FDX earnings call for the period ending June 30, 2023.

FedEx (FDX -0.29%)
Q1 2024 Earnings Call
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Contents:

Prepared Remarks:

Operator

Good day, and welcome to the FedEx fiscal year 2024 first-quarter earnings call. All participants will be in a listen-only mode. [Operator instructions] After today's presentation, there will be an opportunity to ask questions. [Operator instructions] Please note, this -- this event is being recorded. I would now like to turn the conference over to Mr.

Mickey Foster, vice president of investor relations. Please go ahead, sir.

Mickey Foster -- *Vice President, Investor Relations*

Good afternoon and welcome to FedEx Corporation's first-quarter earnings conference call. The first-quarter earnings release, Form 10-Q, and stat book were on our website at fedex.com. This call and the accompanying slides are being streamed from our website, where the replay and slides will be available for about one year. Joining us on the call today are members of the media. During our question-and-answer session, callers will be limited to one question in order to allow us to accommodate all those who would like to participate.

Certain statements in this conference call, 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 filings with the SEC. Please refer to the investor relations portion of our website at fedex.com for a reconciliation of the non-GAAP financial measures discussed on this call to the most directly comparable GAAP measures. Joining us on the call today are Raj Subramaniam, president and CEO; Brie Carere, executive vice president, chief customer officer; and John Dietrich, executive vice president and CFO. Before I turn the call over to Raj, I wanted to let everyone know that I'm retiring from FedEx at the end of October.

t has been a privilege being a longtime part of the FedEx team. I truly believe that FedEx's best days are ahead, but I will be cheering from the sidelines as I am 67 years old and I want to spend more time with my family. With that, I will now turn it over to Raj for him to share his views on the quarter.

Raj Subramaniam -- *President and Chief Executive Officer*

Thank you, Mickey, and good afternoon. I would like to first congratulate Mickey on his upcoming retirement. He has led our investor relations team for nearly 18 years spanning 70 earnings calls and, after tomorrow, 18 annual meetings. He will be missed by all and especially this audience.

And we thank him for his outstanding service to FedEx over the years. And we also take this opportunity to welcome John Dietrich, our chief financial officer for FedEx. With more than 30 years of experience in the aviation and air cargo industries, John brings a unique blend of financial and operational expertise to our leadership team at a very important time for this company. He's already hit the ground running, and I'm very happy that he has joined FedEx. So, now turning to the quarter. We entered fiscal year '24 with strength and momentum, delivering results ahead of expectations in what remains a dynamic environment.

I'm proud of what the FedEx team has accomplished over the last 12 months. Amid significant demand disruption, we delivered on what we said we would do, driving over $2 billion in year-over-year cost savings in fiscal '23. We are now well advanced in executing on that transmission to be the most efficient, flexible, and intelligent global network. Our first-quarter progress gives me great conviction in our ability to execute going forward. We came into the quarter determined to provide excellent service to our customers despite the industry dynamics.

We achieved that goal while delivering innovative and data-driven solutions that further enhance the customer experience. As a result, we are well positioned as we prepare for the peak season. As you can see in our results on Slide 6, our transformation is enhancing our profitability. Ground was a bright spot with higher revenue year over year driven by higher yields. On top of this growth, Ground drove exceptional operational performance, leading to its most profitable quarter ever on an adjusted basis. As expected, total revenue declined as volumes and yields were pressured at Express and Freight .

We indicated last quarter that Express revenue would be adversely impacted by international export yield pressure, as well as a change in strategy by the US Postal Service which we are addressing through DRIVE as we build a more nimble airline. For the total company, we delivered 200 basis points of adjusted margin improvement as we realized efficiencies across our networks. This performance is a testament to the power of DRIVE and the FedEx team working collaboratively to implement structural cost reductions throughout the enterprise. During the quarter, labor negotiations at our primary competitor and the bankruptcy of Yellow disrupted the market. Our priorities were clear: protect our customers, deliver outstanding service, and focus on high-quality revenue.

We delivered on those priorities, leveraging our flexible network to profitably add volume while maintaining the highest levels of service. While the captured upside as a result of these one-time events, we were highly discerning in terms of the business we accepted in keeping with our goal to drive high-quality revenue. Importantly, we expect to maintain the majority of the volume we added in the quarter. I want to thank our FedEx team for deftly navigating these conditions to execute on our disciplined strategy. Now turning to DRIVE.

We are fundamentally changing the way we work, drivers taking cost out of our network, and we are on track to deliver our targeted $1.8 billion in structural benefits from DRIVE this fiscal year. At Ground, our DRIVE initiatives reduced costs by $130 million this quarter. These savings were primarily driven by lower third-party transportation rates as a result of a newly implemented purchase bid system, as well as optimized rail usage, the continued benefit from reduced Sunday coverage, and the consolidation of source. At Freight, we continue to manage our cost base more effectively. For example, during the quarter, Freight completed the planned closure of 29 terminal locations during August. And at Express, despite headwinds from Asia yields and the US Postal Service, we delivered on our plan.

We're making our global network more efficient primarily through structural flight takedowns and efficiencies at our hubs and source as we rightsize the capacity across the network. In Europe, DRIVE initiatives are on track, and we expect them to gain further traction over the course of the year and into FY '25. Looking ahead, we're excited to leverage John's aviation experience as we continue to transform our air network.
Our DRIVE expectations for this year include the G&A savings we have previously outlined, which we believe will start to ramp in the second half of this fiscal year.

Finally, on Slide 8, I will provide a brief update on our key strategic focus areas as we move into the next phase of our transformation. This includes One FedEx, which is how we are better aligning our organization to enable Network 2.0. We are well underway with plans to simplify our organization. In June 2024, FedEx Express, FedEx Ground, and FedEx Services will consolidate into one company, Federal Express Corporation. The reorganization will reduce and optimize overhead, streamline our go-to-market capabilities, and improve the customer experience.

To date, we have implemented or announced Network 2.0 in several markets including Alaska, Hawaii, and Canada. As each market is different, we're continuously learning and tailoring the network to adapt to the operational characteristics unique to each region while delivering the highest-quality service for our customers. We continue to use both employee couriers and service providers for pickup and delivery operations across the network. As with any significant transformation, these changes are being thoughtfully executed and will take time to complete. The network that FedEx has built over the last 50 years provides us a foundation that is unmatched. This physical network enables us to transport millions of packages a day around the world, generating terabytes of data that contain invaluable insights about the global supply chain.

We are focused on harnessing the power of this rich data to make supply chains smarter for everyone, for our customers, for our customers' customers, and for ourselves. As we move to the next phase of our transformation, I've given the team three specific challenges: to use data to make our network more efficient, make our customer experiences better, and drive new profitable revenue streams through digital. Looking ahead to the rest of FY '24. We remain focused on delivering the highest-quality service and aggressively managing what is within our control. Factoring in better-than-expected first-quarter results, we're increasing the midpoint of our adjusted EPS outlook range.

As we continue to deliver on our commitments, I'm confident we have the right strategy and the right team in place to create significant value. With that, let me turn the call over to Brie.

Brie Carere -- *Executive Vice President, Chief Customer Officer*

Thank you, Raj, and good afternoon, everyone. In the first quarter, we remain focused on revenue quality and being a valued partner to our customers. We did this in an operating environment marked by continued but moderating volume pressure, mixed yield dynamics, and unique developments in the competitive landscape. Let's take each segment in turn.

At FedEx Ground, first-quarter revenue was up 3% year over year driven by a 1% increase in volume and 3% increase in yield. Revenue at FedEx Express was down 9% year over year. Volume remained pressured though total Express volume declines moderated sequentially. International export package volumes were up 3% year over year. Similar to the fourth quarter, parcel volume declines were most pronounced in the United States.

Additionally, U.S. freight pounds were down 27%, continuing the trend we mentioned last quarter tied to the change in strategy by the United States Postal Service. Across the Ground and Express, volumes improved sequentially, aided by the threat of a strike at our primary competitor. We onboarded new customers who valued our service and were committed to a long-term partnership with FedEx. As a result, we added approximately 400,000 in average daily volume by the end of the first quarter, and the team did an excellent job focusing on commercial Ground business acquisition.

At FedEx Freight, revenue was down 16% driven by a 13% decline in volume. We experienced significant improvement in volume in August due to Yellow's closure. Freight benefited from approximately 5,000 incremental average daily shipments at attractive rates as we exited the quarter. As you can see on Slide 11, monthly volumes have improved sequentially with Ground and international export volumes inflecting positively on a year-over-year basis. We expect to continue benefiting from this quarter's market share gains throughout the fiscal year. We anticipate improved year-over-year growth rates, especially late in the fiscal year, albeit within a muted demand environment.

The old trends we shared last quarter persisted, particularly at FedEx Express where we saw reduced fuel and demand surcharges year over year. Product mix shifts, including an increase in e-commerce volume and demand for our international economy service after the May reopening in AMEA, also put pressure on yield growth. At FedEx Ground, we saw better than expected yields as a result of higher weight for package and product mix. At

FedEx Freight, base rates were strong despite lower weights. The revenue per shipment year-over-year decline was due to lower fuel surcharges. Now looking ahead to peak.

We recently announced demand surcharges for the holiday shopping season to stay well positioned relative to market. We also announced a 5.9% general rate increase effective this coming January. This average annual increase, one point below last year's rate, reflects the current cost and market environment, along with the investment we need to serve customers effectively. We had a high capture rate for our GRI in FY '23 and believe this year's increase will ensure that continues.

We continue to find new revenue-quality opportunities. In 2024, we will implement technology changes to increase our capture of package dimensions in several markets outside of the United States. Further, we are updating our dimensional pricing to market practice in Europe, moving from per shipment to a per-piece strategy. Moving to Slide 13. I was very pleased with our service levels around the world.

I'm proud of how our team delivered here in the United States as we added volume late in the quarter. We are also building momentum in Europe. We improved service year over year in the region, and as a result, the Europe team was able to win back market share that we lost due to previous service challenges. There's still work to do, but our service improvements are also leading to better financial performance Europe -- in Europe with much more to come. As Raj stated, we have a vision to make supply chain smarter for everyone, and I have a few examples of how our digital infrastructure is enabling new capabilities for our customers.

We are improving the customer experience through technology with recent investment in Salesforce Data Cloud. We will integrate three customer platforms: customer service, marketing, and sales into one, giving the customer a more informed, efficient, and personalized experience when doing business with FedEx. We are now offering our estimated delivery time window, which provides customers with a four-hour window for their package delivery for 96% of inbound volume globally across 48 countries. This growing capability is nicely complemented by picture proof of delivery or, as we like to say, PPOD, which is expanded across Europe in the first quarter. Now available in 53 markets, PPOD provides shippers with increased confidence in package delivery and helps reduce the volume of customer calls and claims. One FedEx and Network 2.0 will simplify how we do business, which is particularly important for our small and medium customers.

For example, our current customer contracts reflect three independent companies. One FedEx will enable us to change that, making doing business with FedEx and becoming a new customer easier. Network 2.0 will be more efficient for FedEx but also more efficient for our customers. When we integrate a market with one truck in one neighborhood that's not just for deliveries, it also means a streamlined pickup experience, one pickup per day versus two. This is a simple but very impactful change, and customer feedback has been overwhelmingly positive. Small and medium businesses are a high-value growth segment, and we are confident that the improvements underway will further enable share gains.

And lastly, we've expanded My FedEx Rewards beyond the United States into nearly 30 other countries, with nine more European countries to launch later this year. My FedEx Rewards is the only loyalty program in the industry and benefits our customers by providing them with rewards they can invest in back into their business. They can use them to recognize their employees for a job well done or give back to their communities. My FedEx Rewards have been a successful program in the United States, and we've built lasting relationships as we continue to invest in our customers. We are excited about the potential to replicate this success in Europe and around the world. Driving to anticipate customers' needs and provide them with superior service is deeply embedded in our FedEx culture.

I'm proud of how our teams work together to support our current customers, build relationships with new ones, and ensure that FedEx is positioned to succeed during the quarter. Now, I will turn it over to John to discuss the financials in more detail.

John Dietrich -- *Executive Vice President, Chief Financial Officer*

Thank you, Brie, and good afternoon, everyone. I'm really excited to be here. It's been a full sprint these last few weeks as I continue to get up to speed with this great company. As some of you may know, I've done business with FedEx throughout my career.

Through that experience, I've always admired how FedEx literally created a new industry and has built a differentiated network that serves customers all over the world. I've also admired its great culture that has thrived through the people-service-profit, or PSP, philosophy. After only being here a few short weeks, I've seen the incredible opportunity we have before us. Not only will we continue to provide our customers with the best service and product offerings, but our plans to bring our businesses together through One FedEx and execute on DRIVE and Network 2.0 initiatives will be truly transformative. These initiatives will leverage and optimize everything that the talented teams across FedEx have built over the last 50 years. It will make us smarter; it will make us more efficient; and it will enable us to serve our customers better.

Before getting into the numbers, I want to share a brief overview of the priorities that will guide me and the finance organization as we move forward. First and foremost, I'm committed to setting stringent financial goals that reflect the significant opportunity we have to improve margins and returns. This will be enabled by the DRIVE initiatives and the integration of Network 2.0 as we move toward One FedEx. I've been really impressed by the tremendous amount of work already completed on DRIVE from the initiatives in place, the accountability embedded in the program, and the team's steadfast focus on execution. In terms of our capital priorities, I'll focus on maintaining a healthy balance sheet, returning cash to shareholders, and reinvesting in the business with a focus on the highest returns. Our finance organization will partner closely with Raj and the leadership team to ensure we deliver consistent progress toward these priorities with the goal of delivering significant value for our employees, partners, customers, and shareholders in the years to come. Finally, a guiding principle for me will be to have open and transparent communication with all key stakeholders, including all of you in the financial community.

I already know some of you from my prior roles. I look forward to continuing to work together and engaging with the rest of you in the weeks and months ahead. Now taking a closer look at our results. Our fiscal year 2024 is off to an outstanding start as demonstrated by the strong operational execution in the first quarter. At FedEx Ground, DRIVE initiatives are taking hold, and we delivered the most profitable quarter in our history for that segment on an adjusted basis. Adjusted operating income at Ground was up 61%, and adjusted operating margin expanded 480 basis points to 13.3%.

These strong results were driven by yield improvement and cost reductions, including lower line haul expense and improved first and last-mile productivity. As a result, cost per package was down more than 2%. At FedEx Express, the business was able to improve operating income despite a decline in revenue. This further demonstrates that DRIVE is working. Adjusted operating income at Express was up 14%, and adjusted operating margin expanded 40 basis points to 2.1%.

Cost reductions and transformation efforts at FedEx Express included structural flight reductions, alignment of staffing with volume levels, parking aircraft, and shifting to one delivery wave per day in the U.S., all of which more than offset the impact of lower revenue. It's important to note that expanding operating margins and reducing costs at Express will be a key focus for me and the team. At FedEx Freight, the team diligently managed costs and revenue quality amid a dynamic volume environment. Operating margin declined 290 basis points based on lower fuel surcharges and shipments but remained strong at 21%. Now turning to our fiscal year outlook on Slide 17.

As we've been discussing, we're beginning to see the benefits of our DRIVE initiatives and our focus on improved revenue quality. Based on our solid first-quarter performance and our view of the rest of the year, we're raising the low end of our full-year adjusted earnings per share outlook by $0.50. We're now expecting adjusted EPS in the range of $17 to $18.50. We're confident we can deliver on this higher earnings outlook despite the constrained demand environment. We're now assuming revenue to be relatively flat at the midpoint of our fiscal year 2024 adjusted EPS outlook range. Of course, an improvement in demand would translate into greater operating leverage and earnings upside, supporting the high end of our range.

We'll be closely monitoring the demand environment going forward, including economic activity in North America, Europe, and Trans-Pacific trade. We'll also be keeping a close watch on other key factors that impact the demand environment, including inventory restocking, inflation, and e-commerce trends. Turning to Slide 18. And consistent with last quarter, we want to share how we're thinking about the operating profit considerations embedded in our full-year outlook. For illustration purposes, we used adjusted operating profit of $6.3 billion, which is the equivalent of the adjusted EPS midpoint of $17.75.

Within this outlook, we're highlighting a few key assumptions. Revenue, net of cost increases, is now expected to be up $500 million due to improved revenue quality and flow-through at Ground. We continue to expect approximately $800 million of international export yield pressure as demand surcharges significantly diminish and service mix continues shifting toward deferred offerings. As a result of our strong first-quarter performance, we're also planning for a $600 million increase in variable compensation. These headwinds are more than offset by the $1.8 billion in structural cost savings from our DRIVE initiatives, which we shared with you last quarter and are on track to achieve. Moving on to Slide 19.

We remain steadfast in our commitment to prudent capital allocation and shareholder returns. Our liquidity position remained strong, and we ended the quarter with $7.1 billion in cash. Capital expenditures for the quarter were $1.3 billion, and we continue to expect to achieve our target of less than 6.5% capex to revenue for the year. Our capital expenditures at Ground will decline as we reduce capacity investment. And we're planning for lower annual aircraft capex over time, which we expect to be approximately $1 billion in fiscal year '26.

As we've previously communicated, we're standing behind our commitment to capital discipline by tying executive compensation to ROIC. Given improved earnings, we're generating significant and improved cash flow. This is supporting our ability to enhance shareholder returns, demonstrated by the completion of our $500 million accelerated share repurchase program in the quarter. Looking ahead, we expect to repurchase an additional $1.5 billion in common stock this fiscal year while we're also paying our dividend. With that, let's open it up for questions.

Questions & Answers:

Operator

Thank you. We will now begin the question-and-answer session. [Operator instructions] We will pause momentarily to assemble our roster. Thank you.

And the first question will come from Jon Chappell with Evercore ISI. Please go ahead.

Jon Chappell -- *Evercore ISI* -- *Analyst*

Thank you. Good afternoon. Brie, if I can ask you a question, you've had a major competitor that's really been very disciplined on price over the last few years. But now, after some of the disruptions that you mentioned in your prepared remarks, it seems like they may be more aggressive on price to win back volume. How does that change the way you think about strategy, both as it relates to share and pricing, not just for this year but kind of for the two- to three-year time period?

Brie Carere -- *Executive Vice President, Chief Customer Officer*

Hi, John, and thanks for the question. So, a couple of things that I would like to comment on. I think the first and foremost is the pricing market has been very rational for the last several years. I think it's also important to remember that we are the price leader in every market segment in the domestic market.

We actually lead on price, and that's because we have the better value proposition. We've got seven days a week; we've got picture POD; and we've got the faster network. So, as I think about responding to the current competitive pressure, my job is to make it very difficult for our primary competitor to win back that share. The team has done an outstanding job of onboarding the business that we won in the last quarter, and we had some time to prepare for it. So, the executive team has been out. We've met with a lot of these new customers.

They're happy service is good, and that's really what I'm focused on right now is delivering just awesome service. And so, they want to stay with FedEx because we're the better provider.

Jon Chappell -- *Evercore ISI* -- *Analyst*

Thanks, Brie.

Operator

The next question will come from Jack Atkins with Stephens. Please go ahead.

Jack Atkins -- *Stephens, Inc.* -- *Analyst*

OK, great, thank you. And first, John, congrats to you on -- on your new role with FedEx. And, Mickey, congratulations on your -- on your great career. So, I guess I would like to maybe dig into the -- the revenue guidance for a moment in terms of what's -- what's changing there.

It feels like the macro assumptions are perhaps a bit weaker, but we have some competitive dynamics both in Freight and -- and at Ground that are helping. Could you maybe kind of help us understand a little bit, Brie, in terms of what's changing to your macro outlook? And, you know, it seems like you're a bit more conservative there.

Brie Carere -- *Executive Vice President, Chief Customer Officer*

Yeah, absolutely. Fair question. So, as I just mentioned, we really did feel good about how we executed within the quarter, but the macro did not help. As we're thinking about the domestic market specifically from a parcel perspective, if you look at calendar year '23, total volume for the whole year -- year will be down about 0.5% for the total year. That's a little bit lower than we anticipated the full year.

So, we have adjusted. Like I said, the market's not helping. So, we really have to work hard to kind of -- to grow the yield, and the team is doing a great job. When we get to international, again, the team executed.

They took share in Europe. But when I look at the macro, a couple of things. You know, trade is growing at, you know, 1.7. That's down versus 2.2 the previous year. As we look at inventories, they're in a pretty good place in that, from a retailer's perspective, I think the retailers have done a good job.

They're not carrying a lot of extra in this -- a lot of extra inventory; wholesalers are. But the net takeaway is that inventory restocking is not going to help us. And then, if you look at capacity, from a tax perspective, trans-Atlantic tax capacity is back. And while it's not that coming out of Asia, total capacity is back to pre-COVID levels. So, we don't see inventories helping, we don't see trade giving us a huge boost, and so, we're going to work really hard to execute.

That being said, I think it's really important to note that this revised sort of demand outlook is already reflected in the range. And so, despite the fact that the macro is a little bit softer, we raised the midpoint, so really good.

Raj Subramaniam -- *President and Chief Executive Officer*

Yeah, Jack, let me just add on to the last point that Brie has mentioned. That's really important as we -- you know, even despite the fact that we had lower revenue expectations, we actually raised the bottom line. This is a sign of our DRIVE execution working. Last time on the call, I gave you all a simple formula of one, two, three, you know, 1% revenue growth at the bottom of the range and 3% to the top of the range. Well, I can now say it's minus one zero one, it's not quite as catchy as one, two, three, but in fact, it's a better performance.

Thank you for the question, Jack.

Jack Atkins -- *Stephens, Inc.* -- *Analyst*

Thank you.

Operator

The next question will come from Tom Wadewitz with UBS. Please go ahead.

Tom Wadewitz -- *UBS* -- *Analyst*

Yeah, good afternoon. And, you know, congratulations on the good results, particularly at Ground a very -- you know, very impressive margin performance. I wanted to ask you about how we think about that Ground margin going forward and what happens if the volume side is a little bit softer. So, I think, you know, we would think that some volume probably came over from diversion maybe from UPS.

You know, kind of how much was that a factor in driving this Ground margin performance? And if you lose a little momentum on volume, should we still expect a lot of momentum on that Ground margin? Thank you.

John Dietrich -- *Executive Vice President, Chief Financial Officer*

Yeah. Hi, Tom, this is John. Thanks for that question. Yeah, look, we've demonstrated substantial improvement in year-over-year margins in Q1, and we anticipate continued improvement in Q2 on a year-over-year basis.

Also, we're focusing on revenue quality, which resulted in solid yields in Q1, you know, up 6% year over year, excluding fuel surcharges, you know, which also helped boost margins. I think the team's doing a great job identifying those opportunities with the best revenue quality and will continue to do so. And as Brie mentioned, you know, we got this business we want to keep. So, thanks for the question.

Operator

The next question will come from Jordan Alliger with -- with Goldman Sachs. Please go ahead.

Jordan Alliger -- *Goldman Sachs -- Analyst*

Yeah. Hi, thanks. Just curious, can you talk a little bit more about DRIVE? You sort of talked about some of the things that you've worked on this quarter, but can you maybe tease up what -- what we could expect the upcoming quarters or two, whether it be, you know, cost savings -- either cost savings expected in the second quarter and maybe some of the targeted areas, you know, in Ground and Express from here, what we could look forward to? Thanks.

Raj Subramaniam -- *President and Chief Executive Officer*

Well, thank you, Jordan. Let me start off and then I will turn it to John for additional color here. I'm just delighted with the way we are executing against DRIVE. You know, it's not any one thing, and it's a series of initiatives.

It's changing the way we are working inside this company with a lot of rigor, a lot of accountability, and a lot of measurement. In fact, last week, we had an internal DRIVE meeting with all the stakeholders. I have not seen much energetic conversation and -- and with the real numbers. So, that's one of the -- you know, if you look at the first quarter, one of the -- obviously, we got some benefit from the competitive activity, but the bigger issue is really the execution of DRIVE, which we expect to continue to perform as we go forward. The momentum that we have in the first quarter gives me a lot of confidence. So, let me give it to John to give some more color on that.

John Dietrich -- *Executive Vice President, Chief Financial Officer*

Yeah, thanks, Raj. And I echo everything that you said. And as I said in my remarks, one of the things I'm most impressed with is the rigor around this program and the accountability and the project plans. It's really extraordinary to see that come together, such that we're really confident in our reaching our goal of the 1.8 for the year. And to Raj's point, it's coming from everywhere in the organization.

One of the examples we used was the example of Ground. I think it was 130 million, we referenced. The reason I referenced that, not only because of the significant savings, because it also adopted some technology tools which helped us in our bidding system, which allowed us to capture more revenue and a more efficient-basis bidding system. So, it's a combination of everything: operational execution, leveraging technology, and going after the market. So, thank you.

Operator

The next question will come from Scott Group with Wolfe Research. Please go ahead.

Scott Group -- *Wolfe Research -- Analyst*

Hey, thanks. Afternoon. I'm in a car. Hopefully, you can hear me OK.

John, any color on how much of the billion aid of DRIVE you've gotten so far? And then, I know you said Ground margins would continue to improve year over year in Q2. Any thoughts on sequential margins at Ground and just across the rest of the business for Q2? Thank you.

John Dietrich -- *Executive Vice President, Chief Financial Officer*

Yeah, thanks, Scott, and good to talk to you again. Yeah, with regard to DRIVE, we're about 1.8, We expect it to be reasonably spread out fairly evenly through the year. We had an exceptional Q1. We're expecting that to continue to ratchet up in Q2, maybe a slightly heavily loaded in the back half of the year as some of these programs get their traction and start to show the results through the year.

So, again, I won't -- I'm not going to sit here and say there's any dramatic changes for any one quarter. It's fairly evenly spread.

Operator

The next question will come from Chris Wetherbee with Citigroup. Please go ahead.

Chris Wetherbee -- *Citi -- Analyst*

Hey, thanks. Good afternoon. Hey, John, just to follow up on that, I guess can you outline what the savings was realized from DRIVE in the other segments, from Express that you outlined, the Ground, the 130 there? That would be helpful. And I just -- just wanted to sort of think about the guidance a little bit bigger picture. So, sounds like you want to hold on to -- or expect to hold on to a big piece of the 400,000 packages per day that you captured from a competitive standpoint.

But can you -- can you walk us through the puts and takes of the guidance of what you're adding in and Yellow and maybe UPS into that, and then maybe some of the macro there to help kind of bridge from where you were before to kind of moving that midpoint up a little bit?

John Dietrich -- *Executive Vice President, Chief Financial Officer*

Sure. With regard to DRIVE, first, it really is coming from every aspect of the organization. We highlighted Ground. But for some of the flight restructurings, for example, I think Express is doing a nice job there as well, taking down aircraft as well as revise the flights -- flight schedules.

And that will be a continued focus for me. I'm not going to be listing by group exactly where specifically on the savings. But in the aggregate, what I will say is we're committed to achieving and will achieve that 1.8 for the year. With regard to the guidance, look, we took a thoughtful approach on guidance.

It was a strong quarter. We recognized that, and we're delighted to have been able to raise our guidance for the full year. Not only does that reflect strong execution for the quarter but really a focus on those things that we can control amid a soft market. Things are playing out largely as we expected, and, you know, there are going to be puts and takes. Yes, we enjoyed some upside from UPS and Yellow, but as Brie mentioned, it was a soft market.

There were some offsets there and yield pressure in the soft market. Also embedded in our outlook is $600 million in incremental variable compensation through the balance of the year. That's $100 million more than our prior estimate. But at the end of the day, we're really pleased to have increased the lower end of the range even when we're seeing this uncertainty, and we will keep you posted as the year progresses.

Operator

The next question will come from Brian Ossenbeck with J.P. Morgan. Please go ahead.

Brian Ossenbeck -- *JPMorgan Chase and Company -- Analyst*

Hey, thanks, good evening. I just wanted to ask about another angle of the Teamsters contract negotiation. Obviously, we've seen a lot of these union contracts get reset higher. This one reset the bar for comp benefits and logistics, and I think it came in even higher than UPS expected.

So, do you think there's a catch-up across the board from a cost perspective as you look across your various segments as they now deal with what was reset and the reality in the market? Thanks.

Raj Subramaniam -- *President and Chief Executive Officer*

Yeah, thank you, Brian. The -- as you all know, I mean, recall that, in FY '22, we increased compensation annually by about $1 billion. I mean, we are dealing with market conditions in real time, and, you know, we knew that our competition would see a step-change, which is exactly what happened. And also, you know, we have two pickup and delivery models in the market. And while we have taken a majority of the increase, we will continue to invest in our people.

That's -- that's a given, and our outlook reflects that. In fact, coming up in October, we have our annual merit increases, which are a regular and important component of our overall compensation structure. It's also important to remember that beyond compensation, working at FedEx offers team members a great overall value proposition, a collaborative culture, and offers great career opportunities, among other things. So, it's very important for all of us -- issue for all of us, and we're staying right on top of it. And we appreciate your question.

Thank you.

Operator

The next question will come from Allison Poliniak with Wells Fargo. Please go ahead.

Allison Poliniak -- *Wells Fargo Securities -- Analyst*

Hi, good evening. Raj, you mentioned peak season -- the upcoming peak season in your opening remarks. Just given sort of the dynamic environment, your approach to disciplined, you know, revenue quality, and such, has your approach to this peak season changed at all? Just any colors there?

Raj Subramaniam -- *President and Chief Executive Officer*

Well, thank you for the question, Allison. The peak season, I would say, is that, you know, there's really no difference in our approach other than to say our service is really strong. There's not -- we expect normal seasonality versus the volumes we are seeing today and probably year-over-year comparable to where we were last year. And the networks are running very well, and the team is ready to support our customers during this most important season. And, Brie, I don't know if you want to add any more to it other than what I just said.

Brie Carere -- *Executive Vice President, Chief Customer Officer*

No, Raj, I think you covered it. We feel good about peak. And from a pricing strategy perspective, we're committed to our strategy which does include peak surcharges. We think that's really important.

We need to invest in the network. This is a really important time of year for us, but it's also a really important time for our customers. And so, having that surcharge there allows us to flex the network, deliver great service, and then we'll wind it down in January. But we -- we see no major change in strategy.

Allison Poliniak -- *Wells Fargo Securities -- Analyst*

Thank you.

Operator

The next question will come from Ken Hoexter with Bank of America. Please go ahead.

Ken Hoexter -- *Bank of America Merrill Lynch -- Analyst*

Hey, great. Good evening. Mickey, best of luck in retirement. It's been a great 18-year run.

And, John, welcome. Look forward to working with you. Just overall, great job in results and particularly at Ground. But at 2% margins at Express, any reason we're not seeing maybe more leverage at Express given the moves you've made with parked aircraft and the structural changes you talked about? Maybe -- maybe walk through some of the timing on the gains at Express in particular.

And then, I guess to wrap it up, like, given the beat of $0.80 in the quarter versus the Street, yet you're raising the bottom target by $0.50, is that, you know -- are there softening gains the rest of the year on -- on some of the margins? I know you talked about the 600 million in costs, but you would -- prior talked about 500 million. So, I'm just wondering if there's maybe some slimmer margins that you're looking at in other areas. Thanks.

Raj Subramaniam -- *President and Chief Executive Officer*

Well, again, let me start off and John can add to what I say here. I think it's important to remember, for Express, some of the key headwinds that we're facing in this quarter. Firstly, the demand surcharges declined substantially year over year. We also opened up international economy, and the reopening of international economy, you know, resulted in yields decline. As you mentioned, and we talked earlier that the volumes from USPS also declined as part of their strategy, that's number three.

And then, at the same time, we also have market-driven headwinds from fuel prices. So, net net all that, it was a revenue decline of $1.1 billion. In addition to that, the variable compensation increase for Express was also there. Despite all that, we increased our earnings and improved profit, and this is actually DRIVE working.

And as we start to lap these headwinds and the DRIVE progress will become even more visible in the numbers, and again, we think there's a tremendous opportunity. And the teams are working hard to capture that. I'll just make a quick comment on the forecast, and then I'll turn it over to John. You know, the demand environment remains uncertain, and we're being prudent in our financial projections given the environment. And once again, our ability to drive better results even in a lower-demand environment is what's really encouraging to me now. The environment changes, and we are more positive.

Obviously, there's significant leverage on that. So, John, if you want to add anything to it?

John Dietrich -- *Executive Vice President, Chief Financial Officer*

No, Raj, I think you've really captured all the significant headwinds that Express face, yet they were able to turn a profit and a year-over-year improvement is exceptional. But that said, we're going to be focusing on those margins. We're going to be focusing on continuous improvement. We're going to be focusing on the DRIVE initiatives to -- to keep improving those margins. And on the guidance, yeah, I think, Raj, you covered it.

Thank you.

Operator

The next question will come from Amit Mehrotra with Deutsche Bank. Please go ahead.

Amit Mehrotra -- *Deutsche Bank -- Analyst*

Thanks, operator. Hi, everyone. Congrats on the quarter. John, I guess I'm wondering, on the Ground performance, obviously, it's incredibly strong.

Just wondering if you would -- is there anything to ring-fence there that you would consider kind of one-time due to the volume diversion opportunity? I'm just looking at that plus four in August and wondering, you know, is there any cadence shift throughout the month and some of that volume went back. And I guess just clarifying on Express, I think it sounds like there was $150 million step-up sequentially in Express related to the incentive comp. Can you just confirm that -- I can get it from the Q, but I was just wondering that maybe that may explain why the decremental sequentially were so high, and I guess that moderates as we go on because that's now in the cost structure. If you can just clarify that.

John Dietrich -- *Executive Vice President, Chief Financial Officer*

You know, I think what I said was $100 million. It's incremental to our last report from -- from the last time we reported on it. So, that's that piece of it. With regard to Ground, look, as I mentioned just a short while ago, we think the improvement is going to continue on a year-over-year basis.

In terms of ring-fencing anything, as we talked about, we're going to be looking to keep that incremental business. And in fact, have terms that require -- we're very discerning on the customers we took on and have agreements in place with those customers. And on the Freight side as well with Yellow, you know, that capacity, at least for now, has come out of the market, and Freight is going to be taking advantage of -- of those additional volumes. But I mean, just getting back to Ground for a moment, we're expecting continued year-over-year improvement and no -- no ring-fence to identify. With regard to Express, the -- we're going to be focusing on the margin expansion.

I'm not exactly sure on, you know, your question from a perspective otherwise, but we're going to be focused on that margin expansion continue to grow and leverage the opportunities we have at Express.

Operator

The next question will come from Bascome Majors with Susquehanna. Please go ahead.

Bascome Majors -- *Susquehanna International Group* -- *Analyst*

This spring, your primary competitor talked about potentially launching some dynamic pricing products in the parcel space, which we haven't seen a lot of from the larger carriers before. Can you talk a little bit about where and if FedEx uses dynamic pricing in its U.S. domestic products at this point? And, you know, has that evolved in the competitive landscape as a tool for -- for market share and network efficiencies? Thank you.

Brie Carere -- *Executive Vice President, Chief Customer Officer*

Sure. Great question. We're actually really pleased with the progress that we're making. You know, our pricing team, along with data works, are building a great platform to be able to dynamic -- to price more dynamically.

Where we are currently using this capability now is we have made our peak surcharges around the world more dynamic. We have a great spot pricing capability that we're using in our airfreight products that we are using to kind of match, you know, capacity to -- you know, to the market, as well as we're starting to use that domestically in some backhaul lanes. We've got a long road map of things that we're going to bring to market that we're very excited about to drive revenue quality. But I have to admit, I really don't want to share much more than what's already visible in the market because I certainly don't want to provide any competitive intelligence that I don't need to.

Operator

The next question will come from David Vernon with Bernstein. Please go ahead.

Dave Vernon -- *AllianceBernstein* -- *Analyst*

Hey, good evening, and thanks for making the time. Mickey, congratulations. John, welcome to the -- welcome to the circus. Quick question for you on the cost per piece in the Ground segment, you know, the 10.30 sort of sequentially, you know, a big surprise.

How should we feel about that number in absolute terms as we look at the rest of the year? Should we be kind of running at that -- at that 10.45, 10.35 range? Are there additional things that are going to be popping in and out of that on a cost-per-piece basis? I'm just trying to get a sense for kind of where we should be expecting the cost structure for the full year. And if you could talk a little bit more about the drivers in this quarter. You mentioned line haul. I'm just wondering if you renegotiated a bunch of line haul rates in a down truck market, that kind of thing, which is -- which should be sticky for the rest of the year.

Thank you.

John Dietrich -- *Executive Vice President, Chief Financial Officer*

So, I'll take that in reverse order. On the measures we're taking, yeah, it's across the board with DRIVE, line haul, and all the things we mentioned in our prepared remarks. And with regard to the rate environment, we're expecting it to remain consistent. So, that's factored into our forecast, and we will continue to update as time goes on.

You know, again, line haul, dock productivity, higher wage, and settlement rates that we're focused on, as Raj touched on, and just across the board focused on productivity. And that's true at Ground, and that's going to be true at Express and with Freight as well. And I mentioned first and last mile in my -- in my remarks.

Operator

The next question will come from Brandon Oglenski with Barclays. Please go ahead.

Eric Morgan -- *Barclays -- Analyst*

Hi, good evening. This is Eric Morgan on for Brandon. Thanks for taking my question. And congrats to Mickey and welcome to John.

I wanted to ask on Network 2.0. As Raj mentioned, you're continually learning and tailoring the network as you go through this process. So, can you give us some color on what has gone right and wrong so far with co-locating the Express and Ground terminals and on the employee service provider decisions? I know it's market by market, but maybe could you give us some insight into what variables you're considering when making those decisions? Just trying to better understand the strategy there and how confident you are in execution.

Raj Subramaniam -- *President and Chief Executive Officer*

Well, thank you for the question. Things are going quite well as we feel we are on track to complete our network [Inaudible] by our commitment of fiscal year '27. As you know, we have announced and/or implemented optimization changes in Alaska, Hawaii, Canada, as well as several other locations in the Lower 48. And we are definitely learning a lot in this process.

I mean, you know, we have technology, we have facilities, we have people. And, you know, our principle is pretty straightforward. You know, it's going to be data-driven, and it's going to follow the PSP philosophy. And -- and again, it's important to note that we will continue to use both the courier and the service provider model for pickup and delivery operations tailored to the characteristics of each market.

So, so far, so good. And, you know, again, we're, you know, putting all this in place as we move forward. And post-peak, we'll announce the next wave of rollout of -- network rollout.

Operator

The next question will come from Helane Becker with TD Cowen. Please go ahead.

Helane Becker -- *TD Cowen -- Analyst*

Oh, thanks very much, operator. Mickey, congratulations. John, welcome on board. And thanks for the time, team.

So, my -- my number one question is, the UAW is doing these targeted strikes, and I know automotive and automotive parts was a big part of your vertical -- one of your big verticals. I'm kind of wondering how you're thinking about that, the impact in the current quarter, or how you're thinking about mitigating any impact, and -- and so on, if you can -- if you can help out there. Thanks.

Brie Carere -- *Executive Vice President, Chief Customer Officer*

Hi, Helane. Yes, it's a fair question. We do have a healthy business in automotive here in the United States and around the world, but we're also highly diversified. We have looked at the -- you know, our initial numbers, and we have accounted for in our current demand forecast for some fluctuations in automotive.

We do anticipate that there will be, you know, in certain locations, some rolling strikes, and so we have accounted for that within the current demand outlook. Right now, we believe that both FedEx and the entire economy would benefit obviously from a fast resolution, but we've accounted for it.

Operator

The next question will come from Bruce Chan with Stifel. Please go ahead.

J. Bruce Chan -- *Stifel Financial Corp. -- Analyst*

Hey, good evening, everyone. Mickey, John, congrats to you both. If I could maybe go back to something that you talked about, Brie, FedEx having a superior value prop with regard to service and speed, does Network 2.0 make FedEx even faster? And if so, do you think that opens more yield capture opportunity that maybe goes beyond some of the guidance that you've given around the initiative?

Brie Carere -- *Executive Vice President, Chief Customer Officer*

So, from a Network 2.0 perspective, I'm actually really excited about this from a FedEx service perspective. You know, the piece that I mentioned in my opening remarks is pickup, and I just wouldn't underestimate this. We have long known that this was an opportunity. And, you know, when Raj talked about some of the early learnings in the U.S.

market, we knew it was an opportunity. But the enthusiasm from customers on how much easier it is to manage as we collapse and make the -- not just the pickup experience, the physical pickup one, but we also will rationalize our pricing there. And we will automate pickups in a more streamlined fashion, so it's a better customer experience. To date, we do not -- we have not yet found opportunities to speed up the network from a Network 2.0 perspective.

But we continue to iterate. What we have found is that's a lot easier to respond and adapt in the network as we bring them together. And so, that has also been something that customers have asked for, especially in the B2B space and healthcare. So, we are learning a lot, but the net takeaway is customers are actually very supportive and excited about Network 2.0.

Operator

The next question will come from Ravi Shanker with Morgan Stanley. Please go ahead.

Ravi Shanker -- *Morgan Stanley -- Analyst*

Thanks, everyone. And, Mickey, good luck, and thanks for the help over the years. Brie, just one quick follow-up for you. You said that pricing traction was good so far, and you're converting a pretty decent amount of the base rate increase.

What percentage of that -- I think, historically has been, like, closer to 50%. Kind of what rate are you converting right now? And also, you said that the pricing environment remains pretty rational, but you saw the US Post Office basically say they're not going to have any pricing surcharges. And the USPS -- the UPS changes were noted on the call. I think Amazon is launching some competitive service as well.

Do you think 2024 could be a tougher environment, pricing-wise, across the industry?

Brie Carere -- *Executive Vice President, Chief Customer Officer*

OK, that was a lot, but I think -- I think I got it. Raj, jump in here if I don't get it all. So, from a GRI perspective, if we go back to last January, the answer is the vast majority of our customers pay the full GRI. That is excluding the large customers where we've already pre-negotiated.

But the customers that are on our service guide terms, we get a very high capture rate. And so, we anticipate that we will see the same thing this -- this coming January. From a peak surcharge perspective, I think it's really important to understand that we structure our peak surcharge to really target volume that will surge and drive the network to flex. So, the vast majority of our customers actually do not pay a peak surcharge because their volume just doesn't flex up enough to qualify for the peak surcharge.

And so, when we look from a competitive environment, I actually don't think the USPS' peak surcharge is particularly relevant in what we're doing. So, I'm not worried about that and actually continue to feel good. And we've also pre-negotiated peak surcharges with the vast majority of those customers that paid up. So, I feel good heading into peak.

And then, when you think about Amazon or ship with -- ship with Amazon, I think it's really important to remember we spent the last 50 years building the best transportation network in the world. We get up every day thinking about nothing other than making our supply chain better for our customers. And the market and customers. I think, really value the fact that when they win, we win, and they don't have to worry about a provider who is going to compete with them.

I do think that, you know, we take competition very seriously. And, you know, I'm focused on continuing to provide an even better value proposition. And we've got some things planned for 2024 that I'm really excited about sharing with you in a couple of months. So, I feel good.

Thanks, Ravi, for the question.

Operator

The next question will come from Stephanie Moore with Jefferies. Please go ahead.

Stephanie Moore -- *Jefferies -- Analyst*

Hi, good evening. Thank you for the question. I appreciate the color that you gave on the Freight segment and kind of what you're seeing in August. But given just the major disruption in the market, , could you talk a little bit about how some of those diverted volumes, just the mix quality, fits with FedEx's current -- current freight mix would be helpful just for context.

Thank you.

Brie Carere -- *Executive Vice President, Chief Customer Officer*

Sure, happy to answer that question. So, when we talk about the volume that came on, I think it's important to split it, actually. If you look at, about half of it came directly from Yellow customers. So, you know, give or take about 2,500 pieces a day.

And the reason being is that Yellow had a lot of low-quality revenue. And so, there was some revenue there and some customers that really didn't want to pay for the value of the FedEx freight speed and the quality that we provide. What happened, however, was some competitors took on more Yellow volume and their service was not what it needed to be. And so, as a result, we went and got an additional 2,500 pieces from the market. Net takeaway is the margin of the 5,000 was very healthy.

The sales team was incredibly disciplined, and both Lance and I are very very pleased with that volume. The network is running really well, and I'm confident that we will keep the majority of that. And that's what we plan to do.

Operator

And our last question today will come from Jeff Kauffman with Vertical Research Partners. Please go ahead.

Jeff Kauffman -- *Vertical Research Partners -- Analyst*

Thank you very much for squeezing me in. And congratulations, John and Mickey. It's been great working with you all these years. So, thank you.

John, question for you, and I just wanted to go back and clarify kind of what Ken Hoexter was asking on the guidance. The adjusted earnings went up, I guess, about $0.25 at the midpoint, and you highlighted the reasons why, but it looked like the unadjusted earnings went down about $0.15 at the midpoint. You took the high end of the range down to 16 60 and the low end up a little bit. And I just want to understand, you talked about the 100 million of incremental incentive comp.

You talked about some of the continued yield pressure. You talked about some of the negatives. And then, I saw that it looked like you also extended the adjustment range for the business optimization costs, up from about 500 million to 620 million. So, is that the net that explains the difference between the $0.15 reduction in the unadjusted guidance and the 25% increase in the adjusted guidance at the midpoint?

John Dietrich -- *Executive Vice President, Chief Financial Officer*

Yes, Jeff, that's correct. You have that right.

Jeff Kauffman -- *Vertical Research Partners -- Analyst*

OK, that's my question. Thank you very much.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Raj Subramaniam for any closing remarks. Please go ahead, sir.

Raj Subramaniam -- *President and Chief Executive Officer*

Thank you very much, operator. Let me say that, in closing, how proud I am of our team for delivering such a strong start for the year. Our execution of the structural cost reductions remain on track. And as we prepare for peak, we will continue to make every FedEx experience outstanding for our customers. They have proven that DRIVE is changing the way we work, and we are enabling continued transformation across FedEx as we build the world's most flexible, efficient, and intelligent network.

Thank you for your attention today. I will see you next time.

Operator

[Operator signoff]

Duration: 0 minutes

Call participants:

Mickey Foster -- *Vice President, Investor Relations*

Raj Subramaniam -- *President and Chief Executive Officer*

Brie Carere -- *Executive Vice President, Chief Customer Officer*

John Dietrich -- *Executive Vice President, Chief Financial Officer*

Jon Chappell -- *Evercore ISI -- Analyst*

Jack Atkins -- *Stephens, Inc. -- Analyst*

Tom Wadewitz -- *UBS -- Analyst*

Jordan Alliger -- *Goldman Sachs -- Analyst*

Scott Group -- *Wolfe Research -- Analyst*

Chris Wetherbee -- *Citi -- Analyst*

Brian Ossenbeck -- *JPMorgan Chase and Company -- Analyst*

Allison Poliniak -- *Wells Fargo Securities -- Analyst*

Ken Hoexter -- *Bank of America Merrill Lynch -- Analyst*

Amit Mehrotra -- *Deutsche Bank -- Analyst*

Bascome Majors -- *Susquehanna International Group -- Analyst*

Dave Vernon -- *AllianceBernstein -- Analyst*

Eric Morgan -- *Barclays -- Analyst*

Helane Becker -- *TD Cowen -- Analyst*

J. Bruce Chan -- *Stifel Financial Corp. -- Analyst*

Ravi Shanker -- *Morgan Stanley -- Analyst*

Stephanie Moore -- *Jefferies -- Analyst*

Jeff Kauffman -- *Vertical Research Partners -- Analyst*