You've done it again!

Congratulations to all of you for delivering a record peak. Once again, you've proven that, despite an uncertain economy, you know how to serve our customers with dedication and drive. You've reminded the world there's no team like the FedEx team. Thanks for your outstanding efforts to keep our Purple Promise.

Now let's channel that momentum from peak toward achieving success in the new year. Despite all the gloomy news we see about the economy, and the outlook certainly remains challenging, overall growth continues at a moderate pace. In 2012, the global economy is forecast to grow 2.4%, with Europe being a real question mark. We expect U.S. GDP to grow 2.2%, with industrial production growing 3.9% and consumption 2.2%. Business investment and inventory restocking should support job growth, which is needed to turn the housing market around.

Caution ahead

The road ahead is certainly not clear, with several yellow lights flashing on the horizon. The effect of Europe's debt difficulties on the financial system is a major concern. Escalating tensions in the Middle East could put oil supplies at risk and boost prices even higher. Policy uncertainty in a U.S. election year could suppress investment.

These and other factors extended over time take their toll. Nearly every day, we see headlines about companies struggling or failing. The entire transportation industry was saddened by the iconic American Airlines filing for bankruptcy recently — like United, Delta, and US Air before them. Famous companies like Pan Am, Eastern, and Braniff were liquidated long before that. In other industries, such well-known brands as General Motors, Blockbuster, and the Chicago Cubs have also gone bankrupt.

What happened to these once profitable big names? How could they fail after so many years of success? The record is clear: each allowed expenses and obligations to build over a long period, and when marketplace and competitive circumstances changed, they could not reduce expenses to match lower demand for their products or services. In addition, belated attempts to do so almost always resulted in lower quality and customer dissatisfaction and defections — creating a downward spiral in financial performance.

Lower costs, higher efficiency

FedEx is particularly sensitive to business cycles due to our critical role in customers' supply chains. When volumes fell during the Great Recession, however, we were able to flex our cost structure thanks to strategies and processes we designed to deal with such fluctuations.

Longer term, we are working to be even more effective in this regard …

- By acquiring more efficient aircraft and vehicles, which we buy for cash rather than finance or lease. We can do this because of our healthy balance sheet built up over many years of hard work.
- By continuing to use variable pay and incentive compensation programs, particularly among management and professional ranks.
- By creating greater operational efficiencies such as route optimization, using better technology for customer-contact team members, and constantly looking for expense reductions throughout the organization.

In short, our flexible design kept FedEx healthy during the 2008-2009 meltdown. But the challenge isn't a one-time thing. We can't simply hope for a long, robust recovery to ensure our future health. We must run a lean and adaptable organization. How? Through lower costs and higher efficiency.

All businesses face the ongoing pressure of rising costs they cannot directly control. This means a constant focus on lowering overhead and operational costs. The key to whittling costs is Quality Driven Management (QDM) which I've talked about many times before in this letter.

And for good reason. QDM is built on the proven premise that *better quality decreases costs*. Did you know that 10 to 20% of any organization's expenses are due to rework, remediation, and replacement of customers? The reason for this is simple: it's called the 1:10:100 rule among quality experts. A dollar spent performing a task correctly is worth 10 times the cost to fix a mistake after the fact. And poor quality that loses a good customer is 100 times more expensive than meeting expectations in the first place. QDM's methods, which help us get it right the first time, can subtract millions of dollars of costs from our operations.

Here's a great example of how QDM works. Delivery exceptions (when a package can't be delivered on the first attempt) cost FedEx $165 million a year and also frustrate thousands of our customers.

To reduce that cost and create a better customer experience, the Channel Management group brought together team members representing 12 customer touch points.

The Quality Action Team used QDM's ABLE (Assess, Build, Launch, Evaluate) process to map existing procedures, identify root causes of problems, and develop new approaches. The team launched a short-term solution last November. It expands TechConnect's outbound voice notification service into a comprehensive notification service that proactively advises consenting customers by text, email, or call that a forthcoming delivery needs their attention.

When recipients are notified in advance of a delivery, the likelihood of delivering on the first attempt increases by 30%. This solution is projected to save $6.19 million in the next six months alone. Longer term, we'll migrate more solutions to the recipient's control, creating more satisfied, loyal customers and saving even more money.

On the opposite side of the coin, seldom have I been so personally disappointed as when seeing the YouTube piece about a FedEx Express courier throwing a customer's package over a gate. As you know, to keep the Purple Promise, we use QDM constantly to improve every customer experience — as a result, our loss-and-damage rate is very low.

But this single episode, viewed by millions, has tarnished our wonderful reputation built over many years through billions of perfectly handled transactions by hundreds of thousands of dedicated team members. I shudder to think what this incident cost us on a "1:10:100" basis.

This inexcusable episode should serve as a reminder that every package is "the golden package," and we must treat each shipment as the most important one FedEx has ever handled — because it is! But as QDM teaches, use every failure as an opportunity to learn and improve. In this case, it's pretty simple: NEVER THROW OR DROP A PACKAGE — something we emphasize constantly!

In the last issue of From the Chairman, I mentioned the QDM principles campaign, designed to help each of us apply Quality Driven Management techniques to the work we do every day. So far, about 30,000 team members have accessed these QDM campaign materials to learn more about all the tools at their disposal. I encourage you to do the same.

I am also pleased to see the big role our management teams have been playing in integrating QDM principles into our culture through town hall discussions, executive videos, and communications.

Many managers have directly sponsored Quality Action Teams (QATs) that contribute to the successful execution of our strategies. The best of these QATs will receive the Purple Promise Quality Award. In turn, those recipients will vie for the greatest quality honor — the QDM Cup. Next August, together with other senior executives, I look forward to personally awarding the gold, silver, and bronze FY12 QDM Cups to our winners. You'll be able to see it as a video-on-demand on the FedEx intranet.

Companywide efforts

While it's essential that each of us, and our teams, manage costs and improve efficiency, let's look at what we're doing more broadly as a company to shave expenses and sharpen our efficiency game. I'm proud of all the initiatives under way to increase our productivity. To name a few:

- FedEx Express ROADS builds delivery routes based on the day's inbound volume. It results in fewer routes and less driving — lowering fuel and maintenance costs.
- FedEx Ground Project VISION improves vehicle load quality and accuracy by automating packages to the proper vehicle. It also provides more scans for better shipper and recipient information.
- FedEx Freight Project EDEN uses GPS and wireless technology to connect operations equipment to the real-time movement of freight to create better information for the company and its customers.
- The FedEx Office enhanced color management system enables our locations to print color of the highest quality, using substantially less ink.
- The Sales team's iSell uses a global technology platform to enable collaborative selling, easier reporting on smartphones, and hence more time to interface with customers and produce new business for FedEx.

Particularly important is managing input costs. Smart, collaborative purchasing across the enterprise and new, innovative processes are essential. Our recent changes in U.S. healthcare were driven by the need to better align our benefits with needs while controlling cost increases. On a broader scale, lowering fixed costs during the 2008 contraction was necessary to reflect the "new normal" of a U.S. economy with lower growth prospects in the foreseeable future.

Fueling energy change

Of course, the major expense over which we have the least control is fuel — and that will be the case as long as demand is high and sources are limited. While we can't outwit the fuel market, our dynamic fuel charge helps us mitigate this volatility. Longer term, we must improve fuel efficiency through better technology and operating techniques. And we are doing a great deal to meet this challenge. One big push is the modernization of our aircraft and vehicle fleets.

Last month, we announced the acquisition of 27 new Boeing 767-300F aircraft that offer an approximate 30% increase in fuel efficiency and at least a 20% reduction in operating costs over the MD-10s they will replace. In addition, our new 777Fs fly farther on less fuel (and fewer emissions) while carrying more cargo than the MD-11s. Likewise, we are replacing our 727s with 757s, which have 40%-plus lower fuel consumption per pound of revenue payload as well as lower maintenance costs.

That's the picture on our aircraft upgrades, but you may not be as familiar with what we're doing to modernize our vehicle fleets.

This fiscal year FedEx Express added 3,900 Sprinter vans. These vans get over 18 miles per gallon, twice the mileage of the vans they are replacing. In addition, we have new scheduling processes in place to ensure that the most fuel-efficient vehicles are used on the longest routes. The result? Less fuel consumed, lower emissions, and more savings.

Our all-electric vehicle fleet is growing around the world as we seek to be a moving force in this technology. We will have over 100 electric vehicles by the end of this fiscal year. While EVs are still in the developmental phase, they are proving to be reliable and are very impressive with their reduced operating cost — 60 to 70% less than internal-combustion-powered vehicles. As the price of batteries comes down, EVs will be even more affordable. We are also operating more than 365 hybrid pickup-and-delivery vehicles.

As has been widely reported, natural gas is becoming more readily available, and in the U.S. it's generally much cheaper than an equivalent gallon of diesel or gasoline. Also, new natural-gas engines are being introduced. That's why we've begun to test natural-gas-powered vehicles. Right now, the greatest opportunity lies in our heavy-truck fleet, but we may see benefits for a broader range of vehicles in the future.

Beyond aircraft and revenue vehicles, we plan to be more productive with less money in a host of other areas — fuel-cell forklifts, green roofs, solar facilities, jet biofuel research, and more. We are determined to pursue a variety of energy options that can significantly reduce FedEx petroleum consumption per pound transported.

But we have to go beyond our own company and help effect change worldwide. FedEx continues to be a bold voice in national energy policy. To these ends, I serve on the Energy Security Leadership Council (ESLC) which urges U.S. energy independence as a national security issue. The ESLC was instrumental in effecting new fuel- efficiency standards for vehicles in 2007 and for additional standards in the Obama administration. The Electrification Coalition, of which we are also a member, promotes policies and action to encourage widespread use of electric vehicles — particularly in the commercial sector.

FedEx Express President/CEO Dave Bronczek, as former chairman and member of the Board of Governors of the International Air Transport Association, advocated new aviation technologies that improve safety and reduce fuel consumption. FedEx Freight President/CEO Bill Logue represents FedEx on the American Trucking Association Board where he has worked hard to develop new national policies for highway investments and safety enhancements, reduced congestion, and better truck fuel efficiency. Also, we continue collaborating across industries such as utilities, manufacturing, and transportation, as well as government and academia, to expedite and expand the potential of all-electric transportation and biofuel alternatives.

To sum up, we took the hard but necessary steps during the economic downturn to position FedEx for success long term. Though we all hope for an economically stronger 2012, in any case, we must continue to be disciplined in looking for more efficient ways to do our work while simultaneously enhancing the customer experience. We must *constantly* control expenses, become more productive, and improve service levels to avoid the fate of those famous companies that allowed their costs to outrun what their customers were willing to pay. After all, the only way any business can continue to expand and invest for the future is to remain consistently profitable. By remaining financially strong, flexible, and focused on QDM and the Purple Promise, FedEx can meet future challenges. That's the way to shape our own destiny, for the new year and many more to come.

Frederick W. Smith
Chairman, President and CEO