

FEDEX CORP  
Form 10-Q  
September 19, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED AUGUST 31, 2008  
OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

**Commission File Number: 1-15829  
FEDEX CORPORATION**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or  
organization)

62-1721435  
(I.R.S. Employer Identification No.)

942 South Shady Grove Road  
Memphis, Tennessee  
(Address of principal executive offices)

38120  
(ZIP Code)

(901) 818-7500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock  
Common Stock, par value \$0.10 per share

Outstanding Shares at September 15, 2008  
311,241,913



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FEDEX CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN MILLIONS)

	August 31, 2008 (Unaudited)	May 31, 2008
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 1,573	\$ 1,539
Receivables, less allowances of \$155 and \$158	4,361	4,359
Spare parts, supplies and fuel, less allowances of \$164 and \$163	412	435
Deferred income taxes	528	544
Prepaid expenses and other	300	367
Total current assets	7,174	7,244
<b>PROPERTY AND EQUIPMENT, AT COST</b>		
Less accumulated depreciation and amortization	28,710	29,305
	15,177	15,827
Net property and equipment	13,533	13,478
<b>OTHER LONG-TERM ASSETS</b>		
Goodwill	3,160	3,165
Pension assets	1,310	827
Intangible and other assets	966	919
Total other long-term assets	5,436	4,911
	\$ 26,143	\$ 25,633

The accompanying notes are an integral part of these condensed consolidated financial statements.

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FEDEX CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(IN MILLIONS, EXCEPT SHARE DATA)

	August 31, 2008 (Unaudited)	May 31, 2008
<b>LIABILITIES AND STOCKHOLDERS INVESTMENT</b>		
<b>CURRENT LIABILITIES</b>		
Current portion of long-term debt	\$ 1,001	\$ 502
Accrued salaries and employee benefits	890	1,118
Accounts payable	2,050	2,195
Accrued expenses	1,578	1,553
 Total current liabilities	 5,519	 5,368
 LONG-TERM DEBT, LESS CURRENT PORTION	 1,007	 1,506
 OTHER LONG-TERM LIABILITIES		
Deferred income taxes	1,484	1,264
Pension, postretirement healthcare and other benefit obligations	997	989
Self-insurance accruals	813	804
Deferred lease obligations	683	671
Deferred gains, principally related to aircraft transactions	309	315
Other liabilities	191	190
 Total other long-term liabilities	 4,477	 4,233
 COMMITMENTS AND CONTINGENCIES		
 COMMON STOCKHOLDERS INVESTMENT		
Common stock, \$0.10 par value; 800 million shares authorized; 311 million shares issued as of August 31, 2008 and May 31, 2008	31	31
Additional paid-in capital	1,954	1,922
Retained earnings	13,274	13,002
Accumulated other comprehensive loss	(115)	(425)
Treasury stock, at cost	(4)	(4)
 Total common stockholders investment	 15,140	 14,526
	\$ 26,143	\$ 25,633

The accompanying notes are an integral part of these condensed consolidated financial statements.



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FEDEX CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 (UNAUDITED)  
 (IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended August 31,	
	2008	2007
REVENUES	\$ 9,970	\$ 9,199
OPERATING EXPENSES:		
Salaries and employee benefits	3,585	3,483
Purchased transportation	1,207	1,025
Rentals and landing fees	617	593
Depreciation and amortization	492	473
Fuel	1,599	964
Maintenance and repairs	537	544
Other	1,303	1,303
	9,340	8,385
OPERATING INCOME	630	814
OTHER INCOME (EXPENSE):		
Interest, net	(9)	(25)
Other, net	(3)	(2)
	(12)	(27)
INCOME BEFORE INCOME TAXES	618	787
PROVISION FOR INCOME TAXES	234	293
NET INCOME	\$ 384	\$ 494
EARNINGS PER COMMON SHARE:		
Basic	\$ 1.24	\$ 1.60
Diluted	\$ 1.23	\$ 1.58
DIVIDENDS DECLARED PER COMMON SHARE	\$ 0.22	\$ 0.10



The accompanying notes are an integral part of these condensed consolidated financial statements.

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FEDEX CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (UNAUDITED)  
 (IN MILLIONS)

	Three Months Ended August 31,	
	2008	2007
Operating Activities:		
Net income	\$ 384	\$ 494
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	492	473
Provision for uncollectible accounts	35	33
Stock-based compensation	33	29
Deferred income taxes and other noncash items	35	32
Changes in operating assets and liabilities:		
Receivables	(98)	(35)
Other assets	97	(32)
Accounts payable and other operating liabilities	(306)	(166)
Other, net	26	(27)
Cash provided by operating activities	698	801
Investing Activities:		
Capital expenditures	(636)	(775)
Proceeds from asset dispositions and other	15	4
Cash used in investing activities	(621)	(771)
Financing Activities:		
Principal payments on debt	(1)	(507)
Proceeds from stock issuances	5	40
Excess tax benefit on the exercise of stock options		9
Dividends paid	(34)	(31)
Cash used in financing activities	(30)	(489)
Effect of exchange rate changes on cash	(13)	2
Net increase (decrease) in cash and cash equivalents	34	(457)
Cash and cash equivalents at beginning of period	1,539	1,569
Cash and cash equivalents at end of period	\$ 1,573	\$ 1,112

The accompanying notes are an integral part of these condensed consolidated financial statements.

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FEDEX CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

(1) **General**

*SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES.* These interim financial statements of FedEx Corporation ( FedEx ) have been prepared in accordance with accounting principles generally accepted in the United States and Securities and Exchange Commission ( SEC ) instructions for interim financial information, and should be read in conjunction with our Annual Report on Form 10-K for the year ended May 31, 2008 ( Annual Report ). Accordingly, significant accounting policies and other disclosures normally provided have been omitted since such items are disclosed therein.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (including normal recurring adjustments) necessary to present fairly our financial position as of August 31, 2008 and the results of our operations and cash flows for the three-month periods ended August 31, 2008 and 2007. Operating results for the three-month period ended August 31, 2008 are not necessarily indicative of the results that may be expected for the year ending May 31, 2009.

Except as otherwise specified, references to years indicate our fiscal year ending May 31, 2009 or ended May 31 of the year referenced and comparisons are to the corresponding period of the prior year.

Certain prior period amounts have been reclassified to conform to the current period's presentation.

*NEW ACCOUNTING PRONOUNCEMENTS.* New accounting rules and disclosure requirements can significantly impact our reported results and the comparability of our financial statements. We believe the following new accounting pronouncements are relevant to the readers of our financial statements.

On May 31, 2007, we adopted Statement of Financial Accounting Standards ( SFAS ) 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. SFAS 158 requires recognition in the balance sheet of the funded status of defined benefit pension and other postretirement benefit plans, and the recognition in accumulated other comprehensive income ( AOCI ) of unrecognized gains or losses and prior service costs or credits. Additionally, SFAS 158 requires the measurement date for plan assets and liabilities to coincide with the sponsor's year end. On June 1, 2008, we made our transition election for the measurement date provision of SFAS 158 using the two-measurement approach. Under this approach, we completed two actuarial measurements, one at February 29, 2008 and the other at June 1, 2008. This approach requires us to record the net periodic benefit cost for the transition period from March 1, 2008 through May 31, 2008 as an adjustment to beginning retained earnings (\$44 million, net of tax) and actuarial gains and losses for the period (a gain of \$372 million, net of tax) as an adjustment to the opening balance of AOCI. These adjustments increased the amount recorded for our pension assets by \$528 million. Our actuarial gains resulted primarily from a 19 basis point increase in the discount rate for our primary pension plan and an increase in plan assets at June 1, 2008.

On June 1, 2008, we adopted SFAS 157, Fair Value Measurements, which provides a common definition of fair value, establishes a uniform framework for measuring fair value and requires expanded disclosures about fair value measurements. There is a one-year deferral of the adoption of the standard as it relates to non-financial assets and liabilities. The adoption of SFAS 157 had no impact on our financial statements at June 1, 2008.

In December 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS 141R, Business Combinations, and SFAS 160, Accounting and Reporting Noncontrolling Interest in Consolidated Financial Statements, an amendment of ARB No. 51.

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These new standards significantly change the accounting for and reporting of business combination transactions, including noncontrolling interests (previously referred to as minority interests). For example, these standards require the acquiring entity to recognize the full fair value of assets acquired and liabilities assumed in the transaction and require the expensing of most transaction and restructuring costs. Both standards are effective for us beginning June 1, 2009 (fiscal 2010) and are applicable only to transactions occurring after the effective date.

*DIVIDENDS DECLARED PER COMMON SHARE.* In 2009, we declared two quarterly dividends within the first quarter. On June 2, 2008, our Board of Directors declared a dividend of \$0.11 per share of common stock. The dividend was paid on July 1, 2008 to stockholders of record as of the close of business on June 13, 2008. On August 15, 2008, our Board of Directors declared a dividend of \$0.11 per share of common stock. The dividend will be paid on October 1, 2008 to stockholders of record as of the close of business on September 10, 2008. Each quarterly dividend payment is subject to review and approval by our Board of Directors, and we evaluate our dividend payment amount on an annual basis at the end of each fiscal year.

**(2) Stock-Based Compensation**

We have two types of equity-based compensation: stock options and restricted stock. The key terms of the stock option and restricted stock awards granted under our incentive stock plans are set forth in our Annual Report. We use the Black-Scholes option pricing model to calculate the fair value of stock options. The value of restricted stock awards is based on the price of the stock on the grant date. We recognize stock-based compensation expense on a straight-line basis over the requisite service period of the award in the Salaries and employee benefits caption of our condensed consolidated income statement.

Our total stock-based compensation expense was \$33 million for the three months ended August 31, 2008 and \$29 million for the three months ended August 31, 2007.

During the first quarter of 2009, we made stock option grants of 1.9 million shares, primarily in connection with our principal annual stock option grant. We granted options to purchase 2.4 million shares during the first quarter of 2008. See our Annual Report for a discussion of our methodology for developing each of the assumptions used in the valuation model. The fair value of our stock option grants, as determined by the Black-Scholes valuation model, was \$24.87 during the first quarter of 2009 and \$31.21 during the first quarter of 2008, using the following assumptions:

	Three Months Ended August 31,	
	2008	2007
Expected lives	5.5 years	5 years
Expected volatility	23%	19%
Risk-free interest rate	3.56%	5.03%
Dividend yield	0.452%	0.322%

**Table of Contents****(3) Comprehensive Income**

The following table provides a reconciliation of net income reported in our financial statements to comprehensive income for the three-month periods ended August 31 (in millions):

	2008	2007
Net income	\$ 384	\$ 494
Other comprehensive income:		
Foreign currency translation adjustments, net of deferred tax benefit of \$11 in 2008 and deferred taxes of \$1 in 2007	(47)	16
Amortization of unrealized pension actuarial gains/losses, net of deferred tax benefit of \$7 in 2008 and deferred taxes of \$8 in 2007	(11)	14
Comprehensive income	\$ 326	\$ 524

**(4) Financing Arrangements**

We have a shelf registration statement filed with the SEC that allows us to sell, in one or more future offerings, any combination of unsecured debt securities and common stock.

From time to time, we finance certain operating and investing activities, including acquisitions, through borrowings under our \$1.0 billion revolving credit facility or the issuance of commercial paper. The revolving credit agreement contains certain covenants and restrictions, none of which are expected to significantly affect our operations or ability to pay dividends. Our commercial paper program is backed by unused commitments under the revolving credit facility and borrowings under the program reduce the amount available under the credit facility. At August 31, 2008, no commercial paper borrowings were outstanding and the entire amount under the credit facility was available.

**Table of Contents****(5) Computation of Earnings Per Share**

The calculation of basic and diluted earnings per common share for the three-month periods ended August 31 was as follows (in millions, except per share amounts):

	2008	2007
Net income	\$ 384	\$ 494
Weighted-average shares of common stock outstanding	311	308
Common equivalent shares:		
Assumed exercise of outstanding dilutive options	9	16
Less shares repurchased from proceeds of assumed exercise of options	(7)	(12)
Weighted-average common and common equivalent shares outstanding	313	312
Basic earnings per common share	\$ 1.24	\$ 1.60
Diluted earnings per common share	\$ 1.23	\$ 1.58
Antidilutive options excluded from diluted earnings per common share calculation	9.6	2.7

**(6) Retirement Plans**

We sponsor programs that provide retirement benefits to most of our employees. These programs include defined benefit pension plans, defined contribution plans and postretirement healthcare plans. Key terms of our retirement plans are provided in our Annual Report. Our retirement plans costs for the three-month periods ended August 31 were as follows (in millions):

	2008	2007
U.S. domestic and international pension plans	\$ 44	\$ 85
U.S. domestic and international defined contribution plans	84	38
Postretirement healthcare plans	14	16
	\$ 142	\$ 139

The reduction in pension costs for the three-month period ended August 31, 2008 was due to lower pension expense attributable to a significantly higher discount rate used to determine our 2009 expense. The increase in defined contribution costs for the three-month period ended August 31, 2008 was due to plan design changes, which are described in our Annual Report.

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Net periodic benefit cost for the three-month periods ended August 31 was as follows (in millions):

	Pension Plans		Postretirement Healthcare Plans	
	2008	2007	2008	2007
Service cost	\$ 125	\$ 129	\$ 8	\$ 9
Interest cost	200	180	8	8
Expected return on plan assets	(265)	(246)		
Amortization of prior service cost and other	(16)	22	(2)	(1)
	\$ 44	\$ 85	\$ 14	\$ 16

We made no contributions to our qualified U.S. domestic pension plans during the first quarter of 2009 and \$110 million of such contributions during the first quarter of 2008. However, on September 2, 2008, we made tax-deductible voluntary contributions of \$483 million to these plans. We do not expect to make further contributions to our qualified U.S. domestic pension plans for the remainder of 2009. In 2008, we contributed an aggregate of \$479 million to these plans.

(7) **Business Segment Information**

We provide a broad portfolio of transportation, e-commerce and business services through companies competing collectively, operating independently and managed collaboratively under the respected FedEx brand. Our primary operating companies include Federal Express Corporation ( FedEx Express ), the world's largest express transportation company; FedEx Ground Package System, Inc. ( FedEx Ground ), a leading provider of small-package ground delivery services; and FedEx Freight Corporation, a leading U.S. provider of less-than-truckload ( LTL ) freight services. Our FedEx Services segment provides customer-facing sales, marketing, information technology and customer service support, as well as retail access for customers through FedEx Office and Print Services, Inc. ( FedEx Office ), primarily for the benefit of FedEx Express and FedEx Ground. These companies represent our major service lines and form the core of our reportable segments.

Our reportable segments include the following businesses:

<b>FedEx Express Segment</b>	FedEx Express (express transportation) FedEx Trade Networks (global trade services)
<b>FedEx Ground Segment</b>	FedEx Ground (small-package ground delivery) FedEx SmartPost (small-parcel consolidator)
<b>FedEx Freight Segment</b>	FedEx Freight LTL Group: FedEx Freight (regional LTL freight transportation) FedEx National LTL (long-haul LTL freight transportation) FedEx Custom Critical (time-critical transportation) Caribbean Transportation Services (airfreight forwarding)
<b>FedEx Services Segment</b>	FedEx Services (sales, marketing and information technology functions) FedEx Office (document and business services and package acceptance) FedEx Customer Information Services ( FCIS ) (customer service, billings and collections) FedEx Global Supply Chain Services (logistics services)





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The FedEx Services segment includes: FedEx Services, which provides sales, marketing and information technology support; FCIS, which is responsible for customer service, billings and collections for FedEx Express and FedEx Ground U.S. customers; FedEx Global Supply Chain Services, which provides a range of logistics services to our customers; and FedEx Office, which provides retail access to our customers for our package transportation businesses and an array of document and business services.

The costs of the sales, marketing and information technology support provided by FedEx Services and the customer service functions of FCIS, together with the normal, ongoing net operating costs of FedEx Global Supply Chain Services and FedEx Office, are allocated primarily to the FedEx Express and FedEx Ground segments based on metrics such as relative revenues or estimated services provided. We believe these allocations approximate the net cost of providing these functions.

Certain FedEx operating companies provide transportation and related services for other FedEx companies outside their reportable segment. Billings for such services are based on negotiated rates, which we believe approximate fair value, and are reflected as revenues of the billing segment. These rates are adjusted from time to time based on market conditions. Such intersegment revenues and expenses are eliminated in the consolidated results and are not separately identified in the following segment information, as the amounts are not material.

The operating expenses line item Intercompany charges on the accompanying unaudited financial summaries of our transportation segments in Management's Discussion and Analysis of Operations and Financial Condition ( MD&A ) includes the allocations from the FedEx Services segment to the respective transportation segments. The

Intercompany charges caption also includes allocations for administrative services provided between operating companies and certain other costs such as corporate management fees related to services received for general corporate oversight, including executive officers and certain legal and finance functions. Management evaluates segment financial performance based on operating income.

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The following table provides a reconciliation of reportable segment revenues and operating income to our condensed consolidated financial statement totals for the three-month periods ended August 31 (in millions):

	2008	2007
Revenue		
FedEx Express segment	\$ 6,419	\$ 5,889
FedEx Ground segment	1,761	1,618
FedEx Freight segment	1,353	1,233
FedEx Services segment	513	525
Other and eliminations	(76)	(66)
	\$ 9,970	\$ 9,199
Operating Income		
FedEx Express segment	\$ 345	\$ 519
FedEx Ground segment	196	190
FedEx Freight segment	89	105
FedEx Services segment <sup>(1)</sup>		
Other and eliminations		
	\$ 630	\$ 814

(1) The normal, ongoing net operating costs of the FedEx Services segment are allocated back to the transportation segments.

**(8) Commitments**

As of August 31, 2008, our purchase commitments under various contracts for the remainder of 2009 and annually thereafter were as follows (in millions):

	Aircraft	Aircraft- Related <sup>(1)</sup>	Other <sup>(2)</sup>	Total
2009 (remainder)	\$ 727	\$ 154	\$ 387	\$ 1,268
2010	910	132	137	1,179
2011	736	9	69	814
2012	82		58	140
2013			33	33
Thereafter			133	133

(1)

Primarily  
aircraft  
modifications.

- (2) Primarily  
vehicles,  
facilities, and  
advertising and  
promotions  
contracts.

The amounts reflected in the table above for purchase commitments represent non-cancelable agreements to purchase goods or services. Commitments to purchase aircraft in passenger configuration do not include the attendant costs to modify these aircraft for cargo transport unless we have entered into non-cancelable commitments to modify such aircraft. Open purchase orders that are cancelable are not considered unconditional purchase obligations for financial reporting purposes and are not included in the table above.

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Deposits and progress payments of \$326 million have been made toward aircraft purchases, options to purchase additional aircraft and other planned aircraft-related transactions. Our primary aircraft purchase commitments include the Boeing 757 ( B757 ) in passenger configuration, which will require additional costs to modify for cargo transport, and the new Boeing 777 Freighter ( B777F ) aircraft. In addition, we have committed to modify our DC10 aircraft for two-man cockpit configurations. Future payments related to these activities are included in the table above. Aircraft and aircraft-related contracts are subject to price escalations. The following table is a summary of the number and type of aircraft we are committed to purchase as of August 31, 2008, with the year of expected delivery:

	A300	B757	B777F	MD11	Total
2009 (remainder)	3	13		1	17
2010		6	4	1	11
2011		5	10		15
2012		2	1		3
Total	3	26	15	2	46

A summary of future minimum lease payments under capital leases and noncancelable operating leases with an initial or remaining term in excess of one year at August 31, 2008 is as follows (in millions):

	Operating Leases			
	Capital Leases	Aircraft and Related Equipment	Facilities and Other	Total Operating Leases
2009 (remainder)	\$ 10	\$ 454	\$ 947	\$ 1,401
2010	97	545	1,140	1,685
2011	8	526	984	1,510
2012	8	504	855	1,359
2013	119	499	736	1,235
Thereafter	17	2,931	5,501	8,432
Total	259	\$ 5,459	\$ 10,163	\$ 15,622
Less amount representing interest	40			
Present value of net minimum lease payments	\$ 219			

While certain of our lease agreements contain covenants governing the use of the leased assets or require us to maintain certain levels of insurance, none of our lease agreements include material financial covenants or limitations. FedEx Express makes payments under certain leveraged operating leases that are sufficient to pay principal and interest on certain pass-through certificates. The pass-through certificates are not direct obligations of, or guaranteed by, FedEx or FedEx Express.

**Table of Contents****(9) Contingencies**

*Wage-and-Hour.* We have agreed to settle two wage-and-hour lawsuits against FedEx Ground for an immaterial amount and executed a settlement agreement, which awaits court approval. We are a defendant in a number of other lawsuits containing various class-action allegations of wage-and-hour violations. The plaintiffs in these lawsuits allege, among other things, that they were forced to work off the clock, were not paid overtime or were not provided work breaks or other benefits. The complaints generally seek unspecified monetary damages, injunctive relief, or both. In February 2008, one of these wage-and-hour cases, *Wiegele v. FedEx Ground*, was certified as a class action by a California federal court, and in April 2008, the U.S. Court of Appeals for the Ninth Circuit denied our petition to review the class certification ruling. The class certification ruling, however, does not address whether we will ultimately be held liable. The plaintiffs in *Wiegele* represent a class of FedEx Ground sort managers and dock service managers in California from May 10, 2002 to present. The plaintiffs allege that FedEx Ground has misclassified the managers as exempt from the overtime requirements of California wage-and-hour laws and is correspondingly liable for failing to pay them overtime compensation and for failing to provide them with rest and meal breaks.

On September 17, 2008, in another of these wage-and-hour cases, *Tidd v. Adecco USA, Kelly Services and FedEx Ground*, a Massachusetts federal court conditionally certified a class limited to individuals who were employed by two temporary employment agencies and who worked as temporary pick-up-and-delivery drivers for FedEx Ground in the New England region within the past three years. Potential claimants must voluntarily opt in to the lawsuit in order to be considered part of the class, and the conditional class certification ruling does not address whether we will ultimately be held liable. In addition, in the same opinion, the court granted summary judgment in favor of the defendants with respect to the plaintiffs' claims for unpaid overtime wages under the federal Fair Labor Standards Act (FLSA) and Massachusetts law. Accordingly, the conditionally certified class of plaintiffs is now limited to a claim of failure to pay regular wages due under the FLSA.

We have denied any liability and intend to vigorously defend ourselves in these wage-and-hour lawsuits. We do not believe that any loss is probable in these lawsuits, and given the nature and status of the claims, we cannot yet determine the amount or a reasonable range of potential loss, if any.

*Independent Contractor Estrada and Mason.* *Estrada v. FedEx Ground* is a class action involving FedEx Ground single-route contractors in California. In August 2007, the California appellate court affirmed the trial court's ruling in *Estrada* that a limited number of California single-route contractors (most of whom have not contracted with FedEx Ground since 2001) should be reimbursed as employees for some of their operating expenses. The Supreme Court of California has affirmed the appellate court's liability and class certification decisions. The case has been remanded to the trial court for reconsideration of the amount of such reimbursable expenses and attorneys' fees. Forty of the class members from the *Estrada* litigation have filed another lawsuit (entitled *Mason*) seeking reimbursement of expenses for the post-*Estrada* period (January 1, 2005 to present). The forty plaintiffs continued to provide pickup-and-delivery services to FedEx Ground after the damages period terminated in *Estrada* (December 31, 2004). We do not expect to incur a material loss in the *Estrada* and *Mason* matters.

*Independent Contractor Other Lawsuits and State Administrative Proceedings.* FedEx Ground is involved in approximately 50 other class-action lawsuits (including 21 that have been certified as class actions), several individual lawsuits and approximately 35 state tax and other administrative proceedings that claim that the company's owner-operators should be treated as employees, rather than independent contractors.

Most of the class-action lawsuits have been consolidated for administration of the pre-trial proceedings by a single federal court, the U.S. District Court for the Northern District of Indiana. With the exception of recently filed cases that have been or will be transferred to the multidistrict litigation, discovery and class certification briefing are now complete. In October 2007, we received a decision from the court granting class certification in a Kansas action alleging state law claims on behalf of a statewide class and federal law claims under the Employee Retirement Income Security Act of 1974 on behalf of a nationwide class. In January 2008, the U.S. Court of Appeals for the Seventh Circuit declined our request for appellate review of the class certification decision. In March 2008, the court granted class certification in 19 additional cases and denied it in nine cases. The court has not yet ruled on class certification in the other cases that are pending in the multidistrict litigation. Motions for summary judgment on the classification issue (*i.e.*, independent contractor vs. employee) are pending in all 20 of the multidistrict litigation cases that have

been certified as class actions.

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In January 2008, one of the contractor-model lawsuits that is not part of the multidistrict litigation, *Anfinson v. FedEx Ground*, was certified as a class action by a Washington state court. The plaintiffs in *Anfinson* represent a class of FedEx Ground single-route, pickup-and-delivery owner-operators in Washington from December 21, 2001 through December 31, 2005 and allege that the class members should be reimbursed as employees for their uniform expenses and should receive overtime pay. The *Anfinson* case is scheduled for trial in October 2008. The other contractor-model lawsuits that are not part of the multidistrict litigation are not as far along procedurally as *Anfinson*.

FedEx Ground is also involved in several lawsuits, including three purported class actions, brought by drivers of the company's independent contractors who claim that they were jointly employed by the contractor and FedEx Ground. Adverse determinations in these matters could, among other things, entitle certain of our contractors and their drivers to the reimbursement of certain expenses and to the benefit of wage-and-hour laws and result in employment and withholding tax and benefit liability for FedEx Ground, and could result in changes to the independent contractor status of FedEx Ground's owner-operators. We believe that FedEx Ground's owner-operators are properly classified as independent contractors and that FedEx Ground is not an employer of the drivers of the company's independent contractors. Given the nature and status of these lawsuits, we cannot yet determine the amount or a reasonable range of potential loss, if any, but it is reasonably possible that such potential loss or such changes to the independent contractor status of FedEx Ground's owner-operators could be material. However, we do not believe that a material loss is probable in any of these matters.

*Independent Contractor - IRS Audit.* In December 2007, the Internal Revenue Service ( IRS ) informed us that its audit team had concluded an audit for the 2002 calendar year regarding the classification of owner-operators at FedEx Ground. The IRS has tentatively concluded, subject to ongoing discussions with us, that FedEx Ground's pickup-and-delivery owner-operators should be reclassified as employees for federal employment tax purposes. The IRS has indicated that it anticipates assessing tax and penalties of \$319 million plus interest for 2002. Substantially all of the IRS's tentative assessment relates to employment and withholding taxes for the 2002 calendar year and, if paid by the company, would be fully deductible. Similar issues are under audit by the IRS for calendar years 2004 through 2006. We are in discussions with the IRS audit team and expect that a final resolution of this matter will not occur for some time. We believe that we have strong defenses to the IRS's tentative assessment and will vigorously defend our position, as we continue to believe that FedEx Ground's owner-operators are independent contractors. Given the preliminary status of this matter, we cannot yet determine the amount or a reasonable range of potential loss. However, we do not believe that any loss is probable.

*Independent Contractor - Shareholder Derivative Lawsuits.* The Plumbers and Pipefitters Local 51 Pension Fund and the Western Pennsylvania Bricklayers Pension Fund each filed shareholder derivative lawsuits (which have now been consolidated) in Tennessee federal court naming FedEx Corporation as a nominal defendant and the members of the Board of Directors of FedEx Corporation as defendants (the Plumbers and Pipefitters suit was filed in May 2008 and the Bricklayers suit was filed in June 2008). The derivative lawsuits, which are purportedly brought to assert the rights of FedEx Corporation, assert claims against the Board members for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment in connection with the management of FedEx Ground in particular, the classification of FedEx Ground's owner-operators as independent contractors. Given the preliminary status of these matters, we cannot yet determine the amount or a reasonable range of potential loss. However, we do not believe that any loss is probable.



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*Antitrust FedEx Freight Fuel Surcharge.* In July 2007, a purported antitrust class-action lawsuit was filed in California federal court, naming FedEx Corporation (particularly FedEx Freight Corporation and its LTL freight subsidiaries) and several other major LTL freight carriers as defendants. The lawsuit alleges that the defendants conspired to fix fuel surcharge rates in violation of federal antitrust laws and seeks injunctive relief, treble damages and attorneys' fees. Since the filing of the original case, numerous similar cases have been filed against us and other LTL freight carriers, each with allegations of conspiracy to fix fuel surcharge rates along with other related allegations. The U.S. Judicial Panel on Multidistrict Litigation has consolidated these cases for administration of the pre-trial proceedings by a single federal court, the U.S. District Court for the Northern District of Georgia. We do not believe that any loss is probable, and given the nature and status of the claims, we cannot yet determine the amount or a reasonable range of potential loss, if any, in these matters.

*Other.* FedEx and its subsidiaries are subject to other legal proceedings that arise in the ordinary course of their business. In the opinion of management, the aggregate liability, if any, with respect to these other actions will not have a material adverse effect on our financial position, results of operations or cash flows.

**(10) Supplemental Cash Flow Information**

The following table presents supplemental cash flow information for the three-month periods ended August 31 (in millions):

	2008	2007
Cash payments for:		
Interest (net of capitalized interest)	\$ 29	\$ 60
Income taxes	73	91

**(11) Condensed Consolidating Financial Statements**

We are required to present condensed consolidating financial information in order for the subsidiary guarantors (other than FedEx Express) of our public debt to continue to be exempt from reporting under the Securities Exchange Act of 1934.

The guarantor subsidiaries, which are wholly owned by FedEx, guarantee approximately \$1.2 billion of our debt. The guarantees are full and unconditional and joint and several. Our guarantor subsidiaries were not determined using geographic, service line or other similar criteria, and as a result, the Guarantor and Non-Guarantor columns each include portions of our domestic and international operations. Accordingly, this basis of presentation is not intended to present our financial condition, results of operations or cash flows for any purpose other than to comply with the specific requirements for subsidiary guarantor reporting. Condensed consolidating financial statements for our guarantor subsidiaries and non-guarantor subsidiaries are presented in the following tables (in millions):

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CONDENSED CONSOLIDATING BALANCE SHEETS  
(UNAUDITED)  
August 31, 2008

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
<b>CURRENT ASSETS</b>					
Cash and cash equivalents	\$ 1,121	\$ 191	\$ 261	\$	\$ 1,573
Receivables, less allowances	4	3,327	1,061	(31)	4,361
Spare parts, supplies, fuel, prepaid expenses and other, less allowances	6	624	82		712
Deferred income taxes		495	33		528
Total current assets	1,131	4,637	1,437	(31)	7,174
<b>PROPERTY AND EQUIPMENT, AT COST</b>					
	23	26,056	2,631		28,710
Less accumulated depreciation and amortization	16	13,910	1,251		15,177
Net property and equipment	7	12,146	1,380		13,533
INTERCOMPANY RECEIVABLE	1,860		397	(2,257)	
GOODWILL		2,299	861		3,160
INVESTMENT IN SUBSIDIARIES	11,992	2,694		(14,686)	
PENSION ASSETS	1,304	6			1,310
OTHER ASSETS	197	800	140	(171)	966
	\$ 16,491	\$ 22,582	\$ 4,215	\$ (17,145)	\$ 26,143
<b>LIABILITIES AND STOCKHOLDERS' INVESTMENT</b>					
<b>CURRENT LIABILITIES</b>					
Current portion of long-term debt	\$ 1,000	\$	\$ 1	\$	\$ 1,001
Accrued salaries and employee benefits	25	708	157		890
Accounts payable	49	1,596	436	(31)	2,050
Accrued expenses	15	1,343	220		1,578
Total current liabilities	1,089	3,647	814	(31)	5,519
<b>LONG-TERM DEBT, LESS CURRENT PORTION</b>					
	250	756	1		1,007
INTERCOMPANY PAYABLE		2,257		(2,257)	
<b>OTHER LONG-TERM LIABILITIES</b>					
Deferred income taxes		1,544	111	(171)	1,484

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Other liabilities	293	2,588	112		2,993
Total other long-term liabilities	293	4,132	223	(171)	4,477
STOCKHOLDERS INVESTMENT	14,859	11,790	3,177	(14,686)	15,140
	\$ 16,491	\$ 22,582	\$ 4,215	\$ (17,145)	\$ 26,143

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CONDENSED CONSOLIDATING BALANCE SHEETS  
May 31, 2008

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
<b>CURRENT ASSETS</b>					
Cash and cash equivalents	\$ 1,101	\$ 166	\$ 272	\$	\$ 1,539
Receivables, less allowances	4	3,310	1,083	(38)	4,359
Spare parts, supplies, fuel, prepaid expenses and other, less allowances	10	710	82		802
Deferred income taxes		512	32		544
Total current assets	1,115	4,698	1,469	(38)	7,244
PROPERTY AND EQUIPMENT, AT COST	24	26,658	2,623		29,305
Less accumulated depreciation and amortization	16	14,578	1,233		15,827
Net property and equipment	8	12,080	1,390		13,478
INTERCOMPANY RECEIVABLE	1,902		333	(2,235)	
GOODWILL		2,299	866		3,165
INVESTMENT IN SUBSIDIARIES	11,683	2,678		(14,361)	
PENSION ASSETS	813	1	13		827
OTHER ASSETS	381	744	153	(359)	919
	\$ 15,902	\$ 22,500	\$ 4,224	\$ (16,993)	\$ 25,633
<b>LIABILITIES AND STOCKHOLDERS INVESTMENT</b>					
<b>CURRENT LIABILITIES</b>					
Current portion of long-term debt	\$ 500	\$	\$ 2	\$	\$ 502
Accrued salaries and employee benefits	41	881	196		1,118
Accounts payable	11	1,774	448	(38)	2,195
Accrued expenses	23	1,301	229		1,553
Total current liabilities	575	3,956	875	(38)	5,368
LONG-TERM DEBT, LESS CURRENT PORTION	749	756	1		1,506
INTERCOMPANY PAYABLE		2,235		(2,235)	
<b>OTHER LONG-TERM LIABILITIES</b>					
Deferred income taxes		1,518	105	(359)	1,264
Other liabilities	288	2,549	132		2,969
Total other long-term liabilities	288	4,067	237	(359)	4,233
STOCKHOLDERS INVESTMENT	14,290	11,486	3,111	(14,361)	14,526

\$ 15,902 \$ 22,500 \$ 4,224 \$ (16,993) \$ 25,633

**Table of Contents**CONDENSED CONSOLIDATING STATEMENTS OF INCOME  
(UNAUDITED)

Three Months Ended August 31, 2008

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
REVENUES	\$	\$ 8,246	\$ 1,795	\$ (71)	\$ 9,970
OPERATING EXPENSES:					
Salaries and employee benefits	24	2,931	630		3,585
Purchased transportation		842	375	(10)	1,207
Rentals and landing fees	1	535	82	(1)	617
Depreciation and amortization		421	71		492
Fuel		1,490	109		1,599
Maintenance and repairs		497	40		537
Intercompany charges, net	(56)	(32)	89	(1)	
Other	31	1,073	258	(59)	1,303
		7,757	1,654	(71)	9,340
OPERATING INCOME		489	141		630
OTHER INCOME (EXPENSE):					
Equity in earnings of subsidiaries	384	77		(461)	
Interest, net	(10)	5	(4)		(9)
Intercompany charges, net	14	(24)	10		
Other, net	(4)	(6)	7		(3)
INCOME BEFORE INCOME TAXES	384	541	154	(461)	618
Provision for income taxes		176	58		234
NET INCOME	\$ 384	\$ 365	\$ 96	\$ (461)	\$ 384

CONDENSED CONSOLIDATING STATEMENTS OF INCOME  
(UNAUDITED)

Three Months Ended August 31, 2007

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
REVENUES	\$	\$ 7,646	\$ 1,649	\$ (96)	\$ 9,199
OPERATING EXPENSES:					

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Salaries and employee benefits	33	2,856	594		3,483
Purchased transportation		746	298	(19)	1,025
Rentals and landing fees	1	519	74	(1)	593
Depreciation and amortization		399	74		473
Fuel		896	68		964
Maintenance and repairs		506	38		544
Intercompany charges, net	(53)	(18)	71		
Other	19	1,100	260	(76)	1,303
		7,004	1,477	(96)	8,385
OPERATING INCOME		642	172		814
OTHER INCOME (EXPENSE):					
Equity in earnings of subsidiaries	494	74		(568)	
Interest, net	(9)	(13)	(3)		(25)
Intercompany charges, net	12	(13)	1		
Other, net	(3)	1			(2)
INCOME BEFORE INCOME TAXES	494	691	170	(568)	787
Provision for income taxes		245	48		293
NET INCOME	\$ 494	\$ 446	\$ 122	\$ (568)	\$ 494

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CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS  
(UNAUDITED)

Three Months Ended August 31, 2008

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
<b>CASH PROVIDED BY OPERATING ACTIVITIES</b>	\$ 82	\$ 560	\$ 56	\$	\$ 698
<b>INVESTING ACTIVITIES</b>					
Capital expenditures		(571)	(65)		(636)
Proceeds from asset dispositions and other		10	5		15
<b>CASH USED IN INVESTING ACTIVITIES</b>		(561)	(60)		(621)
<b>FINANCING ACTIVITIES</b>					
Net transfers (to) from Parent	(33)	30	3		
Principal payments on debt			(1)		(1)
Proceeds from stock issuances	5				5
Dividends paid	(34)				(34)
<b>CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>	(62)	30	2		(30)
Effect of exchange rate changes on cash		(4)	(9)		(13)
Net increase (decrease) in cash and cash equivalents	20	25	(11)		34
Cash and cash equivalents at beginning of period	1,101	166	272		1,539
Cash and cash equivalents at end of period	\$ 1,121	\$ 191	\$ 261	\$	\$ 1,573

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS  
(UNAUDITED)

Three Months Ended August 31, 2007

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
<b>CASH PROVIDED BY OPERATING ACTIVITIES</b>	\$ 123	\$ 636	\$ 42	\$	\$ 801
<b>INVESTING ACTIVITIES</b>					



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Capital expenditures		(708)		(67)		(775)
Proceeds from asset dispositions and other		2		2		4
<b>CASH USED IN INVESTING ACTIVITIES</b>		<b>(706)</b>		<b>(65)</b>		<b>(771)</b>
<b>FINANCING ACTIVITIES</b>						
Net transfers (to) from Parent	(86)		87		(1)	
Principal payments on debt	(505)		(1)		(1)	(507)
Proceeds from stock issuances	40					40
Excess tax benefit on the exercise of stock options	9					9
Dividends paid	(31)					(31)
<b>CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>	<b>(573)</b>		<b>86</b>		<b>(2)</b>	<b>(489)</b>
Effect of exchange rate changes on cash			1		1	2
Net (decrease) increase in cash and cash equivalents	(450)		17		(24)	(457)
Cash and cash equivalents at beginning of period	1,212		124		233	1,569
Cash and cash equivalents at end of period	\$ 762	\$	141	\$	209	\$ 1,112

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REPORT OF INDEPENDENT REGISTERED  
PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders

FedEx Corporation

We have reviewed the condensed consolidated balance sheet of FedEx Corporation as of August 31, 2008, and the related condensed consolidated statements of income and cash flows for the three-month periods ended August 31, 2008 and 2007. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of FedEx Corporation as of May 31, 2008, and the related consolidated statements of income, changes in stockholders' investment and comprehensive income, and cash flows for the year then ended not presented herein, and in our report dated July 10, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of May 31, 2008, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Memphis, Tennessee  
September 17, 2008

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**Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition**

**GENERAL**

The following Management's Discussion and Analysis of Results of Operations and Financial Condition describes the principal factors affecting the results of operations, liquidity, capital resources, contractual cash obligations and critical accounting estimates of FedEx. This discussion should be read in conjunction with the accompanying quarterly unaudited condensed consolidated financial statements and our Annual Report on Form 10-K for the year ended May 31, 2008 ( Annual Report ). Our Annual Report includes additional information about our significant accounting policies, practices and the transactions that underlie our financial results, as well as a detailed discussion of the most significant risks and uncertainties associated with our financial and operating results.

We provide a broad portfolio of transportation, e-commerce and business services through companies competing collectively, operating independently and managed collaboratively under the respected FedEx brand. Our primary operating companies include Federal Express Corporation ( FedEx Express ), the world's largest express transportation company; FedEx Ground Package System, Inc. ( FedEx Ground ), a leading provider of small-package ground delivery services; and FedEx Freight Corporation, a leading U.S. provider of less-than-truckload ( LTL ) freight services. Our FedEx Services segment provides customer-facing sales, marketing, information technology and customer service support, as well as retail access for customers through FedEx Office and Print Services, Inc. ( FedEx Office ), primarily for the benefit of FedEx Express and FedEx Ground. These companies represent our major service lines and form the core of our reportable segments. See Reportable Segments for further discussion.

The key indicators necessary to understand our operating results include:

the overall customer demand for our various services;

the volumes of transportation services provided through our networks, primarily measured by our average daily volume and shipment weight;

the mix of services purchased by our customers;

the prices we obtain for our services, primarily measured by yield (average price per shipment or pound or average price per hundredweight for FedEx Freight LTL Group shipments);

our ability to manage our cost structure (capital expenditures and operating expenses) to match shifting volume levels; and

the timing and amount of fluctuations in fuel prices and our ability to recover incremental fuel costs through our fuel surcharges.

The majority of our operating expenses are directly impacted by revenue and volume levels. Accordingly, we expect these operating expenses to fluctuate on a year-over-year basis consistent with the change in revenues and volume. The following discussion of operating expenses describes the key drivers impacting expense trends beyond changes in revenues and volume.

Except as otherwise specified, references to years indicate our fiscal year ending May 31, 2009 or ended May 31 of the year referenced and comparisons are to the corresponding period of the prior year. References to our transportation segments include, collectively, our FedEx Express, FedEx Ground and FedEx Freight segments.

**Table of Contents****RESULTS OF OPERATIONS****CONSOLIDATED RESULTS**

The following table compares revenues, operating income, operating margin, net income and diluted earnings per share (dollars in millions, except per share amounts) for the three months ended August 31:

	2008	2007	Percent Change
Revenues	\$ 9,970	\$ 9,199	8
Operating income	630	814	(23)
Operating margin	6.3%	8.8%	(250)bp
Net income	\$ 384	\$ 494	(22)
Diluted earnings per share	\$ 1.23	\$ 1.58	(22)

The following table shows changes in revenues and operating income by reportable segment for the three months ended August 31, 2008 compared to August 31, 2007 (in millions):

	Revenues		Operating Income	
	Dollar Change	Percent Change	Dollar Change	Percent Change
FedEx Express segment	\$ 530	9	\$ (174)	(34)
FedEx Ground segment	143	9	6	3
FedEx Freight segment	120	10	(16)	(15)
FedEx Services segment	(12)	(2)		
Other and eliminations	(10)	NM		
	\$ 771	8	\$ (184)	(23)

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The following graphs for FedEx Express, FedEx Ground and the FedEx Freight LTL Group show selected volume statistics (in thousands) for the five most recent quarters:

The following graphs for FedEx Express, FedEx Ground and the FedEx Freight LTL Group show selected yield statistics for the five most recent quarters:

- (1) Package statistics do not include the operations of FedEx SmartPost.

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The following graph for our transportation segments shows our average cost of jet and vehicle fuel per gallon for the five most recent quarters:

***Overview***

As anticipated, the difficult economic environment that impacted our profitability in the last three quarters of 2008 continued into the first quarter of 2009, causing a significant reduction in our earnings. Our results in the first quarter of 2008 reflect a more favorable economic environment, both in the U.S. and global economies, as demand for our services was significantly stronger and fuel prices were significantly lower a year ago. While fuel prices decreased from their historic highs late in the first quarter of 2009, our cost per gallon of jet fuel increased 77% year-over-year, which significantly increased our fuel surcharge levels and adversely affected demand for our services. One fewer operating day at each of our transportation segments also negatively affected our results.

For the first quarter of 2009, our results were negatively impacted by the continued weak U.S. economy, which reflects ongoing high fuel prices and a significant contraction in consumer spending. In addition, FedEx International Priority® package ( IP ) volumes were flat during the first quarter of 2009 due to a softening in all major regions of the global economy. Cost containment activities, including lower variable incentive compensation, partially mitigated the impact of higher fuel costs and the weak global economy on our results for the first quarter of 2009.

***Revenue***

Revenue growth for the first quarter of 2009 was primarily attributable to yield increases in FedEx Express U.S. domestic package, IP and domestic freight services. FedEx Ground package and FedEx Freight LTL volume growth also contributed to revenue growth for the first quarter of 2009. Yield increases in all of our transportation segments continue to be driven by higher fuel surcharges, partially offset by competitive pricing pressure across all of our markets. Revenue growth during the first quarter of 2009 was partially offset by reduced U.S. domestic express and freight volumes as a result of the ongoing weak U.S. economy and higher fuel surcharges, which drove U.S. domestic express shipping volumes to pre-1998 levels and led some customers to shift to lower-yielding services.

**Table of Contents*****Operating Income***

The following table compares operating expenses and operating income as a percent of revenue for the three months ended August 31:

	Percent of Revenue	
	2008	2007
Operating expenses:		
Salaries and employee benefits	36.0%	37.9%
Purchased transportation	12.1	11.1
Rentals and landing fees	6.2	6.4
Depreciation and amortization	4.9	5.2
Fuel	16.0	10.5
Maintenance and repairs	5.4	5.9
Other	13.1	14.2
Total operating expenses	93.7	91.2
Operating income (margin)	6.3%	8.8%

Operating income and operating margin decreased substantially in the first quarter of 2009, as weak economic conditions drove decreases in U.S. domestic volumes at FedEx Express, restrained volume growth at FedEx Ground and FedEx Freight and contributed to a more competitive pricing environment, which pressured base yields.

Our results were also negatively impacted by the overall effects of significantly higher fuel and purchased transportation costs. Fuel expenses increased 66% during the first quarter of 2009, primarily due to an increase in the average price per gallon of fuel. However, jet fuel usage was down 5% from last year's first quarter, as we temporarily grounded certain aircraft and reduced flight hours in light of lower business levels. Fuel surcharges were sufficient to offset incremental fuel costs for the first quarter of 2009, based on a static analysis of the impact to operating income of year-over-year changes in fuel prices compared to changes in fuel surcharges. This analysis considers the estimated benefits of the reduction in fuel surcharges included in the base rates charged for FedEx Express services. However, this analysis does not consider the negative effects that the significantly higher fuel surcharge levels have on our business, including reduced demand and shifts by our customers to lower-yielding services.

While fluctuations in fuel surcharge rates can be significant from period to period, fuel surcharges represent one of the many individual components of our pricing structure that impact our overall revenue and yield. Additional components include the mix of services purchased, the base price and other extra service charges we obtain for these services and the level of pricing discounts offered. In order to provide information about the impact of fuel surcharges on the trend in revenue and yield growth, we have included the comparative fuel surcharge rates in effect for the first quarter of 2009 and 2008 in the accompanying discussions of each of our transportation segments.

Purchased transportation costs increased significantly during the first quarter of 2009, primarily due to higher rates paid to FedEx Ground's contractors and our other third-party transportation providers (including higher fuel supplement costs). Reduced copy revenues and higher operating expenses at FedEx Office, primarily due to new locations opened in 2008, also had a negative impact on our results for the first quarter of 2009. Cost containment activities, including lower variable incentive compensation, partially mitigated the negative impact of these factors. Key cost containment activities during the quarter included reductions in flight and labor hours, fuel consumption and maintenance costs primarily due to lower volumes and temporarily grounded aircraft and freezes in hiring for open positions (excluding operational and sales positions). In addition, we continue to exercise stringent control over discretionary spending, such as travel, entertainment and professional fees.





**Table of Contents*****Income Taxes***

Our effective tax rate was 37.9% for the first quarter of 2009 and 37.2% for the first quarter of 2008. The 2009 tax rate was higher than the 2008 rate primarily due to a favorable tax audit settlement in 2008. We expect the effective tax rate to be between 37.0% and 38.0% for 2009. The actual rate will depend on a number of factors, including the amount and source of operating income.

As of August 31, 2008, there had been no material changes to our liabilities recorded under Financial Accounting Standards Board ( FASB ) Interpretation No. ( FIN ) 48, Accounting for Uncertainty in Income Taxes. The U.S. Internal Revenue Service ( IRS ) and certain state tax authorities are currently examining our returns for various years through 2007. It is reasonably possible that the 2004-2006 IRS audit, along with certain state income tax return audits, will be completed during the next 12 months, and could result in a change in our balance of unrecognized tax benefits. The expected net impact of any changes would not be material to our consolidated financial statements.

***Outlook***

We expect our results throughout the remainder of 2009 to continue to be constrained, as we expect no significant improvement in the U.S. economy in the near term and a continued slowdown in the global economy. While year-over-year comparisons will be somewhat better by the second half of 2009, ongoing weak economic factors and continued high fuel prices are expected to reduce demand for all of our transportation services. However, if fuel prices decline for a sustained period, our outlook for the second half of 2009 may improve.

We will continue to have cost containment initiatives in place across all segments in 2009, including controlling discretionary spending and limiting staffing. Additionally, we continue to rationalize our networks by adjusting routes and equipment types and deferring facility expansions to match current demand levels for our shipping and business services. If the economic downturn becomes even more pronounced, additional actions will be taken to control costs. However, we will not compromise our outstanding service levels or take actions that negatively impact the customer experience in exchange for short-term cost reductions.

During the first quarter, we lowered our capital spending forecast for 2009 to \$2.6 billion from approximately \$3 billion. However, we will continue to balance the need to control spending with the opportunity to make investments with high returns, such as in substantially more fuel-efficient Boeing 757 ( B757 ) and Boeing 777 Freighter ( B777F ) aircraft. Moreover, we will continue to invest in critical long-term strategic projects focused on expanding our global networks and broadening our service offerings to position us for stronger growth under improved economic conditions. For additional details on key 2009 capital projects, refer to the Liquidity Outlook section of this MD&A.

All of our businesses operate in a competitive pricing environment, exacerbated by continuing volatile fuel prices. Historically, our fuel surcharges have largely been sufficient to offset incremental fuel costs; however, volatility in fuel costs may impact earnings because adjustments to our fuel surcharges lag changes in actual fuel prices paid. Therefore, the trailing impact of adjustments to our fuel surcharges can significantly affect our earnings in the short-term.

As described in Note 9 of the accompanying unaudited condensed consolidated financial statements and the Independent Contractor Matters section of our FedEx Ground segment MD&A, we are involved in a number of litigation matters and other proceedings that challenge the status of FedEx Ground's owner-operators as independent contractors. FedEx Ground anticipates continuing changes to its relationships with its contractors. The nature, timing and amount of any changes are dependent on the outcome of numerous future events. We cannot reasonably estimate the potential impact of any such changes or a meaningful range of potential outcomes, although they could be material. However, we do not believe that any such changes will impair our ability to operate and profitably grow our FedEx Ground business.

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See *Forward-Looking Statements* for a discussion of these and other potential risks and uncertainties that could materially affect our future performance.

***NEW ACCOUNTING PRONOUNCEMENTS***

New accounting rules and disclosure requirements can significantly impact our reported results and the comparability of our financial statements. We believe the following new accounting pronouncements are relevant to the readers of our financial statements.

On May 31, 2007, we adopted Statement of Financial Accounting Standards ( SFAS ) 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*. SFAS 158 requires recognition in the balance sheet of the funded status of defined benefit pension and other postretirement benefit plans, and the recognition in accumulated other comprehensive income ( AOCI ) of unrecognized gains or losses and prior service costs or credits. Additionally, SFAS 158 requires the measurement date for plan assets and liabilities to coincide with the sponsor s year end. On June 1, 2008, we made our transition election for the measurement date provision of SFAS 158 using the two-measurement approach. Under this approach, we completed two actuarial measurements, one at February 29, 2008 and the other at June 1, 2008. This approach requires us to record the net periodic benefit cost for the transition period from March 1, 2008 through May 31, 2008 as an adjustment to beginning retained earnings (\$44 million, net of tax) and actuarial gains and losses for the period (a gain of \$372 million, net of tax) as an adjustment to the opening balance of AOCI. These adjustments increased the amount recorded for our pension assets by \$528 million. Our actuarial gains resulted primarily from a 19 basis point increase in the discount rate for our primary pension plan and an increase in plan assets at June 1, 2008.

On June 1, 2008, we adopted SFAS 157, *Fair Value Measurements*, which provides a common definition of fair value, establishes a uniform framework for measuring fair value and requires expanded disclosures about fair value measurements. There is a one-year deferral of the adoption of the standard as it relates to non-financial assets and liabilities. The adoption of SFAS 157 had no impact on our financial statements at June 1, 2008.

In December 2007, the FASB issued SFAS 141R, *Business Combinations*, and SFAS 160, *Accounting and Reporting Noncontrolling Interest in Consolidated Financial Statements*, an amendment of ARB No. 51. These new standards significantly change the accounting for and reporting of business combination transactions, including noncontrolling interests (previously referred to as minority interests). For example, these standards require the acquiring entity to recognize the full fair value of assets acquired and liabilities assumed in the transaction and require the expensing of most transaction and restructuring costs. Both standards are effective for us beginning June 1, 2009 (fiscal 2010) and are applicable only to transactions occurring after the effective date.

**Table of Contents*****REPORTABLE SEGMENTS***

FedEx Express, FedEx Ground and FedEx Freight represent our major service lines and, along with FedEx Services, form the core of our reportable segments. Our reportable segments include the following businesses:

<b>FedEx Express Segment</b>	FedEx Express (express transportation) FedEx Trade Networks (global trade services)
<b>FedEx Ground Segment</b>	FedEx Ground (small-package ground delivery) FedEx SmartPost (small-parcel consolidator)
<b>FedEx Freight Segment</b>	FedEx Freight LTL Group: FedEx Freight (regional LTL freight transportation) FedEx National LTL (long-haul LTL freight transportation) FedEx Custom Critical (time-critical transportation) Caribbean Transportation Services (airfreight forwarding)
<b>FedEx Services Segment</b>	FedEx Services (sales, marketing and information technology functions) FedEx Office (document and business services and package acceptance) FedEx Customer Information Services ( FCIS ) (customer service, billings and collections) FedEx Global Supply Chain Services (logistics services)

***FEDEX SERVICES SEGMENT***

The FedEx Services segment includes: FedEx Services, which provides sales, marketing and information technology support; FCIS, which is responsible for customer service, billings and collections for FedEx Express and FedEx Ground U.S. customers; FedEx Global Supply Chain Services, which provides a range of logistics services to our customers; and FedEx Office, which provides retail access to our customers for our package transportation businesses and an array of document and business services.

The costs of the sales, marketing and information technology support provided by FedEx Services and the customer service functions of FCIS, together with the normal, ongoing net operating costs of FedEx Global Supply Chain Services and FedEx Office, are allocated primarily to the FedEx Express and FedEx Ground segments based on metrics such as relative revenues or estimated services provided. We believe these allocations approximate the net cost of providing these functions.

FedEx Services segment revenues, which reflect the operations of FedEx Office and FedEx Global Supply Chain Services, decreased during the first quarter of 2009. Revenue generated from new FedEx Office locations added in 2008 and the first quarter of 2009 did not offset declines in copy revenues and higher operating costs. Therefore, the allocated net operating costs of FedEx Office increased during the first quarter of 2009 despite ongoing cost management efforts.

The operating expenses line item *Intercompany charges* on the accompanying unaudited financial summaries of our transportation segments includes the allocations from the FedEx Services segment to the respective transportation segments. The *Intercompany charges* caption also includes allocations for administrative services provided between operating companies and certain other costs such as corporate management fees related to services received for general corporate oversight, including executive officers and certain legal and finance functions. Management evaluates transportation segment financial performance based on operating income.

**Table of Contents****OTHER INTERSEGMENT TRANSACTIONS**

Certain FedEx operating companies provide transportation and related services for other FedEx companies outside their reportable segment. Billings for such services are based on negotiated rates, which we believe approximate fair value, and are reflected as revenues of the billing segment. These rates are adjusted from time to time based on market conditions. Such intersegment revenues and expenses are eliminated in the consolidated results and are not separately identified in the following segment information, as the amounts are not material.

**FEDEX EXPRESS SEGMENT**

The following table compares revenues, operating expenses, operating income and operating margin (dollars in millions) for the three-month periods ended August 31:

	2008	2007	Percent Change
Revenues:			
Package:			
U.S. overnight box	\$ 1,711	\$ 1,615	6
U.S. overnight envelope	525	512	3
U.S. deferred	762	711	7
Total U.S. domestic package revenue	2,998	2,838	6
International Priority (IP)	2,044	1,820	12
International domestic <sup>(1)</sup>	170	156	9
Total package revenue	5,212	4,814	8
Freight:			
U.S.	598	593	1
International priority freight	340	292	16
International airfreight	131	94	39
Total freight revenue	1,069	979	9
Other <sup>(2)</sup>	138	96	44
Total revenues	6,419	5,889	9
Operating expenses:			
Salaries and employee benefits	2,129	2,060	3
Purchased transportation	336	280	20
Rentals and landing fees	417	411	1
Depreciation and amortization	239	230	4
Fuel	1,319	800	65
Maintenance and repairs	394	402	(2)
Intercompany charges	533	515	3
Other	707	672	5
Total operating expenses	6,074	5,370	13
Operating income	\$ 345	\$ 519	(34)
Operating margin	5.4%	8.8%	(340)bp

- (1) International domestic revenues include our international domestic express operations, primarily in the United Kingdom, Canada, China and India.
- (2) Other revenues includes FedEx Trade Networks.

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The following table compares selected statistics (in thousands, except yield amounts) for the three-month periods ended August 31:

	2008	2007	Percent Change
Package Statistics <sup>(1)</sup>			
Average daily package volume (ADV):			
U.S. overnight box	1,103	1,139	(3)
U.S. overnight envelope	629	699	(10)
U.S. deferred	828	863	(4)
Total U.S. domestic ADV	2,560	2,701	(5)
IP	495	496	
International domestic <sup>(2)</sup>	307	279	10
Total ADV	3,362	3,476	(3)
Revenue per package (yield):			
U.S. overnight box	\$ 24.24	\$ 21.83	11
U.S. overnight envelope	13.04	11.26	16
U.S. deferred	14.38	12.67	13
U.S. domestic composite	18.30	16.17	13
IP	64.54	56.42	14
International domestic <sup>(2)</sup>	8.63	8.59	
Composite package yield	24.23	21.31	14
Freight Statistics <sup>(1)</sup>			
Average daily freight pounds:			
U.S.	7,296	8,843	(17)
International priority freight	2,312	2,025	14
International airfreight	1,866	1,752	7
Total average daily freight pounds	11,474	12,620	(9)
Revenue per pound (yield):			
U.S.	\$ 1.28	\$ 1.03	24
International priority freight	2.30	2.22	4
International airfreight	1.10	0.83	33
Composite freight yield	1.46	1.19	23

<sup>(1)</sup> Package and freight statistics include only the operations of FedEx Express.

- (2) International domestic statistics include our international domestic express operations, primarily in the United Kingdom, Canada, China and India.

***FedEx Express Segment Revenues***

FedEx Express segment revenues increased 9% in the first quarter of 2009, primarily due to yield improvement driven by increases in fuel surcharges. Yield improvements during the first quarter of 2009 were partially offset by decreased volumes in U.S. domestic package and freight services, as the weak U.S. economy and persistently higher fuel prices and the related impact on our fuel surcharges have reduced demand for these services, pressured base yields and driven a change in the mix of our services. In addition, the impact of one fewer operating day partially offset the revenue increase during the first quarter of 2009.

The increase in composite package yield in the first quarter of 2009 reflects substantially higher fuel surcharges in U.S. domestic and IP services. IP yield improvement in the first quarter of 2009 was also impacted by favorable exchange rates. Composite freight yield increased in the first quarter of 2009 due to higher fuel surcharges and a 14% increase in pounds in our higher-yielding international priority freight service.

IP volumes were flat during the first quarter of 2009 due to a softening in all major regions of the global economy. Additionally, the ongoing weak U.S. economy drove U.S. domestic express shipping volumes to pre-1998 levels.

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Our fuel surcharges are indexed to the spot price for jet fuel. Using this index, the U.S. domestic and outbound fuel surcharge and the international fuel surcharges ranged as follows for the three-month periods ended August 31:

	2008	2007
U.S. Domestic and Outbound Fuel Surcharge:		
Low	28.00%	13.50%
High	34.50	14.00
Weighted-average	31.67	13.67
International Fuel Surcharges:		
Low	18.00	12.00
High	34.50	15.50
Weighted-average	25.26	14.00

On September 18, 2008, we announced a 6.9% average list price increase effective January 5, 2009 on FedEx Express U.S. domestic and U.S. outbound express package and freight shipments and made various changes to other surcharges, while we lowered our fuel surcharge index by 2%.

**FedEx Express Segment Operating Income**

The following table compares operating expenses and operating income as a percent of revenue for the three-month periods ended August 31:

	Percent of Revenue	
	2008	2007
Operating expenses:		
Salaries and employee benefits	33.2%	35.0%
Purchased transportation	5.2	4.8
Rentals and landing fees	6.5	7.0
Depreciation and amortization	3.7	3.9
Fuel	20.6	13.6
Maintenance and repairs	6.1	6.8
Intercompany charges	8.3	8.7
Other	11.0	11.4
Total operating expenses	94.6	91.2
Operating income (margin)	5.4%	8.8%

FedEx Express segment operating results for the first quarter of 2009 were negatively impacted by the continued weak U.S. economy and higher fuel prices, which limited demand for our U.S. domestic express package services, and a softening global economy. Cost containment activities, including lower variable incentive compensation, partially mitigated the negative impact of these factors on our operating results for the first quarter of 2009. Other key cost containment activities during the quarter included reductions in flight and labor hours, fuel consumption and maintenance costs primarily due to lower volumes and temporarily grounded aircraft, and freezes in hiring for open positions (excluding operational and sales positions). In addition, we continue to exercise stringent control over discretionary spending, such as travel, entertainment and professional fees.

Fuel costs increased 65% in the first quarter of 2009 due to an increase in the average price per gallon of fuel. Fuel surcharges were sufficient to offset incremental fuel costs, based on a static analysis of the year-over-year changes in fuel prices compared to changes in fuel surcharges. Purchased transportation costs increased 20% in the first quarter of



2009 primarily due to higher utilization of third-party transportation providers (primarily in international locations).

**Table of Contents****FEDEX GROUND SEGMENT**

The following table compares revenues, operating expenses, operating income and operating margin (dollars in millions) and selected package statistics (in thousands, except yield amounts) for the three-month periods ended August 31:

	2008	2007	Percent Change
Revenues	\$ 1,761	\$ 1,618	9
Operating expenses:			
Salaries and employee benefits	267	260	3
Purchased transportation	699	620	13
Rentals	51	43	19
Depreciation and amortization	80	73	10
Fuel	74	34	118
Maintenance and repairs	37	34	9
Intercompany charges	178	159	12
Other	179	205	(13)
Total operating expenses	1,565	1,428	10
Operating income	\$ 196	\$ 190	3
Operating margin	11.1%	11.7%	(60)bp
Average daily package volume:			
FedEx Ground	3,339	3,211	4
FedEx SmartPost	584	535	9
Revenue per package (yield):			
FedEx Ground	\$ 7.86	\$ 7.41	6
FedEx SmartPost	\$ 2.14	\$ 2.01	6

**FedEx Ground Segment Revenues**

FedEx Ground segment revenues increased 9% during the first quarter of 2009 due to yield and volume growth, partially offset by one fewer operating day. Yield improvement during the first quarter of 2009 was primarily due to higher fuel surcharges, higher base rates (partially offset by customer discounting) and higher extra service revenue (primarily through our residential and declared value surcharges). Average daily volumes at FedEx Ground increased 4% during the first quarter of 2009 due to the continued growth of our FedEx Home Delivery service and increased commercial business resulting from market share gains.

The FedEx Ground fuel surcharge is based on a rounded average of the national U.S. on-highway average prices for a gallon of diesel fuel, as published by the Department of Energy. Our fuel surcharge ranged as follows for the three-month periods ended August 31:

	2008	2007
Low	8.50%	4.50%
High	10.25	4.50
Weighted-average	9.43	4.50



**Table of Contents*****FedEx Ground Segment Operating Income***

The following table compares operating expenses and operating income as a percent of revenue for the three-month periods ended August 31:

	Percent of Revenue	
	2008	2007
Operating expenses:		
Salaries and employee benefits	15.2%	16.1%
Purchased transportation	39.7	38.3
Rentals	2.9	2.7
Depreciation and amortization	4.5	4.5
Fuel	4.2	2.1
Maintenance and repairs	2.1	2.1
Intercompany charges	10.1	9.8
Other	10.2	12.7
Total operating expenses	88.9	88.3
Operating income (margin)	11.1%	11.7%

FedEx Ground segment operating income was modestly higher for the first quarter of 2009, as revenue growth and lower other operating expenses offset higher fuel prices and a competitive pricing environment.

Fuel costs increased 118% during the first quarter of 2009 primarily due to a significant increase in the average price per gallon of fuel. However, fuel surcharges substantially mitigated the impact of fuel costs on our year-over-year operating results for the first quarter of 2009, due to the timing lag that exists between when we purchase fuel and when our indexed fuel surcharges automatically adjust. Rent expense increased 19% in the first quarter of 2009 primarily due to higher spending on facilities associated with our multi-year capacity expansion plan. Purchased transportation costs increased 13% in the first quarter of 2009 as a result of higher rates paid to our independent contractors and increased fuel supplement costs. Intercompany charges increased 12% in the first quarter of 2009 primarily due to increased net operating costs at FedEx Office and higher allocated customer service and information technology costs. Other operating expenses decreased 13% primarily due to lower legal costs, including settlements, in the first quarter of 2009, as well as lower self-insurance costs. Depreciation expense increased 10% in the first quarter of 2009 primarily due to higher spending on material-handling equipment associated with our multi-year capacity expansion plan and trailer purchases associated with our fleet upgrade.

***Independent Contractor Matters***

FedEx Ground faces increased regulatory and legal uncertainty with respect to its independent contractors. As part of its operations, FedEx Ground has made changes to its relationships with contractors that, among other things, provide incentives for improved service and enhanced regulatory and other compliance by our contractors. During the second quarter of 2008, FedEx Ground announced an on-going nationwide program, which provides greater incentives to certain of its contractors who choose to grow their businesses by adding routes. As of August 31, 2008, nearly 60% of all service areas nationwide are supported by multiple-route contractors.

FedEx Ground is involved in numerous purported or certified class-action lawsuits, state tax and other administrative proceedings and Internal Revenue Service audits that claim the company's owner-operators should be treated as employees, rather than independent contractors. For a description of these proceedings, see Note 9 of the accompanying unaudited condensed consolidated financial statements.



**Table of Contents****FEDEX FREIGHT SEGMENT**

The following table shows revenues, operating expenses, operating income and operating margin (dollars in millions) and selected statistics for the three-month periods ended August 31:

	2008	2007	Percent Change
Revenues	\$ 1,353	\$ 1,233	10
Operating expenses:			
Salaries and employee benefits	614	595	3
Purchased transportation	180	130	38
Rentals and landing fees	33	28	18
Depreciation and amortization	54	57	(5)
Fuel	206	130	58
Maintenance and repairs	43	47	(9)
Intercompany charges	22	21	5
Other	112	120	(7)
Total operating expenses	1,264	1,128	12
Operating income	\$ 89	\$ 105	(15)
Operating margin	6.6%	8.5%	(190)bp
Average daily LTL shipments (in thousands)	82.7	79.3	4
Weight per LTL shipment (lbs)	1,140	1,131	1
LTL yield (revenue per hundredweight)	\$ 20.44	\$ 19.39	5

**FedEx Freight Segment Revenues**

FedEx Freight segment revenues increased 10% during the first quarter of 2009 due to higher LTL yield and shipment growth, partially offset by one fewer operating day. LTL yield increased 5% during the first quarter of 2009 primarily due to higher fuel surcharges despite the 25% rate reduction described below. However, base yields declined during the quarter due to a competitive pricing environment. During the first quarter of 2009, average daily LTL shipments increased 4% resulting from market share gains, despite the weak U.S. economy and a competitive pricing environment.

In July 2007, FedEx Freight reduced its standard regional LTL fuel surcharge by 25% and FedEx National LTL reduced its standard LTL fuel surcharge to levels commensurate with FedEx Freight. The indexed LTL fuel surcharge is based on the average of the national U.S. on-highway average prices for a gallon of diesel fuel, as published by the Department of Energy. The indexed LTL fuel surcharge ranged as follows for the three-month periods ended August 31:

	2008	2007
Low	20.80%	14.50%
High	23.90	19.70
Weighted-average	22.90	17.10



**Table of Contents*****FedEx Freight Segment Operating Income***

The following table compares operating expenses and operating income as a percent of revenue for the three-month periods ended August 31:

	Percent of Revenue	
	2008	2007
Operating expenses:		
Salaries and employee benefits	45.4%	48.3%
Purchased transportation	13.3	10.6
Rentals and landing fees	2.4	2.3
Depreciation and amortization	4.0	4.6
Fuel	15.2	10.5
Maintenance and repairs	3.2	3.8
Intercompany charges	1.6	1.7
Other	8.3	9.7
Total operating expenses	93.4	91.5
Operating income (margin)	6.6%	8.5%

FedEx Freight segment operating income and operating margin decreased in the first quarter of 2009 due to the competitive pricing environment, the fuel surcharge rate reduction described above and higher purchased transportation costs. Lower variable incentive compensation and other continued cost containment activities partially offset the negative impact of these factors on operating income in the first quarter of 2009.

Fuel costs increased 58% during the first quarter of 2009 due to an increase in the average price per gallon of diesel fuel, which also increased rates paid to our third-party transportation providers. Fuel surcharges offset the impact of incremental fuel costs for the first quarter of 2009, based on a static analysis of the year-over-year changes in fuel costs compared to changes in fuel surcharges. However, this analysis does not consider several other negative effects that the significantly higher fuel costs and related surcharge levels have on our business, including increased rates paid to our third-party transportation providers and reduced demand in response to higher fuel surcharges. Purchased transportation costs increased 38% in the first quarter of 2009 primarily due to higher rates paid to and greater utilization of third-party providers. Rentals and landing fees increased 18% in the first quarter of 2009 primarily due to service center expansions.



**Table of Contents****FINANCIAL CONDITION****LIQUIDITY**

Cash and cash equivalents totaled \$1.573 billion at August 31, 2008, compared to \$1.539 billion at May 31, 2008. The following table provides a summary of our cash flows for the three-month periods ended August 31 (in millions):

	2008	2007
Operating activities:		
Net income	\$ 384	\$ 494
Noncash charges and credits	595	567
Changes in operating assets and liabilities	(281)	(260)
Cash provided by operating activities	698	801
Investing activities:		
Capital expenditures and other investing activities	(621)	(771)
Cash used in investing activities	(621)	(771)
Financing activities:		
Principal payments on debt	(1)	(507)
Dividends paid	(34)	(31)
Proceeds from stock issuances	5	40
Other		9
Cash used in financing activities	(30)	(489)
Effect of exchange rate changes on cash	(13)	2
Net increase (decrease) in cash and cash equivalents	\$ 34	\$ (457)

*Cash Provided by Operating Activities.* Cash flows from operating activities decreased \$103 million in the first quarter of 2009 primarily due to decreased earnings, primarily resulting from higher fuel and purchased transportation costs. We made no contributions to our qualified U.S. domestic pension plans during the first quarter of 2009 and \$110 million of such contributions during the first quarter of 2008. However, on September 2, 2008, we made tax-deductible voluntary contributions of \$483 million to these plans. We do not expect to make further contributions to our qualified U.S. domestic pension plans for the remainder of 2009.

*Cash Used for Investing Activities.* Capital expenditures during the first quarter of 2009 were 18% lower largely due to decreased spending at FedEx Express. See *Capital Resources* for a discussion of capital expenditures during 2009 and 2008.

*Debt Financing Activities.* We have a shelf registration statement filed with the Securities and Exchange Commission ( SEC ) that allows us to sell, in one or more future offerings, any combination of unsecured debt securities and common stock.

A \$1 billion revolving credit agreement is available to finance our operations and other cash flow needs and to provide support for the issuance of commercial paper. Our revolving credit agreement contains a financial covenant, which

requires us to maintain a leverage ratio of adjusted debt (long-term debt, including the current portion of such debt, plus six times rentals and landing fees) to capital (adjusted debt plus total common stockholders' investment) that does not exceed 0.7 to 1.0. Our leverage ratio of adjusted debt to capital was 0.5 at August 31, 2008. We are in compliance with this and all other restrictive covenants of our revolving credit agreement and do not expect the covenants to affect our operations. As of August 31, 2008, no commercial paper was outstanding and the entire \$1 billion under the revolving credit facility was available for future borrowings.

*Dividends.* We paid \$34 million of dividends in the first quarter of 2009 and \$31 million in the first quarter of 2008. On June 2, 2008, our Board of Directors declared a dividend of \$0.11 per share of common stock. The dividend was paid on July 1, 2008 to stockholders of record as of the close of business on June 13, 2008. On August 15, 2008, our Board of Directors declared a dividend of \$0.11 per share of common stock. The dividend is payable on October 1, 2008, to stockholders of record as of the close of business on September 10, 2008. Each quarterly dividend payment is subject to review and approval by our Board of Directors, and we evaluate our dividend payment amount on an annual basis at the end of each fiscal year.

**Table of Contents****CAPITAL RESOURCES**

Our operations are capital intensive, characterized by significant investments in aircraft, vehicles, technology, facilities, package-handling facilities and sort equipment. The amount and timing of capital additions depend on various factors, including pre-existing contractual commitments, anticipated volume growth, domestic and international economic conditions, new or enhanced services, geographical expansion of services, availability of satisfactory financing and actions of regulatory authorities.

The following table compares capital expenditures by asset category and reportable segment for the three-month periods ended August 31 (in millions):

	2008	2007	Dollar Change	Percent Change
Aircraft and related equipment	\$ 240	\$ 296	\$ (56)	(19)
Facilities and sort equipment	153	158	(5)	(3)
Information and technology investments	67	90	(23)	(26)
Vehicles	133	164	(31)	(19)
Other equipment	43	67	(24)	(36)
Total capital expenditures	\$ 636	\$ 775	\$ (139)	(18)
FedEx Express segment	\$ 333	\$ 457	\$ (124)	(27)
FedEx Ground segment	134	132	2	2
FedEx Freight segment	100	74	26	35
FedEx Services segment	69	112	(43)	(38)
Total capital expenditures	\$ 636	\$ 775	\$ (139)	(18)

Capital expenditures during the first quarter of 2009 were lower than the prior-year period primarily due to the purchase of three A300 aircraft by FedEx Express in the first quarter of 2008. Additionally, capital expenditures decreased at FedEx Services due to the postponement of several information technology projects and fewer FedEx Office location openings in 2009. This decrease was partially offset by increased spending at FedEx Freight for revenue equipment and at FedEx Ground for facilities and sort equipment associated with its comprehensive network expansion plan.

**LIQUIDITY OUTLOOK**

We believe that our existing cash and cash equivalents, cash flow from operations, our commercial paper program, revolving bank credit facility and shelf registration statement with the SEC are adequate to meet our current and foreseeable future working capital and capital expenditure needs. In addition, other forms of secured financing may be used to obtain capital assets if we determine that they best suit our needs for the foreseeable future. We have been successful in obtaining investment capital, both domestic and international, although the marketplace for such capital can become restricted depending on a variety of economic factors. We believe the capital resources available to us provide flexibility to access the most efficient markets for financing capital acquisitions, including aircraft, and are adequate for our future capital needs.

Our capital expenditures are expected to be approximately \$2.6 billion in 2009 and will include spending for aircraft and related equipment at FedEx Express, facility expansion at FedEx Ground and revenue equipment at FedEx Freight. We also continue to invest in productivity-enhancing technologies. Aircraft-related capital outlays include the B757s, the first of which entered revenue service in 2009 and which are 47% more fuel-efficient per unit than the aircraft type they are replacing, and the new B777Fs, the first of which enter revenue service in 2010. These aircraft

capital expenditures are necessary to achieve significant long-term operating savings and to support projected long-term international volume growth. However, we may continue to temporarily ground certain aircraft due to excess capacity in the current economic environment.

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We are closely managing our capital spending based on current and anticipated volume levels and will defer or limit capital additions where economically feasible, while continuing to invest strategically in growing service lines. We currently expect to fund our 2009 capital requirements with cash from operations.

We have not repurchased any shares in recent years. However, we currently have the liquidity to repurchase shares and may do so in the future. A total of 5.75 million shares remain under existing share repurchase authorizations.

We have a senior unsecured debt credit rating from Standard & Poor's of BBB and a commercial paper rating of A-2. Moody's Investors Service has assigned us a senior unsecured debt credit rating of Baa2 and a commercial paper rating of P-2. Moody's and Standard & Poor's characterize our ratings outlook as stable. If our credit ratings drop, our interest expense may increase. If our commercial paper ratings drop below current levels, we may have difficulty utilizing the commercial paper market. If our senior unsecured debt ratings drop below investment grade, our access to financing may become limited.

**CONTRACTUAL CASH OBLIGATIONS**

The following table sets forth a summary of our contractual cash obligations as of August 31, 2008. Certain of these contractual obligations are reflected in our balance sheet, while others are disclosed as future obligations under accounting principles generally accepted in the United States. Except for the current portion of long-term debt and capital lease obligations, this table does not include amounts already recorded in our balance sheet as current liabilities at August 31, 2008. Accordingly, this table is not meant to represent a forecast of our total cash expenditures for any of the periods presented.

	Payments Due by Fiscal Year						Total
	2009 <sup>(1)</sup>	2010	2011	2012	2013	Thereafter	
Operating activities:							
Operating leases	\$ 1,401	\$ 1,685	\$ 1,510	\$ 1,359	\$ 1,235	\$ 8,432	\$ 15,622
Non-capital purchase obligations and other	306	133	69	58	33	133	732
Interest on long-term debt	76	79	66	47	20	1,534	1,822
Investing activities:							
Aircraft and aircraft-related capital commitments	881	1,042	745	82			2,750
Other capital purchase obligations	86	4					90
Financing activities:							
Debt	500	500	250		300	239	1,789
Capital lease obligations	10	97	8	8	119	17	259
<b>Total</b>	<b>\$ 3,260</b>	<b>\$ 3,540</b>	<b>\$ 2,648</b>	<b>\$ 1,554</b>	<b>\$ 1,707</b>	<b>\$ 10,355</b>	<b>\$ 23,064</b>

<sup>(1)</sup> Cash obligations for the remainder of 2009.

We have certain contingent liabilities that are not accrued in our balance sheet in accordance with accounting principles generally accepted in the United States. These contingent liabilities are not included in the table above. In addition, we have historically made voluntary tax-deductible contributions to our principal U.S. domestic pension plans; however, such amounts have not been legally required and therefore are not reflected in the table above.

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We have other long-term liabilities reflected in our balance sheet, including deferred income taxes, qualified and non-qualified pension and postretirement healthcare plan liabilities and other self-insurance accruals. The payment obligations associated with these liabilities are not reflected in the table above due to the absence of scheduled maturities. Therefore, the timing of these payments cannot be determined, except for amounts estimated to be payable within twelve months, which are included in current liabilities.

*Operating Activities*

The amounts reflected in the table above for operating leases represent future minimum lease payments under noncancelable operating leases (principally aircraft and facilities) with an initial or remaining term in excess of one year at August 31, 2008.

The amounts included for purchase obligations represent noncancelable agreements to purchase goods or services that are not capital related. Such contracts include those for printing and advertising and promotions contracts. Open purchase orders that are cancelable are not considered unconditional purchase obligations for financial reporting purposes and are not included in the table above. See Note 8 of the accompanying unaudited condensed consolidated financial statements for more information.

Included in the preceding table within the caption entitled Non-capital purchase obligations and other is our estimate of the current portion of the liability for uncertain tax positions under FIN 48. We cannot reasonably estimate the timing of the long-term payments or the amount by which the liability will increase or decrease over time; therefore, the long-term portion of the liability (\$82 million) is excluded from the preceding table.

*Investing Activities*

The amounts reflected in the table above for capital purchase obligations represent noncancelable agreements to purchase capital-related equipment. Such contracts include those for certain purchases of aircraft, aircraft modifications, vehicles, facilities, computers and other equipment contracts. Open purchase orders that are cancelable are not considered unconditional purchase obligations for financial reporting purposes and are not included in the table above. See Note 8 of the accompanying unaudited condensed consolidated financial statements for more information.

*Financing Activities*

The amounts reflected in the table above for long-term debt represent future scheduled payments on our long-term debt. In 2009, we have scheduled debt payments of \$510 million, which includes \$500 million of principal payments on our 3.5% unsecured notes maturing in April 2009 and payments on capital leases. Capital lease obligations represent principal and interest payments.

Additional information on amounts included within the operating, investing and financing activities captions in the table above can be found in our Annual Report.

**CRITICAL ACCOUNTING ESTIMATES**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make significant judgments and estimates to develop amounts reflected and disclosed in the financial statements. In many cases, there are alternative policies or estimation techniques that could be used. We maintain a thorough process to review the application of our accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements of a complex, global corporation. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and new or better information.

Information regarding our critical accounting estimates can be found in our Annual Report, including Note 1 to the financial statements therein. Management has discussed the development and selection of these critical accounting estimates with the Audit Committee of our Board of Directors and with our independent registered public accounting firm.

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**FORWARD-LOOKING STATEMENTS**

Certain statements in this report, including (but not limited to) those contained in Outlook, Liquidity, Capital Resources, Liquidity Outlook, and Contractual Cash Obligations, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our financial condition, results of operations, cash flows, plans, objectives, future performance and business. Forward-looking statements include those preceded by, followed by or that include the words may, could, would, should, believes, expects, anticipates, plans, targets, projects, intends or similar expressions. These forward-looking statements involve risks and uncertainties. Actual results may differ materially from those contemplated (expressed or implied) by such forward-looking statements, because of, among other things, potential risks and uncertainties, such as:

- economic conditions in the global markets in which we operate;
- the impact of any international conflicts or terrorist activities on the United States and global economies in general, the transportation industry or us in particular, and what effects these events will have on our costs or the demand for our services;
- damage to our reputation or loss of brand equity;
- disruptions to the Internet or our technology infrastructure, including those impacting our computer systems and Web site, which can adversely affect shipment levels;
- the price and availability of jet and vehicle fuel;
- the impact of intense competition on our ability to maintain or increase our prices (including our fuel surcharges in response to rising fuel costs) or to maintain or grow our market share;
- our ability to manage our cost structure for capital expenditures and operating expenses, and match it to shifting and future customer volume levels;
- our ability to effectively operate, integrate, leverage and grow acquired businesses, and to continue to support the value we allocate to these acquired businesses, including their goodwill;
- any impacts on our businesses resulting from new domestic or international government laws and regulation, including regulatory actions affecting global aviation rights, increased air cargo and other security requirements, and tax, accounting, trade, labor (such as card check legislation), environmental (such as climate change legislation) or postal rules;
- changes in foreign currency exchange rates, especially in the euro, Chinese yuan, Canadian dollar, British pound and Japanese yen, which can affect our sales levels and foreign currency sales prices;
- the impact of costs related to (i) challenges to the status of FedEx Ground's owner-operators as independent contractors, rather than employees, and (ii) any related changes to our relationship with these owner-operators;
- any liability resulting from and the costs of defending against class-action litigation, such as wage-and-hour and discrimination and retaliation claims, patent litigation, and any other legal proceedings;



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our ability to maintain good relationships with our employees and prevent attempts by labor organizations to organize groups of our employees, which could significantly increase our operating costs and reduce our operational flexibility;

a shortage of qualified labor and our ability to mitigate this shortage through recruiting and retention efforts and productivity gains;

increasing costs, the volatility of costs and legal mandates for employee benefits, especially pension and healthcare benefits;

significant changes in the volumes of shipments transported through our networks, customer demand for our various services or the prices we obtain for our services;

market acceptance of our new service and growth initiatives;

the impact of technology developments on our operations and on demand for our services;

adverse weather conditions or natural disasters, such as earthquakes and hurricanes, which can damage our property, disrupt our operations, increase fuel costs and adversely affect shipment levels;

widespread outbreak of an illness or any other communicable disease, or any other public health crisis;

availability of financing on terms acceptable to us and our ability to maintain our current credit ratings, especially given the capital intensity of our operations and the current volatility of credit markets; and

other risks and uncertainties you can find in our press releases and SEC filings, including the risk factors identified under the heading **Risk Factors** in **Management's Discussion and Analysis of Results of Operations and Financial Condition** in our Annual Report, as updated by our quarterly reports on Form 10-Q.

As a result of these and other factors, no assurance can be given as to our future results and achievements.

Accordingly, a forward-looking statement is neither a prediction nor a guarantee of future events or circumstances and those future events or circumstances may not occur. You should not place undue reliance on forward-looking statements, which speak only as of the date on which they are made. We undertake no obligation to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

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**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

As of August 31, 2008, there had been no material changes in our market risk sensitive instruments and positions since our disclosures in our Annual Report. While we are a global provider of transportation, e-commerce and business services, the substantial majority of our transactions are denominated in U.S. dollars. The distribution of our foreign currency denominated transactions is such that foreign currency declines in some areas of the world are often offset by foreign currency gains in other areas of the world. The principal foreign currency exchange rate risks to which we are exposed are in the euro, Chinese yuan, Canadian dollar, British pound and Japanese yen. Our exposure to foreign currency fluctuations is more significant with respect to our revenues rather than our expenses, as a significant portion of our expenses are denominated in U.S. dollars, such as aircraft and fuel expenses. During the first quarter of 2009, the U.S. dollar has strengthened relative to the currencies of the foreign countries in which we operate; however, this strengthening did not have a material effect on our results of operations.

While we have market risk for changes in the price of jet and vehicle fuel, this risk is largely mitigated by our fuel surcharges. However, our fuel surcharges for FedEx Express and FedEx Ground have a timing lag of approximately six to eight weeks before they are adjusted for changes in fuel prices. Our fuel surcharge index also allows fuel prices to fluctuate approximately 2% for FedEx Express and approximately 3% for FedEx Ground before an adjustment to the fuel surcharge occurs. Therefore, our operating income may be affected should the spot price of fuel suddenly change by a significant amount or change by amounts that do not result in an adjustment in our fuel surcharges.

**Item 4. Controls and Procedures**

The management of FedEx, with the participation of our principal executive and financial officers, has evaluated the effectiveness of our disclosure controls and procedures in ensuring that the information required to be disclosed in our filings under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, including ensuring that such information is accumulated and communicated to FedEx management as appropriate to allow timely decisions regarding required disclosure. Based on such evaluation, our principal executive and financial officers have concluded that such disclosure controls and procedures were effective as of August 31, 2008 (the end of the period covered by this Quarterly Report on Form 10-Q).

During our fiscal quarter ended August 31, 2008, no change occurred in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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## PART II. OTHER INFORMATION

*Item 1. Legal Proceedings*

For a description of all material pending legal proceedings, see Note 9 of the accompanying condensed consolidated financial statements.

In July 2008, we received a formal request for certain information in connection with an ongoing investigation by the Japan Fair Trade Commission into possible anti-competitive behavior in the international freight forwarding industry. This investigation is separate from the ongoing investigations by the Antitrust Division of the U.S. Department of Justice, the Australian Competition and Consumer Commission and the Korea Fair Trade Commission that were disclosed in our Annual Report. We do not believe that we have engaged in any anti-competitive activities, and we are cooperating with these investigations.

*Item 1A. Risk Factors*

There have been no material changes from the risk factors disclosed in our Annual Report (under the heading "Risk Factors" in Management's Discussion and Analysis of Results of Operations and Financial Condition) in response to Part I, Item 1A of Form 10-K.

*Item 6. Exhibits*

Exhibit Number	Description of Exhibit
12.1	Computation of Ratio of Earnings to Fixed Charges.
15.1	Letter re: Unaudited Interim Financial Statements.
31.1	Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FEDEX CORPORATION

Date: September 19, 2008

/s/ JOHN L. MERINO  
JOHN L. MERINO  
CORPORATE VICE PRESIDENT  
PRINCIPAL ACCOUNTING OFFICER

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