

FY11 was a year of transition for FedEx.

Coming out of the worst economic contraction since World War II, we increased volumes and yields across all transportation segments. Specifically, we saw more FedEx International Priority shipments at FedEx Express; excellent volume, yield and operating margins at FedEx Ground; and FedEx Freight's return to profitability in the fourth quarter. FedEx Office had record online printing, packing, and shipping transactions. There were great improvements in the customer experience in many areas across the company.

These achievements are due in large measure to your efforts to keep our Purple Promise to our customers and to become more cost-effective given the new economic realities. Thank you for your hard work and great esprit de corps. You are an amazing team.

Now, with the start of FY12, we must be clearly focused on taking our performance to the next level. During the great recession, we made tough decisions to lower expenses, acquire strategic assets, and expand networks to improve our competitiveness in the marketplace. The key to our success now is to break out on the profit side and get back to our earnings levels of FY07. FedEx is a capital-intensive business — particularly FedEx Express — and in the next few years we must improve margins and cash flow to pay for future growth and maintain competitive leadership. What are some ways we can do that?

Our DNA: People-Service-Profit

The first is continued focus on People-Service-Profit. The P-S-P philosophy, on which this company was founded, is more relevant than ever. Each element — People, Service and Profit — is essential for the success of FedEx, and each must be in balance with the others to remain an efficient business model. In fact, the order of the three elements is interchangeable. The P-S-P philosophy is like an unbroken circle or chain. There are no clearly definable points of entry or exit. It's a continuum. Each link upholds the others and is, in turn, supported by them. Our People emphasis produces outstanding Service for customers, which in turn produces the Profit required to fund our future and reward our People, and so it goes — each aspect of P-S-P is integral to the whole. [Go to fromthechairman.com to see the new P-S-P logo.]

We have tried diligently to follow the P-S-P philosophy for almost four decades, and it's still a vibrant reflection of who we are, no matter which operating company, region or work group. I think our recent actions regarding pay and benefit programs as the economy has improved are good examples of that.

But make no mistake: P-S-P is a hard-headed business approach to a very demanding service business that requires a motivated team to deliver the discretionary effort to meet customers' high expectations. We believe it's the right way to run a modern business as well.

To reach our business goals, we must reaffirm and abide by our core P-S-P philosophy. It's as essential to our operations as planes, trucks and fuel. In fact, it's a great competitive advantage for FedEx, and it is key to achieving the breakthrough profits and investments required to ensure future success for the Corporation and its team members.

A tradition: Quality Driven Management

A proven way to boost profits is through continued, relentless pursuit of quality improvement, which has always been a key premise at FedEx. Quality Driven Management (QDM) has helped FedEx team members work smarter and deliver improved customer experiences over many years. It's at the heart of our ability to deliver on the Purple Promise — "I will make every FedEx experience outstanding."

QDM is also essential to designing systems for greater flexibility in the event of disasters, political unrest or isolated work disruptions. In this regard, hats off to the EMEA and AOD teams that migrated, on short notice, many operations to our new Cologne hub to mitigate the effects of a work stoppage at CDG. Thanks for an exceptional effort to serve our customers and protect our wonderful reputation and great brand.

While many assume that high quality means high costs, the great thing about QDM is that it improves efficiency at the same time it lowers costs. So it is one more way to achieve the higher margins we need.

Here are a few examples of how QDM pays off:

- The Learning and Development team at FedEx Office applied QDM principles to improve new-hire training compliance by 23%. The increased yield helped eliminate about \$150,000 in trainer travel costs.
- A Desert District team at FedEx Ground used QDM principles to reduce waste removal and recycling costs by more than \$34,000. They not only saved money but cut waste-dumpster use by half at every facility that recycles.

From the Chairman

JULY/AUGUST 2011

- A part-time employee in the FedEx Express international area of the Memphis hub used QDM to help revamp their process and reduced on-the-belt items needing special handling by 22%, saving time and money.

To reach our goals, we must intensify our QDM efforts. Based on recent interviews and focus groups, the biggest question team members have is, "How can QDM help me in my daily work?"

To these ends, the six QDM principles help us focus on the right things and eliminate non-essential activities.

- **Customers Define Quality:** Strive to understand customer requirements and expectations.
- **Be Scientific:** Base decisions on facts and data, not guesses or opinions.
- **Measure, Measure, Measure:** Measure failures, measure variation.
- **Optimize Business Performance:** Minimize unnecessary effort, time, and cost.
- **Quality Involves Teamwork:** See work as a collaborative process.
- **View Failures as Opportunities:** Seek the truth and end the blame game.

Throughout FY12, we will highlight a single principle every six weeks and suggest ways all of us can practice each aspect of QDM in our daily work.

The year-long focus on QDM principles will culminate in the debut of the QDM Cup. This award will be the highest level of FedEx recognition for exemplary team effort in using QDM principles, methods and tools to improve business performance and customer experience. Three winning teams — gold, silver and bronze — will be selected from among all FY12 Purple Promise Quality Award winners and honored at a special event.

This initiative will help all of us better understand how QDM applies to our jobs and how it can make a difference in the time and costs associated with our work.

A major challenge: healthcare costs

Another area that affects our bottom line is healthcare costs in the U.S. While we can't control many of the circumstances surrounding the healthcare industry, we can make intelligent choices about how to manage them.

FedEx has a long history of providing quality, cost-effective medical benefits to employees and remains committed to that principle. Like most large employers, FedEx medical benefits are self-insured — *meaning no insurance company is paying our bills*. We utilize insurance companies and various medical providers solely to administer our healthcare plans across the country.

FedEx pays the majority of the costs, and employees pay a share through their paycheck contributions and out-of-pocket expenses such as co-payments and deductibles. Right now in the U.S., we provide healthcare benefits for employees and their families — about 405,000 people — at an annual cost of more than \$1 billion. This cost comes directly off our bottom line.

Unlike some countries, the U.S. has no national or state-funded coverage. Medical expenses in the U.S. are rising faster than inflation, about 8% annually, and for FedEx, that translates into an additional \$100 million each year just to cover the cost increase. The best way to shield ourselves and the company from health cost increases is to make wellness a priority.

As you may have seen in the news, U.S. healthcare continues to be reshaped by federal healthcare reform legislation, and the debate is ongoing. Some recent changes include 100% coverage for preventive care, coverage for children to age 26, and elimination of pre-existing condition denials. The legislative climate remains uncertain, and it's clear that companies and their employees must be prepared to respond to change.

FedEx remains committed to providing good healthcare benefits to its employees. You're familiar with changes we made in healthcare carriers in 2010. We will continue to look hard at what we all can do to make smarter choices in such a challenging environment.

Over the coming months, we will discuss how our U.S. employees can focus on a lifestyle of wellness through easy-to-access health and wellness opportunities that deliver the most for everyone's money. Our people remain our greatest asset, and these programs are designed to help us take better care of ourselves. By working together to develop healthy habits and make wise healthcare choices, FedEx can continue the benefits and programs that keep us competitive both within and outside our industry.

To sum up, we have our work cut out for us in FY12

The head winds? The uncertainty of oil prices, an intensely competitive marketplace, and an uneven economic recovery.

The tail winds? Increasing volumes, growing world trade, and a great strategy, fueled by your efforts, which have positioned us to restore adequate profit levels and succeed in the future.

Let's use all the tools at our disposal — P-S-P, the Purple Promise, QDM and smart decision-making — to ensure that we build the muscle we need for an even stronger FedEx.



Frederick W. Smith
Chairman, President and CEO