



To FedEx Team Members

Each of us has probably taken familiar ideas and recombined them into something new—that's what it means to be innovative. Gutenberg's printing press was a combination of the wine press and the coin punch. Not long ago, a Chinese industrial

designer combined video games with mass transit to produce a subway strap with screen and buttons for game play en route.

Why is innovation important? Because things are always changing. Old solutions won't work in new circumstances, but recombining existing ideas can. Just look at the many FedEx innovations from our original hub-and-spoke, air-ground Express-delivery model to our recent introduction of FedEx Delivery Manager for all FedEx residential package services.

In this issue, I'll discuss how FedEx continues to lead in industry innovation in three areas:

- Peak season activities;
- Our participation in the rise of e-commerce; and
- Our response to global trade trends.

Recapping peak

Let me extend a heartfelt *thanks to the entire FedEx team—especially those in the U.S.—for executing an excellent peak season with record volumes*. As you'll see below, the rise of e-commerce (and social media) played a much bigger role during the recent holiday season.

As widely reported, UPS had significant service difficulties, particularly in their air system. On Tuesday, December 24, UPS publicly announced that large numbers of shipments would not be delivered on schedule before Christmas—primarily because their air system had been overwhelmed with volume.

While we had some weather disruptions and a few mechanical issues (as is always the case given the enormous scope of our operations), our actual delivery metrics were among the best we've ever recorded. Despite this, some TV and Internet news headlines equated FedEx with UPS problems, though most fully written reports made it clear this was not the case! Such is the world of "Twitter reporting," when facts and context are often

obscured and overwhelmed by pithy one-liners, pop-ups, YouTube videos, and screen crawler headlines.

Like it or not, today's modern media creates unprecedented consumer expectations and risks to our outstanding brand and reputation. And so absolute commitment to our Purple Promise—to make every FedEx experience outstanding—and continuous improvement through Quality Driven Management become even more vital to our success.

There were, as well, several significant marketplace changes this season compared to those past, and we are evaluating all such issues as part of our annual post-peak review process. From that review, we'll adopt QDM continuous improvement plans for the 2014 holiday season.

In the July From the Chairman, I'll report on some of these future initiatives, but let me note a few things regarding peak:

- 1) This year, many e-tailers overwhelmed with orders often issued FedEx and UPS tracking numbers before the shipments were actually tendered to the carriers—sometimes several days in advance. This caused a huge overload of telephone inquiries for our FedEx TechConnect team when customers could not track packages online as there was no possession scan. Our customer service agents handled these unprecedented issues magnificently.
- 2) While our Sales and Solutions group has a disciplined process for peak planning with customers, including limits on peak shipping to avoid service failures, many customers' projections were wildly off the mark. This required quick, unprecedented operations changes by our FedEx Ground and Express units, which were very well executed.
- 3) Our Compete Collectively, Operate Independently strategy demonstrated its inherent flexibility and customer responsiveness vs. that of the competition. Our FedEx Ground system operated at extremely high service levels, assisted in large measure by extra line haul capacity provided by FedEx Freight. There was no interference between the FedEx Ground package system and our FedEx Express network, which is designed so that many extra sort hours at our regional hubs and at the Memphis SuperHub can be added. Team members at all stations and sort

facilities went “above and beyond.” Air Operations’ performance was outstanding as we added scores of extra flights and managed extreme weather events exceptionally well.

- 4) Our IT systems, due to their robust design and great technical sophistication, performed flawlessly, despite enormous increase in demand. Our IT team is simply superb.
- 5) And most important, the unique FedEx culture—based on our Purple Promise—resulted in service levels throughout the enterprise that others cannot match.

Riding the e-commerce wave

This past peak was emblematic of one of the most game-changing trends in recent years—the rise of e-commerce! It’s among the largest driving forces in the world economy today and a real opportunity in an otherwise low-growth environment. In 2013 alone, U.S. e-commerce grew more than 15%, and the double-digit growth rate is expected to continue. The U.S. currently has the largest e-commerce market, and global business-to-consumer e-commerce sales were highest in North America last year. (China e-commerce will likely push the Asia-Pacific region ahead soon.) Looking further out, Forrester Research predicts that worldwide B2C sales will reach \$1.33 trillion in 2017, compared to \$656 billion in 2012. A proof point: U.S. sales in the 2013 five-day period from Thanksgiving through Cyber Monday leapt an impressive 26% year-over-year!

Why is e-commerce exploding around the globe? It’s due to the following:

- The increasing number of online and mobile users and easy-to-use shopping apps;
- The development of more advanced payment and shipping options;
- The expansion of e-tailers’ product lines; and
- An increasing number of major brands opening and heavily promoting “digital storefronts.”

The result: Consumers can now take full advantage of “sit-back shopping” with its convenience, greater selection, and competitive pricing.

Let’s talk about the shipping options. FedEx has always been a major participant and innovator in the e-commerce space. We were the first to launch online tracking and shipping and the first in the industry to launch a dedicated residential delivery service—FedEx Home Delivery, with features of service

particularly focused on the needs of the demanding and hard-to-serve residential market. Beginning a decade ago, FedEx SmartPost gave online retailers an economical option to help reduce costs for lightweight shipments. FedEx SameDay City and FedEx Express Saturday delivery services have added important delivery options for retailers and consumers. Add to that the convenience afforded by our network of more than 1,800 FedEx Office locations and 600 FedEx Express service centers, which can securely hold packages for customers to pick up on their schedule.

More recently, FedEx Delivery Manager enables customers to personalize their delivery experience, even while shipments are en route, by requesting a time, date, or location to suit their needs. And FedEx One Rate, launched late last year, allows users to easily know exactly what shipping costs will be if they use our FedEx Express One Rate boxes—no measuring or weighing.

The power of FedEx e-commerce capabilities is really apparent in the case of eBay, one of the largest online marketplaces in the world. Last year, FedEx was integrated into eBay labels for complete shipping, label printing, and tracking. EBay sellers can now access FedEx Ground, FedEx Express, International, and FedEx SmartPost services and enjoy our reliable, on-time service, and special volume discount rates. With eBay Labels, sellers get a door-to-door view of shipment status with tracking numbers automatically uploaded to My eBay for free.

In view of the tremendous growth of e-commerce, a little over a year ago we established the E-commerce Center of Excellence. It orchestrates all FedEx efforts across operating companies to grow our business in this important market. The Center focuses on several key areas, among them: giving customers more tools and delivery options while minimizing hassles associated with returns by streamlining the process for both customers and e-tailers. We’re actively working on new ideas sure to be game changers for online retailers, so look for more E-commerce Center of Excellence updates in the months ahead. (Yes, we’ve been looking at drones for a while but *no*, it’s not cost-effective now.)

FedEx will continue its e-commerce innovation to create a trouble-free experience for both retailers and shoppers. And we’ll continue to calibrate our operations to funnel the resulting revenue to our bottom line. As Mike Glenn said recently, “We are at the tip of the iceberg in terms of e-commerce potential.” Make no mistake, however, in understanding the inherent

challenges of residential deliveries. The nature of this market makes it very difficult to profitably serve it, and future innovation will be critical to doing so.

Meeting the challenges of a global economy

The success of e-commerce contrasts sharply with the low growth in most of the world economy. Since the end of World War II until very recently, international trade has expanded faster than global GDP. But for the past several years, international trade has *trailed* an already slow-growth world economy. This trend has been worsened by increasing protectionism in many countries. Such policies insulate economies from each other rather than connect them for greater prosperity. A sobering statistic: Last year, the top 20 world economies passed 23% more protectionist measures than in 2009.

But as e-commerce expands, more small and medium businesses increasingly want to trade on an international scale. So some countries are turning their attention to cutting the red tape that restricts the world's flow of goods. There's mounting pushback against the many complex and competing regulations in international shipping. FedEx commends the recent World Trade Organization's multilateral trade agreement (the first in its 19-year history). While not comprehensive, its goal is to make global trade simpler, more transparent and more predictable. The streamlining proposed by this agreement and others under discussion such as the Trans-Pacific Partnership (TPP) and the Trans-Atlantic Trade and Investment Partnership (TTIP) could drive up world GDP by as much as 5% just by simplifying trade regulations.

FedEx continues to offer online shipping tools designed to ease the challenges of international shipping. However, we know that broad synchronization of Customs rules will do the most to jumpstart the world trading engine.

Another major trend: Because the price of fuel remains high, door-to-door air express and ocean cargo segments are growing and taking share from the global airport-to-airport cargo market. Shippers continue to look for ways to gain efficiencies in their supply chains, and FedEx offers a wide range of shipping options to accommodate various needs. We work hard to put customers' shipments in the right FedEx network depending on their service and cost requirements.

In this regard, last summer, we adjusted our international express network by subtracting two Asia-Pacific flights to a total of eight trans-Pacific and seven trans-Atlantic daily frequencies.

Minor adjustments have been made to our networks in other theaters as well. We retired many older planes and are replacing them with more fuel-efficient aircraft. We are building two new state-of-the-art hubs in Osaka (to open in the spring) and Shanghai that are more efficient and in the heart of our Asia-Pacific opportunities. They will allow us to offer competitively superior cut-off and transit times for customers who need our FedEx International Priority service, which constitutes the vast majority of our FedEx Express volume.

At the same time, we're using the fast growing underbelly capacity on passenger widebodies to move some of our lighter FedEx International Economy traffic, as demand for this service is rapidly expanding. One 777 airliner, even after baggage storage, still has unused belly space equivalent to a narrow body freighter. So we're taking advantage of that cost-effective space on passenger flights to augment our unmatched Priority "Purple tail" network. It's clear: Having both Priority and Economy options allows us to increase our Express market share overall.

Simultaneously, we're moving lower-yielding heavier traffic into other networks, primarily through FedEx Trade Networks. With its bulk-freight capabilities around the world, Trade Networks can put shipments in both FedEx and third-party systems for those customers who require lower costs and are willing to settle for longer delivery times. Trade Networks sea transport now has better schedules and enhanced information technology. Lower value goods can be economically moved by Trade Networks in a heavy ocean lane like Shanghai to Los Angeles, and then delivered by FedEx Ground or FedEx Freight to diverse final destinations in North America.

The new year promises to be one of achievement and challenge for FedEx. In a slow-growth economy, we must innovate, differentiate, and execute flawlessly. And thanks to your outstanding efforts during peak, we have the momentum to deliver an excellent 2014. We never take for granted the extra effort it takes to keep the Purple Promise and make every FedEx experience outstanding. *Thank you all* for your dedication to doing so.

We also note that crucial to FedEx success is doing our jobs with complete integrity. If a company cannot be trusted to behave above reproach and deliver on promises, customers will leave. For FedEx team members, acting with integrity means following all laws applicable to our industry and strictly adhering

to our Code of Business Conduct and Ethics. It also means personally exhibiting—*a/ways*—the values of honesty, fairness, reliability, respect, and trustworthiness. If you'd like some inspiration on how to apply these values in your job, check out the story "What Would You Do?" in the online issue. The behaviors of these team members are the essence of integrity and exemplify the Purple Promise.

Finally, our New Year's wish to all of you is happiness and health in your personal life, satisfaction with your work, and the hope for a better future for us all.

Thanks again for making FedEx successful.



Frederick W. Smith
Chairman and CEO