FedEx Corporation

From the Chairman

JULY 2013

To FedEx Team Members

The world economy and our industry continue to change, reminding me of the toy vehicles my grandkids play with that morph into robots. Of course, FedEx is known for turning change into opportunity, for you and our business. I'd like to share some examples of how, with your help, we are transforming our company on several fronts.

Transforming our networks

Take the overall air cargo market for instance. World air cargo traffic has shown consistent growth historically but has slowed significantly in four of the last five years.

Several related economic factors have radically changed this huge market:

- Global GDP has been growing at a slower pace.
- Global trade, which drives air cargo, has traditionally expanded faster than global GDP. But it is now growing slower than global GDP. Europe is in recession; China's economic boom has slowed; and trade/economic policies both here and abroad have impeded economic growth.
- Higher energy prices over the last decade are adding costs to long-distance supply chains.
- The high price of fuel is spurring customers to choose lower-cost, slower-transit services. The result? The demand for lower-yielding Economy services is expanding faster than demand for Priority offerings.

While the cargo market is soft, international passenger traffic is growing. So passenger airlines have retooled their fleets to move more people on bigger, more-efficient planes with lots of cargo space in their underbellies. Thus we're seeing a glut of air cargo capacity, much of it from 777 passenger aircraft belly space.

To put it in perspective, the cargo capacity of one 777 passenger aircraft is roughly the capacity of an entire 757 freighter. This excess capacity lowers prices for the entire air cargo market, but particularly for Economy shipments.

At the same time, many combination carriers and airport-to-airport all-cargo airlines have taken delivery of new 747-8Fs, 777Fs and A330-200Fs, which have exacerbated the capacity glut for the general air cargo market.

As a result of these changes, we've been adjusting our ExpressFreighter networks. As I noted in January, we added nonstop SuperExpressFreighter flights from Taiwan and Milan to give customers in those markets improved service for Priority shipping to North America. Simultaneously, we're reducing the number of flights in the trans-Pacific market because Asia-North America trade has slowed. There are two other significant factors in this major trade lane:

1) There's a significant imbalance in traffic *from* Asia to North America vs. westbound shipping across the Pacific; and

2) Due to the long distances involved, many customers are opting for less expensive, but slower Economy air services.

At the same time, we've begun driving demand for our Priority services and ExpressFreighter schedules by specifically targeting high-growth sectors like healthcare and aerospace.

We'll continue to expand our portfolio of offerings through FedEx Trade Networks (FTN) and FedEx SupplyChain (FSC) to funnel the right products into the right networks. For example, through the expansion of FTN over the past few years, we've been able to capture a much larger share of the price-sensitive international market, putting that traffic on the ocean or in passenger underbellies.

In addition, we're strategically expanding domestic businesses in non-U.S. markets to lower our overall door-to-door costs and offer a broader portfolio of services to our customers. In this vein, we recently announced completion of the first stage of a strategic acquisition of businesses operated by Supaswift (Pty) Ltd. in five African countries—South Africa, Malawi, Mozambique, Swaziland and Zambia, and we continue to look for similar opportunities around the world.

FSC is rolling out specialty services such as managing customers' critical inventory in forward-stocking locations globally, which will generate more Priority shipping.

For a more detailed discussion of changes in both the air and ocean cargo markets, link to my Wings Club speech in my online letter at **fromthechairman.com**.

Transforming the customer experience

As we begin FY14, it's important to take stock of our progress in improving the customer experience—after all, as customers' expectations rise, their tolerance for error drops. The good news for us is that fewer errors mean lower costs. And the best news is that the more often we deliver on our Purple Promise—to make every FedEx experience outstanding—the more loyal our customers become, which history shows creates more business for FedEx.

While we've made steady improvements in the last fiscal year, in FY14 we have to "up our game" using Quality Driven Management (QDM) throughout our operations. But we absolutely *must* continue improvement in four key areas:

- Better custodial control of shipments through improved and more timely shipment and scanning information to both our operations teams and customers (Project TITAN);
- More effective, real-time problem resolution;
- Cutting wrong-day-late (WDL) shipments by half; and
- Reducing losses and damages even further despite industry-leading performance.

Regarding custodial control, we've repeated for more than 30 years: "Information about the package is as important as the package itself." We know from decades of customer feedback that if we can give customers the status of their shipment at any point en route, their satisfaction jumps and more problems can be quickly resolved. Accordingly, our goal is capturing 100% of required scans and thereby knowing where each and every shipment is, instantaneously, upon any inquiry. I'm happy to report that in FY13 both FedEx Ground and FedEx Freight improved the timeliness of scan posting by as much as 35%, and FedEx Express Domestic, FedEx Ground and FedEx Freight also reduced missing scans by double-digit percentages. These improvements help our service reps respond more accurately to customer inquiries about their shipments. Congratulations on the great work, but we need even more progress this fiscal year.

That leads us to problem resolution in general. Customers want us to solve their problems in *one* contact—on the phone or online—quickly and efficiently. Last year we assessed the **main** obstacles for our customers and they were:

1) delivery problems; 2) call-backs; and 3) tracking.

Since then, we've made good progress. FedEx Express streamlined routing of same-day re-attempts, resulting in a 20% improvement. FedEx TechConnect achieved more than 80% compliance on a two-hour call-back goal. Now FedEx Express and FedEx Ground are building processes to dramatically shorten the call- back window and to provide more complete and timely delivery information.

We've declared "War on Wrong-Day-Late" shipments—those delivered one or more days late. Again, improvements in WDLs substantially improve customer satisfaction and loyalty while simultaneously reducing our costs associated with re-attempts and money-back guarantees. Last fiscal year, we challenged the operating companies to cut WDL rates in half by the end of FY15. We've made great headway, but we've got more to do to achieve this goal. We are particularly focused on issues related to bad addresses, businesses closed, and customs clearance. It's hard work to find root causes and solutions because absolute numbers are already low, but we have definitely made improvements so far. In addition to these process improvements, we will have to revise some operations to win our War on WDLs. To these ends, over the next two fiscal years, we must continue to rigorously apply QDM principles throughout FedEx to substantially improve this important metric.

Finally, our focus on loss and damage has yielded excellent results. Between FY09 and FY12, FedEx Express, FedEx Ground and FedEx Freight together saved $60 million by reducing loss and damage claims! We're continuing to focus on proper packaging to prevent damage claims. For example, FedEx Office has new intensive training for team members in package acceptance, any necessary repacking, and offering customers expert packing by FedEx. In two locations, FedEx Office is testing Pack Plus, a dedicated retail packing zone. Team members use specifically designed new packaging to ensure the utmost protection of our customers' shipments regardless of size, shape, or type of shipment.

Transforming U.S. health care management

Just as we must adjust to new economic and industry realities, we're also treading into new territory in the United States regarding employer-provided health care to meet the stringent requirements of the Patient Protection and Affordable Care Act

(PPACA), often called ObamaCare. As I explained last January, all large U.S. companies must modify their plans to remain competitive and comply with the new law.

FedEx has a history of providing high-quality, affordable health care coverage to our employees, who pay a portion of the health care cost and FedEx pays the rest. FedEx is self-insured, which means ***we** pay substantially all the claims, **not** an insurance company*. Health care costs at FedEx are projected to exceed $1.5 billion in 2014 for our employees and their covered, eligible dependents. That number will continue to increase each year. Beginning in 2014, we're changing our health care program to better manage increasing costs and to help you make smarter choices.

Let's look at the PPACA more closely. The act requires most individuals to prove they carry "minimum essential coverage," which may come from employer-sponsored health insurance plans, individually purchased plans, or government-sponsored health insurance programs such as Medicare. Beginning in 2014, failure to prove such coverage will subject an individual to a health care tax that keeps going up each year thereafter.

With the recently announced changes, beginning in 2015, the PPACA requires large employers (those with 50 or more full-time employees) to either offer minimum essential coverage to full-time employees or pay a penalty per employee. While FedEx will not be subject to this per-employee penalty, other provisions of the PPACA will require *FedEx to pay an estimated $56 million in new fees to the federal government through 2016* based on the number of employees and dependents we cover. Also, companies that offer their employees high-value plans that exceed a certain amount will have to pay a tax on these so-called "Cadillac" plans beginning in 2018. (See related story at **fromthechairman.com**.)

This tax, along with other PPACA requirements, is designed to force health care coverage to become more uniform across the nation's population, regardless of the source of the benefits: large employers, small businesses, or the government.

While there are some exceptions to PPACA requirements, all plans must be in full compliance within four years. It's important to understand that one of the main purposes of the PPACA was to collect money from companies or individuals who have medical coverage (or were healthy enough to feel it was unnecessary) to help pay for others who did not have medical insurance either because they could not afford it or could not get it due to existing health problems.

Transforming FedEx health care options

We have already modified some aspects of our plans to meet PPACA requirements. The modifications, along with our high standards of health coverage, are increasing the cost of healthcare at FedEx. To reduce the risk of future punitive taxes on "Cadillac" plans such as ours, beginning next year, FedEx will offer two consumer medical plan options: Consumer Choice and Consumer Premier. Consumer medical plans tend to have higher deductibles than traditional plans and engage employees more actively in controlling their healthcare costs and carefully weighing treatment options. *It is important to note this was another objective of PPACA.*

One key feature of the new options to help offset higher deductibles is a company-funded Health Reimbursement Account (HRA) to assist employees in paying qualifying medical expenses. In addition, and unlike many consumer plans, in-network primary care doctor visits are not subject to the deductible. Employees will only be responsible for a 20% or 30% co-insurance, depending on the option they choose. Prescription coverage will likewise not be subject to the deductible, and preventive care will continue to be covered at no cost to employees for in-network services such as annual physicals, routine shots, and common screenings such as mammograms and colonoscopies. These new plans focus squarely on employee wellness—and we offer many programs to motivate you toward good health—while continuing to pay a large majority of employees' health care expenses. These are structured to help you while putting FedEx in compliance with PPACA standards.

Over the next few months, U.S. team members will receive many communications about these new consumer plan options. I urge you to pay careful attention to the materials you receive from your manager and the online tools we've developed for you. And look for communications that can help you "do the math" and determine which option is best for you and your family.

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While FY13 was a tough year, your hard work gave us some big wins, and we are positioned for solid improvement in the months to come due to our revised strategies and the future benefits of the voluntary buyout program. Improving our financial results won't be easy, but our team connects people and possibilities around the world in unique ways that are highly valued by our customers, and the transformations above which are necessary to keep our future strong and bright are well underway.

Frederick W. Smith
Chairman and CEO