FEDEX CORP
Form 10-Q
September 18, 2009

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

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED AUGUST 31, 2009

OR

o **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	62-1721435
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
942 South Shady Grove Road Memphis, Tennessee	38120
(Address of principal executive offices)	(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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Date File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

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

Common Stock	Outstanding Shares at September 15, 2009
Common Stock, par value $0.10 per share	312,518,509

FEDEX CORPORATION
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FEDEX CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN MILLIONS)

	August 31, 2009 (Unaudited)	May 31, 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,789	$ 2,292
Receivables, less allowances of $155 and $196	3,410	3,391
Spare parts, supplies and fuel, less allowances of $164 and $175	372	367
Deferred income taxes	510	511
Prepaid expenses and other	307	555
Total current assets	6,388	7,116
PROPERTY AND EQUIPMENT, AT COST	29,484	29,260
Less accumulated depreciation and amortization	15,946	15,843
Net property and equipment	13,538	13,417
OTHER LONG-TERM ASSETS		
Goodwill	2,233	2,229
Pension assets	263	311
Other assets	1,435	1,171
Total other long-term assets	3,931	3,711
	$ 23,857	$ 24,244

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, 2009 (Unaudited)	May 31, 2009
LIABILITIES AND STOCKHOLDERS INVESTMENT		
CURRENT LIABILITIES		
Current portion of long-term debt	$ 158	$ 653
Accrued salaries and employee benefits	884	861
Accounts payable	1,311	1,372
Accrued expenses	1,533	1,638
Total current liabilities	3,886	4,524
LONG-TERM DEBT, LESS CURRENT PORTION	1,918	1,930
OTHER LONG-TERM LIABILITIES		
Deferred income taxes	1,132	1,071
Pension, postretirement healthcare and other benefit obligations	955	934
Self-insurance accruals	932	904
Deferred lease obligations	811	802
Deferred gains, principally related to aircraft transactions	283	289
Other liabilities	154	164
Total other long-term liabilities	4,267	4,164
COMMITMENTS AND CONTINGENCIES		
COMMON STOCKHOLDERS INVESTMENT		
Common stock, $0.10 par value; 800 million shares authorized; 313 million shares issued as of August 31, 2009 and 312 million shares issued as of May 31, 2009	31	31
Additional paid-in capital	2,091	2,053
Retained earnings	13,031	12,919
Accumulated other comprehensive loss	(1,363)	(1,373)
Treasury stock, at cost	(4)	(4)
Total common stockholders investment	13,786	13,626
	$ 23,857	$ 24,244

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, 2009	Three Months Ended August 31, 2008
REVENUES	$ 8,009	$ 9,970
OPERATING EXPENSES:		
Salaries and employee benefits	3,377	3,585
Purchased transportation	1,054	1,278
Rentals and landing fees	578	617
Depreciation and amortization	495	492
Fuel	666	1,528
Maintenance and repairs	401	537
Other	1,123	1,303
	7,694	9,340
OPERATING INCOME	315	630
OTHER INCOME (EXPENSE):		
Interest, net	(18)	(9)
Other, net	(3)	(3)
	(21)	(12)
INCOME BEFORE INCOME TAXES	294	618
PROVISION FOR INCOME TAXES	113	234
NET INCOME	$ 181	$ 384
EARNINGS PER COMMON SHARE:		
Basic	$ 0.58	$ 1.24
Diluted	$ 0.58	$ 1.23
DIVIDENDS DECLARED PER COMMON SHARE	$ 0.22	$ 0.22

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, 2009	Three Months Ended August 31, 2008
Operating Activities:		
Net income	$ 181	$ 384
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	495	492
Provision for uncollectible accounts	35	35
Stock-based compensation	35	33
Deferred income taxes and other noncash items	52	35
Changes in operating assets and liabilities:		
Receivables	(52)	(98)
Other assets	242	97
Accounts payable and other operating liabilities	(135)	(306)
Other, net	45	26
Cash provided by operating activities	898	698
Investing Activities:		
Capital expenditures	(880)	(636)
Proceeds from asset dispositions and other	26	15
Cash used in investing activities	(854)	(621)
Financing Activities:		
Principal payments on debt	(508)	(1)
Proceeds from stock issuances	7	5
Excess tax benefit on the exercise of stock options	1	
Dividends paid	(34)	(34)
Other, net	(16)	
Cash used in financing activities	(550)	(30)
Effect of exchange rate changes on cash	3	(13)
Net (decrease) increase in cash and cash equivalents	(503)	34
Cash and cash equivalents at beginning of period	2,292	1,539

Cash and cash equivalents at end of period	$	1,789	$	1,573

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

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, 2009 (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, 2009 and the results of our operations and cash flows for the three-month periods ended August 31, 2009 and 2008. Operating results for the three-month period ended August 31, 2009 are not necessarily indicative of the results that may be expected for the year ending May 31, 2010.

Except as otherwise specified, references to years indicate our fiscal year ending May 31, 2010 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. For example, at FedEx Ground certain fuel supplement costs related to our independent contractors were reclassified from fuel expense to purchased transportation to conform to the current period 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 June 1, 2008, we adopted Statement of Financial Accounting Standards (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. On June 1, 2009, we implemented the previously deferred provisions of SFAS 157 for nonfinancial assets and liabilities recorded at fair value, as required. The adoption of SFAS 157 had no impact on our financial statements.

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS 141R, Business Combinations, and SFAS 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin (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 became effective for us beginning June 1, 2009 and had no impact on our financial statements.

In December 2008, the FASB issued FASB Staff Position (FSP) 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets. This FSP provides guidance on the objectives an employer should consider when providing detailed disclosures about assets of a defined benefit pension or other postretirement plan, including disclosures about investment policies and strategies, categories of plan assets, significant concentrations of risk and the inputs and valuation techniques used to measure the fair value of plan assets. This FSP will be effective for our fiscal year ending May 31, 2010.

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In April 2009, the FASB issued FSP No. 107-1 and Accounting Principles Board Opinion (APB) No. 28-1, Interim Disclosures about Fair Value of Financial Instruments. This FSP requires disclosures about the fair value of financial instruments for interim reporting periods in addition to annual reporting periods. This FSP became effective for us beginning with the first quarter of fiscal year 2010.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events, which establishes general standards for accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This standard requires us to disclose the date through which we have evaluated subsequent events, which for SEC registrants is the date we file our financial statements with the SEC. This standard became effective for our first quarter of fiscal year 2010. Events occurring after the date of the condensed consolidated balance sheet but before the issuance of the financial statements included in this filing have been evaluated through the time of this filing.

In June 2009, the FASB issued Statement No. 168, The FASB Accounting Standards Codification (Codification) and the Hierarchy of GAAP, (SFAS 168), which establishes the Codification as the single source of authoritative U.S. GAAP recognized by the FASB. SEC rules and interpretive releases are also sources of authoritative GAAP for SEC registrants. SFAS 168 is effective beginning for periods ending after September 15, 2009. As SFAS 168 is not intended to change or alter existing GAAP, it will not impact our results of operations, cash flows or financial position. We will adjust historical GAAP references in our second quarter 2010 Form 10-Q to reflect accounting guidance references included in the Codification.

DIVIDENDS DECLARED PER COMMON SHARE. On June 8, 2009, our Board of Directors declared a dividend of $0.11 per share of common stock. The dividend was paid on July 1, 2009 to stockholders of record as of the close of business on June 18, 2009. On August 14, 2009, our Board of Directors declared a dividend of $0.11 per share of common stock. The dividend is payable on October 1, 2009, to stockholders of record as of the close of business on September 10, 2009. 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 $35 million for the three months ended August 31, 2009 and $33 million for the three months ended August 31, 2008.

During the first quarter of 2010, we made stock option grants of 4.3 million shares, primarily in connection with our principal annual stock option grant. We granted options to purchase 1.9 million shares during the first quarter of 2009.

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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 $18.96 during the first quarter of 2010 and $24.87 during the first quarter of 2009, using the following assumptions:

	Three Months Ended August 31,	
	2009	2008
Expected lives	5.7 years	5.5 years
Expected volatility	32%	23%
Risk-free interest rate	3.31%	3.56%
Dividend yield	0.780%	0.452%

(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):

	2009	2008
Net income	$ 181	$ 384
Other comprehensive income:		
Foreign currency translation adjustments, net of tax of $8 in 2009 and benefit of $11 in 2008	9	(47)
Amortization of unrealized pension actuarial (gains) losses, net of tax benefit of $7 in 2008	1	(11)
Comprehensive income	$ 191	$ 326

(4) Financing Arrangements

On July 31, 2009, we filed an updated shelf registration statement with the SEC that allows us to sell, in one or more future offerings, any combination of our unsecured debt securities and common stock. During the first quarter of 2010, we repaid our $500 million 5.50% notes that matured on August 15, 2009 using cash from operations and a portion of the proceeds of our January 2009 $1 billion senior unsecured debt offering.

A new three-year $1 billion revolving credit facility was executed in July 2009, which replaced our prior $1 billion revolving credit facility. The new revolving credit agreement is available to finance our operations and other cash flow needs and to provide support for the issuance of commercial paper. This revolving credit agreement expires in July 2012. 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. This covenant was unchanged from our prior revolving credit facility. Our leverage ratio of adjusted debt to capital was 0.5 at August 31, 2009. 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, 2009, no commercial paper was outstanding and the entire $1 billion under the revolving credit facility was available for future borrowings.

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Long-term debt, exclusive of capital leases, had carrying values of $1.8 billion compared with an estimated fair value of $2.1 billion at August 31, 2009, and $2.3 billion compared with an estimated fair value of $2.4 billion at May 31, 2009. The estimated fair values were determined based on quoted market prices or on the current rates offered for debt with similar terms and maturities.

(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):

	2009	2008
Basic earnings per common share:		
Net earnings allocable to common shares	$ 180	$ 383
Weighted-average common shares	312	311
Basic earnings per common share	$ 0.58	$ 1.24
Diluted earnings per common share:		
Net earnings allocable to common shares	$ 180	$ 383
Weighted-average common shares	312	311
Dilutive effect of share-based awards		2
Weighted-average diluted shares	312	313
Diluted earnings per common share	$ 0.58	$ 1.23
Anti-dilutive options excluded from diluted earnings per common share	17.5	9.6

(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):

	2009	2008
U.S. domestic and international pension plans	$ 75	$ 44
U.S. domestic and international defined contribution plans	22	84
Postretirement healthcare plans	11	14
	$ 108	$ 142

The three-month period ended August 31, 2009 reflects higher pension costs in 2010 due to the negative impact of market conditions on our pension plan assets at our May 31, 2009 measurement date. This increase in pension costs was offset by lower expenses for our 401(k) plans due to the temporary suspension of the company-matching contributions, as 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	
	2009	2008	2009	2008
Service cost	$ 104	$ 125	$ 6	$ 8
Interest cost	206	200	8	8
Expected return on plan assets	(239)	(265)		
Recognized actuarial losses (gains) and other	4	(16)	(3)	(2)
	$ 75	$ 44	$ 11	$ 14

We made no contributions to our tax-qualified U.S. domestic pension plans (U.S. Retirement Plans) during the first quarter of 2010 or 2009. However, in September 2009, we made $495 million in tax-deductible voluntary contributions plus $118 million in minimum required contributions to our U.S. Retirement Plans. Our U.S. Retirement Plans have ample funds to meet benefit payments. For 2010, we have $235 million in remaining minimum required contributions to our U.S. Retirement Plans. In 2009, we contributed an aggregate of $1.1 billion 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.

As of August 31, 2009, our reportable segments included the following businesses:

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

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The FedEx Services segment operates combined sales, marketing, administrative and information technology functions in shared services operations that support our transportation businesses and allow us to pursue synergies from the combination of these functions. The FedEx Services segment includes: FedEx Services, which provides sales, marketing and information technology support to our other companies; FCIS, which is responsible for customer service, billings and collections for FedEx Express, FedEx Ground (including FedEx SmartPost), the FedEx Freight LTL Group and FedEx Office U.S. customers; FedEx 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. Effective September 1, 2009, FedEx Supply Chain Services was realigned to become part of the FedEx Express reporting segment.

The FedEx Services segment provides direct and indirect support to our transportation businesses and accordingly we allocate all of the net operating costs of the FedEx Services segment (including the net operating results of FedEx Office) to reflect the full cost of operating our transportation businesses in the results of those segments. Within the FedEx Services segment allocation, the net operating results of FedEx Office are allocated to FedEx Express and FedEx Ground. We review and evaluate the performance of our transportation segments based on operating income (inclusive of FedEx Services allocations). For the FedEx Services segment, performance is evaluated based on the impact of the total allocated net operating costs of the FedEx Services segment on our transportation segments. The allocations of net operating costs are based on metrics such as relative revenues or estimated services provided. We believe these allocations approximate the net cost of providing these functions.

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) reflects the allocations from the FedEx Services segment to the respective transportation segments. The Intercompany charges caption also includes charges and credits 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.

Effective August 1, 2009, approximately 3,600 employees (predominantly from the FedEx Freight segment) were transferred to entities within the FedEx Services segment. This internal reorganization further centralizes most customer support functions, such as sales, customer service and information technology, into our shared services organizations. While the reorganization had no impact on the net operating results of any of our transportation segments, the net intercompany charges to our FedEx Freight segment increased significantly with corresponding decreases to other expense captions, such as salaries and employee benefits. The impact of this internal reorganization to the expense captions in our other segments was immaterial.

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.

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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):

	2009	2008
Revenue		
FedEx Express segment	$ 4,924	$ 6,419
FedEx Ground segment	1,730	1,761
FedEx Freight segment	982	1,353
FedEx Services segment	451	513
Other and eliminations	(78)	(76)
	$ 8,009	$ 9,970
Operating Income [1]		
FedEx Express segment	$ 104	$ 345
FedEx Ground segment	209	196
FedEx Freight segment	2	89
	$ 315	$ 630

(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, 2009, our purchase commitments under various contracts for the remainder of 2010 and annually thereafter were as follows (in millions):

	Aircraft [1]	Aircraft-Related [2]	Other [3]	Total
2010 (remainder)	$ 300	$ 197	$ 690	$ 1,187
2011	765	26	145	936
2012	527		118	645
2013	425		63	488
2014	466		12	478
Thereafter	1,924		125	2,049

(1) Our obligation to purchase 15 of these aircraft

(Boeing 777 Freighters, or B777Fs) is conditioned upon there being no event that causes FedEx Express or its employees not to be covered by the Railway Labor Act of 1926, as amended.

(2) Primarily aircraft modifications.

(3) Primarily vehicles, facilities, advertising and promotions contracts, and for the remainder of 2010, a total of $353 million of required quarterly contributions to our U.S. domestic pension plans.

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The amounts reflected in the table above for purchase commitments represent noncancelable 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 noncancelable 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.

We had $762 million in deposits and progress payments as of August 31, 2009 (an increase of $218 million from May 31, 2009) on aircraft purchases and other planned aircraft-related transactions. These deposits are classified in the Other assets caption of our condensed consolidated balance sheets. 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 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, 2009, with the year of expected delivery:

	B757	B777F [1]	Total
2010 (remainder)	6	4	10
2011	16	4	20
2012	8	3	11
2013		3	3
2014		3	3
Thereafter		13	13
Total	30	30	60

(1) Our obligation to purchase 15 of these aircraft is conditioned upon there being no event that causes FedEx Express or its employees not to be covered by the Railway Labor Act of 1926, as amended.

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, 2009 is as follows (in millions):

		Operating Leases		
	Capital Leases	Aircraft and Related Equipment	Facilities and Other	Total Operating Leases

2010 (remainder)	$	153	$	402	$	964	$	1,366
2011		20		525		1,160		1,685
2012		8		504		989		1,493
2013		119		499		852		1,351
2014		2		473		723		1,196
Thereafter		15		2,459		5,056		7,515
Total		317	$	4,862	$	9,744	$	14,606
Less amount representing interest		31						
Present value of net minimum lease payments	$	286						

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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.

(9) Contingencies

Wage-and-Hour. We are a defendant in a number of 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 certified class initially included FedEx Ground sort managers and dock service managers in California from May 10, 2002 to the present, but the court subsequently approved the dismissal of the sort managers, leaving only the dock service managers in the class. 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 provide them with rest and meal breaks.

In September 2008, in another one 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. In addition, in the same opinion, the court granted summary judgment in favor of FedEx Ground with respect to the plaintiffs claims for unpaid overtime wages. Accordingly, as to FedEx Ground, the conditionally certified class of plaintiffs is now limited to a claim of failure to pay regular wages due under the federal Fair Labor Standards Act.

In April 2009, in another one of these wage-and-hour cases, *Bibo v. FedEx Express*, a California federal court granted class certification, certifying several subclasses of FedEx Express couriers in California from April 14, 2006 (the date of the settlement of the *Foster* class action) to the present. The plaintiffs allege that FedEx Express violated California wage-and-hour laws after the date of the *Foster* settlement. In particular, the plaintiffs allege, among other things, that they were forced to work off the clock and were not provided with required meal breaks or split-shift premiums. We asked the U.S. Court of Appeals for the Ninth Circuit to accept a discretionary appeal of the class certification order, but the court refused to accept it at this time.

In July 2009, in another one of these wage-and-hour cases, *Taylor v. FedEx Freight*, a California state court indicated that it would grant class certification, and an order is being prepared for issuance by the court. The plaintiffs purport to represent a class of all current and former drivers employed by FedEx Freight in California who performed line haul services since June 2003. The plaintiffs allege, among other things, that they were forced to work off the clock and were not provided with required rest or meal breaks.

These class certification rulings do not address whether we will ultimately be held liable. 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.

Independent Contractor Lawsuits and State Administrative Proceedings. FedEx Ground is involved in approximately 50 class-action lawsuits (including 29 that have been certified as class actions), several individual lawsuits and approximately 40 state tax and other administrative proceedings that claim that the company s owner-operators should be treated as employees, rather than independent contractors.

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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 on class certification and classification issues 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. In July 2009, the court granted class certification in eight additional cases and denied it in five 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 (or are expected soon to be) pending in all 28 of the multidistrict litigation cases that have been certified as class actions.

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. In March 2009, a jury trial in the *Anfinson* case was held, and the jury returned a verdict in favor of FedEx Ground, finding that all 320 class members were independent contractors, not employees. The plaintiffs have appealed the verdict. The other contractor-model lawsuits that are not part of the multidistrict litigation are not as far along procedurally as *Anfinson* and all but one of the lawsuits are currently stayed pending further developments in the multidistrict litigation.

FedEx Ground is also involved in several lawsuits, including one purported class action, 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 September 2009, the Internal Revenue Service s audit team (Audit Team) fully informed us of the results of their employment tax audit for the 2002 calendar year regarding the classification of independent contractors at FedEx Ground. The Audit Team has proposed that no assessment of federal employment tax be made with respect to FedEx Ground s independent contractors, with the exception of independent contractors providing the FedEx Home Delivery service. With respect to those independent contractors, the Audit Team has notified us that they propose to assess tax and penalties of $14 million plus interest for 2002. Substantially all of the proposed assessment relates to employment and withholding taxes for the 2002 calendar year. Previously, in December 2007, the IRS indicated it tentatively anticipated assessing tax and penalties of $319 million, plus interest, for 2002 related to all FedEx Ground pick-up-and-delivery owner-operators. In October 2008, the IRS withdrew its tentative assessment of $319 million plus interest while continuing its audit. The $14 million assessment for our FedEx Home Delivery independent contractors noted above represents the results of that audit.

We intend to contest the erroneous conclusions in the audit. We expect that a final resolution may not occur for some time. We believe that we have strong defenses to the proposed assessment and will vigorously defend our position, as we continue to believe that all of FedEx Ground s independent contractors, including those providing the FedEx Home Delivery service, are independent contractors.

Similar issues relating to our independent contractors are under audit by the IRS for calendar years 2004 through 2008. As the IRS is still conducting audit work for calendar years 2004 through 2008, we cannot yet determine the amount or a reasonable range of potential loss for these periods. However, we do not believe that loss is probable for either calendar year 2002 or any subsequent period.

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 were purportedly brought to assert the rights of FedEx Corporation, asserted 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. In July 2009, the court dismissed the consolidated shareholder derivative lawsuits, and the time period for appeal has expired.

ATA Airlines. ATA Airlines has sued FedEx Express in Indiana federal court alleging that we breached a contract by not including ATA on our 2009 Civil Reserve Air Fleet (CRAF)/Air Mobility Command (AMC) team, which provides cargo and passenger service to the U.S. military. After being advised that it would not be a part of the 2009 team, ATA ceased operations and filed for bankruptcy. ATA s alleged damages include lost profits, aircraft acquisition costs and bankruptcy-related expenses. We have denied any liability and contend that ATA has suffered no damages. Discovery is ongoing, and given the preliminary status of the matter, we cannot yet determine the amount or a reasonable range of potential loss, if any. However, we do not believe that any loss is probable.

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.

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(10) Supplemental Cash Flow Information

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

	2009	2008
Cash payments for:		
Interest (net of capitalized interest)	$ 70	$ 29
Income taxes	$ 50	$ 79
Income tax refunds received [1]	(263)	(6)
Cash tax payments, net	$ (213)	$ 73

(1) Amount in the first quarter of 2010 is primarily related to a federal income tax refund received.

(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 $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. The internal reorganization discussed in Note 7 had no significant impact on the assets or operations of the guarantor entities. 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, 2009

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
CURRENT ASSETS					
Cash and cash equivalents	$ 1,329	$ 248	$ 275	$ (63)	$ 1,789
Receivables, less allowances	1	2,822	626	(39)	3,410
Spare parts, supplies, fuel, prepaid expenses and other, less allowances	5	619	55		679
Deferred income taxes		486	24		510
Total current assets	1,335	4,175	980	(102)	6,388
PROPERTY AND EQUIPMENT, AT COST	23	27,448	2,013		29,484
Less accumulated depreciation and amortization	17	14,923	1,006		15,946
Net property and equipment	6	12,525	1,007		13,538
INTERCOMPANY RECEIVABLE	584		505	(1,089)	
GOODWILL		1,551	682		2,233
INVESTMENT IN SUBSIDIARIES	12,272	1,996		(14,268)	
PENSION ASSETS	263				263
OTHER ASSETS	931	1,243	116	(855)	1,435
	$ 15,391	$ 21,490	$ 3,290	$ (16,314)	$ 23,857
LIABILITIES AND STOCKHOLDERS INVESTMENT					
CURRENT LIABILITIES					
Current portion of long-term debt	$	$ 158	$	$	$ 158
Accrued salaries and employee benefits	28	735	121		884
Accounts payable	36	1,022	355	(102)	1,311
Accrued expenses	20	1,358	155		1,533
Total current liabilities	84	3,273	631	(102)	3,886
LONG-TERM DEBT, LESS CURRENT PORTION	1,250	668			1,918
INTERCOMPANY PAYABLE		1,089		(1,089)	
OTHER LONG-TERM LIABILITIES					
Deferred income taxes		1,948	39	(855)	1,132
Other liabilities	271	2,769	95		3,135

Total other long-term liabilities	271		4,717		134		(855)		4,267
STOCKHOLDERS INVESTMENT	13,786		11,743		2,525		(14,268)		13,786
	$ 15,391	$	21,490	$	3,290	$	(16,314)	$	23,857

CONDENSED CONSOLIDATING BALANCE SHEETS
May 31, 2009

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
ASSETS					
CURRENT ASSETS					
Cash and cash equivalents	$ 1,768	$ 272	$ 304	$ (52)	$ 2,292
Receivables, less allowances	1	2,717	712	(39)	3,391
Spare parts, supplies, fuel, prepaid expenses and other, less allowances	1	838	83		922
Deferred income taxes		486	25		511
Total current assets	1,770	4,313	1,124	(91)	7,116
PROPERTY AND EQUIPMENT, AT COST	23	26,984	2,253		29,260
Less accumulated depreciation and amortization	17	14,659	1,167		15,843
Net property and equipment	6	12,325	1,086		13,417
INTERCOMPANY RECEIVABLE	758		379	(1,137)	
GOODWILL		1,485	744		2,229
INVESTMENT IN SUBSIDIARIES	11,973	2,129		(14,102)	
PENSION ASSETS	311				311
OTHER ASSETS	911	994	121	(855)	1,171
	$ 15,729	$ 21,246	$ 3,454	$ (16,185)	$ 24,244
LIABILITIES AND STOCKHOLDERS INVESTMENT					
CURRENT LIABILITIES					
Current portion of long-term debt	$ 500	$ 153	$	$	$ 653
Accrued salaries and employee benefits	26	711	124		861
Accounts payable	5	1,078	380	(91)	1,372
Accrued expenses	51	1,426	161		1,638
Total current liabilities	582	3,368	665	(91)	4,524
LONG-TERM DEBT, LESS CURRENT PORTION	1,250	680			1,930
INTERCOMPANY PAYABLE		1,137		(1,137)	
OTHER LONG-TERM LIABILITIES					
Deferred income taxes		1,875	51	(855)	1,071
Other liabilities	271	2,732	90		3,093

Total other long-term liabilities	271	4,607	141	(855)	4,164
STOCKHOLDERS INVESTMENT	13,626	11,454	2,648	(14,102)	13,626
	$ 15,729	$ 21,246	$ 3,454	$ (16,185)	$ 24,244

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CONDENSED CONSOLIDATING STATEMENTS OF INCOME
(UNAUDITED)
Three Months Ended August 31, 2009

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
REVENUES	$	$ 6,851	$ 1,228	$ (70)	$ 8,009
OPERATING EXPENSES:					
Salaries and employee benefits	23	2,893	461		3,377
Purchased transportation		796	271	(13)	1,054
Rentals and landing fees	1	520	58	(1)	578
Depreciation and amortization		438	57		495
Fuel		631	35		666
Maintenance and repairs		372	29		401
Intercompany charges, net	(47)	27	20		
Other	23	930	226	(56)	1,123
		6,607	1,157	(70)	7,694
OPERATING INCOME		244	71		315
OTHER INCOME (EXPENSE):					
Equity in earnings of subsidiaries	181	34		(215)	
Interest, net	(29)	14	(3)		(18)
Intercompany charges, net	31	(39)	8		
Other, net	(2)		(1)		(3)
INCOME BEFORE INCOME TAXES	181	253	75	(215)	294
Provision for income taxes		88	25		113
NET INCOME	$ 181	$ 165	$ 50	$ (215)	$ 181

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		910	378	(10)	1,278
Rentals and landing fees	1	535	82	(1)	617
Depreciation and amortization		421	71		492
Fuel		1,422	106		1,528
Maintenance and repairs		497	40		537
Intercompany charges, net	(56)	(26)	82		
Other	31	1,073	259	(60)	1,303
		7,763	1,648	(71)	9,340
OPERATING INCOME		483	147		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)		1		(3)
INCOME BEFORE INCOME TAXES	384	541	154	(461)	618
Provision for income taxes		176	58		234
NET INCOME	$ 384	$ 365	$ 96	$ (461)	$ 384

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CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
(UNAUDITED)
Three Months Ended August 31, 2009

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	$ 164	$ 563	$ 182	$ (11)	$ 898
INVESTING ACTIVITIES					
Capital expenditures		(841)	(39)		(880)
Proceeds from asset dispositions and other		26			26
CASH USED IN INVESTING ACTIVITIES		(815)	(39)		(854)
FINANCING ACTIVITIES					
Net transfers (to) from Parent	(61)	200	(139)		
Payment on loan between subsidiaries		35	(35)		
Principal payments on debt	(500)	(8)			(508)
Proceeds from stock issuances	7				7
Excess tax benefit on the exercise of stock options	1				1
Dividends paid	(34)				(34)
Other, net	(16)				(16)
CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(603)	227	(174)		(550)
Effect of exchange rate changes on cash		1	2		3
Net decrease in cash and cash equivalents	(439)	(24)	(29)	(11)	(503)
Cash and cash equivalents at beginning of period	1,768	272	304	(52)	2,292
Cash and cash equivalents at end of period	$ 1,329	$ 248	$ 275	$ (63)	$ 1,789

CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS
(UNAUDITED)
Three Months Ended August 31, 2008

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated

CASH PROVIDED BY OPERATING ACTIVITIES	$ 82	$ 560	$ 56	$	$ 698
INVESTING ACTIVITIES					
Capital expenditures		(571)	(65)		(636)
Proceeds from asset dispositions and other		10	5		15
CASH USED IN INVESTING ACTIVITIES		(561)	(60)		(621)
FINANCING ACTIVITIES					
Net transfers (to) from Parent	(33)	30	3		
Principal payments on debt			(1)		(1)
Proceeds from stock issuances	5				5
Dividends paid	(34)				(34)
CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(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

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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, 2009, and the related condensed consolidated statements of income and cash flows for the three-month periods ended August 31, 2009 and 2008. 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, 2009, 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, 2009, 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, 2009, 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 18, 2009

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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 Corporation (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, 2009 (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 condition 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 to our transportation segments. In addition, the FedEx Services segment provides customers with retail access to FedEx Express and FedEx Ground shipping services through FedEx Office and Print Services, Inc. (FedEx Office). 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 (revenue per package or pound or revenue per hundredweight for LTL freight 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, 2010 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.

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RESULTS OF OPERATIONS

CONSOLIDATED RESULTS

The following table compares summary operating results (dollars in millions, except per share amounts) for the three-month periods ended August 31:

	2009	2008	Percent Change
Revenues	$ 8,009	$ 9,970	(20)
Operating income	315	630	(50)
Operating margin	3.9%	6.3%	(240) bp
Net income	$ 181	$ 384	(53)
Diluted earnings per share	$ 0.58	$ 1.23	(53)

The following table shows changes in revenues and operating income by reportable segment for the three-month periods ended August 31, 2009 compared to August 31, 2008 (dollars in millions):

	Revenues		Operating Income	
	Dollar Change	Percent Change	Dollar Change	Percent Change
FedEx Express segment	$ (1,495)	(23)	$ (241)	(70)
FedEx Ground segment	(31)	(2)	13	7
FedEx Freight segment	(371)	(27)	(87)	(98)
FedEx Services segment	(62)	(12)		
Other and eliminations	(2)	NM		
	$ (1,961)	(20)	$ (315)	(50)

Overview

Our revenues and earnings decreased significantly in the first quarter of 2010, as weak global economic conditions continued to negatively impact our yields and volumes. By comparison, our results for the first quarter of 2009 reflected better global economic conditions and a significant benefit from rapidly declining fuel prices as a result of the timing lag that exists between when fuel prices change and when our indexed fuel surcharges automatically adjust. For the first quarter of 2010, the indices used to determine the fuel surcharges for our shipping services were significantly lower year over year based on lower fuel prices, which significantly decreased our fuel surcharge levels. The benefits of numerous cost-reduction activities implemented in 2009 (described below) and one additional operating day favorably impacted our results for the first quarter of 2010.

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The following graphs for FedEx Express, FedEx Ground and the FedEx Freight LTL Group, which comprises the FedEx Freight and FedEx National LTL businesses of FedEx Freight Corporation, show selected volume trends (in thousands) over the five most recent quarters:
The following graphs for FedEx Express, FedEx Ground and the FedEx Freight LTL Group show selected yield trends over the five most recent quarters:

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

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Revenue

Revenue decreased during the first quarter of 2010 due to yield decreases across all of our major service lines as a result of lower fuel surcharges and an aggressive pricing environment. The pricing environment is being significantly impacted by overcapacity in the LTL sector and competitors seeking to protect market share during the recession through heavy discounting. Lower fuel surcharges are due to lower fuel prices. For example, at FedEx Express, our weighted-average U.S. domestic and outbound fuel surcharge was 31.7% in the first quarter of 2009 versus 3.3% in the first quarter of 2010. Reductions in volumes at our FedEx Express and FedEx Freight segments as a result of continued weak global economic conditions also contributed to the revenue decrease. At FedEx Express, FedEx International Priority® package (IP) volume declined in every major region of the world. At the FedEx Ground segment, slightly lower average daily volume at FedEx Ground was more than offset by increased volume at FedEx SmartPost resulting from market share gains.

Despite these significant year-over-year declines, during the first quarter of 2010 we noted positive sequential month-over-month volume trends at the FedEx Ground segment and the FedEx Freight LTL Group. IP volume at the FedEx Express segment had positive sequential volume trends from the fourth quarter of 2009. These trends are indicating a possible stabilization of economic conditions in the U.S. and certain international regions. However, it remains difficult to predict the timing and pace of any economic recovery.

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Operating Income

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

	2009 [1]		2008	
	Amount	% of Revenue	Amount	% of Revenue
Operating expenses:				
Salaries and employee benefits	$ 3,377	42.2%	$ 3,585	36.0%
Purchased transportation	1,054	13.2	1,278	12.8
Rentals and landing fees	578	7.2	617	6.2
Depreciation and amortization	495	6.2	492	4.9
Fuel	666	8.3	1,528	15.3
Maintenance and repairs	401	5.0	537	5.4
Other	1,123	14.0	1,303	13.1
Total operating expenses	$ 7,694	96.1	$ 9,340	93.7
Operating margin		3.9%		6.3%

(1) Due to the fixed-cost structure of our transportation networks, the year-over-year comparison of our operating expenses as a percentage of revenue has been affected by a number of factors, including the impact of lower fuel surcharges, significant declines in volume due to economic conditions and our cost-containment activities. Collectively, these factors have

distorted the comparability of certain of our operating expense captions on a relative basis.

Operating income and operating margin declined significantly in the first quarter of 2010, as a reduction in fuel surcharges (described below) and a more competitive pricing environment reduced yields. Volume declines at the FedEx Express and FedEx Freight segments as a result of continued weak global economic conditions also contributed to the decrease in operating income and operating margin during the first quarter of 2010. Cost-reduction initiatives implemented during 2009 partially mitigated the negative impact of these factors on our results for the first quarter of 2010. During 2009, in response to weak business conditions, we implemented several actions to lower our cost structure, including base salary reductions for U.S. salaried personnel effective January 1, 2009, a suspension of 401(k) company-matching contributions effective February 1, 2009, and implementation of a hiring freeze. In addition, we further optimized our networks by adjusting routes and equipment types, permanently and temporarily idling certain equipment and consolidating facilities. We continue to exercise stringent control over discretionary spending, such as travel, entertainment and professional fees, and defer capital investments when possible to better match current demand levels.

Salaries and wages declined 6% in the first quarter of 2010, reflecting a strict freeze on hiring, reduced hours and the pay actions described above. Purchased transportation costs decreased 18% in the first quarter of 2010 due to lower volume, which reduced the utilization of contract pickup-and-delivery services, and a lower average price per gallon of fuel. Maintenance and repairs expense decreased 25% in the first quarter of 2010 primarily due to volume-related reductions in flight hours and the grounding of certain aircraft due to excess capacity in the current economic environment.

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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:

Fuel expense decreased 56% during the first quarter of 2010, primarily due to decreases in the average price per gallon of fuel and fuel consumption. Jet fuel usage decreased 11% during the first quarter of 2010, as we reduced flight hours in light of lower business levels.

We experienced significant fuel price and fuel surcharge volatility in the first quarter of 2009, when fuel prices peaked at their historical highs before beginning to rapidly decrease. The change in our fuel surcharges for FedEx Express and FedEx Ground lagged the price decrease by approximately six to eight weeks, resulting in a benefit to operating income in the first quarter of 2009. In contrast, in the first quarter of 2010 fuel prices rose during the beginning of the quarter and then stabilized, with significantly less volatility than in the first quarter of 2009. Accordingly, based on a static analysis of the net impact of year-over-year changes in fuel prices compared to year-over-year changes in fuel surcharges, fuel had a significant negative impact to operating income in the first quarter of 2010.

Our 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 fuel surcharge levels may 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 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 2010 and 2009 in the accompanying discussions of each of our transportation segments.

Income Taxes

Our effective tax rate was 38.5% for the first quarter of 2010 and 37.9% for the first quarter of 2009. The increase in the tax rate in the first quarter of 2010 was primarily due to lower pre-tax income. For 2010, we expect the effective tax rate to be between 38.0% and 39.0%. The actual rate, however, will depend on a number of factors, including the amount and source of operating income.

As of August 31, 2009, 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, from May 31, 2009. During the first quarter of 2010, the Internal Revenue Service commenced an audit of our 2007 and 2008 consolidated U.S. income tax returns.

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We file income tax returns in the U.S. and various U.S. states and foreign jurisdictions. It is reasonably possible that certain U.S. federal, U.S. state and foreign jurisdiction income tax return proceedings will be completed during the next 12 months and could result in a change in our balance of unrecognized tax benefits. An estimate of the range of the change cannot be made at this time. The expected impact of any changes would not be material to our consolidated financial statements.

Outlook

We expect continued weakness in yields and comparatively soft demand for our services into the second quarter of 2010. Our results for the first half of 2009 reflected the benefits of better global economic conditions and rapidly declining fuel prices, creating difficult year-over-year comparisons. However, we have noted some positive sequential trends in volumes and yields from the fourth quarter of 2009, indicating a possible stabilization of economic conditions. Furthermore, our cost-reduction actions during late 2009 are firmly in place, providing favorable expense comparisons for the remainder of the 2010 fiscal year.

We believe our year-over-year comparisons will be somewhat better by the second half of 2010; however, our expectations assume a modest recovery in global economic conditions, the timing and pace of which is difficult to predict, and fuel prices that remain at current forecasted levels. Further, our current results reflect the suspension of many employee compensation programs (as indicated above) that may be reinstated if our financial results begin to improve, somewhat dampening the near-term earnings potential of an economic recovery. If economic conditions deteriorate further, additional actions will be necessary to reduce the size of our networks. 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.

For the remainder of 2010, 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 enhancing and broadening our service offerings to position us for stronger growth under improved economic conditions. For additional details on key 2010 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, which impact our fuel surcharge levels. Historically, our fuel surcharges have largely 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 either positively or negatively 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.

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

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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 June 1, 2008, we adopted Statement of Financial Accounting Standards (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. On June 1, 2009, we implemented the previously deferred provisions of SFAS 157 for nonfinancial assets and liabilities recorded at fair value, as required. The adoption of SFAS 157 had no impact on our financial statements.

In December 2007, the FASB issued SFAS 141R, Business Combinations, and SFAS 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin (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 became effective for us beginning June 1, 2009 and had no impact on our financial statements.

In December 2008, the FASB issued FASB Staff Position (FSP) 132(R)-1, Employers Disclosures about Postretirement Benefit Plan Assets. This FSP provides guidance on the objectives an employer should consider when providing detailed disclosures about assets of a defined benefit pension or other postretirement plan, including disclosures about investment policies and strategies, categories of plan assets, significant concentrations of risk and the inputs and valuation techniques used to measure the fair value of plan assets. This FSP will be effective for our fiscal year ending May 31, 2010.

In April 2009, the FASB issued FSP No. 107-1 and Accounting Principles Board Opinion (APB) No. 28-1, Interim Disclosures about Fair Value of Financial Instruments. This FSP requires disclosures about the fair value of financial instruments for interim reporting periods in addition to annual reporting periods. This FSP became effective for us beginning with the first quarter of fiscal year 2010.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events, which establishes general standards for accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This standard requires us to disclose the date through which we have evaluated subsequent events, which for Securities and Exchange Commission (SEC) registrants is the date we file our financial statements with the SEC. This standard became effective for our first quarter of fiscal year 2010. Events occurring after the date of the condensed consolidated balance sheet but before the issuance of the financial statements included in this filing have been evaluated through the time of this filing.

In June 2009, the FASB issued Statement No. 168, The FASB Accounting Standards Codification (Codification) and the Hierarchy of GAAP, (SFAS 168), which establishes the Codification as the single source of authoritative U.S. GAAP recognized by the FASB. SEC rules and interpretive releases are also sources of authoritative GAAP for SEC registrants. SFAS 168 is effective beginning for periods ending after September 15, 2009. As SFAS 168 is not intended to change or alter existing GAAP, it will not impact our results of operations, cash flows or financial position. We will adjust historical GAAP references in our second quarter 2010 Form 10-Q to reflect accounting guidance references included in the Codification.

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REPORTABLE SEGMENTS

FedEx Express, FedEx Ground and the FedEx Freight LTL Group represent our major service lines and, along with FedEx Services, form the core of our reportable segments. As of August 31, 2009, our reportable segments included the following businesses:

FedEx Express Segment	FedEx Express (express transportation) FedEx Trade Networks (global trade services)
FedEx Ground Segment	FedEx Ground (small-package ground delivery) FedEx SmartPost (small-parcel consolidator)