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| Identify & Monitor a Stock’s Critical Factors |
| Learner Workbook |
| NOTE: Please ensure you can interact with this document during the workshop in one of these methods:   * With a keyboard (as a Word document);or * With pen (as a hard copy) |
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Identify & Monitor a Stock’s Critical Factors

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|  | Acknowledgements  Much of the content for this workshop comes from *Best Practices for Equity Research Analysts* authored by James J. Valentine, CFA and published by McGraw-Hill. |
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Overview

| Purpose & Learning Objectives | |
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| Description: Welcome%201 | Why an *Identify & Monitor a Stock’s Critical Factors* program?  Information overload is one of the biggest contributors to missing great stock calls. Analysts are typically inundated with excessive “noise” about their universe of stocks: hundreds of pieces of information each week from company management, the media and sell-side, much of which has no influence on stock prices. When a stock materially outperforms its peers or the market, it’s usually due to only one key factor that often gets buried among all of this noise. Until an analyst can identify and monitor these few key factors, there’s a good chance great stocks calls will be missed.  Analysts use our process to identify and then monitor the most critical factors that deserve their time and attention. As discussed in the best-selling book *Best Practices for Equity Research Analysts*, the top performing buy-side and sell-side analysts use this winning formula for their success, by investing time to identify the 2 to 4 critical factors most likely to move their stocks during their investment time horizon. Then they spend a disproportionate amount of their time proactively researching these critical factors to determine where consensus could be wrong, which becomes the basis for great stock calls. Mastering this skill of identifying just the few critical factors per stock helps analysts in generating informed insights, forecasting, making stock calls, communicating their calls, and for sell-side analysts, maximizing their client votes. |
| Description: Purpose%201 | Learning Objectives  After completing this program, you will be able to:   * Improve time management, forecasting, stock picking and communications by focusing only on a stock’s 1-4 critical factors * Identify the financial statement impact zone for a potential critical factor * Quickly compute materiality to determine how much a factor may impact a stock’s price * Evaluate historical and current investment controversies to determine if they are likely to evolve into new critical factors * Use our EPIC™ framework to quickly process inbound information to separate potential critical factors from noise |
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Introduction

| How Does This Skill Help Me Succeed? | | |
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| Defining a Critical Factor | | |
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| z | Source: |
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| Four Steps to Identify Critical Factors | | |
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| Example Critical Factors | |
| --- | --- |
| z | Example Critical Factors and Key Assumptions\*   |  |  |  |  | | --- | --- | --- | --- | | Sector or Stock | Critical Factor | Assumption #1 | Assumption #2 | | Amazon.com | Market share shift from traditional retailers | Adoption rate of e-commerce within emerging markets | Adoption rate of mobile apps for retail purchases | | Ford Motor Company | New car pricing in North America | Change in capacity in the North American market | Changes in lending standards | | Time Warner Cable | Growth of competing content providers such as Netflix, Amazon and HBO | Customer loyalty for the cable bundle vs. new entrants | Potential growth of cable-provider broadband offering (which is required to access new entrants) | | Interpublic Group (advertising) | Changes in ad spending for traditional channels (e.g. TV, print) | Adoption of advertising on mobile devices | Adoption of online video advertising | | Nike | Top line growth rate keeping up with historical trends | Changes in demand from international markets | Changes in broad athletic activities | | Union Pacific | Freight railroad customer pricing | Changes in freight railroad capacity | Changes in competing mode (trucking and barge) capacity | | SolarCity | Growth of renewable energy revenue | Changes in energy storage costs | Impact from changes in oil and natural gas prices | | The Gap | Apparel pricing deflation | Adoption of off-price and low-price fashion | Use of mobile devices for price discovery | | VMware (software) | Growth of Open Source software vs. traditional vendors | Open Source providers going public | IT leaders selling services that rely on Open Source solutions | | T-Mobile | Competitive pricing among the wireless carriers | Timing when domestic smartphone becomes saturated | Changing regulations | | Walgreens (drug retailer) | Generic drug price inflation | Changes in FDA regulation of non-generic drug manufacturers | Distribution channel consolidation |   \* These critical factors may become out of date over time and should be viewed as just an example | |

Module 1: Identify When Anomalies Occurred

| Simulation, Part A | | | |
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| Handouts%201 | | Instructions for the Simulation, Part A:   * As pre-work you may have brought a chart(s) showing the performance of your stock going back at least 10 years (if the stock has traded that long) relative to:   + The sector index   + A broader index (e.g. S&P500) * If you did not bring your own chart, use the one for FedEx that follows * After reviewing the chart note the 3-5 most interesting points in time worth investigating, in your effort to identify the factors that caused the stock to out- or under-perform in the past |
| z | Please do not review the next page until told to do so | |

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Module 2: Identify Why Anomalies Occurred

| Correlation Matrix | | | |
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| Description: Handouts Content Block Icon | | The correlation matrix below illustrates the relationship between each stock’s price movement and:   * The stock’s financial data * Macro data   Use the “PEARSON” function in Excel to build your own |
| z | Correlation Matrix, December 2001 to June 2014 | |

| Corporate Actions May Explain Performance | | |
| --- | --- | --- |
| z | Screen Shots of Corporate Actions (from Bloomberg: FDX <Equity> CACS)  The screen the follows shows FDX’s Announced Acquisitions from 1997 to 2006. Following this image, we have provided details for the four highlighted transactions. Try to assess if any of the transactions caused anomalies in FDX’s stock price. FedEx’s market capitalization during this time period grew steadily from $8B in 1997 to $35B in 2006.    **Specifics of each transaction can be found on the following pages** | |
| z | Screen Shots of Corporate Actions (from Bloomberg: FDX <Equity> CACS) | |
| z | Screen Shots of Corporate Actions (from Bloomberg: FDX <Equity> CACS) | |
| z | | FedEx’s Larger Acquisitions | |

| Food Chain Example | |
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| Self-Assess Your Historical Tool Kit | | | | |
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| Assessment%202 | | Instructions for Assessing Your Historical Knowledge   * Evaluate each item on a scale of 1 to 5 with 5 as “strongly agree” * If you are covering a sector that has not been in existence for at least 10 years, reduce the time period to when the sector formally developed |
| z | |  |  | | --- | --- | | 1. I possess the data that shows the primary factor(s) that caused ROIC to change for my sector over at least the past 10 years. |  | | 1. I know the factor(s) that caused each of my stocks to substantially out- or under-perform their peers over the past 10 years. |  | | 1. I know the factor(s) that caused each of my sectors to substantially out- or under-perform my broader benchmark over the past 10 years. |  | | 1. I have industry-level data that provides a good gauge of supply/capacity and demand/units/revenue going back at least 10 years. |  | | 1. I have built, or could quickly build, a comprehensive food chain analysis for my sector, showing the upstream and downstream players for the companies in my universe. |  | | 1. When forecasting revenue for my individual companies, I ensure their combined revenue growth is within a realistic industry growth rate based on historical trends. |  | | 1. I know the high, low and mid-point of longer-term historical valuation ranges for each of my stocks for at least the past 10 years. |  | | Total |  | | | |

| What’s “Material” to You? | | | | | |
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| Handouts%201 | | | Instructions for What’s “Material” to You?:   * Answer the question below, found above the table * For the table, list three stocks in the first column that you are familiar with, making sure to include the one that is the subject of your materials, if you brought for this workshop. * Ignore the other columns until you receive further instructions from the facilitator. | |
| z | Approximately how much does a stock need to move relative to a benchmark or in absolute terms for you to consider recommending it as a buy at your firm?: \_\_\_\_\_\_\_% | | |
| z | | |  |  |  |  | | --- | --- | --- | --- | | Ticker | Revenue from Volume | Revenue from Pricing | Expenses | |  |  |  |  | |  |  |  |  | |  |  |  |  | | | |

| “Is It Worth Your Time?” Exercise | | | |
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| Handouts%201 | | | Instructions for “Is It Worth Your Time?” Exercise:   * From your research you have come across the following scenarios. Using the basic income statement data below, determine if each is material, assuming “materiality” is defined as a 10% change to EPS.   + FDX has had a 4% fuel surcharge for the past year but only collected half (2%) from its customers. Due to a new policy, the company is going to start to collect 3%. Is this 1 percentage point increase material? To keep the math simple, assume the surcharge covers all of FedEx’s revenue (in reality some of its revenue is not subject to a fuel surcharge).   + FDX is going to change a pension assumption that will raise the company’s overall costs by $150 million per year.   + FDX has just won a new agreement with the U.S. Postal service to haul Priority Mail, which will likely result in $1 billion of additional annual revenue. This new contract has been priced to achieve the overall company’s existing margins. |
| z | | |  |  | | --- | --- | | Data Below is Actual for Fiscal Year Ending: | 30-May-12 | | Total Revenue | $42,800 | | Total Operating Expenses | $39,600 | | EBIT | $3,200 | | EBIT margin | 7.5% | | Interest Expense | $55 | | Interest Income | $0 | | Other | $0 | | Pre-tax Income | $3,145 | | Tax Expense | $1,116 | | Effective Tax Rate | 35.5% | | Net Income | $2,029 | | EPS | $6.42 | | Fully Diluted Share Count | 316 | | |

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| z | Answer Key   |  |  |  | | --- | --- | --- | | Scenario | EPS Impact | Change to EPS | | 1% higher pricing from better fuel surcharge collection | $0.87 | 14% | | $150 million higher pension costs | $0.31 | 5% | | $1 billion of USPS revenue | $0.15 | 2% |  |  |  | | --- | --- | | Company ticker: | FDX | | Company name: | FedEx | | **Step 1: Compute 10% of net income** |  | | 10% change to last fiscal year's EPS | 0.64 | | Materiality threshold as measured in net income | $203 | |  |  | | **Step 2: Convert to pre-tax EBIT** |  | | Materiality threshold as measured in pre-tax EBIT | $315 | |  |  | | **Step 3: Compute threshold for changes from pricing and expenses** |  | | Materiality threshold as measured in changes to pricing1 | 0.7% | | Materiality threshold as measured in changes in expenses2 | 0.8% | |  |  | | **Step 4: Compute threshold for change in revenue from sales/volume** |  | | Materiality threshold as measured in changes from sales/volume3 | $4,206 | | As a percent of revenue | 9.8% | |  |  | | Data Below is Actual for Fiscal Year Ending: | 30-May-12 | | Total Revenue | $42,800 | | Total Operating Expenses | $39,600 | | EBIT | $3,200 | | EBIT margin | 7.5% | | Interest Expense | $55 | | Interest Income | $0 | | Other | $0 | | Pre-tax Income | $3,145 | | Tax Expense | $1,116 | | Effective Tax Rate | 35.5% | | Net Income | $2,029 | | EPS | $6.42 | | Fully Diluted Share Count | 316 | |  |  | | 1 Assuming pricing drops directly to EBIT |  | | 2 Assuming expenses change with no change in volumes or sales |  | | 3 Assuming all incremental revenue is at average EBIT margins |  | |

| Simulation, Part B | | | | | | |
| --- | --- | --- | --- | --- | --- | --- |
| Handouts%201 | | | | Instructions for Simulation, Part B:   * In this step, you are going compile a list of all the potential factors (not necessarily “critical” factors) that may explain why a stock substantially out- or under-performed (step 2 of the 4-step process) * As pre-work you may have prepared by obtaining the following for a company of interest:   + A quarterly filing from a period when the stock substantially out- or under-performed its peers   + An earnings model * If you did not bring your own material:   + Use the information on the following pages for FedEx   + Recall, for FDX, we are looking for factors that help explain why FDX’s stock has out-performed so significantly up to May 2006   + As you are reading the material below, be aware the term “Yield” refers to revenue per package * While reviewing the material, try to highlight 5 to 10 potential critical factors |
| z | |  | | | |
| z | | Read the following excerpts from FDX documents for the period ending May 2006 and highlight any that appear to be critical factors.  FDX 10-K For the fiscal year ended May 31, 2006  Management’s Discussion and Analysis  Operating income increased during 2006 primarily due to revenue growth and improved margins across all our transportation segments. Yield and cost management activities, combined with productivity gains across all transportation segments, contributed to our margin growth. Operating income improvement was partially offset by higher costs at FedEx Express to support international volume growth, expansion costs at FedEx Ground and reduced operating profit at FedEx Kinko’s.  While fuel costs increased substantially in 2006, fuel surcharges more than offset the effect of higher fuel costs on our operating results.  Revenue growth during 2005 was attributable to volume and yield improvements across all transportation segments and the inclusion of FedEx Kinko’s for the full year. Combined volume growth in our package businesses increased 8%. Yields improved during 2005 primarily due to incremental fuel surcharges and base rate increases.  During 2005, operating income increased primarily due to revenue growth in all transportation segments and improved margins at FedEx Express and FedEx Freight. FedEx Express benefited from the realization of a full year of savings from our 2004 business realignment programs (versus a half year in 2004), which reduced the growth in salaries, wages and benefits.  Continue to the next page to complete this exercise | | | |
| z | | FDX Press Release For the Quarter Ending May 31, 2006  Portion Discussing Segment Details  **FedEx Express** [the company’s overnight express division] achieved a double-digit operating margin in the seasonally strong fourth quarter, driven by revenue growth, yield management and effective cost controls. International Priority (IP) package revenue grew 15% for the quarter, as IP revenue per package grew 9%, primarily due to fuel surcharges, a higher rate per pound and an increase in package weights. IP average daily package volume grew 6%. U.S. domestic express package revenue increased more than 5%, as yield increased 8% and U.S. domestic average daily package volume declined 2%. The yield increase was driven by the January 2006 rate increases, higher fuel surcharges and yield management actions. U.S. deferred express services continue to show higher yields and lower volumes due to the continuing impact of previous yield management action  **FedEx Ground** average daily package volume grew 11% year over year in the fourth quarter. Yield improved 3% primarily due to higher extra-services revenue, increased fuel surcharges and the January 2006 general rate increase. Operating margin improved due to revenue growth, higher productivity and effective cost controls, offset in part by investments in new technology and the company’s capacity expansion program.  Continue to the answer key on the next page to see if you found a good selection of potential critical factors | | | |

| Simulation, Part B Answer Key | | | | |
| --- | --- | --- | --- | --- |
| Description: Handouts Content Block Icon | | The answer key below includes many of the potential factors that could be on your list |
| z | FDX 10-K For the fiscal year ended May 31, 2006  Management’s Discussion and Analysis  Operating income increased during 2006 primarily due to revenue growth and improved margins across all our transportation segments. Yield and cost management activities, combined with productivity gains across all transportation segments, contributed to our margin growth. Operating income improvement was partially offset by higher costs at FedEx Express to support international volume growth, expansion costs at FedEx Ground and reduced operating profit at FedEx Kinko’s.  While fuel costs increased substantially in 2006, fuel surcharges more than offset the effect of higher fuel costs on our operating results.  Revenue growth during 2005 was attributable to volume and yield improvements across all transportation segments and the inclusion of FedEx Kinko’s for the full year. Combined volume growth in our package businesses increased 8%. Yields improved during 2005 primarily due to incremental fuel surcharges and base rate increases.  During 2005, operating income increased primarily due to revenue growth in all transportation segments and improved margins at FedEx Express and FedEx Freight. FedEx Express benefited from the realization of a full year of savings from our 2004 business realignment programs (versus a half year in 2004), which reduced the growth in salaries, wages and benefits. | | |
| z | FDX Press Release For the Quarter Ending May 31, 2006  Portion Discussing Segment Details  **FedEx Express** [the company’s overnight express division] achieved a double-digit operating margin in the seasonally strong fourth quarter, driven by revenue growth, yield management and effective cost controls. International Priority (IP) package revenue grew 15% for the quarter, as IP revenue per package grew 9%, primarily due to fuel surcharges, a higher rate per pound and an increase in package weights. IP average daily package volume grew 6%. U.S. domestic express package revenue increased more than 5%, as yield increased 8% and U.S. domestic average daily package volume declined 2%. The yield increase was driven by the January 2006 rate increases, higher fuel surcharges and yield management actions. U.S. deferred express services continue to show higher yields and lower volumes due to the continuing impact of previous yield management action  **FedEx Ground** average daily package volume grew 11% year over year in the fourth quarter. Yield improved 3% primarily due to higher extra-services revenue, increased fuel surcharges and the January 2006 general rate increase. Operating margin improved due to revenue growth, higher productivity and effective cost controls, offset in part by investments in new technology and the company’s capacity expansion program. | | | |

Module 3: Identify Current Investment Controversies

| Simulation, Part C | | | |
| --- | --- | --- | --- |
| Handouts%201 | | Instructions for the Simulation, Part C:   * In this step, you are going compile a list of *new* or *emerging* factors that may explain why a stock will substantially out- or under-perform during your upcoming investment time horizon (step 3 of the 4-step process) * If you brought your own materials or will be using the FedEx materials we provide beginning on the next page, review the following:   + Company’s most recent regulatory filing   + Transcript from the most recent company call   + Topics of recent news stories   + Topics in recent sell-side reports (for copyright purposes we did not provide this below for FedEx) * While reviewing the material, attempt to highlight 3 to 7 new or emerging factors * Unlike the prior step where we knew the direction of the stock’s performance leading up to the time period being studied, we do not know if the stock will out- or under-perform from this point forward and so highlight factors that may result in upward and downward revisions to consensus’ expectations |
| z | Materials for FedEx   * Assume the materials that follow are the most current available (the time is late 2013)   Excerpt From a “Current” Regulatory Filing (Fiscal 2Q14 – Dec 2013)  FedEx Ground average daily volume grew 8% in the second quarter, as growth in both business-to-business and FedEx Home Delivery services was driven by market share gains. Revenue per package increased 2% due to rate increases and higher residential surcharges, partially offset by lower fuel surcharges. FedEx SmartPost average daily volume increased 9% primarily due to growth in e-commerce. FedEx SmartPost net revenue per package was down 3% due to higher postage rates and lower fuel surcharges, partially offset by rate increases.  Operating income increased due to higher volume and revenue per package. Operating margin declined primarily due to this year's later start of the holiday shipping season, as Cyber Week occurred in December this year versus November last year. The seasonal increases in volume, revenue and operating income related to Cyber Week will be realized in this year's third quarter versus the second quarter last year.  Continue to the next page to complete this exercise | |
| z | Materials for FedEx (continued)  Excerpt From the Transcript of the “Most Recent” Company Call  Alan B. Graf, Jr.  Executive Vice President & CFO, FedEx Corp.  *Good morning everyone. Second-quarter earnings increased to $1.57 per share and operating income increased 15% to $827 million. Yield improvements and cost management at Express were the primary drivers of the profitability improvement. Results also benefited from the favorable comparison to last year's Sandy impacted results, lower pension expense and a modest benefit from the voluntary employee severance program.*  *During the second quarter the Company repurchased 7.2 million shares of FedEx common stock for a total of 10 million shares repurchased fiscal year to date. The second-quarter share repurchases had no effect on the quarter's earnings per share, but will have an estimated $0.04 per share impact for the full-year.*  *Express had a wonderful quarter, operating income increased to $326 million, and margin increased to 4.8% despite slightly lower revenue. The profitability improvement was driven by stronger base U.S. and international package yields, lower pension expense and lower net expenses from ongoing cost reduction activities.*  *Turning to our Ground segment, revenues increased 10% to $2.9 billion and operating income increased $424 million due to volume and yield growth at Ground and volume growth at SmartPost.*  *Turning to the outlook, we expect revenue and earnings growth to continue into the third quarter and the remainder of FY 2014 from ongoing improvements in the results of all of our transportation segments. Based on these improvements, plus our to date share repurchase results, we are raising our earnings per share guidance for the full-year to 8% to 14% from the FY 2013 adjusted results. This compares to our previous growth range of 7% to 13%.*  *We are continuing to execute on the profit improvement programs we announced in October of 2012. The majority of the benefits from our profit improvement programs will occur in FY 2015 and to a greater extent FY 2016.*  Continue to the next page to complete this exercise | |
| z | Materials for FedEx (continued)  Topics of “Recent” News Stories    Continue to the answer key on the next page to see if you found a good selection of potential critical factors | |

| Simulation, Part C Answer Key | | | |
| --- | --- | --- | --- |
| Description: Handouts Content Block Icon | | The answer key below includes many of the potential factors that could be on your list |
| z | | Materials for FedEx   * Assume the materials that follow are the most current available (the time is late 2013)   Excerpt From a “Current” Regulatory Filing (Fiscal 2Q14 – Dec 2013)  FedEx Ground average daily volume grew 8% in the second quarter, as growth in both business-to-business and FedEx Home Delivery services was driven by market share gains. Revenue per package increased 2% due to rate increases and higher residential surcharges, partially offset by lower fuel surcharges. FedEx SmartPost average daily volume increased 9% primarily due to growth in e-commerce. FedEx SmartPost net revenue per package was down 3% due to higher postage rates and lower fuel surcharges, partially offset by rate increases.  Operating income increased due to higher volume and revenue per package. Operating margin declined primarily due to this year's later start of the holiday shipping season, as Cyber Week occurred in December this year versus November last year. The seasonal increases in volume, revenue and operating income related to Cyber Week will be realized in this year's third quarter versus the second quarter last year. | |
| z | | Materials for FedEx (continued)  Excerpt From the Transcript of the “Most Recent” Company Call  Alan B. Graf, Jr.  Executive Vice President & CFO, FedEx Corp.  *Good morning everyone. Second-quarter earnings increased to $1.57 per share and operating income increased 15% to $827 million. Yield improvements and cost management at Express were the primary drivers of the profitability improvement. Results also benefited from the favorable comparison to last year's Sandy impacted results, lower pension expense and a modest benefit from the voluntary employee severance program.*  *During the second quarter the Company repurchased 7.2 million shares of FedEx common stock for a total of 10 million shares repurchased fiscal year to date. The second-quarter share repurchases had no effect on the quarter's earnings per share, but will have an estimated $0.04 per share impact for the full-year.*  *Express had a wonderful quarter, operating income increased to $326 million, and margin increased to 4.8% despite slightly lower revenue. The profitability improvement was driven by stronger base U.S. and international package yields, lower pension expense and lower net expenses from ongoing cost reduction activities.*  *Turning to our Ground segment, revenues increased 10% to $2.9 billion and operating income increased $424 million due to volume and yield growth at Ground and volume growth at SmartPost.*  *Turning to the outlook, we expect revenue and earnings growth to continue into the third quarter and the remainder of FY 2014 from ongoing improvements in the results of all of our transportation segments. Based on these improvements, plus our to date share repurchase results, we are raising our earnings per share guidance for the full-year to 8% to 14% from the FY 2013 adjusted results. This compares to our previous growth range of 7% to 13%.*  *We are continuing to execute on the profit improvement programs we announced in October of 2012. The majority of the benefits from our profit improvement programs will occur in FY 2015 and to a greater extent FY 2016.* | |
| z | | Materials for FedEx (continued)  Topics of “Recent” News Stories | |

Module 4: Speak to Participants

| “Get to the Critical Factors” Exercise | | |
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| Handouts%201 | Instructions for “Get to the Critical Factors” Exercise Prep Work   * The purpose of this exercise is to hone your skills for interviewing others to get to the critical factors as quickly as possible * Select one item from the materials you have reviewed during the prior activities, preferably one that can be quantified in terms of its impact on the company’s income statement * Spend 2-3 minutes on your own to quantify the *materiality* of this critical factor before continuing to the next step (improvise if you do not have enough information to make an exact calculation)   + Use your earnings model to quantify the impact, or   + If you did not bring an earnings model, use the FedEx income statement found earlier in this guide (improvise if necessary)   + For example, in a prior exercise you determined a 1% increase in FedEx’s fuel surcharge (a critical factor at the time) impacted EPS by $0.87 * Let the facilitator know you’re ready by:   + Putting down your pen (if in-person); or   + Select the green “Agree” status icon (if working on-line) |

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| Description: Handouts Content Block Icon | Instructions for “Get to the Critical Factors” Exercise   * After the facilitator instructs you to continue: * Divide into pairs of learners, and try not to work with someone who covers your sector or a related sector   + One of you will start by being a sell-side analyst making a call to the other person who will be a buy-side analyst   + After you end your first conversation, switch roles   + Select your role first and then read **ONLY YOUR ROLE** on one of the next two pages * The work you did directly above is used when you play the Sell-side role only * Do not turn to the next page until you have:   + Identified a critical factor and computed its materiality   + Paired up with another learner   + Selected your role |

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| Handouts%201 | Read ONLY if you are playing the SELL-SIDE Role:   * It is *Institutional Investor* voting season and you want to get a vote from the client you are about to call, who just picked up your sector. Your goal is to make the conversation go as long as possible. * Think of a *fictitious* research report you have written on the topic that shows **you have a proprietary insight about the critical factor you just selected** * Call the client to discuss your research report * The client is new to following the sector and so avoid complex ideas or terms * Ground rule: you must remain very professional because you work for a prestigious firm and would not want to harm its reputation * Improvise as needed |

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| Handouts%201 | Read ONLY if you are playing the BUY-SIDE Role:   * You receive a call from a sell-side analyst about a stock that you have just been assigned. Ask questions to determine if the research is about a **true critical factor** or if the analyst is wasting your time. * Your goal is to get off the phone as quickly as possible because you want to continue conducting your own proprietary research. Specifically, ask the analyst about the four areas in the EPIC™ framework:   + Is the factor the analyst is calling about likely to **E**xceed your materiality threshold? **Demand to get exact numbers** by conducting the math with the sell-side analyst (any self-respecting sell-side analyst should have his/her model available when they call you). **Do not let them avoid giving you a number**.   + **P**robability of occurring?     - What unique work or insight do they have that suggests this is likely to occur during your investment time horizon?     - Does the timing of the “materiality” impact on EPS they provided above match the timing of your investment time horizon? (if not, ask why)   + Determine if the analyst is good at forecasting the catalyst (what has the analyst done to provide a forecast more accurate than consensus on this issue?)   + Are the analyst’s assumptions about the factor already in **C**onsensus? If so, why are is the sell-side analyst wasting your time? If not:     - Why has consensus missed this?     - What catalyst is going to occur (and when) to bring around consensus’ way of thinking? * Ground rule: you must remain very professional because you work for a prestigious firm and would not want to harm its reputation * Improvise as needed |

Module 5: Monitoring Critical Factors

| Flow Chart | | |
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| z | Flow Chart for “Monitor” Process (see next 2 pages for enlarged details) |
| z | Flow Chart for “Monitor” Process (left side expanded) |
| z | Flow Chart for “Monitor” Process (right side expanded) |

| “Monitoring for Critical Factors” Exercise | | |
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| Handouts%201 | Instructions for the “Monitoring for Critical Factors” Exercise:   * The objective of the “game” is to get to one of the tan or blue ovals by asking the questions in the flow chart. The “winner” is the person who asks the author of a card as few questions as possible. * Before starting, each player creates two factors for their stock, one per index card:   + - 1. A true critical factor that moved the stock     - 2. A factor the market or financial media initially thought was a critical factor that may have initially moved the stock but DID NOT move it for long * Write the two factors on separate blank index cards, but do not state which is a critical factor (your colleagues will need to determine this). Provide some detail so they can understand the concept. * Include the following items on the card:   + Company or sector (for example, FedEx/express parcel industry)   + The factor (for example, FedEx announced the purchase of Caliber System, a ground parcel and trucking company competing in areas where FedEx did not have exposure) * Get into pairs and place the flowchart so you can all see it clearly * Exchange cards with your partner * Put a coin on the top oval of the flowchart * Player A reads a card and asks questions to Player B to navigate the coin through the flow chart until arriving on an oval * After Player A arrives at an oval, put the coin back at the top and Player B now reads a card and asks questions to Player A in order to get the coin to an oval at the bottom of the flow chart |

Module 6: Appendix

| Transformation Action Plan (TAP) | | | | | |
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| Handouts%201 | | | | Instructions for the Transformation Action Plan (TAP):   * Throughout this workshop complete the TAP below * Apply the key points after the workshop to help you improve your performance. * This will not be collected and so write in a manner that will help you utilize the concepts being learned. |
| z | | TAP Section Speak to Market Participants to Test Hypothesis  * Answer the questions to the 3 questions in the tables that follow:  |  | | --- | | 1. Steps I can take to better evaluate my potential critical factors | |  | |  | |  | | | |
| z | | |  | | --- | | 2. I will do the following to increase the amount of time I’m communicating with good sources of information to identify and assess critical factors (this will likely include reducing some existing activities): | |  | |  | |  | | | | |
| z | | |  | | --- | | 3. Individuals or specific types of individuals I will add to my communication effort who are knowledgeable about my critical factors: | |  | |  | |  | |  | |  | | | | |
| z | | TAP Section Simulation, Part D  * This is the most important part of the process, where you will prioritize the *potential* critical factors you highlighted earlier in Parts B and C of the simulation (either using the materials for your stock or FedEx) * Go to the next page and complete “Exhibit A”:   + Start by listing at least 5 factors you collected earlier, preferably 2-3 that you believe are most likely critical factors and 2-3 least likely (if you are not sure how to start the list, peek at the “Sample for Exhibit A” which is found immediately after Exhibit A)   + In four columns right of your list of factors, rank each factor on a scale of 1 to 5, with 5 as “strongly agree”, using statements based on the EPIC™ framework discussed earlier * Given the limited time you have had to conduct the initial research on your stock or FedEx, you will probably need to guess for your rankings in many of the cells. Don’t become frustrated for not knowing the answer – **this exercise is to help you become familiar with the process, not be an expert on the stock** * Once you have evaluated at least 5 factors, add up the score of each row in the right most column * If you have been using FedEx as your stock for this workshop, review “Answer Key” at the end of your Learner Workbook to see the examples for FedEx   Note: To save time, if you are using the Microsoft Word version of this file, after entering the numbers in the first four columns, highlight the entire table and press the F9 key to automatically populate the “Total” column. Then change the font color to see the values. | | | |
| z | | EXHIBIT A Critical Factors for (ticker):\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_   |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | | Complete this column from the factors you highlighted in Parts B & C of the Simulation | Rank each factor on a scale of 1 to 5, with 5 as “strongly agree” | | | | | | Factor to Potentially Be Researched | If this factor were to occur or change from trend, it would cause changes in consensus’ expectations to **E**xceed my materiality threshold | This factor will **P**robably deviate materially from consensus expectations during my investment time horizon | Based on my research on the factor, **I**'m good at forecasting this factor and its catalyst (it’s not just a guess) | The overall **C**onsensus will be poor at accurately forecasting or spotting an anomaly for this factor | Total | | If you’re not sure where to start, see samples for FDX in table that follows |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | |  |  |  |  |  | 0 | | | | |
| z | | SAMPLE for Exhibit A based on FedEx (sorted alphabetically)  |  | | --- | | Factor to Potentially Be Researched | | Acquisition(s) | | Asia-Pacific volume growth | | Change in level of tech shippers vs. non-tech shippers | | Change in senior management | | Cost management/productivity/Improved network efficiency | | Depreciation rate | | Domestic Express package pricing/yield | | Domestic Express package volume growth | | Electronic documents reducing need for overnight envelopes | | GDP growth | | Ground package pricing/yield | | Ground package volume growth | | International Priority package pricing/yield | | International Priority package volume growth | | Labor cost trends | | Level of fuel surcharge collected | | Level of major weather disruptions | | Purchase of new aircraft | | Service levels at holiday season | | Service levels other than during the holiday season | | | | | | |
| z | | | ANSWER KEY FOR FEDEX  PLEASE DO NOT REVIEW UNTIL TOLD TO DO SO:  Factors for: FedEx in the 2005-2006 time period, ranked by “Total” column   |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | | Factor to Potentially Be Researched | If this factor were to occur or change from trend, it would cause changes in consensus’ expectations to **E**xceed my materiality threshold | This factor will **P**robably deviate materially from consensus expectations during my investment time horizon | Based on my research on the factor, **I**'m good at forecasting this factor and its catalyst (it’s not just a guess) | The overall **C**onsensus will be poor at accurately forecasting or spotting an anomaly for this factor | Total | | Cost management/productivity/Improved network efficiency | 5 | 4 | 4 | 5 | 18 | | Level of fuel surcharge collected | 5 | 4 | 4 | 4 | 17 | | Acquisition(s) | 5 | 3 | 2 | 5 | 15 | | Ground package volume growth | 3 | 4 | 4 | 4 | 15 | | Domestic Express package pricing/yield | 4 | 3 | 4 | 3 | 14 | | Ground package pricing/yield | 4 | 3 | 3 | 4 | 14 | | International Priority package pricing/yield | 3 | 4 | 3 | 4 | 14 | | International Priority package volume growth | 2 | 4 | 4 | 4 | 14 | | Service levels other than during the holiday season | 3 | 2 | 4 | 5 | 14 | | Change in senior management | 5 | 2 | 2 | 4 | 13 | | Electronic documents reducing need for overnight envelopes | 2 | 4 | 3 | 4 | 13 | | GDP growth | 5 | 3 | 2 | 3 | 13 | | Labor cost trends | 3 | 3 | 3 | 4 | 13 | | Domestic Express package volume growth | 2 | 3 | 4 | 3 | 12 | | Service levels at holiday season | 2 | 2 | 3 | 5 | 12 | | Asia-Pacific volume growth | 2 | 3 | 4 | 2 | 11 | | Change in level of tech shippers vs. non-tech shippers | 4 | 2 | 3 | 2 | 11 | | Purchase of new aircraft | 1 | 3 | 3 | 4 | 11 | | Level of major weather disruptions | 1 | 3 | 1 | 5 | 10 | | Depreciation rate | 1 | 2 | 2 | 4 | 9 |   Note: Some of the new or emerging factors you highlighted in Part C of the simulation may not be in the list above because this list is for the period ending mid-2006 | | | | |
| Description: Handouts Content Block Icon | | | | TAP Section Create Critical Factors Worthy of Further Research  * Read the list of potential critical factors below from a variety of North American sectors * Below the table, record three potential critical factors for stocks in your universe that you intend to research further after this workshop | | | |
| z | | | Potential Critical Factors Worth Further Research   |  |  | | --- | --- | | Sector | Critical Factor?\* | | Automobile Manufacturers | Will deflation of new car pricing cause unexpected downward pressure on used car pricing, beyond current consensus thinking? | | Cable Providers | Will growth of non-cable content providers such as Netflix, Amazon and HBO deteriorate the cable bundle faster than consensus expectations? | | Drug Retailers | Will drug retailers be hurt by unexpectedly strong inflation in generic drug pricing? | | Media | Will the growth of advertising on mobile devices take more spending away from traditional channels (e.g. TV) than current consensus expectations? | | Oil Services | Will the decline in oil prices drive consolidation and if so, who will be the winners and losers? | | Railroads | Will railroad customer pricing accelerate higher than expected due to tight trucking capacity? | | Renewable Energy | Will energy storage costs decline faster than consensus expectations, leading more users away from traditional utilities? | | Retail, Apparel | Will apparel pricing grow slower on a secular basis, given the consumer’s newfound appetite for discounting brought about during the 2008 recession? | | Software | Will newfound growth of the distribution channels for Open Source software have a negative impact on traditional software companies? | | Telecom | Will saturation of the domestic smartphone market lead to price wars among the wireless carriers that causes consensus expectations to drop? | | Wireless Equipment | Will a more competitive wireless phone market and greater emphasis by the carriers to improve efficiency (rather than their historical emphasis on upgrading networks) cause a bigger-than-expected drop in capital spending? |   \* Created in early 2015 and therefore some of the examples will become outdated over time | | | | |
| z | | | |  | | --- | | These are potential critical factors for stocks in my sector that I intend to research further: | |  | |  | |  | | | | | |
| z | | | TAP Section Create Your Monitoring Matrix Complete the following table for the four highest-ranked factors in Exhibit A.   |  |  |  |  |  | | --- | --- | --- | --- | --- | | Critical Factor | Issue to Explore | Potential Catalysts | Contact Source | Frequency | |  |  |  |  |  | |  |  |  |  |  | |  |  |  |  |  | |  |  |  |  |  | | | | | | |

| Notes |
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