raj is going to kick us off to some prepared remarks, and then we'll get into the Q&A. So, thanks again for attending the conference. Thanks to FedEx for attending, and I'll hand it to Jeni.

Jenifer Hollander
Vice President-Investor Relations, FedEx Corp.

Thanks, David. Certain statements made today, such as projections regarding future performance, may be considered forward-looking statements. 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 the filings with the SEC.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

All right.

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

Ready for me?

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

With that, I think we'll let Raj kick us off with some prepared remarks.

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

Okay. Well, thank you, David, and thank you all. This is my first time to be at this conference, and I look forward to sharing some comments about FedEx, who we are, how we are transforming, and where we are headed. And then we'll take questions after that. So firstly, I just want to talk to you all about the critical role that FedEx plays in expanding global trade and to help build smarter supply chains and delivering products and services to customers around the world. I thought I'd start by giving you all a few stats that illustrates the scale of our operation.

We link more than 99% of the world's GDP. We deliver more than 15 million packages every single day. We reach over 220 countries and territories, including every single address in the U.S. We operate more than 5,000 facilities, 700 aircraft, and more than 200,000 vehicles. More than -- we have more than 500,000 employees worldwide and generate 1 petabyte of data every single day.

Now, of course, we didn't achieve all this overnight, and over the course of 51 years, that's what has taken us to get here. Our service offering started in -- with just 186 deliveries back in 1973, beginning with our express, our time-definite business, which is now the world's largest air cargo airline. We expanded into the ground, our day- definite parcel business in the late '90s with our acquisition of Caliber Systems, which has now become FedEx Ground.

And following the acquisition of American Freightways in 2001, we rounded out our offering, establishing FedEx Freight, which is now the country's largest, less-than- truckloader LTL carrier.

Now, as we have grown these businesses over time, our customers have embraced the bundled offering with nearly 80% of our U.S. revenue now coming from customers using express, ground, and freight services. The first point I want to really make now is that building networks is a hard and time-consuming work, and it is, thanks to these networks, we can pick up a package or a pallet anywhere in the world and get it to any other part of the world in a very short time.

People use the word networks all the time, but sometimes they don't really get it. When you use a telephone, you understand what a network is. You can pick up a phone and call anyone. Similarly, when you have a global network, you pick it up from anywhere and deliver it anywhere else. And that is an enormous moat that we have around us that would be almost impossible to replicate. But try getting a square foot of space in either the Paris airport or Shanghai or in Delhi or wherever, and you know what I'm talking about.

And with the unmatched global logistics networks, outstanding customer service, and an iconic culture driven by our people, we have built deep relationships with our customers, and we are extremely proud of the work we do. For example, we continue to deliver vaccines and critical healthcare equipment as we did throughout the pandemic. We transport key manufacturing inputs to keep the supply chains moving or even ensuring that the Lombardi Trophy makes it a Super Bowl in town.

Since the turn of the century, we have grown our revenue at roughly 6% compound annual growth rate. This is true, even including the demand volatility we saw during and after the pandemic.

With our resilient networks, we managed this unprecedented COVID demand surge when our revenue grew at a roughly 15% compound annual rate for two years. And more recently, we have navigated the retraction in demand experience across our industry. The market has evolved, and we are evolving our business with it. We saw this downturn come early and embarked on a structural cost reduction program.

And we are ensuring that we are well positioned to improve profitability irrespective of the demand environment. And we are ready to emerge as an even stronger company when demand inflects positively and we return to that normalized growth rate. And through these efforts, we are significantly improving the profitability of the company as we lower our cost to serve, enhance capital efficiency and better serve our customers with market-leading capabilities.

We are in the early innings of our cost reduction efforts, but progress is already evident in our results. This includes margin expansion and earnings improvement over the past three consecutive quarters despite the declining revenue environment. The entire industry is feeling the revenue pressure, but we are unique in our ability to grow profit even in these market conditions. And this is a clear sign that our efforts are working.

Our target is a combined $4 billion in cost reductions in fiscal year '24 -- by the way, our fiscal year '24 ends on Friday -- and combined fiscal '24 and '25, which begins on Saturday. We are examining every aspect of our cost structure with a focus on our surface network, our air and international network and G&A. We shared at our Q3 results that we expect to deliver $1.8 billion in savings this fiscal year and another $2.2 billion in fiscal '25.

When it comes to CapEx, FedEx is at an important inflection point. Our multi-year aircraft fleet modernization strategy positions as well as one of the youngest fleets in the industry. Our capital expenditure continues to decline as a percentage of revenue as we reduce capacity investment and plan for lower annual aircraft CapEx. This enables us to focus on returning cash to stockholders through share buybacks and dividends.

Now let's talk about network transformation. And first, let me provide you a little bit of context of how we got here. And more importantly, where we're going. For many years, we ran our businesses with a strategy to compete collectively and operate independently, which served us quite well.

For example, 25 years ago, we held a 10% share in the ground parcel market, 10%, with a 70 point market share gap versus our primary competitor. And thanks to our simpler and faster model, paired with a stronger service, we grew market share every quarter for several years, narrowing that gap to about 10 percentage points today, 70 points to 10 point gap. So, you may ask the question, why change?

Well, the most meaningful change in the market is the emergence of e-commerce. A vast majority of growth in the parcel market is now driven by e-commerce. A little less than 10 years ago, roughly 75% of the stops, not packages, stops were businesses. What that means is we have a FedEx Express truck and a FedEx Ground truck pulling up to a business just like this building, perhaps delivering six time- definite packages and 10 day-definite packages at the same stop, and this approach made business sense, because the rest of the network was fully optimized for time- definite and day-definite services respectively.

You fast forward to today, now about 75% of our stops, again, not packages, stops are residential. So, you might see a FedEx Express truck drop off a package at your house, followed by a FedEx Ground truck, sometimes delivering another package later in the day. So now you can imagine the room for improved density and efficiency.

So that brings me to our transformation and how we're changing the way we run our business to better align with market demand and operate more efficiently. And this is the reason why in April 2023, just over a year ago, we announced a multi-year strategy to unify our businesses and create the world's most flexible and efficient and intelligent network. And one important pillar of that transformation is what we call Network 2.0. It is the network of the future where we're combining our express and ground networks in the U.S. and Canada. And the best way to think of Network 2.0 is one truck, one neighborhood. We've spent the past several years updating our technology and facilities to prepare, and we are now in the execution phase.

We have already implemented Network 2.0 in over 50 locations with dozens more to follow this calendar year. And as we have stated previously, we're targeting a $2 billion in cost savings in FY '27.

Additionally, we are redesigning our global air network. We will improve the efficiency and asset utilization of the entire FedEx system to put the right product and the right network to drive density. Our work here will allow us to use our unique pallet distribution capabilities worldwide to profitably target more of the premium air freight segment. We will do this with a truck-fly-truck model, leveraging existing capacity in our trucking networks to move the international freight shipments.

All our revenue growth initiatives, structural cost reductions, and network transformation efforts are managed through a program that we call DRIVE. DRIVE is simply the way we work. It's characterized by rigor and discipline with a keen focus on business outcomes and very quick decision-making timelines, especially for an organization of our size.

So now that you have a glimpse of the major change underway at FedEx, let me share a few thoughts on our formula for future success. First, we are focused on return to profitable growth. This is growth in higher-margin segments like technology, healthcare, and small and medium businesses.

Second, we will continue to drive our structural cost improvements, lowering our cost to serve. We have made considerable progress here, but there's more value to unlock. As I shared previously, we expect to achieve $4 billion in savings in fiscal year '25, plus an additional $2 billion from Network 2.0 in FY '27.

And third, we leverage the vast amount of data we access from the 15 million packages we deliver each day. We will create data-driven solutions that bring internal efficiencies and enable us to better serve our customers. These solutions will rebuild a platform mindset of reusability and scalability with a mission to make supply chains smarter for everyone.

Just think about this. Prior to the pandemic, if I hadn't mentioned the word supply chain, I probably would have been politely escorted out of the room. It was the preview of procurement managers, perhaps the CFO. But ever since the pandemic, supply chains have now risen to board-level conversations, and you hear it even in talk shows these days. So, this is the right time for us to make our mission to now make supply chains smarter for everyone. We're already, obviously, a leading supply chain company with an unmatched global physical network. We move more than $2 trillion worth of goods every year, and we sit in the middle of an immensely powerful data ecosystem. Leveraging our physical network and our digital platform, we are on our way to becoming a leading supply chain technology company as well.

So, these three long-term strategic priorities are interconnected and create even more value when they are all in motion together. I hope that you will take away from today's conversation my conviction that there's enormous opportunity ahead of FedEx, as we transform how we operate while continuing to offer our customers' unmatched speed and service. Thank you for your attention here. Look forward to the Q&A. Thank you, David.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

All right. Thank you very much for the overview, Raj. So, I want to kind of structure our discussion in a couple of different areas. First, talking a little bit about some bigger market trends that you might be able to help shed light on for investors. Talk about some of the sector themes that are important and then maybe dig into some of the cost production plans and restructuring that you've got underway.

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

Okay.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So, starting in the area of these sort of big picture themes. You mentioned, supply chain being at the forefront of many companies' minds. And it does feel like we're now in a world where there's always a supply chain crisis somewhere. How is FedEx positioned in the marketplace to capitalize on that or uniquely benefit from the increasing volatility that seems to be affecting the global supply chain?

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

Yes, so 100% agree with you that supply chain has now suddenly risen to the top of the list on several people's agendas. And if you go back in history, and especially in the last 35 years that I've been working at FedEx, that the supply chain perturbations have been rather muted. Even in like, the oil crisis, or even in the 2008 financial crisis and so on and so forth, this is because of the physical systems like ours and the improvements in technology. So, the perturbations were, of course they were, but they were minimal. What we are now seeing the pandemic was, it's not -- is one giant change. And so, the supply chain bullwhip effect that we are seeing right now.

So, from a FedEx perspective, we've -- if you go back, if you're like, when I, like Rip van Winkle, went to sleep in 2020 and woke up today, we grew roughly 6% CAGR in the last four years. And it's comparable to the last 25 years, except the fact that there was a huge spike for two years and then a modest decline in the last two. So, I think this is a unique period in the last 35 years. And so that's why, you see so much, it's not multiple things happening, it's part of the same, still reverberating from the historic pandemic issue.

So, from a FedEx point of view, we get to see the signals early and we're able to move faster. Our mission to make supply chain smarter for everyone has come -- came from this idea, that we simply have the data and more importantly the insights about the global supply chain every single day, especially the high value goods of the economy. So, today's supply chain is different than tomorrows and the aftermath is changing.

And so -- and the, we are watching it very carefully. We're making sure that, we use information to make sure our networks are very efficient, but we're also integrating with our customers to make sure that their supply chains are efficient. And in the age of e-commerce, make sure that the end consumer gets the value by getting increasing predictability and reliability. So that's how we're doing our physical and digital networks and now working together to make that happen.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Is it fair to say that volatility is actually helping from a revenue growth standpoint in terms of the demand angle or is it more episodic?

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

The volatility, is -- if you think about the last four years, I mean that's where we're in a two years of real steeping increase in the demand and then two years of slight decline. I think, we are all, seeing as an industry now, when that bottoms out, then I think the rest of it gets back into a more normalized environment. But again, if you think back about the e-commerce as a penetrated percentage of retail, it spiked, came back, a lot of things have really come back to the original trend except for interest rates and inflation.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

And one of the other sort of supply chain megatrends we've talked a lot about, and frankly, a lot I think is built on, is this issue of nearshoring.

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

Yes.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

And I want to ask a question to you in two ways around nearshoring. Number one, are you seeing those shifts in sourcing and are they tangible enough to actually impact your business?

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

Yes, the supply chain patterns are fundamentally changing, and you can see it. The -- it's not just as people talk about, a diversification into new markets. It's not just that. It's like all of the intermediate products were built in different countries. They made their way to China, for example, assembled, and then went to the final consumption point of U.S. and Europe. That pattern is now changing. And we can see different things are happening in that. So, it is not only that new countries are coming to play, it is the patterns of how goods are producing change.

And the good news for FedEx is that we see it from the bottom up because practitioners in this business, when a manufacturer wants to change any kind of thing in their supply chain, they need to make sure that the logistics is taken care of. So, we hear about it first. And so, we -- and the good news from FedEx point of view here, again, is that because of the network that we already have in place, nearly every single time that you want to move, you're already there. And so, it's just a matter of, just connecting to that point.

Even if there was a new point, it's a matter of connecting that point to the nearest node and boom, that world is connected. So, we are -- we have an inherent advantage in that sense that we already have a network in place. Now to specifically - - Mexico is an area where things are moving towards, you can see it in Vietnam, you can see in Southeast Asia, you can see in India. And we'll see how these trends play out. But we see it, like I said, in the bottom up, and we move fast, the manufacturing can move faster.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So, if you think about Mexico becoming more important than China sort of at the margin, does that pose a unique risk to you guys --

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

No, not at all.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

In terms of the cargo network, because you probably don't need a plane to get there?

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

No, but we have a -- as you know, I was there in Mexico actually we have a fantastic advantage, FedEx in that sense, because if you think about the presence we have in Mexico and the ground-based networks that we have in the United States, when you put the two together, we actually have a very unique situation there, because if you look at our competition, they're not that big in Mexico, if you look at DHL, they're not that big in the United States. And so, it's a -- we are actually in a catbird seat in that perspective, and we have all the ground-based distribution models that we have in the U.S., so no, I think that's actually, like I said, it doesn't matter where it moves, we're already there.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

But does it create a challenge around the air assets?

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

No, we'll size our air assets depending upon traffic. I think today, Asia represents, I don't know, 40% of global manufacturing, and I'd see that go down maybe a little bit, but so it's -- we'll manage overall capacity based on the demand environment, and that's not a problem.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. And then if we were to talk a little bit about some of the sector themes, obviously, the growth of e-commerce. I mean, you talked about the mode and the connectivity of the networks, and it's something that we think we understand pretty well, but when talking to investors, we hear a lot about this idea that, hey, what mode? Amazon just stood up a network with more trucks than FedEx Ground has. How was it -- what mode are you talking about?

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

Well, when you talk about a mode, the business itself is fundamentally different, because it's pick up, sort, and deliver, not just deliver. So, if you look at our FedEx facility, packages come in and out, they've moved through it in minutes. When you look at a comparable e-tailer facility, they go in and stay there for days and weeks. It's a different business, different mode. So that's not even a comparable thing. So, this idea of a network, that's why I specifically said a network, a network is you have to pick up and deliver, and that's what we uniquely have.

And so there is a significant mode. The other part is that if you look at a FedEx truck delivering -- moving on the road, there's packages from all over the world on the packages, and the revenue on this -- on that truck is significantly higher than just what you can pick up from local delivery. So, there's significant scale advantages that we have. Of course, we had to adapt our network, just the e-commerce growth is which is what we're doing right now, which we've done. We are actually very, we have done a pretty good job of adapting to the changes, but I think with more to come, and the technology also plays a significantly critical role as we move forward. So, for e- commerce, it's ultimately a good thing for FedEx.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

But do you think it's fair to say that the growth of e-commerce has brought margin pressure for the industry?

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

Well, in the original get-go, yes. But if you now look at what we have done with FedEx Ground, and even literally in the last three or four years, you can see the margins continue to expand. So, it's even with this significant e-commerce, it's just that our network is now adapted to this new environment. And we are -- people talk about the last mile, but they forget about the first few thousand miles. And there is only -- there are only very, very few people, very few companies who can deliver, who can move that.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

If you just kind of think about the diagnosis of some of the problems before, obviously, we're coping and we're adapting. But there was some margin pressure there from e-commerce. It looks like in the data.

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

If you look in, as I said, there was a period of adapting to this. But I think now we're on -- we've moved on. So, things have changed. And we have -- we had to put some, specific infrastructure to support e-commerce, for example. That's all in there.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So, what about pricing? And the challenges you have around the residential delivery part of the business just being, in general, less productive than making it?

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

No, I think, we know, I'm really proud of the way that we have managed our revenue management function. And this is something that's differentiated in the market for us. We look at this very, very carefully. And if you look, close your eyes, pick up any quarter that in the last 20 years, pick one, open and compare our yield versus our competition, we'll be better. And it's just -- we've done a much, much better job of managing, because the value that we provide for our customers is significant. And we will provide, because of that, we can -- we need to balance out the needs of our customers and shareholders and our employees, and we do that very carefully. And again, we have done a really remarkable job on the revenue management side.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Before we kind of dig deeper into the pricing question, I wanted to follow up on one of the things you mentioned before some of the investments that you needed to make. What did you need to do to adapt that?

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

Yeah, that's a great question. Yes. So, when we, we had to put in what we call regional sort facilities, for example, FedEx Ground. And so, then we're able to pause in and out of that facility to look to some of the local markets, which is the demand for e- commerce. That's all in place now.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So regional sorts, you mean like the Brazil, the auto sat facility?

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

Well, we own auto sats into these, what we call RSFs, and we set them up in during the pandemic. And that was just, that was very well in terms of moving the, especially the e-commerce business, which, bypassed the major hubs into RSFs and into the customers' hands.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So basically, basically routing some of that higher volume residential stuff around the commercial network.

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

Yes.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. Interesting. So, if you think about, again, back to that comment of whether the mode has been breached, right? Obviously, it does feel like it was Amazon controlling its own supply chain with just the delivery component with an inventory space, that's growing faster than the market. How do you think about the, the rest of that market growth opportunity?

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

Yes, I think a very good question. So, when the point here is that the e-commerce market, I think, I suspect Amazon's about 40% to 50% of the market. Now we are partnered with all the retailers. They can name one, every one of them, we have a partnership with them. And we are there, transportation logistics arm and their growth of e-commerce. If you look at their growth of e-commerce of some of these big retailers, they're also growing very fast. And we are now linked in some of the best relationships we have is we are linked at the data level, the technological level, right behind, at the point of order by the end customer. And we were able to get that information into FedEx's hands, 12 hours before we normally would have gotten, which is a lifetime for FedEx.

But most importantly, we were able to then let our customers know how, how best to optimize their supply chains, given the latest in weather, traffic conditions, and so on. And we're also able to get the end consumer significantly more visibility. So, we are now, really strategically hooked up with many of the retailers to enable their e- commerce, which is 60% of the market. And that's also growing, so that there's a significant balancing act that's happening.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. So, when you think about the -- going back to the revenue management side of the equation, right, you mentioned you're really proud of the way the team's sort of helped to adapt and respond.

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

Yes.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

How has the growth of e-commerce created challenges for you on that pricing front? Because it does seem like, there's some perception out there that delivery is free and it's harder to get a grade in that market, and maybe Amazon's having an impact, because now they're offering some excess capacity in some markets.

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

No, I think, you're talking about 15 million packages per day that go through a system. And I think we have, the value that we provide our retailers is very, very clear. And so, we have, very productive conversations. I mean, for example, peak, we now have the peak surcharges and that's basically changed the industry, how we deal with peak, for example.

So, I think we have -- overall, the idea -- there's a significant piece of the market that we play in, in e-commerce, it is growing, and we have now have a very efficient system to deliver it. We have a good revenue management philosophy, good pricing mechanisms to deliver value for all our stakeholders. I think we're in a good place here. And as especially as the industrial market comes back to some kind of equilibrium, I think we'll change.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Let's kind of dig into that for a second, the industrial part of the economy, because a lot of time investors focus is solely, surely on e-commerce and the potential disruptive effects, and all the horror stories you can read about. The B2B part of the business, it does feel like that growth has been a little bit more subdued at a market level for the last couple of years. What do you think is driving that? I mean, what do you think about the outlook, maybe looking out five years on the B2B side?

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

Yes. So first of all, that's why I wonder is, when we, the goods that we move through our system are the high value goods of the economy. That's why we estimate about - - we move about $2 trillion worth of goods if we actually size the value of the goods that we move through the system. So, these are things that, go through the FedEx, whether it is medical equipment, whether it is high fashion, whether it is electronics and so on and so forth.

So, what we are now seeing is the tail-end of the pandemic whiplash. And that's where the industrial goods, they're caught up in this bigger supply chain bull impact that I talked about. But again, like I said, if you actually close your eyes and look four years, we're still going 6% CAGR. It's just that the recent two years have been on the down draft. And the great news for FedEx is that we have now uniquely growing operating profit, even in a declining demand environment.

And so there is, when this bottoms out and comes back, and I'm not going to sit here and give you timing right now, that's not as good as the same time period, is that there's significant leverage in our business, especially as we have shown our ability uniquely in our industry to generate operating profit growth despite the level of decline.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. So, do you think about the network integration? Now, you mentioned you're starting to take the time-definite error and the day-definite ground that we're going to put together into a new solution, right? The driver of this is efficiency gain, capabilities.

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

Well, I think it's very simply, when we have, as I said in my opening remarks, we have two trucks coming to a business delivering multiple packages there's insignificant density and be able to optimize the rest of the network for that. But when you're delivering to a house and you order two packages and one is coming from one truck and the other one from the other truck, that's where, we have to do this restructuring. So, the Network 2.0 ultimately delivers one package, one truck, one neighborhood, and that's where the efficiency comes from. And it requires a lot of work, and we are prepared for it. We have technology at work, facilities having to work, and so that's -- we're excited about the progress we're making so far.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So, it takes a lot of pre-work, but we've announced this a while back. We're now getting to the point where the rubber is going to start meeting the --

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

It already is. It already is. It already is.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

The Express and the Ground overhead structures are going to be collapsed.

Rajesh Subramaniam
President, Chief Executive Officer & Director, FedEx Corp.
Well, so I'm going to distinguish between the network that is coming together and the organization. So as of June 1st, we're going to an organization construct that's just one organization. So instead of having two or three of everything, we have one of everything. And so that work has already been done. And it will go into a new structure starting on Saturday.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Yes.

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

Then, over the next two or three years, FY '27 is when we get to the network integration part of it. So, it's just -- but the work is well underway. I mean, and we're making progress. We're making very steady progress, keeping in mind that the customer experience should get better. That's our mantra here, making sure our customer experience gets better.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So, as we're thinking about putting these networks together, is the idea, take all the volumes, stick it in one network, shut down a bunch of buildings, keep the existing assets? Like, how do -- how should we be thinking about the capacity implications?

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

Well, if you think about it, I think, we will be able to bring down the total footprint of our facilities and to be able to serve the same market. Now, of course, when there's growth, we can grow into it as well. So, we'll get more efficient in the number of facilities we have. We'll get more efficient in the utilization of our routes and all the way around, and of course, the back office.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

And that's not going to be like a one-size-fits-all solution. Different markets are going to have different types of implementation, so it's a little bit of a hybrid.

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

Yes. It's going to be a hybrid model, and we will, again, based on data and flows, we will determine which model makes sense for any particular market.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. And as you think about that asset rationalization component of that, is that a meaningful source of potential uplift for investors to think about or is that just a byproduct of.

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

Well, I'm not going to break it up today, but we have committed to delivering $2 billion of savings, over and above the $4 billion of savings in FY '25, plus another $2 billion by FY '27. That's a sizable chunk of money. So, I think we'll get significantly more efficient that way. So that -- we're in that exact period where all this is going to happen.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. So, within those numbers, right, those cost target numbers, the $2.4 billion?

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

Yes. This fiscal year, fiscal '24 is $1.8 billion, next fiscal year, $2.2 billion, that's $4 billion total, plus another $2 billion by FY '27.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So that $2.2 billion, right, as you guys are managing that from a program office level, how should investors think about that dropping to the bottom line?

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

Yes, I mean --

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Because obviously, changes in the business and changes in the baseline affect the capital.

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

Again, I'm not talk -- going to talk about FY '25 right now, that's just --

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Directionally, yes.

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

Directionally, you can see what’ happened here this year in the $1.8 billion. That's -- so you can see, we have broken it down into, how -- when it began, let me just make it simple. When I began the fiscal year, I gave you all a simple formula. I said, revenue growth, one, two, three, between $16.50 to $18.50 is what we said. And revenue growth was not one, two, three at all. In fact, we haven’t seen the revenue decline yet. We have now the ranges between $17.25 and $18.50 (Correction: $17.25 to $18.25). That's what we're on -- that’s what we told the Street third quarter. The only way that we made it happen is because the execution of our strategic cost reduction initiatives. And that's what does deliver on this bottom line growth, despite the revenue being off.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Is it right to think, though, that if business conditions start to improve, that drop- through should be better?

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

If the business -- the leverage is significant, yes. I mean, I think we -- as I can't tell you exactly when the turn is coming, but yes, that's when the jaws of the crocodile.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

All right. And then just kind of still sitting on this capacity issue, right? So obviously coming out of the pandemic, volume spiked, everybody added trucks, maybe the trucks are -- maybe we're in an overcapacity situation, maybe we're not. What's your view on capacity generally? And more importantly, as you think about charging the revenue management team with setting pricing, are you worried about that? Or were you worried about your capacity in your network?

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

I think we are I think though, we have gone through a period of this demand decline in the last two years. We've managed -- we can manage the last two years going forward it actually gets easier. And so, we are definitely managing our capacity to demand in a very stringent and strict way. And that's what we have to do.

Now, we have to have a minimum network in place to connect all these points. But I think, the issue that you're talking about would have been a much more important issue 12 months ago, or even 18 months ago. And I think it starts, as you look forward, as the demand starts to – we return to growth at some point here that becomes a less of an issue.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. So, as we talk about some of the pending sort of air network changes that you're going to be making, your long running air contract with the USPS has kind of come to an end, or it's going to come to an end in September. Does that create opportunities in excess of the revenue you're going to lose? Or does that maybe make it harder for you to do some of the things you want to do in the day network?

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

Well, one of the things that we were absolutely clear about with the post office was that we're not going to do a deal that's bad for the long term interest of the shareholders. So, we'll -- I was very clear about that. And so, we couldn't get to a place where we would make sense for us to do this. So, I'll just leave it at that for today. But the idea is at the end of the day, is that when Network 2.0 comes along, and as soon as we launch a Network 2.0, we can make our networks significantly more efficient, and which will benefit the long term interest of our shareholders. That's where we are.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. And as you think about the -- I am talking about the air network specifically, the fleet strategy, obviously, without that incremental data line, does that change the rate of rationalization, maybe some of the aircraft or maybe early retirements? Or should we be thinking about that as?

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

Well, wait, you're going to have to wait for us to talk about this when we are past the quiet period.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

All right. I figured I'd take a shot. So, let's talk about portfolio for a second.

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

Yes.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So, you have, congratulations, inherited as the second CEO in over 50 years with company. A broad portfolio of transportation business.

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

Yes.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

In a market where that seems to reward more singularly focused transportation enterprises. So, as you think about the idea of being a portfolio of companies being the right strategy for FedEx, how do you think about that being the right strategy given the market's seeming preference for cleaner, purer?

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

Yes. Well, we, we constantly review this as a matter of course. So that's a -- it's a discipline that we consistently have, but what we now have is a unique set of solutions that's across the board that sets us up very well.

As I said in my opening remarks, 80% of our customers buy -- 80% of the revenue comes from customers who buy all three pieces of the portfolio. Increasingly now, especially with Network 2.0 and because of our international, operations, we are now leveraging all parts of our portfolio to make this much, much more efficient, whole network, much more efficient. And so, they're now much more integrated than you would call a separate. This whole notion of one here, one there, there's all sudden moving to the place where we're able to optimize across the full set of networks.

So, customer facing and custom portfolio, they're buying as a portfolio from FedEx is differentiated, because we now have an offering that our competition does not have. And then secondly, on an operational basis, we are significantly more efficient with the networks now that we have, because we can use one to the other.

And that's especially now with, example on the international side, we're going to have a truck-flight-truck model, which actually opens up a whole premium segment of the international air freight market where we have a small share today. And that is -- again, networks are very important here where we can go end to end without an intermediary. So, this is a -- we value the port, the networks that we now have and be breaking a more integrated one.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

But you think about it from a market value perspective, just to address the issue, because it gets brought up to me a lot. The market has seemingly fell in love with the LTL sector in recent years. Capacity management is, say, yellow. Revenue management is disciplined. Service levels are improving and that's resulting in much higher equity valuations.

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

Well, we're, again -- we look at this portfolio constantly. We think it's a long-term interest of the shareholders to keep the full portfolio. We'll constantly -- we'll look at it from a -- we've done a really, really good job of our LTL portfolio 10 years ago, 8 years ago, and that was a 6% margin business. Now it's -- that business is at almost 20% -- around 20% margin. And that's the work that we have done not only on revenue management, but also our operations -- I mean our efficiency for operations. And but now it's becoming an integral part of the rest of the company, and increasingly, so as we move forward.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

So, as you did dial into what changed in FedEx Freight.

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

Right.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

How much of that margin improvement is better price discipline versus actual operation?

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

Well, I think it's, I don't know, I can't tell you how much, but it's both, definitely both. Revenue management was one piece of the equation, but the operational efficiency and the work that John Smith and team have done there is just fantastic. So, we've done a really remarkable job of managing both the operations and the revenue side.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. But if you think about what that business could be worth as a standalone LTL business, it's probably half the market value.

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

I don't know. I mean that's all -- what we think in the long-term interest of the FedEx shareholder, that this is, we will continue to look at it, but it's like, it is a clear part of, I'd say, especially as we move forward in Network 2.0, as we move forward into our international, this becomes a significantly increasing portion of our network strategy, in addition to the fact that the customers buy the full portfolio.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. So, as you think about another part of the portfolio, I do want to talk about Europe.

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

Sure.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Right. The TNT acquisition, 2016.

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

Yes.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Bit of tough road.

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

Yes. So let me talk about Europe, because that's a very important question for us. Europe, just to make sure that everyone's on the same page, Europe had -- has basically four different market segments. One is international express market segment, where historically FedEx has had a high team share, no problem, we live there. We also -- the intra-European express, think airplanes market, where we had team share as well. And then there's a larger intra-European ground market, and then intra-country domestic market parcel. These are the bigger market spaces, and we didn't have any presence in that. So, imagine if you didn't have FedEx Ground in the U.S. So increasingly the conversations with customers were getting more difficult, because you're basically asking the customers to parse out the traffic, give us the express, but give the larger ground to the competition.

So organically building out that out versus, buying an existing company, which has a significant presence, especially in the intra-European ground market. So that's where TNT came in. So, we had the acquisition, we had a couple of unfortunate incidents along the way.

One was a cyber attack, and then the other one was a pandemic. And so, we had -- the environment was not the greatest in the way we integrated. But now that we are moved on from integration to value creation. And we also now have a full portfolio of services that's differentiated in the marketplace, what parcel and pallet-based services that we have, and we just started to gain share again in Europe.

So, Europe is a significant opportunity for FedEx. It is a high amount of focus for me personally, for all our ex-com. I'm headed there tomorrow to kick off the new year. And it's a significant upside for FedEx. And I think, as you said, we've moved now from integration into value creation mode, and -- the pieces have started to work together.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

And as you think about that, that line of sight to getting that business back to an acceptable rate of return?

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

Yes. I know in DRIVE, we have, specifically called out the year-over-year improvement in FY '25 and -- at just the beginning. And we will go on from there. So, it's -- we have a very, very targeted number, managed very, very carefully every week. And so yes, we're confident that we can get this to a place where we are, I think the upside opportunity for FedEx as well.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. And the Board has now sort of adopted ROIC as a formal benchmark and measurement.

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

Yes, yes.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Like, where do you think the potential is to push that? Yes.

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

Yes. And so --

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

And then as you think about that growth part of it, right? So, what rate of return do you then maybe start thinking about growth as a bigger part of the story versus margin improvement?

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

Well, I think, so there are many aspects of that question. So let me start to peel back down in here a little bit. So yes, we have ROIC now as part of the metrics that we

measure and compensate our teams on. And we already made some remarkable progress in this last, literally in the last two years. And I think one of the things is the fact that the aircraft modernization program is kind of on the tail end. And 10 years ago, versus now, we now have a fleet, one of the youngest fleets in our industry.

And so, the aircraft CapEx is going to come down. And so overall now, when you return to growth and then we have this structural cost reduction, so we have a significant amount of operating income that starts to come in with the lower CapEx, suddenly we have opportunity to really improve the ROIC and then of course free cash flow.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

And the destination for that free cash flow. Should investors be thinking that's a capital return story or is that going to be a redeployment story?

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

Well, at this point, those are the conversations we continuously have in the last -- what was announced in the last, literally in the last two quarters. Of course, it has been primarily in the form of dividend increases and share buybacks. But we'll look forward as we'll see an opportunity to come up and make those calls.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Okay. And as you now are a year or two-ish in the chair, two years in, all right.

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

Two.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Congratulations.

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

Thank you.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

As you think about, kind of what you want your legacy to be now, obviously, taking over from Fred Smith is a challenge. It's hard out, Fred Smith, Fred Smith. What do you want to be known for, kind of coming out of this? And what do you think your key message is to investors around what's going to be different about investing in FedEx from today than maybe it has been in the past?

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

Well, I'll tell you the first thing with Fred. I mean, it's just to build something from nothing and to build from scratch and to build it into this incredible network of statistics that I just read out to you. I mean, that is an incredible feat. I'm a -- I often quote Galileo when I say this, I see far because I'm standing on the shoulder of a giant. I mean, it's just plain and simple. And it's just, what Fred has accomplished and what FedEx has accomplished in 50 years is just starting from scratch and facing a very, very significantly larger and very tough competition.

So, I think now, we have the opportunity to significantly leap forward because of the infrastructure that we have already built. And I think that's -- we have, we've been through two years. I've been -- we have an unusual period of revenue picture for the industry. Historically, FedEx has, our revenue has never actually declined. I mean, even any period of decline, we had significant hits to the profitability, but we have now fundamentally changed that dynamic that we are improving our operating income in a -- even in a decreasing revenue environment. But that's going to change.

So, looking forward, I think, firstly and foremost, I'm very, very proud of the FedEx culture. And that's, I got to say that upfront. And then that, we will, it's something that was unique to FedEx and idiosyncratic to us and very, we're very proud of that, and that we will maintain that culture going forward.

But I think the networks that we now have in place that already establishes gives us a differentiated play in the marketplace. And we will, use that to really make supply chain smarter for everyone. Supply chain smarter for FedEx, make sure our operations are as smooth as we possibly can, supply chain smarter for our customers and supply chain smarter for the end consumer in the e-commerce world. And in this environment, our digital story plays a very important role. We have already built a digital twin of FedEx. And we are integrating very deeply into our customer supply chains, making sure that we are able to provide additional value over and above.

So, at the end of the day, if we look 5, 10 years from now, I think, we will see FedEx as established globally, the full portfolio of services that are differentiated in the marketplace to provide deep supply chain solutions for the company, but while maintaining the overall FedEx culture.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

And do you think about, from an investor standpoint, historically FedEx is maybe viewed as a lot more of a cyclical play, booms and busts. How does that proposition change over the next several years?

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

I think from an investor point of view, I think it's a, FedEx is really at an inflection point right now for many reasons. First, the fact that we are able to generate operating income improvement even in the face of demand issues. That sets us up well for going forward. So that's first.

Second, the capital story that I just talked about, we are in a place where, we are again, inflecting upwards on our ROIC. We have significant upside opportunities that are unique to FedEx. And that's the Network 2.0 that is a unique upside opportunity for FedEx. The idea of the Europe performance we have, that's an upside opportunity for FedEx.

Going after the premium LTL market and international LTL market, I coined that term international LTL just to make it, it's the international premium air freight market using our networks that we have, that's an opportunity for FedEx. And then the cherry on top is a digital platform story that we are starting to engage on. So, I think there's several things that are unique to FedEx. I think we are just at an inflection point as well.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Excellent. Well, we're coming up to the end of our time together.

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

Thank you.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

I want to thank you for coming out and joining us. Thank you all for participation. Obviously, if there's questions for us, you know where to reach us. And thank you, Jeni, for putting us on the calendar.

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

Thank you very much. Hope it was useful.

David Vernon
Analyst, Sanford C. Bernstein & Co. LLC

Absolutely. Thank you.