FedEx Corp. (FDX) CEO Fred Smith on Q1 2020 Results - Earnings Call Transcript

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FQ1: 09-17-19 Earnings Summary

Press Release *Slides*

EPS of $3.05 misses by $-0.10 | Revenue of $17.05B (-0.02% Y/Y) misses by $-0.54M

Earning Call Audio

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FedEx Corporation (NYSE:FDX) Q1 2020 Earnings Conference Call September 17, 2019 5:30 PM ET

Company Participants

Mickey Foster - VP, IR

Fred Smith - Chairman and CEO

Brie Carere - EVP, Chief Marketing and Communications Officer

Raj Subramaniam - President and COO

Alan Graf - EVP and CFO

Henry Maier - President and CEO, FedEx Ground

Conference Call Participants

Chris Wetherbee - Citi

Scott Group - Wolfe Research

Jack Atkins - Stephens

Brandon Oglenski - Barclays

Allison Landry - Credit Suisse

Jordan Alliger - Goldman Sachs

David Ross - Stifel

Helane Becker - Cowen & Company

Scott Schneeberger - Oppenheimer

Amit Mehrotra - Deutsche Bank

Operator

Good day, everyone, and welcome to the FedEx Corporation First Quarter Fiscal Year 2020 Earnings Conference. Today's call is being recorded.

At this time, I would turn the call over to Mickey Foster, Vice President of Investor Relations for FedEx Corporation. Please go ahead.

Mickey Foster

Good afternoon, and welcome to FedEx Corporation's first quarter earnings conference call. The first quarter earnings release and stat book are on our website at fedex.com. In addition certain speakers may refer to charts we posted on the website this afternoon. This call is being streamed from our website where the replay will be available for about one year.

Joining us on the call today are members of the media. During our Q&A session, callers will be limited to one question in order to allow us to accommodate all those who would like to participate. I want to remind all listeners that FedEx Corporation desires to take advantage of the Safe Harbor provisions of the Private Securities Litigation Reform Act.

Certain statements in this conference call, such as projections regarding future performance, may be considered forward-looking statements within the meaning of the act.

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 Fred Smith, Chairman; Raj Subramaniam, President and COO; Alan Graf, Executive Vice President and CFO; Mark Allen, Executive VP, General Counsel and Secretary; Brie Carere; Executive VP, Chief Marketing and Communications Officer; and Rob Carter, Executive Vice President, FedEx Information Services and CIO who is calling in remotely.

And now, Fred Smith will share his views in the quarter.

Fred Smith

Thank you, Mickey. Good afternoon. Thanks everyone for participating in our first quarter FY 2020 analysts' call. Let me also thank the hundreds of thousands of FedEx teammates around the world who work everyday to keep our purple promise, I will make every FedEx experience outstanding.

When our strategic management committee presented the FY 2020 business plan to our Board of Directors last spring, we identified three significant challenges to increasing earnings this fiscal year, consistent with our stated long-term goals. One, beginning in the fall of 2018, it had become clear that global trade disputes were adversely affecting manufacturing in Europe and Asia, thereby slowing international shipping demand.

Two, our TNT integration was facing its most important phase, leading to the integration of European ground operations by the end of FY 2020. And three, we plan to add capabilities to enhance our services for the rapidly growing e-commerce market, which we expect to grow in the United States from 50 million to 100 million packages per day by 2026.

These shipments will be destined increasingly to residences, and one in four packages will be short distance deliveries. While the backbone of FedEx is the B2B business, our unmatched ground and express line haul and short networks carry both B2B and B2C commerce with great efficiency. The lead in e-commerce we have launched or announced FedEx extra hours and express service which provides nightly pick up with the delivery the next business day.

In sourcing FedEx SmartPost packages for FedEx Ground delivery by peak 2020. FedEx Ground six and seven day delivery. Expanding the FedEx Ground oversized package network to approximately 100 facilities by peak 2020, new return services and thousands of additional pickup and shipping points, including $8,000 general onsite locations in less dense areas.

And finally, FedEx Freight Direct for heavy and hard to handle items requiring delivery over the threshold, the so called H-3D [ph] market. FedEx can handle millions of additional shipments generated by these new offerings without adding significant additional sortation capacity.

It should be noted a large amount of Ground growth will be short haul zone one that will be lower yield, but with improved margin due to increasing density and minimal line haul cost. There is a new video on our website that goes into detail about our broad portfolio and I hope you will watch it. Our services and capabilities and cost will be industry leading in the short haul zone one sector.

The FedEx Board of Directors endorse making these moves as FY 2019 came to a close understanding the short-term cost, as we believe by the end of this fiscal year FY 2020, we will have significantly repositioned FedEx for strong future earnings. The market is changing as volumes are moving out of the USPS. And we are in-sourcing more, we have a chart on the IR website that shows these trends.

Over the summer, these challenges increased somewhat due to the decision to not renew our largest Amazon contract and deepening trade disputes. While the Amazon contract represented only a small proportion of our revenues, the nature of our business is such that near-term profits will be adversely affected since the last bit of volume has significant flow through to the bottom line. However, we have closed additional business to replace this traffic, which is being onboarded and we are taking out significant costs which were unique to Amazon's requirements.

Also, the global macro economy continues to soften and we are taking steps to reduce capacity. Specifically we will retire 20 MD-10-10 Aircraft over the current and next fiscal year, which will eliminate that fleet type from our air operations.

We are highly likely to also retire the remaining 10 A310 aircraft this year, which will also lead to the elimination of that fleet type. In addition, we are parking the equivalent capacity of seven MD-11 aircraft this fiscal year. Accordingly, assuming no recession, we will continue the initiatives announced in May and June with confident optimism about FedEx's long-term future competitive position and industry leadership.

We posted a chart on our website that shows the significant customer correlation among our three core OpCos. Our ability to bundle Express, Ground and Freight services is essential to success in our competitive exosphere. FedEx Office and FedEx Logistics also provide important value added services to our portfolio against the major competitors we face every day.

Let me now ask Brie to amplify our views on the marketplace and the economy, then Raj to discuss current operations, including our plans for peak season. And Alan will give you more details on our financials. Then we will take your questions. Brie?

Brie Carere

Thank you, Fred. Good afternoon, everyone. I'll open with our economic outlook then dive directly into how we're tackling market opportunities and delivering solutions for our customers at FedEx.

Comparing to where we were in June, our overall outlook for U.S. economic growth is down 20 basis points currently at 2.3% for real GDP. Our outlook has changed despite consumer driven growth of 2% in the U.S. in Q2 of CY 2019. This changes because the industrial sector remains sluggish due to an inventory build-up and increased geopolitical trade tensions. As you can see in chart number three on the IR site, U.S. manufacturing PMI has been very weak this year. Given that our industrial production outlook is down 70 basis points from June currently at 0.9%.

From a global perspective, economic growth has decreased as the developed world outside of the U.S. sees weaker growth and both domestic and external factors weigh on emerging markets. In Europe, ongoing decline in Germany's industrial sector is a drag on growth. While uncertainty over Brexit is impacting not just the UK where no sector has been immune to the negative impact, but its major trading partners as well. Growth in Italy remains week with Q2 CY 2019 data showing no gain in real GDP.

In reference to chart four in the presentation, you can see Eurozone manufacturing PMI has been signalling contraction for most of the year. In Asia, Chinese industrial production growth had a 10 year low in July and exports remain week. Chinese exports to the U.S. of the client every month in 2019. More broadly all manufacturer -- excuse me, all major exporting economies have been impacted by the slowdown in trade, especially Asian economies with high exposure to China.

I want to highlight that Q2 CY 2019 global trade volumes declined year-over-year, which is the first decline since 2009. This decline coupled with JPMorgan's global PMI manufacturing export orders index falling from 47.5 and August from 49 in May leads us to expect global trade volumes will contrast this year on an annual basis for the first time since 2009.

As we have stressed before, a zero tariff zero subsidy global trade environment is the most powerful economic growth engine there is. We will continue to push for policies that stimulate rather than depressed global trade.

Now, turning our focus to what we can control we remained laser focused on executing strategies across three key areas international, ecommerce, and small business. Right now our sights are set on an addressable transportation market totalling $550 billion worldwide. The majority of this opportunity lies outside of the United States where FedEx share has significant opportunity for growth. International is a clear opportunity for us with tremendous runway ahead.

As we integrate TNT and lower our costs to serve in Europe, we will be ideally positioned to gain share from the competition, the European team is gaining traction and accelerating the acquisition of parcel customers. Unfortunately, this momentum has been offset by reduction in industry air freight volumes between Europe and the United States.

In Europe, we are simplifying our pricing structures and are opening the valve for e-commerce for the first time ever to further stimulate growth. It is important to note that our European competitors have a larger ecommerce volume base, which insulates them from economic headwinds impacting commercial business. We are very excited about the e-commerce potential for our European business.

We are also creating new pricing and improving our value proposition between Asia and Europe. This is the largest trade lane in the world. Prior to the TNT acquisition, we did not have the European buyer base to pull this volume from Asia, as European payers make the majority of buying decisions in this lane.

Now shifting my focus to e-commerce, in reference to chart five on the IR site. In the U.S. more than 90% of incremental domestic parcel volume from 2018 to 2026 is expected to come from e-commerce period. This is why we are busy building a world class portfolio of solutions to best serve thousands of retailers in this space. We are very proud of the rapid innovation we have brought to e-commerce in the last three years and you can certainly expect more innovation in the months ahead.

On this same chart you'll see that more than 50% of the U.S. domestic e-commerce market is our addressable growth market with a CAGR of 12%. As the e-commerce market grows, so does the market for returns up 35% since 2015. Packages dropped off at our retail locations result in a higher pickup density and drive greater operational efficiency making FedEx even more competitive in the returns market. We're very excited about our network expansion with Dollar General. We will have 1,800 incremental locations open by peak. We also expect our [Technical difficulty] volume to reach a record high this holiday season.

Innovation and customer value are driving every decision we make when it comes to e-commerce. We are very excited about making everyday a delivery day with the launch of our Seven-Day service at FedEx Ground. We are already faster than the competition by at least one day in 26% of the lanes. This move will further speed up our network and allow us to continue to gain market share.

We are also building powerful relationships with many retailers and leveraging solutions like FedEx extra hours, and FedEx Ground zone one which is our local portfolio. Our local portfolio enables retailers to leverage local inventory and stores and DCs to take orders later in the day and still deliver them the next day.

We just forged a new strategic delivery partnership with Dick’s Sporting Goods. The majority of their spend with us is on their e-commerce business by leveraging our portfolio of ground commercial, home delivery and express services. They are getting the product to their customers faster, which of course is paramount to them and to their business growth.

Another retailer we work closely with is Chewy. Chewy was one of the first home delivery customers that benefited from our Six-Day expansion. Due to their one to two-day shipping commitment and 24x7 operations, they are ready to take full advantage of our new Seven-Day service. Retailers and brands, large and small have recognized our commercial teams for their partnership and for our ability to help them grow their business and successful compete in the market.

Also e-commerce will continue to create great opportunities for our LTL business. Our new FedEx Freight Direct service moves large bulky items into consumer's homes and into businesses. Backed by the power of the FedEx brand and the speed and reliability of our nationwide priority network, we are able to reach over 80% of the U.S. population, and we have a unique ability to serve as a large part of this $10 billion market.

And of course, we can't forget about Roxo, the FedEx SameDay Bot, who has recently been in three test markets, Memphis, Tennessee, Plano, Texas and Manchester, New Hampshire. Roxo was preparing to change the way on-demand e-commerce shipments make it to customer's doorsteps.

While these e-commerce investments benefit the broader market, I am particularly excited about how this strategy will support small and medium businesses, who remain our most profitable customers. In FY 2019 our small and medium businesses grew more than 8% and there is still a lot of room to grow as there are more than 32 million small businesses in the U.S.

Speaking of being there for small and medium businesses, we will not apply a residential peak surcharge this holiday season, a decision that has received outstanding feedback from countless small and medium sized customers. It's a great way to help make our customers the hero as e-commerce continues to grow and become a major part of their business.

Now let me turn the call over to Raj for his remarks.

Raj Subramaniam

Thank you, Brie and good afternoon, everyone. As you are all aware, the global economic and trade environment remains very uncertain. Despite this uncertainty, FedEx remains committed to delivering long-term profitable growth. We are taking decisive actions to address the three topics that Fred covered in his opening.

Number one, reducing capacity, especially in our intercontinental network and overall reduction of costs in our Express business. Number two, completing TNT integration. And number three, leveraging our infrastructure at FedEx Ground and making targeted investment that allow us to successfully go all-in on e-commerce.

Let me talk about each of these in turn. First, capacity cuts and overall cost reduction at FedEx Express. We expect the current softness in air cargo demand to continue into calendar year 2020. As such, we will take action to reduce our intercontinental flights after our peak season to better match supply to demand. We have already decreased U.S. domestic flight hours and we will be aggressively looking for additional opportunities.

The Express team is intensely focused on overall cost reduction. This includes deferring non-critical hiring, limiting discretionary spending, and implementing structural costs initiatives such as the United States voluntary buyout program. In addition, we're looking at every opportunity to reduce capital spending, benefits from all these changes will be realized in the coming quarters.

Secondly, let me update you on TNT integration. Overall, I'm pleased to report that we have picked up the pace of integration and are continuing to improve our value proposition for our customers. Cross utilization of combined FedEx Express and TNT networks, which we share on our previous calls was a major step toward full integration of the operations. In June, these capabilities expanded across Europe. The transit time for FedEx intra-European economy parcel shipments improved by at least one business day on approximately 40% of the European lanes across the 28 countries in Europe. We are well on our way to achieving full Ground interoperability in our pickup and delivery networks in Europe by the end of May 2020.

Growing intercontinental packages into the combined European Ground network allows us to improve service, while simultaneously reducing our costs to serve. This will help us accelerate growth into Europe from all around the world. Asia-Europe lane, which remains the largest intercontinental trade lane is particularly important in this regard. Given our strong presence in APAC and significantly enhanced presence in Europe, we expect to gain share in this lane in the months and years to come.

Additionally, in Q1 we integrated customs clearance and brokerage services in Europe to provide a more seamless experience for our customers. This milestone ensures we are well prepared for Brexit no matter the outcome. Clearance integration is also very important for us to enable cross utilization of TNT road network for intercontinental shipments. And as mentioned on the previous call, Sales integration is practically complete. And now we are presenting a single phase to our customers nearly everywhere around the world.

And thirdly, e-commerce, Fred and Brie have discussed our robust portfolio. Let me now address the enhancements specifically underway within FedEx Ground, which is the backbone of our e-commerce strategy. FedEx Ground continues to transform the package delivery business in response to a growing market demand. Network investments including seven-day residential delivery, large package capabilities and SmartPost integration position us for future growth.

Leveraging the most automated network in the industry, we will once again offer seven day residential service to our customers throughout the peak season. After peak, the seven day residential delivery will become a permanent piece of our service offering. This will speed up our lanes throughout the week, and further extend our competitive advantage in some cases by two days.

We're also well underway in building our Ground's large package handling capabilities to accommodate items like TVs, tires and furniture. This includes dedicated large package facilities, plus new handling equipment in more than 30 of our existing stations prior to peak.

In terms of SmartPost, the integration of that volume into our network directly addresses one of the biggest challenges in the industry density. From a cost perspective moving these packages to the same service providers already delivering Ground commercial and residential packages goes a long way in driving density up and driving the cost per delivery down.

Integrating this volume provide significant growth opportunities with thousands of entrepreneurs who run pickup and delivery businesses with FedEx Ground.

We've already started transitioning SmartPost volume, majority of which will move during next calendar year. This should be complete before peak season in 2020. Investment in FedEx Ground was made and will continue to make in technology aim to optimize operations, reduce costs and enable real time decision making based on applied data analytics. We're offering our service providers new technology tools, so they can make decisions about how best to run their business each day in terms of staffing needs, vehicle load plans and optimize routes. Arming our employees and service providers with the state-of-the art tools expected to drive efficiency in FedEx Ground's operation, as well as the operations of service providers all the while strengthening the reliability of FedEx Ground service.

Several of these tools have started to be implemented in select markets prior to peak, immediate benefits will begin to be realized in fiscal year 2020, with increased benefits in the years to come. These investments will allow us to provide the speed and reliability our customers value, while offering market competitive prices as the low cost last mile provider. This means we are facing near-term headwinds including additional costs related to our service expansions and SmartPost volume integration. But these investments are necessary and will pay off in coming years.

And speaking of Last Mile, we’re strategically working with a number of retailers to leverage their physical infrastructure with our transportation and logistic infrastructure to provide market leading value proposition for the end consumer. Interest from retailers remains very high in this regard.

In closing, as we approach another busy peak season shipping season, we are well prepared to once again deliver exceptional service to our customers. We expect record breaking volumes in multiple Mondays during the peak season. E-commerce growth continues, which in turns drives strong demand for residential delivery. Peak season is four day shorter this year and operational intensity remains the same.

We have been preparing in close collaboration with our customers all year. The FedEx team of more than 450,000 outstanding team members is the best in the business and is ready to deliver the holidays once again for our customers around the world.

In summary, the power of our network, coupled with the hard work and dedication of our global team sets us on a path of long-term profitable growth.

Now I'll turn it over to Alan Graf to provide details on our financials. Alan.

Alan Graf

Thank you, Raj and good afternoon, everyone. First quarter operating results were impacted by several factors. Weakening global trade and industrial production have resulted in less than expected demand for our most profitable Express package and Freight services.

Express yields have also been negatively impacted due to the resulting mix shift, lower weight per package, and customer trade down to slower lower price services. These conditions are especially challenging in Europe, where capacity and network reductions are limited due to the current stage of integration as we are operating duplicate road and air networks.

FedEx Ground operating costs were higher due primarily to our expansion of operations to six days per week, higher purchase transportation costs attributable to volume growth and expansion to six day operations and higher self-insurance expenses. Each transportation segment had one fewer operating day in the first quarter versus the prior year, which is estimated to have lowered earnings by approximately $100 million.

The loss of volume from Amazon had a negative impact to the quarter. Operating costs including depreciation also increased with strategic investment programs, including the modernization of FedEx Express aircraft and hubs and investment in technology across the enterprise that will further optimize our networks, as well as enhanced safety and capabilities.

The modernization of our aircraft fleet lowers costs through enhanced reliability, reduced maintenance costs, and improve fuel efficiency. Partially offsetting these negative factors were the benefits from an approximate $300 million decrease in variable incentive compensation, FedEx Ground volume growth of 7%, increased revenue per shipment at FedEx Freight and FedEx Ground and cost reductions from business realignment activities, including the U.S. voluntary employee buyout initiated last year.

Looking ahead to the rest of fiscal 2020, we are now forecasting adjusted earnings per share of $11 to $13 per share. The new forecast reflects our lowered revenue outlook, driven by increasing trade tensions, and the corresponding weakening in global economic conditions, especially industrial production that has occurred since our June earnings release. With the increasing uncertainty of trade negotiations and government policies, forecasting customer demand and our corresponding earnings is exceedingly difficult.

Our forecasts assume moderate U.S. economic growth, current fuel price expectations and no further weakening in international economic conditions. A further ramping and anti-trade measures and/or adverse changes in international trade policies and relations would likely drive additional weakness in our business. While our current expectation is to earn slightly above the midpoint of our $11 to $13 range, we believe the range is appropriate given the current macro and business conditions we are experiencing.

In addition to the impact of macro uncertainty, FedEx Ground operating expenses are expected to be higher than our previous forecast due to volume mix, lower than planned delivery density, higher wage rates and ongoing investments to enhance our e-commerce capabilities, including our expansion to seven day operations. The new forecast also reflects the loss of FedEx Ground business from Amazon that began in August.

Our FY 2020 effective tax rate prior to the year-end mark-to-market retirement plan accounting adjustment is now expected to increase 24% to 26% due to lower than expected earnings in certain non-U.S. jurisdictions. In response to these issues, we are taking additional actions on a number of fronts to better align our costs, including post peak reductions to the global FedEx Express air network.

We continue to expect to incur $350 million of TNT integration expenses in FY 2020 and $1.7 billion in total through FY 2021. We also continue to expect FY 2020 capital spending to be approximately $5.9 billion. While it's early in the process, we anticipate FY 2021 capital spending will be similar to FY 2020.

During the first quarter, we issued $2.1 billion of debt. We use the proceeds to redeem debt maturing in this fiscal year, as well as to contribute $1 billion into our pension plans. We do not expect to make additional contributions to our U.S. pension plans this fiscal year. We also have no material debt maturities prior to fiscal 2022.

In conclusion, we are taking actions to mitigate the effects of macroeconomic uncertainty. However, we are continuing to make strategic investments to improve our capabilities and efficiency, which we expect will drive long-term growth of earnings, margins, cash flow and returns.

Now the operator can begin the question-and-answer session.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions] We'll hear first from Chris Wetherbee with Citi.

Chris Wetherbee

Hey, thanks. Good afternoon. Thanks for taking the question. I guess, I wanted to just talk about the reduction in guidance and get a little bit specific if we could. If you think about the difference of where you were three months ago versus where you are today, it kind of equates to almost a $900 million write down in the operating profit of the business this fiscal year. So if you give us a little bit more specific sort of buckets breakdown, what may be the lower revenues based on macro? And then maybe what may be caused by higher costs associated with certain restructuring the network to adapt to e-commerce that would be very helpful.

Alan Graf

Chris, I would say that the vast majority this 900 is the reduction of our revenue forecasts associated with the macroeconomic conditions that we did not expect. Some of the cost increases that you are seeing did have some impact, but the main reason was the macro. The biggest impact, of course, was at Express, and that was in international with a large degree of that in Europe.

Operator

We'll hear next from Scott Group with Wolfe Research.

Scott Group

Hey, thanks. Afternoon, guys. So this is I think, the fifth straight quarter of either missing or cutting -- missing numbers or cutting guidance. Are you approaching guidance any differently meaning taking a more conservative approach here. Anything that you think that gives you some confidence or us some confidence that this is the final cut?

And then I separately just want to understand, Raj, you said we're doing everything we can to reduce capital spending, and yet, CapEx is staying unchanged and now flat next year as well. So can you help us understand that? I know that's two questions, but hope we need some hand holding here I think.

Alan Graf

Scott, I'll take on both. The lack of being able to hit our forecast is just the difficulty associated with forecasting in this environment. I don't think, we've been too aggressive based on what we knew at the time. You have noticed that, we've widen the range this year and I did mention that our current point estimate is higher than the midpoint of that range, so we've given ourselves a little bit more downside. I also said that we don't -- we're not expecting any additional weaknesses in the international macro environment from where we are today, which is a wild card. So I just want to point those things now to.

As far as CapEx, trust me, FY 2021 would be a lot higher than $5.9 billion have we not started cutting already. I think there are two things that are really important to understand. And number one is, we have to continue to modernize the fleet. The profound impact of the lower costs and higher reliability of the new twins is just remarkable. And we're going to continue to do that, we're going to maybe stretch it out a bit, but not much because the faster we can get those in there, the faster we can enjoy those benefits.

Fred mentioned the number of aircraft that we're going to take out a service either fully retiring or parking, so we're not adding capacity in our international network. And in fact, we're reducing that and we're reducing our domestic flight hours. But we need to modernize the fleet. It's very important.

Secondarily, on the hubs at Express, where they’re underway, we have a lot of things that are committed. But the improved automation and processing capabilities of those two hubs when we finish are also profound in terms of the productivity and the amount of throughput we can handle. And we anticipate that we're going to need that. If we get further deterioration in the macro environment or we see something in the U.S., that looks like a recession, we’ll definitely cut further, but those are our plans at the moment.

Operator

We’ll hear next from Jack Atkins with Stephens.

Jack Atkins

Hey guys, good afternoon. Thank you for taking my question. Can you quantify the P&L benefits from the capacity and cost actions you announced this afternoon. And I guess from a bigger picture perspective, why are these capacity adjustments only being made now when it feels like we've been facing more challenging trade and industrial production trends since last December, what's prevented you from taking these actions before today? Thank you.

Fred Smith

Let me take a shot at that. This is Fred Smith speaking. First of all, I think it's important to look at the things that we've said over the last few earnings call in the context of about what's going on globally. I mean, I watch the business press every day and I have to tell you, I think there's a lot of whistling past the graveyard about the U.S. consumer and the United States economy versus what's going on globally.

So, the serious trade dispute began in the spring of 2018 and they escalated throughout the summer of 2018. And most people don't think about the fact that when China slows down because of U.S. tariffs or uncertainty or for whatever reason, as big of a victim, if you want to call it that, of the China slowdown is Europe, because Germany's contraction is because they're not selling as much to China, which is a huge customer of Europe.

So remember, last spring, there was a tremendous amount of euphoria when we were going to get a deal, China trade deal. And then at the last minute, it broke up and then over the period of the summer there have been escalating tariffs on both sides and increasingly lowered industrial production and that's why we’ve put those charts up on the IR website.

So we're reacting inside of FedEx to the same thing. So as we went into the fiscal year, we were hopeful of a trade deal and some sort of restoration of normalcy that has not taken place. And the U.S. consumer, which is a remarkable driver of growth in employment, and all the things that are spoken about every day, sort of mass the fact that the goods producing sector, which we're in the midst of is much more global in nature than the U.S. consumer, which is largely services and certain consumption.

So that's the reason that we began the year the way we began it, and should we have moved faster or known faster or what have you, I mean all I can do is report the numbers as we see them. And I would point out to you that last fall, we were the first people that call this out. And I remember very vividly. I mean, we are the leading prognosticator of this, we have 15 million votes every day in our system. And I remember when we made this call on CNBC, they took our heads off that we were, “blaming someone.” We're just reporting what's going on and reacting to these macroeconomic things. And as Alan said, that's why it makes us so hard to forecast. We think we've taken appropriate steps. We'll do more if we have to, but I can't give any better answer than what I just did.

Operator

And from Barclays, we'll move on to Brandon Oglenski.

Brandon Oglenski

Good afternoon, everyone. Thanks for taking my question. So Fred, I guess coming off of that, I mean, clearly you guys have a culture of forward innovation and growth at FedEx. But I guess On the flip side, is there any like real ingrained process of the company that says, hey, we need to challenge every day what isn't working, because maybe even outside of these cyclical pressures.

I mean, if you look at your LTL business, we can benchmark to other carriers that do better. Obviously, Express margins are at quite a low point right now. And you look at logistics or like FedEx Office, which we don't think have contributed a lot in the past. So, I guess, what can you tell investors that is the process for looking at things that maybe didn't pan out quite as well as you thought?

Fred Smith

Well, I think you're a great person to ask that Brandon because you’re so called the deep dive, so let's talk about LTL. I don't think we have John Smith here to here today. First of all, there are other carriers that do better than FedEx with the exclusion of perhaps a little smaller carriers and ones sort of I'm not familiar with, I believe the better way to put that is there's one LTL carrier that does better than we do. And that's Old Dominion, and we're great admirers of Old Dominion.

But Old Dominion operates a network that has I believe somewhere in the 200 and some odd stations, versus our 360. They don't deliver every day to every part of the United States. And they've been very brilliant in finding a niche that's for lack of a better term near TL. It's in that zone between LTL and TL and their average weight per shipment in much more dense network is about 350-400 pounds higher.

So their margins are outstanding, and they have terrific and obviously, we benchmark them carefully as our other competitors, which gets to you your point, do we ever think about doing things differently? And the answer to that question is we think about doing things differently constantly.

Secondly, in the Express business, there is a belief, including you, Brandon, that somehow our Express operation in the United States is not profitable. Our Express operation in United States is very profitable. And we have some of the best industrial engineers and operations research people in the country.

So there has been this constant mantra for 10 years that we ought to put Express and Ground together. Well, my goodness, we’ve gained market share in Ground for 19 out of 20 years. And Brie and Raj just told you we think it's going to continue and our competitive advantage is going to improve. So we're very convinced that the way that we are operating is the preferred way. And yes, we look at it at it every day.

The third thing that gets people fired up. And I guess, Scott Group just mentioned it about CapEx is we are profligate in terms of CapEx. The reality is about $0.60 out of every dollar we're spending on CapEx are to modernize the Express hubs, to put in this new technology, we can't get people in Indianapolis and Memphis to work it. They're not out there plus it improves the productivity. So the failure to do it would be very dire.

And as Alan has said, and we've said over and over again, every time we bring on a 767 and to a much lesser degree, the 777 because we're not buying many other of them. It's accretive to earnings, the reliability goes up. So could we stop buying 767, and 777s? Yes, why don't we stop buying them, because we put a chart on the earnings -- the IR website today that showed the synergy between the three major OpCos. So 80% of our customers buy all three of the services.

So, if you took FedEx and tried to subject it, let's say to I think it was BCG that came up to that diagram, you have dogs and cash flows and one thing or another. If you did not improve the Express company, unless your costs get out of control, you couldn't win in the Ground sector and vice versa.

So, we are very convinced and we put up a chart that specifically addressed your comments about this, FedEx will unquestionably be the low cost producer in the domestic Express business because of the fleet modernization and that includes any new entrance into the business.

Yes, we have higher pilot costs and AMT costs perhaps, than the third-party providers. We think that's a good thing. But our total productivity and our cost per tonne mile are down 2% over the past 10 years, in this year's dollars. I'm not talking about inflated dollars, I'm talking about 2019 dollars are 2% less than 2009 dollars.

So the fleet modernization, yes, we could stop it and yes, we could stop that CapEx, but the competitive positioning against our major competitors.

And the last thing I'm going to say is, we basically compete in an ecosphere that's got five entities in it. There's UPS, there's DHL, there's a US Postal Service, and now increasingly, there is Amazon. That's who we wake up every day, trying to think about how we compete against and give the best services to our sales force.

So, it reminds me of my days in the service where you run all these fake manoeuvres one thing another, it's a lot different when you got competition on the other side. So we try to beat these folks, UPS, and in particular has a very strong retail presence and both UPS and DHL have significant forwarding presences. So we’ve decided that we would basically cover those portfolio gaps with more focused capabilities, and that's why we operate differently.

We carry retail freight on our purple tails and interline it, we don't have a huge forwarding operation. And we have a retail network that is smaller than UPS store franchise network, but utilizes partners as Brie talked to you about Walgreens, and dollar -- more recently Dollar General and some others.

So the reason I'm going on about this, I'm not quite sure how this mantra got started, that we're hard hitted, or we're not willing to look, we'll look at anything. But what we can’t do is to change the reality of the math. We can't make the competition go away, I wish they would, just leave the field, they're very good operators.

And the third thing that we have to deal with is the macroeconomic environment. And by the way, there's no company and no person that has been more vocal in our opposition to the trade policies that we are pursuing. Now, to be fair, I think it's not just the U.S., I think China is also pursuing bad trade policy. So you're taking a system over the last seven years that’s drawn more people out of poverty than in the entire previous history of the world, and essentially putting it all at risk.

So these numbers on these macroeconomic production indicators, we didn't make those up. That's what's going on. So I apologize for the length of the response. But it's to this continuing drumbeat that somehow we're not willing to look at something and you take selective things like your LTL operation in as good as, all the others, it's not as good as one and it's not as good as the other ones in terms of margins for the reasons that I gave you. So it's important to look at this thing with those contexts in mind.

Next question.

Operator

We’ll hear now from Allison Landry with Credit Suisse.

Allison Landry

Thanks, good afternoon. So you talked a lot about the short-term cost inflation at Ground and driving down the cost of delivery longer term. I think you've done a pretty good job of explaining that to the market. But it sounds like you're also seeing some unexpected costs creep, higher wage rates, lower delivery density so forth. So, I guess, could you help us understand some kind of timeline for when we should expect to see some of the operating leverage and inflection of margins at the Ground segment, is fiscal 2021 the right way to think about it or do we need to look further out than that? Thank you.

Alan Graf

I like your Ground margins, I think they're fine. And I think we told you early on in the intro, Allison, as at least it goes to zone one where we think we're going to grow really rapidly. We're talking about lower yields and higher margins. So I think Ground performing admittedly. The issue at Ground is there's just not the commercial traffic we'd plan to have, which has significantly higher density than home delivery does. Home delivery is growing like crazy and the commercial businesses not because of industrial production, and all the other things we said.

So that's a fairly simple explanation. We're adjusting the model accordingly to do that. I think Ground’s in great shape. I think it's doing fantastic. And I don't see anybody making better margins than us.

Fred Smith

Let me let me make one comment here, and then Raj and or Henry Maier, the CEO of FedEx Ground is sitting here so he can speak to this too, Allison. First thing that people need to understand the things we announced this spring and this summer, we just didn't dream them up in the last few months.

We've been working on these for almost four years. And during that period of time, we have invested enormous amount of money in IT, which has been dragged through the P&L to make sure that I can make a statement and let me make it again because I think it may have gone over some people's heads.

We will in the short zone market, the zone one market, the ship from store or ship from local DC, FedEx will be the low cost, high service producer, you can put the traffic in very, very late in night or in the morning and at lower cost than anybody and I mean anybody, all of the five competitors that I mentioned a moment ago.

So all of these moves that we announced were triggered by a series of developments. And the strategy has been in production for a long time. So we're very confident about where this market is going that Brie described to you and we're very confident in Ground’s position. But as Alan just mentioned, the B2B Ground business is being adversely affected for the same reason that the international PMI is going down.

The trade effects and the goods production side of the house is much greater than it is in the services business. And that's being reflected across all our businesses; Freight, Ground Commercial, and particularly International. Henry, Raj?

Raj Subramaniam

Well, let me just add on to that by just saying that there's a strong divergence between the strong consumer sector and the weak factory sector around the world and U.S. as being no exception. That the industrial production in U.S. is expected to be flat to negative in the second half of CY 2019 that's the issue and once we get the commercial traffic -- that's the issue. Ground is doing very, very well. And we are definitely investing for the future and we are going to have the market leading value proposition, best service at low cost. So let me turn it over to Henry for his comment.

Henry Maier

Allison, let me just add cost headwinds at Ground are largely six and seven-day, because there's a minimum number of people and to staff a billing in order to operate it prior to the volume and revenue coming on. The wage rate issue is a number of things. First is year-over-year driver rates, which are reflective of the intense competition for truck drivers in certain geographic markets, both in PMD and line haul.

However, what we see going forward, as we transition out of the current model into the independent service provider model, which will be completely stood up on October 12th is annual, if not multi-year negotiations with those businesses about the rate -- about their settlement rates.

Finally, we've talked about the robust labor environment out there. There are geographic markets, where it's highly competitive to get package handlers into the building. And while our automated network benefits us greatly in that regard for employees, where we're competing for the same unskilled labor in the market we have to be cost competitive. And that's just a function of the strength of the economy and the markets we operate in.

Operator

And from Goldman Sachs we move to Jordan Alliger.

Jordan Alliger

Yes. Hi, guys. Just sort of from a big picture standpoint, can you remind a little bit what your long-term earnings or profit growth targets would be sort of once we get past this noise? And perhaps assess the ability of things to bounce back. Assuming the economy is okay, and assuming you implement the cost initiatives and the capacity initiatives that you do. Do you anticipate as we look into fiscal 2021 and 2022, that sort of growth can exceed sort of that long-term EPS growth target? Thanks.

Fred Smith

It depends on your outlook for the economy for sure. I mean, we said we're going to be really well positioned by the end of 2021. Yes, we were late and over budget on the TNT integration, but we're there we're will be there. And I don't know what the economic environment in Europe will be at that point, but we will be able to significantly reduce our costs and improve our service for all the reasons we've told you about. That's one.

Two, some of the things that we've talked about at Ground, like the loss of Amazon, getting ready for six and seven day, a lot of that stuff will be behind us. And we'll be ready to move forward. So given a decent economic environment, we ought to be able to easily hit our 10% to 15% earnings EPS growth going forward. But I can't tell you that that's going to be the case because I can't tell you what exactly the economy is going to look like right now. So if I'm a little gun shy, yes, probably I’m.

Operator

Moving on to David Ross with Stifel.

David Ross

Yes. Good afternoon. Maybe a question for Mark, with Assembly Bill 5 out in California, I know since the extradition and refining [ph] the independent contractor model and now are moving towards an all ISP model. Is there anything in that proposed bill that could challenge the current ISP model or how are you guys viewing that right now?

Henry Myer

Hey, David, it’s Henry Myer. I've been designated the company paralegal for this call. Let me get it up -- let me give the people listening in a little bit of background on Assembly Bill 5. Back on April 30, 2018, The California Supreme Court issued a ruling in the dynamics case, which held an ABC test should be used to determine whether a worker who is an employee or an independent contractor. Assembly Bill 5 is just an attempt by the legislature to codify the dynamics decision of the Supreme Court.

For those who aren't aware, there are a number of states that have ABC test, the A prong says an individual must be free of control and direction. The B prong a service has to be performed outside the usual course of business of the employer. And the C prong is the individual is customarily engage in an independently established trade, occupation, profession or business.

This is intended to address individuals who are classified as independent contractors. We believe it's largely directed at the ride sharing and food delivery business in California. And because FedEx Ground only contracts with businesses that are incorporated in a good standing in the states in which they operate. We therefore have no individuals who are classified as independent contractors.

All service provider employees under contract to FedEx Ground are subject to tax withholdings and are eligible for workers comp unemployment insurance and over time. And all of our service providers are contractually obligated to treat their workers as employees are registered as I said, in a good standing with the states and agreed to compliance audits by the company.

So therefore, we think that any risks that would accrue to FedEx Ground would be minimal to non-existent the way the bill is currently structured.

Operator

Helane Becker with Cowen & Company has our next question.

Helane Backer

Thanks, operator. Hi, everybody. Thank you very much for the time. Brie, I think you talked about demand from China being down between China and the U.S. and China and Europe. But did you speak at all to goods going from China to third countries? And then how those volumes are doing, for example, China to Vietnam and then Vietnam to the U.S. or Taiwan or places elsewhere in Asia. So maybe you could talk about trends you're seeing and goods moving that way, if at all?

Brie Carere

So great question, obviously, right now, from an outlook perspective, we are seeing pressure on all intercontinental and even within Asia, all of intra-Asia really is connected from a supply chain perspective. So even if it isn't direct to China, we are seeing a lot of pressure intra-Asia. What I think is most important to note, is we both Raj and I mentioned, is we are under penetrated from a market share perspective between Asia and Europe and Europe to Asia.

We now have unleashed an incredible buyer base in Europe which we never had access to before and we have traditionally been very underpenetrated in this lane, and Jill and I are locked arm and arm to grow share despite the macroeconomic headwinds. So I think that's really what's most important. And that's what's newsworthy for us as we think about growth moving forward.

Operator

And from Oppenheimer, we'll move to Scott Schneeberger.

Scott Schneeberger

Thanks, good afternoon. [Technical difficulty] in international priority and international economy in the environment and perhaps provide a perspective on the influence of fuel prices and the trade down dynamic, if and how that may factor into this updated guidance? Thanks.

Raj Subramaniam

Scott, fuel prices have very little to do with this at this point. And I think there's a macroeconomic environment and primarily the industrial sector of the global economy that's driving that change.

Operator

We'll go next to Bernstein Research, David Vernon.

Unidentified Analyst

Hi, everyone. Thank you for taking our question asking on behalf of David Vernon, how should we think about the greater than 20% increase in corporate center loss? And is there any outlook there?

Fred Smith

Well, we have moved FedEx Office out to its own now, as you noticed, and while FedEx Office itself for reporting purposes, reports a loss gives you that as a channel cost, if you like. It's a vital channel and we've talked about this over and over and over again, our most profitable packages come through FedEx Office, FedEx Office has got many, many places where you can pick up, drop off great relationship going with in-store at Walmart.

So, I wouldn't be too concerned about that we have work to do on our logistics side of the house, we are working very hard on that. And I expect those will improve over time. But really at the end of the day, the real -- again, the real issue, I want to make sure I get this clear to everybody. All the things we've talked about. Our issue is international at Express.

Operator

Now from Deutsche Bank will move to Amit Mehrotra.

Amit Mehrotra

Thanks, thanks for squeezing me in here. Just wanted to ask if you think 2020 will represent a trough in Ground margins that you can build on in 2021 given the, I guess, the SmartPost integration? And then can you just update us on the integration of TNT businesses in the UK, France and Germany? Where are those countries, given their size and when do you expect the integration to be complete for those regions? Thank you.

Fred Smith

I think that was two. I think, we've answered them both, but I'll try to stab at this again. We will be complete with those countries at the end of May 2020. Again, as you have well pointed out in your note, we were a little bit late, a little bit over budget on that. Thank you for that.

And as far as FedEx Ground margins, again, we will have a lot of these things behind us, it will depend on our mix and economic environment about how fast we can move margins up, but we do expect our zone one traffic to grow rapidly and although at lower yield it will be at higher margins.

Operator

And with that at this time, I'd like to turn things back to you, to offer any additional or closing remarks.

Mickey Foster

Thank you for your participation in the FedEx Corporation first quarter earnings conference call. Feel free to call anyone on the Investor Relations team, if you have additional questions about FedEx. Thank you very much.

Operator

Again, that will conclude today's conference. Thank you all for joining us.