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**Financial Results**

## Overview of Financial Section

The financial section of the FedEx Corporation ("FedEx") Annual Report consists of the following Management's Discussion and Analysis of Results of Operations and Financial Condition ("MD&A"), the Consolidated Financial Statements and the notes to the Consolidated Financial Statements, and Other Financial Information, all of which include information about our significant accounting policies, practices and the transactions that underlie our financial results. The following MD&A describes the principal factors affecting the results of operations, liquidity, capital resources, contractual cash obligations and the critical accounting estimates of FedEx. The discussion in the financial section should be read in conjunction with the other sections of this Annual Report and our detailed discussion of risk factors included in this MD&A.

### ORGANIZATION OF INFORMATION

Our MD&A is comprised of three major sections: Results of Operations, Financial Condition and Critical Accounting Estimates. These sections include the following information:

- Results of Operations includes an overview of our consolidated 2007 results compared to 2006, and 2006 results compared to 2005. This section also includes a discussion of key actions and events that impacted our results, as well as a discussion of our outlook for 2008.
- The overview is followed by a financial summary and analysis (including a discussion of both historical operating results and our outlook for 2008) for each of our four reportable business segments.
- Our financial condition is reviewed through an analysis of key elements of our liquidity, capital resources and contractual cash obligations, including a discussion of our cash flow statements and our financial commitments.
- We conclude with a discussion of the critical accounting estimates that we believe are important to understanding certain of the material judgments and assumptions incorporated in our reported financial results.

### DESCRIPTION OF BUSINESS

FedEx provides a broad portfolio of transportation, e-commerce and business services through companies competing collectively, operating independently and managed collaboratively, under the respected FedEx brand. These operating companies are primarily represented by FedEx Express, the world's largest express transportation company; FedEx Ground, a leading provider of small-package ground delivery services; FedEx Freight Corporation, a leading U.S. provider of less-than-truckload ("LTL") freight services; and FedEx Kinko's, a leading provider of document solutions and business services. 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 and business 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 for capital expenditures and operating expenses and to match our cost structure to 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.

Except as otherwise specified, references to years indicate our fiscal year ended May 31, 2007 or ended May 31 of the year referenced and comparisons are to the prior year. References to our transportation segments mean, collectively, our FedEx Express, FedEx Ground and FedEx Freight segments.

## 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 years ended May 31:

	2007 <sup>(1)</sup>	2006 <sup>(2)</sup>	2005 <sup>(3)</sup>	Percent Change	
				2007/2006	2006/2005
Revenues	\$35,214	\$32,294	\$29,363	9	10
Operating income	3,276	3,014	2,471	9	22
Operating margin	9.3%	9.3%	8.4%	-bp	90bp
Net income	\$ 2,016	\$ 1,806	\$ 1,449	12	25
Diluted earnings per share	\$ 6.48	\$ 5.83	\$ 4.72	11	24

(1) Operating expenses include a \$143 million charge at FedEx Express associated with upfront compensation and benefits under the new labor contract with our pilots, which was ratified in October 2006. The impact of this new contract on second quarter net income was approximately \$78 million net of tax, or \$0.25 per diluted share.

(2) Operating expenses include a \$79 million (\$49 million, net of tax, or \$0.16 per diluted share) charge to adjust the accounting for certain facility leases, predominantly at FedEx Express.

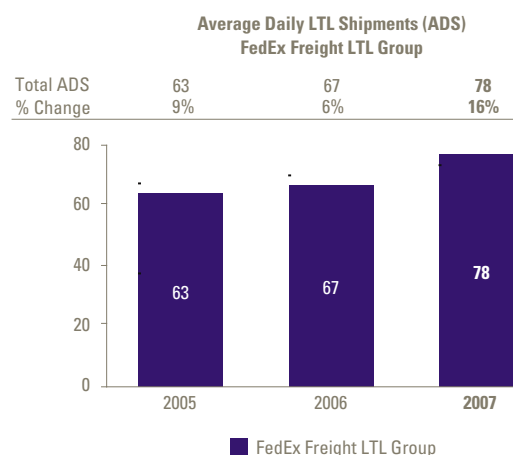
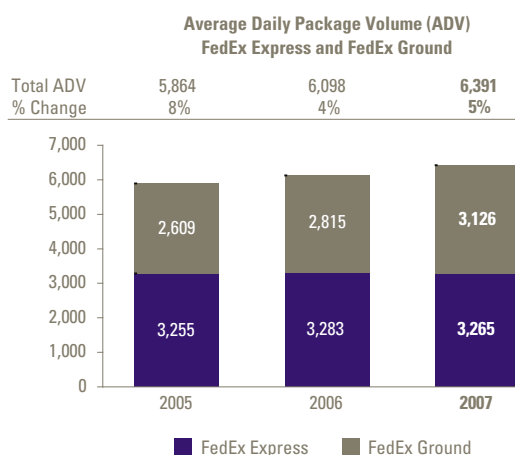
(3) Results include a \$48 million (\$31 million, net of tax, or \$0.10 per diluted share) Airline Stabilization Act charge at FedEx Express and a \$12 million, or \$0.04 per diluted share, benefit from an income tax adjustment.

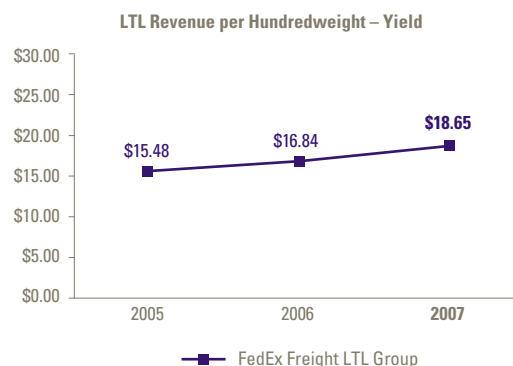
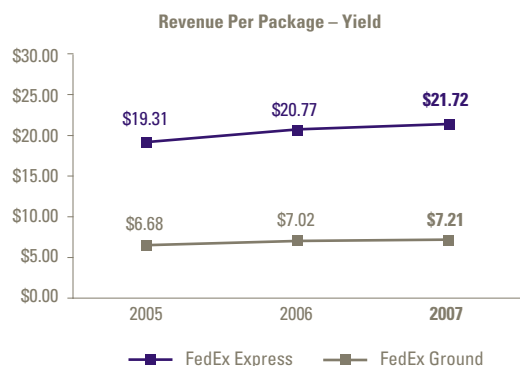
The following table shows changes in revenues and operating income by reportable segment for 2007 compared to 2006, and 2006 compared to 2005 (in millions):

	Revenues				Operating Income			
	Dollar Change		Percent Change		Dollar Change		Percent Change	
	2007/2006	2006/2005	2007/2006	2006/2005	2007/2006	2006/2005	2007/2006	2006/2005
FedEx Express segment <sup>(1)</sup>	\$1,235	\$1,961	6	10	\$188	\$353	11	25
FedEx Ground segment	737	626	14	13	108	101	15	17
FedEx Freight segment	941	428	26	13	(22)	131	(5)	37
FedEx Kinko's segment	(48)	22	(2)	1	(12)	(43)	(21)	(43)
Other and Eliminations	55	(106)	NM	NM	-	1	NM	NM
	\$2,920	\$2,931	9	10	\$262	\$543	9	22

(1) FedEx Express 2007 operating expenses include a \$143 million charge associated with upfront compensation and benefits under the new pilot labor contract, 2006 operating expenses include a \$75 million charge to adjust the accounting for certain facility leases, and 2005 operating expenses include a \$48 million charge related to the Airline Stabilization Act.

The following graphs for FedEx Express, FedEx Ground and the FedEx Freight LTL Group show selected operating statistics (in thousands, except yield amounts) for the years ended May 31:





Overall results for 2007 were solid in spite of several challenges, as we continued to execute our business strategy during a time of slower economic growth and expanded our service offerings through key acquisitions. Operating results moderated during 2007, reflecting the impact of weaker volumes in the second half of our fiscal year in our FedEx Express and FedEx Freight segments due to the slowing economic environment. The year-over-year negative impact from the timing lag in our fuel surcharges and a \$143 million charge associated with upfront compensation and benefits under the new contract with our pilots also negatively impacted 2007 operating results.

Revenue growth in 2007 was due to strong FedEx Ground package volume growth and continued growth in FedEx Express International Priority (“IP”) services, as we continued to focus on expanding these service offerings. Our 2007 revenues also reflected the acquisition of FedEx National LTL (formerly known as Watkins Motor Lines), which added approximately \$760 million to 2007 revenue. Revenue growth in 2007 was slightly offset by declines in copy product revenues at FedEx Kinko’s.

Operating income increased in 2007, as revenue growth at FedEx Express and FedEx Ground more than offset reduced profitability at the FedEx Freight segment and FedEx Kinko’s. Operating margin was flat in 2007 due to slower economic growth, the negative impact of higher salaries and benefits primarily as a result of the new labor contract with our pilots and the timing of adjustments to our fuel surcharges at FedEx Express (described below), as well as operating losses at FedEx National LTL. Softening volumes in the LTL sector and ongoing expenses to integrate the FedEx National LTL network negatively impacted the performance of the FedEx Freight segment in 2007.

Salaries and employee benefits increased in 2007 as a result of the new labor contract for the pilots of FedEx Express and the FedEx National LTL acquisition. The impacts of expensing stock options commencing in 2007 and higher retirement plan costs were largely offset by lower incentive compensation accruals. Purchased transportation costs increased in 2007 due to FedEx Ground volume growth, the FedEx National LTL acquisition and IP package volume growth.

The pilots of FedEx Express, who represent a small number of our total employees, are employed under a collective bargaining agreement. In October 2006, the pilots ratified a new four-year

labor contract that included signing bonuses and other upfront compensation of approximately \$143 million, as well as pay increases and other benefit enhancements. These costs were partially mitigated by reductions in variable incentive compensation. The effect of this new agreement on second quarter 2007 net income was approximately \$78 million net of tax, or \$0.25 per diluted share.

The timing and amount of fluctuations in fuel prices and our ability to recover incremental fuel costs through our various fuel surcharges continue to impact our results. Fuel costs increased during 2007 due to an increase in the average price per gallon of fuel and an increase in gallons consumed. Because of the timing lag that exists between when we purchase fuel and when our fuel surcharges are automatically adjusted at FedEx Express, fuel surcharges were not sufficient to offset the effect of changes in fuel costs on our operating results for 2007. Though 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 fees 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 2007, 2006 and 2005 in the accompanying discussions of each of our transportation segments.

Our 2006 results benefited from strong growth in the global economy. During 2006, revenue growth was primarily attributable to yield improvement across our transportation segments, package volume growth in our IP services at FedEx Express and volume growth at FedEx Ground and FedEx Freight. Yields improved principally due to incremental fuel surcharges and base rate increases.

Operating income increased during 2006 primarily due to revenue growth and improved margins across all our transportation segments. Yield and cost management activities, combined with productivity gains across all transportation segments, contributed to our margin growth. Operating income improvement was partially offset by higher costs at FedEx Express to support international volume growth, expansion costs at FedEx Ground and reduced operating profit at FedEx Kinko’s.

While fuel costs increased substantially in 2006, fuel surcharges more than offset the effect of these higher fuel costs. Salaries and employee benefits increased in 2006 due largely to increases in wage rates, pension and medical expenses. Pension expense increased \$64 million in 2006 due primarily to a reduction in the discount rate. Purchased transportation increased in 2006 due primarily to the continued increase in the use of contract carriers to support increasing volumes at FedEx Ground, increased IP volumes at FedEx Express and higher fuel surcharges from third-party transportation providers, including our independent contractors.

#### **Other Income and Expense**

Net interest expense decreased \$51 million during 2007 primarily due to increased interest income earned on higher cash balances. Net interest expense decreased \$35 million during 2006 due primarily to the reduction in the level of outstanding debt and capital leases as a result of scheduled payments, increased interest income due to higher cash balances and interest rates, and higher capitalized interest related to modification of certain aircraft at FedEx Express.

#### **Income Taxes**

Our effective tax rate was 37.3% in 2007, 37.7% in 2006 and 37.4% in 2005. Our 2007 tax rate was favorably impacted by the conclusion of various state and federal tax audits and appeals. This favorable impact was partially offset by tax charges incurred as a result of a reorganization in Asia associated with our acquisition in China (described below). The 37.4% effective tax rate in 2005 was favorably impacted by the reduction of a valuation allowance on foreign tax credits arising from certain of our international operations as a result of the passage of the American Jobs Creation Act of 2004 and by a lower effective state tax rate. For 2008, we expect our effective tax rate to be between 37.5% and 38%. The actual rate, however, will depend on a number of factors, including the amount and source of operating income.

#### **Business Acquisitions**

On September 3, 2006, we acquired the assets and assumed certain obligations of the LTL operations of Watkins Motor Lines, a privately held company, and certain affiliates for \$787 million in cash. Watkins, a leading provider of long-haul LTL services, was renamed FedEx National LTL and meaningfully extends our leadership position in the heavyweight LTL freight sector. The financial results of FedEx National LTL are included in the FedEx Freight segment from the date of acquisition.

On December 16, 2006, we acquired all of the outstanding capital stock of ANC Holdings Ltd. ("ANC"), a United Kingdom domestic express transportation company, for \$241 million, predominantly in cash. This acquisition allows FedEx Express to better serve the United Kingdom domestic market, which we previously served primarily through independent agents.

On March 1, 2007, FedEx Express acquired Tianjin Datian W. Group Co., Ltd.'s ("DTW Group") 50% share of the FedEx-DTW International Priority express joint venture and assets relating to DTW Group's domestic express network in China for \$427

million in cash. This acquisition converts our joint venture with DTW Group into a wholly owned subsidiary and increases our presence in China in the international and domestic express businesses. Prior to the fourth quarter of 2007, we accounted for our investment in the joint venture under the equity method.

The financial results of the ANC and DTW Group acquisitions, as well as other immaterial business acquisitions during 2007, are included in the FedEx Express segment from the date of acquisition. These acquisitions were not material to our results of operations or financial condition.

We paid the purchase price for these acquisitions from available cash balances, which included the net proceeds from our \$1 billion senior unsecured debt offering completed during 2007. See Note 6 of the accompanying consolidated financial statements for further discussion of this debt offering.

See Note 3 of the accompanying consolidated financial statements for further information about these acquisitions.

#### **Lease Accounting Charge**

Our results for 2006 included a noncash charge of \$79 million (\$49 million net of tax, or \$0.16 per diluted share) to adjust the accounting for certain facility leases, predominantly at FedEx Express. The charge, which included the impact on prior years, related primarily to rent escalations in on-airport facility leases that were not being recognized appropriately.

#### **Airline Stabilization Act Charge**

In 2005, the United States Department of Transportation ("DOT") issued a final order in its administrative review of the FedEx Express claim for compensation under the Air Transportation Safety and System Stabilization Act. As a result, we recorded a charge of \$48 million in 2005 (\$31 million net of tax, or \$0.10 per diluted share), representing the DOT's repayment demand of \$29 million and the write-off of a \$19 million receivable.

#### **Outlook**

Our outlook for 2008 reflects continued investment in several major, long-term initiatives in a soft but stable U.S. economy. Outside the United States, economic activity is expected to continue to expand, but at a more moderate pace than in 2007. As a result, we expect our revenue trends to moderate in 2008, with growth driven by increased shipments at FedEx Ground, the full-year benefit of the FedEx National LTL business and expansion of international business at FedEx Express (both IP and international domestic services).

We expect our earnings in 2008 to be below our long-term goal of 10% to 15% annual earnings growth due to the softening U.S. economy and planned investments in our businesses, which are critical to our long-term strategy. We remain optimistic about the long-term prospects for all of our business segments.

We expect to make significant investments to expand our global networks, in part through the continued integration and expansion of the businesses we acquired in 2007. Our planned investments for 2008 are focused on the following three key opportunities:

- support for long-term volume growth, such as additional or expanded facilities across all segments, new aircraft (such as the Boeing 757 and 777 Freighter) and expansion of our international domestic express businesses;
- improvements in service levels, including expanded delivery areas for the FedEx Priority Overnight and FedEx First Overnight services at FedEx Express and reduced transit times at FedEx Ground; and
- improvements to productivity, including updates and enhancements to our technology capabilities.

FedEx Kinko's will continue to focus on key strategies related to adding new locations, improving customer service and increasing investments in employee development and training. We expect these strategies to continue to adversely affect profitability in 2008. FedEx Kinko's plans to open approximately 300 new centers in the coming year, which will bring the total number of centers to approximately 2,000 by the end of 2008.

All of our transportation businesses operate in a competitive pricing environment, exacerbated by continuing volatile fuel prices. Historically, our fuel surcharges have generally 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 affect our earnings.

See "Risk Factors" for a discussion of these and other potential risks and uncertainties that could materially affect our future performance.

### Seasonality of Business

Our businesses are seasonal in nature. Seasonal fluctuations affect volumes, revenues and earnings. Historically, the U.S. express package business experiences an increase in volumes in late November and December. International business, particularly in the Asia-to-U.S. market, peaks in October and November in advance of the U.S. holiday sales season. Our first and third fiscal quarters, because they are summer vacation and post winter-holiday seasons, have historically experienced lower volumes relative to other periods. Normally, the fall is the busiest shipping period for FedEx Ground, while late December, June and July are the slowest periods. For the FedEx Freight LTL Group, the spring and fall are the busiest periods and the latter part of December, January and February are the slowest periods. For FedEx Kinko's, the summer months are normally the slowest periods. Shipment levels, operating costs and earnings for each of our companies can also be adversely affected by inclement weather, particularly in our third fiscal quarter. In addition, the transportation and business services industries are directly affected by the state of the overall global economy.

### NEW ACCOUNTING PRONOUNCEMENTS

New accounting rules and disclosure requirements can significantly impact the comparability of our financial statements. We believe the following new accounting pronouncements, which were issued or became effective for us during 2007, are relevant to the readers of our financial statements.

On June 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards ("SFAS") 123R, "Share-Based Payment," which requires recognition of compensation expense for stock-based awards using a fair value method. The adoption of SFAS 123R reduced earnings for 2007 by \$0.17 per diluted share. For additional information on the impact of the adoption of SFAS 123R, refer to Note 1 to the accompanying consolidated financial statements.

On May 31, 2007, we adopted SFAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," which 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 of unrecognized gains or losses, prior service costs or credits and transition assets or obligations existing at the time of adoption. Additionally, SFAS 158 requires the measurement date for plan assets and liabilities to coincide with the sponsor's year-end. We currently use a February 28 measurement date for our plans; therefore, this standard will require us to change our measurement date to May 31 (beginning in 2009).

The funded status recognition and disclosure provisions of SFAS 158 were effective for FedEx as of May 31, 2007. The requirement to measure plan assets and benefit obligations as of our fiscal year-end is effective for FedEx no later than 2009.

The adoption of SFAS 158 resulted in a \$982 million charge to shareholders' equity at May 31, 2007 through accumulated other comprehensive income. Under SFAS 158, we were required to write off our prepaid pension asset of \$1.4 billion and increase our pension and other postretirement benefit liabilities by \$120 million. These adjustments, net of deferred taxes of \$582 million, were required to recognize the unfunded projected benefit obligation in our balance sheet. SFAS 158 has no impact on the determination of expense for our pension or other postretirement benefit plans.

In February 2007, we announced changes to modernize certain of our retirement programs over the next two fiscal years. Effective January 1, 2008, we will increase the annual company matching contribution under the largest of our 401(k) plans covering most employees from \$500 to a maximum of 3.5% of eligible compensation. Effective May 31, 2008, benefits previously accrued under our primary pension plans using a traditional pension benefit formula will be capped for most employees, and those benefits will be payable beginning at retirement. Beginning June 1, 2008, future pension benefits for most employees will be accrued under a cash balance formula we call the Portable Pension Account. These changes will not affect the benefits of current retirees. For additional information on the adoption of SFAS 158 and these changes, see Note 12 to the accompanying audited financial statements and the Critical Accounting Estimates section of this MD&A.

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes." This interpretation establishes new standards for the financial statement recognition, measurement and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The new rules will be effective for FedEx in the first quarter of 2008. The adoption of this interpretation will not have a material effect on our financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," which eliminates the diversity in practice surrounding the quantification and evaluation of financial statement errors. The guidance outlined in SAB 108 was effective for FedEx in the fourth quarter of 2007 and is consistent with our historical practices for assessing such matters when circumstances have required such an evaluation.

### REPORTABLE SEGMENTS

FedEx Express, FedEx Ground, FedEx Freight and FedEx Kinko's represent our major service lines and form the core of our reportable segments. As of May 31, 2007, our reportable segments included 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 Kinko's Segment</b>	FedEx Kinko's (document solutions and business services)

### FEDEX SERVICES & OTHER INTERSEGMENT TRANSACTIONS

FedEx Services provides customer-facing sales, marketing and information technology support, primarily for FedEx Express and FedEx Ground. The costs for these activities are allocated based on metrics such as relative revenues or estimated services provided. We believe these allocations approximate the cost of providing these functions.

The operating expenses line item "Intercompany charges" on the accompanying unaudited financial summaries of our reportable segments includes the allocations from FedEx Services to the respective 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.

Effective June 1, 2006, we moved the credit, collections and customer service functions with responsibility for FedEx Express U.S. and FedEx Ground customer information from FedEx Express into a new subsidiary of FedEx Services named FedEx Customer Information Services, Inc. ("FCIS"). Also, effective June 1, 2006, we moved FedEx Supply Chain Services, Inc., the results of which were previously reported in the FedEx Ground segment, into a new subsidiary of FedEx Services named FedEx Global Supply Chain Services, Inc. The costs of providing these customer service functions and the net operating costs of FedEx Global Supply Chain Services are allocated back to the FedEx Express and FedEx Ground segments. Prior year amounts have not been reclassified to conform to the current year segment presentation, as the financial results are materially comparable.

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 that 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. FedEx Kinko's segment revenues include package acceptance revenue, which represents the fee received by FedEx Kinko's from FedEx Express and FedEx Ground for accepting and handling packages at FedEx Kinko's locations on behalf of these operating companies. Package acceptance revenue does not include the external revenue associated with the actual shipments. 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 years ended May 31:

	2007	2006	2005	Percent Change	
				2007/ 2006	2006/ 2005
<b>Revenues:</b>					
Package:					
U.S. overnight box	\$ 6,485	\$ 6,422	\$ 5,969	1	8
U.S. overnight envelope	1,990	1,974	1,798	1	10
U.S. deferred	2,883	2,853	2,799	1	2
Total U.S. domestic package revenue	11,358	11,249	10,566	1	6
International Priority (IP) <sup>(1)</sup>	6,722	6,139	5,464	9	12
Total package revenue	18,080	17,388	16,030	4	8
Freight:					
U.S.	2,412	2,218	1,854	9	20
International priority freight <sup>(1)</sup>	1,045	840	670	24	25
International airfreight	394	434	381	(9)	14
Total freight revenue	3,851	3,492	2,905	10	20
Other <sup>(2)</sup>	750	566	550	33	3
Total revenues	22,681	21,446	19,485	6	10
<b>Operating expenses:</b>					
Salaries and employee benefits	8,234 <sup>(3)</sup>	8,033	7,704	3	4
Purchased transportation	1,098	971	843	13	15
Rentals and landing fees	1,610	1,696 <sup>(4)</sup>	1,608	(5)	5
Depreciation and amortization	856	805	798	6	1
Fuel	2,946	2,786	2,012	6	38
Maintenance and repairs	1,444	1,344	1,276	7	5
Airline Stabilization Act charge	—	—	48	NM	NM
Intercompany charges	2,082	1,542	1,509	35	2
Other	2,456	2,502	2,273	(2)	10
Total operating expenses	20,726	19,679	18,071	5	9
<b>Operating income</b>	<b>\$ 1,955</b>	<b>\$ 1,767</b>	<b>\$ 1,414</b>	<b>11</b>	<b>25</b>
<b>Operating margin</b>	<b>8.6%</b>	<b>8.2%</b>	<b>7.3%</b>	<b>40bp</b>	<b>90bp</b>

(1) We reclassified certain prior period international priority freight service revenues previously included within IP package revenues to international priority freight revenues to conform to the current period presentation and more precisely present the nature of the services provided.

(2) Other revenues includes FedEx Trade Networks and our international domestic express businesses, such as ANC, DTW Group and our Canadian domestic express operations.

(3) Includes a \$143 million charge for signing bonuses and other upfront compensation associated with a new four-year labor contract with our pilots.

(4) Includes a \$75 million one-time, noncash charge to adjust the accounting for certain facility leases.

The following table compares selected statistics (in thousands, except yield amounts) for the years ended May 31:

	2007	2006	2005	Percent Change	
				2007/ 2006	2006/ 2005
<b>Package Statistics<sup>(1)</sup></b>					
Average daily package volume (ADV):					
U.S. overnight box	1,174	1,203	1,184	(2)	2
U.S. overnight envelope	706	713	680	(1)	5
U.S. deferred	898	901	958	—	(6)
Total U.S. domestic ADV	2,778	2,817	2,822	(1)	—
IP <sup>(2)</sup>	487	466	433	5	8
Total ADV	3,265	3,283	3,255	(1)	1
Revenue per package (yield):					
U.S. overnight box	\$21.66	\$20.94	\$19.77	3	6
U.S. overnight envelope	11.06	10.86	10.37	2	5
U.S. deferred	12.59	12.42	11.46	1	8
U.S. domestic composite	16.04	15.66	14.69	2	7
IP <sup>(2)</sup>	54.13	51.64	49.47	5	4
Composite package yield	21.72	20.77	19.31	5	8
<b>Freight Statistics<sup>(1)</sup></b>					
Average daily freight pounds:					
U.S.	9,569	9,374	8,885	2	6
International priority freight <sup>(2)</sup>	1,878	1,634	1,395	15	17
International airfreight	1,831	2,126	1,914	(14)	11
Total average daily freight pounds	13,278	13,134	12,194	1	8
Revenue per pound (yield):					
U.S.	\$ 0.99	\$ 0.93	\$ 0.82	6	13
International priority freight <sup>(2)</sup>	2.18	2.02	1.88	8	7
International airfreight	0.84	0.80	0.78	5	3
Composite freight yield	1.14	1.04	0.93	10	12

(1) Package and freight statistics include only the operations of FedEx Express.

(2) We reclassified certain prior period international priority freight service statistics previously included within the IP package statistics to international priority freight statistics to conform to the current period presentation and more precisely present the nature of the services provided.

### FedEx Express Segment Revenues

Solid yield growth primarily due to pricing discipline contributed to revenue growth in 2007, despite flat package volume growth. Package revenue growth in 2007 was driven by IP revenues, which grew 9% on yield growth of 5% as a result of yield improvements across all regions and a 5% increase in volumes due to IP volume growth in U.S. outbound, Asia and Europe, as we continued to focus on expanding this service. Also contributing to revenue growth in 2007 were increases in other revenues primarily due to our acquisition of ANC and increases in freight revenues due to higher U.S. and international priority freight volumes. U.S. domestic package revenues increased 1% as a result of yield improvements, partially offset by a decrease in volumes.

IP yield increased during 2007 as a result of favorable exchange rates, higher package weights and an increase in the average rate per pound. U.S. domestic composite yield increases in 2007 were due to an increase in the average rate per pound, partially offset by changes in product mix and lower package weights. U.S. freight yield increased in 2007 due to an increase in the average rate per pound and higher fuel surcharges.

IP volume growth in 2007 was primarily due to increased demand in the U.S. outbound, Asia and Europe markets. U.S. domestic package volumes decreased during 2007 primarily due to the moderating growth rate of the U.S. economy.

FedEx Express segment revenues increased in 2006 due to yield improvements and volume growth in IP services (particularly in Asia, U.S. outbound and Europe). U.S. domestic package and U.S. freight revenue growth also contributed to the revenue increase for 2006. U.S. volumes were flat compared to the prior year, as growth in our U.S. domestic overnight services was offset by declines in deferred volumes that resulted from yield management actions.

IP yield increased during 2006 due to higher fuel surcharges and increases in international average weight per package and average rate per pound. U.S. domestic composite yield increases were due to higher fuel surcharges and improved yields on U.S. domestic deferred packages. Improvements in U.S. domestic deferred yield resulted from our continued efforts to improve the profitability of this service. U.S. freight yield increases were due to an increase in average rate per pound and higher fuel surcharges.

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 years ended May 31:

	2007	2006	2005
U.S. Domestic and Outbound Fuel Surcharge:			
Low	<b>8.50%</b>	10.50%	6.00%
High	<b>17.00</b>	20.00	13.00
Weighted-average	<b>12.91</b>	13.69	9.05
International Fuel Surcharges:			
Low	<b>8.50</b>	10.00	3.00
High	<b>17.00</b>	20.00	13.00
Weighted-average	<b>12.98</b>	12.73	8.45

### FedEx Express Segment Operating Income

Despite slower overall revenue growth, operating income and operating margin increased in 2007. Increases in operating income and margin in 2007 resulted from growth in IP services and were partially offset by costs associated with the ratification of a new labor contract with our pilots in October 2006. These costs included signing bonuses and other upfront compensation of \$143 million, as well as pay increases and other benefit enhancements, which were mitigated by reductions in variable incentive compensation. Year-over-year results in 2007 were positively affected by a \$75 million charge in 2006 to adjust the accounting for certain facility leases.

Fuel costs increased during 2007 due to an increase in the average price per gallon of fuel. Fuel surcharges did not offset the effect of higher fuel costs on our year-over-year operating results for 2007, due to the timing lag that exists between when we purchase fuel and when our fuel surcharges are adjusted, based on a static analysis of the year-over-year changes in fuel prices compared to changes in fuel surcharges.

Salaries and employee benefits increased in 2007 primarily as a result of the new labor contract with our pilots. Purchased transportation costs increased 13% in 2007 due to IP volume growth, which required a higher utilization of contract pickup and delivery services and an increase in the cost of purchased transportation. We use purchased transportation in markets where we do not have a direct presence or to meet short-term capacity needs. Maintenance and repairs increased 7% in 2007 primarily due to higher aircraft maintenance expenses for various airframes and Airbus A300 engines. The 5% decrease in rentals and landing fees in 2007 was attributable to the one-time adjustment for leases in 2006 described above. Intercompany charges increased 35% in 2007 due to allocations as a result of moving the FCIS organization from FedEx Express to FedEx Services in 2007. The costs associated with the FCIS organization in 2006 were of a comparable amount but were reported in individual operating expense captions.

During 2007, we terminated our agreement with Airbus for the purchase of A380 aircraft and in March 2007 entered into a separate settlement agreement with Airbus that, among other things, provides us with credit memoranda applicable to the purchase of goods and services in the future. The net impact of this settlement was immaterial to our 2007 results and was recorded as an operating gain during the fourth quarter of 2007.

Operating income grew significantly in 2006 as a result of strong revenue growth and improved operating margin. Volume growth in higher margin U.S. domestic overnight and IP services contributed to yield improvements. Improved yields, combined with productivity gains and cost containment, allowed FedEx Express to improve operating margin in 2006. Revenue and margin growth for 2006 more than offset the one-time adjustment for leases and costs associated with two new around-the-world flights.

In 2006, salaries and benefits increased primarily due to higher pension costs and wage rates. Fuel costs were higher in 2006 primarily due to an increase in the average price per gallon of jet fuel, while gallons consumed increased slightly, primarily related to the two new around-the-world flights. However, our fuel surcharges substantially mitigated the impact of higher jet fuel prices. Purchased transportation costs increased in 2006, though at a slower rate than in 2005, driven by IP volume growth, which required a higher utilization of contract pickup and delivery services. Rentals and landing fees increased in 2006, primarily due to the one-time adjustment for leases of \$75 million.

### FedEx Express Segment Outlook

We expect moderate revenue growth at FedEx Express in 2008, as growth in both IP and domestic package services will continue to slow as a result of the softening U.S. economy and declining growth outside the U.S. The majority of the revenue increase in 2008 will be provided by IP services, as we continue to focus on growing our service offerings in international markets, particularly China and Europe. Our international domestic revenue is projected to increase in 2008 due to the full-year benefit of 2007 acquisitions such as ANC and DTW Group and the expansion of our China domestic service.

Operating income and operating margin are expected to improve in 2008 despite the soft U.S. economy due to continued cost containment and productivity improvements. Capital expenditures at FedEx Express are expected to be higher in 2008 due to investments in equipment and facilities necessary to support projected long-term volume growth, as well as continued investments in China. In March 2006, we broke ground on a new \$150 million Asia-Pacific hub in the southern China city of Guangzhou. This hub is planned to be operational in 2009. Aircraft-related capital and expense outlays, including support of our Boeing 757 program and the new Boeing 777 Freighter fleet, are expected to approximate 2007 spending levels. We will continue to make strategic investments despite short-term economic softness.

### 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 years ended May 31:

	2007	2006	2005	Percent Change	
				2007/ 2006	2006/ 2005
Revenues:	<b>\$6,043</b>	\$5,306	\$4,680	<b>14</b>	13
Operating expenses:					
Salaries and employee benefits	<b>1,006</b>	929	845	<b>8</b>	10
Purchased transportation	<b>2,326</b>	2,019	1,791	<b>15</b>	13
Rentals	<b>166</b>	133	122	<b>25</b>	9
Depreciation and amortization	<b>268</b>	224	176	<b>20</b>	27
Fuel	<b>117</b>	93	48	<b>26</b>	94
Maintenance and repairs	<b>134</b>	118	110	<b>14</b>	7
Intercompany charges	<b>578</b>	526	482	<b>10</b>	9
Other	<b>635</b>	559	502	<b>14</b>	11
Total operating expenses	<b>5,230</b>	4,601	4,076	<b>14</b>	13
Operating income	<b>\$ 813</b>	\$ 705	\$ 604	<b>15</b>	17
Operating margin	<b>13.5%</b>	13.3%	12.9%	<b>20bp</b>	40bp
FedEx Ground:					
Average daily package volume	<b>3,126</b>	2,815	2,609	<b>11</b>	8
Revenue per package (yield)	<b>\$ 7.21</b>	\$ 7.02	\$ 6.68	<b>3</b>	5

### FedEx Ground Segment Revenues

Strong volume growth fueled a 14% increase in revenue during 2007. Average daily volumes at FedEx Ground rose 11% because of increased commercial business and the continued growth of our FedEx Home Delivery service. Yield improvement during 2007 was primarily due to the impact of general rate increases and higher extra service revenues, primarily on our residential services. This yield increase was partially offset by higher customer discounts and a lower average weight and zone per package. Additionally, revenue at FedEx SmartPost increased significantly in 2007 due to increased market share, as a major competitor exited this market in 2006, enabling significant growth in the customer base and related volumes.

Revenues increased during 2006 due to volume increases and yield improvement. Average daily volumes increased across all of our services, led by the continued growth of our FedEx Home Delivery service. Yield improvement during 2006 was primarily due to increased fuel surcharges, higher extra service revenue and the impact of general rate increases. These increases were partially offset by higher customer discounts and a lower average weight per package.

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 years ended May 31:

	2007	2006	2005
Low	3.50%	2.50%	1.80%
High	5.25	5.25	2.50
Weighted-average	4.18	3.54	2.04

No fuel surcharge was in effect from January 2004 to January 2005.

### FedEx Ground Segment Operating Income

FedEx Ground segment operating income increased 15% during 2007 principally due to revenue growth and improved results at FedEx SmartPost. Operating margin increased only slightly in 2007, as revenue growth was partially offset by increased purchased transportation costs, increased legal costs and higher depreciation and rent expense associated with network expansion.

Purchased transportation increased 15% in 2007 primarily due to volume growth and higher rates paid to our independent contractors, including fuel supplements. Our fuel surcharge was sufficient to offset the effect of higher fuel costs on our operating results, based on a static analysis of the year-over-year changes in fuel prices compared to changes in the fuel surcharge. Other operating expenses increased 14% in 2007 primarily due to increased legal costs. Depreciation expense increased 20% and rent expense increased 25% principally due to higher spending on material handling and scanning equipment and facilities associated with our multi-year network expansion.

Effective June 1, 2006, we moved FedEx Supply Chain Services, Inc., the results of which were previously reported in the FedEx Ground segment, into a new subsidiary of FedEx Services named FedEx Global Supply Chain Services, Inc. The net operating costs of this entity are allocated to FedEx Express and FedEx Ground. Prior year amounts have not been reclassified to conform to the current year segment presentation, as financial results are materially comparable.

FedEx Ground segment operating income increased in 2006, resulting principally from revenue growth and yield improvement. Operating margin for the segment improved in 2006 due to fuel surcharges, general rate increases, improved productivity and the inclusion in 2005 of a \$10 million charge at FedEx Supply Chain Services related to the termination of a vendor agreement. A portion of the operating margin improvement was offset by higher year-over-year expenses related to investments in new technology and the opening of additional FedEx Ground facilities.

Salaries and employee benefits increased in 2006 principally due to wage rate increases and increases in staffing and facilities to support volume growth. Depreciation expense in 2006 increased at a higher rate than revenue due to increased spending associated with material handling and scanning equipment. In 2006, purchased transportation increased due to increased volumes and an increase in the cost of purchased transportation due to higher fuel surcharges from third-party transportation providers, including our independent contractors.

### FedEx Ground Segment Outlook

We expect the FedEx Ground segment to have revenue growth in 2008 consistent with 2007, led by continued strong volume growth at FedEx Ground and FedEx SmartPost. FedEx Ground's average daily volume is expected to increase in 2008 due to increased base business and FedEx Home Delivery volumes. FedEx SmartPost volumes are also expected to grow, because of increased market share and improved service levels. Yields for all services at FedEx Ground are expected to increase in 2008 from increases in list prices and residential and commercial delivery area surcharges.

FedEx Ground's operating margin in 2008 is expected to improve from continued cost controls, productivity gains and yield improvements, partially offset by the impact of our network expansion and increased purchased transportation costs. Capital spending is expected to grow, as we continue with comprehensive network expansion and productivity-enhancing technologies within the FedEx Ground segment. During 2008, the multi-phase expansion plan includes one new hub, 14 expanded hubs and two relocated facilities. We are committed to investing in the FedEx Ground network because of the long-term benefits we will experience from these investments.

### FEDEX FREIGHT SEGMENT

The following table shows revenues, operating expenses, operating income and operating margin (dollars in millions) and selected statistics for the years ended May 31:

	2007	2006	2005	Percent Change	
				2007/ 2006	2006/ 2005
Revenues	\$4,586	\$3,645	\$3,217	26	13
Operating expenses:					
Salaries and employee benefits	2,250	1,801	1,650	25	9
Purchased transportation	465	298	315	56	(5)
Rentals and landing fees	112	94	99	19	(5)
Depreciation and amortization	195	120	102	63	18
Fuel	468	377	257	24	47
Maintenance and repairs	165	120	128	38	(6)
Intercompany charges	61	37	26	65	42
Other	407	313	286	30	9
Total operating expenses	4,123	3,160	2,863	30	10
Operating income	\$ 463	\$ 485	\$ 354	(5)	37
Operating margin	10.1%	13.3%	11.0%	(320)bp	230bp
Average daily LTL shipments (in thousands)	78	67	63	16	6
Weight per LTL shipment (lbs)	1,130	1,143	1,132	(1)	1
LTL yield (revenue per hundredweight)	\$18.65	\$16.84	\$15.48	11	9

The results of operations of FedEx National LTL are included in FedEx Freight segment results from the date of acquisition on September 3, 2006.

### FedEx Freight Segment Revenues

FedEx Freight segment revenues increased 26% in 2007 primarily as a result of the acquisition of FedEx National LTL, which contributed significantly to an increase in average daily LTL shipments of 16% and LTL yield of 11%. Average daily LTL shipments excluding FedEx National LTL grew slightly in 2007 due to increased demand for our regional and interregional services. This growth rate moderated throughout the year, however, with year-over-year declines in the second half of 2007. LTL yield growth was due to higher yields from longer-haul FedEx National LTL shipments, higher rates and favorable contract renewals.

FedEx Freight segment revenues increased 13% in 2006 due to growth in LTL yield and average daily LTL shipments. LTL yield grew during 2006, reflecting incremental fuel surcharges resulting from higher fuel prices and higher rates. Average daily LTL shipment growth in 2006 was driven in part by features such as our no-fee money-back guarantee and our Advance Notice service, which continue to differentiate us in the LTL market.

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 years ended May 31:

	2007	2006	2005
Low	<b>14.0%</b>	12.5%	7.6%
High	<b>21.2</b>	20.1	14.0
Weighted-average	<b>17.8</b>	16.3	11.0

### FedEx Freight Segment Operating Income

FedEx Freight segment operating income decreased 5% during 2007 due to operating losses at FedEx National LTL, which resulted from softening volumes and ongoing expenses to integrate its network. The inclusion of FedEx National LTL in our results has impacted the year-over-year comparability of all of our operating expenses. Along with incremental costs from FedEx National LTL (including amortization of acquired intangible assets), depreciation expense increased due to prior-year purchases of vehicles and other operating equipment to support volume growth. Purchased transportation increased due to higher rates paid to our third-party transportation providers and the utilization of third-party providers at FedEx National LTL. While fuel costs increased in 2007, our fuel surcharge was more than sufficient to offset the effect of higher fuel costs, based on a static analysis of the year-over-year changes in fuel prices compared to changes in the fuel surcharge.

FedEx Freight segment operating income increased in 2006 primarily due to LTL revenue growth, as well as our ability to control costs in line with volume growth. Increased staffing to support volume growth and higher incentive compensation expense increased salaries and employee benefits in 2006. While fuel costs increased substantially in 2006, fuel surcharges more than offset the effect of higher fuel costs. Depreciation costs increased in 2006 primarily due to investments in operating equipment, which in some cases replaced leased equipment. Maintenance and repairs decreased in 2006 due to the presence of rebranding costs in 2005, as well as an increase in the purchase of new fleet vehicles. Purchased transportation costs

decreased, due to increased utilization of company equipment in our interregional freight services.

### FedEx Freight Segment Outlook

We expect FedEx Freight segment revenue to increase in 2008 due to continued growth in our LTL business and the inclusion of FedEx National LTL for the full year. LTL yield is expected to increase due to our continued focus on pricing discipline, as well as the impact of higher yields on longer-haul FedEx National LTL shipments. Ongoing costs to integrate information technology systems and to increase sales resources to support long-term growth opportunities, as well as incremental costs associated with facility expansions, are expected to restrain operating income and operating margin growth in 2008. Continued investments in facilities and equipment to support revenue growth and in technology to improve productivity and to meet our customers' needs account for the majority of the total incremental capital spending anticipated for 2008. We expect our rebranding efforts at FedEx National LTL to continue in 2008.

### FEDEX KINKO'S SEGMENT

The following table shows revenues, operating expenses, operating income and operating margin (dollars in millions) for the years ended May 31:

	2007	2006	2005	Percent Change	
				2007/ 2006	2006/ 2005
Revenues	<b>\$2,040</b>	\$2,088	\$2,066	<b>(2)</b>	1
Operating expenses:					
Salaries and employee benefits	<b>781</b>	752	742	<b>4</b>	1
Rentals	<b>375</b>	394	412	<b>(5)</b>	(4)
Depreciation and amortization	<b>139</b>	148	138	<b>(6)</b>	7
Maintenance and repairs	<b>66</b>	73	70	<b>(10)</b>	4
Intercompany charges	<b>57</b>	26	6	<b>NM</b>	NM
Other operating expenses:					
Supplies, including paper and toner	<b>263</b>	274	278	<b>(4)</b>	(1)
Other	<b>314</b>	364	320	<b>(14)</b>	14
Total operating expenses	<b>1,995</b>	2,031	1,966	<b>(2)</b>	3
Operating income	<b>\$ 45</b>	\$ 57	\$ 100	<b>(21)</b>	(43)
Operating margin	<b>2.2%</b>	2.7%	4.8%	<b>(50)bp</b>	(210)bp

### FedEx Kinko's Segment Revenues

Revenues decreased slightly during 2007 due to decreased demand for copy products and the discontinuation of unprofitable service offerings, which more than offset higher package acceptance fees from FedEx Express and FedEx Ground. During 2007, FedEx Kinko's announced a multi-year network expansion plan, including the model for new centers, which will be approximately one-third the size of a traditional center and will include enhanced pack-and-ship stations and a doubling of the number of retail office products offered. While revenues from new centers were not significant in 2007, this multi-year expansion of the FedEx Kinko's network is a key strategy relating to FedEx Kinko's future revenue growth. In addition, this expansion

will provide FedEx Express and FedEx Ground customers with more retail access points. FedEx Kinko's opened 226 new centers during 2007.

In 2006, a year-over-year increase in package acceptance revenue led to modest revenue growth. Package acceptance revenue benefited year over year from the April 2005 conversion of FedEx World Service Centers to FedEx Kinko's Ship Centers. FedEx Kinko's experienced declines in copy product line revenues in 2006 due to decreased demand for these services and a competitive pricing environment.

#### FedEx Kinko's Segment Operating Income

Operating income decreased \$12 million during 2007 primarily due to the decrease in copy product revenues, as well as the impact of increased salaries and employee benefit costs incurred in connection with expansion activities and significant investments in employee training and development programs. Rentals decreased during 2007 due to declines in copier rental expenses, which are variable based on usage. The increase in intercompany charges was primarily due to increased allocations of sales and marketing and IT support functions in 2007.

Operating income decreased in 2006, as the increase in package acceptance revenues was more than offset by a decline in copy product line revenues. In 2006, salaries and employee benefits increased due to the addition of FedEx Kinko's Ship Centers, higher group health insurance costs and increased costs associated with employee training and development programs. Increased depreciation in 2006 was driven by center rebranding and investments in new technology to replace legacy systems. The increase for 2006 in other operating expenses was primarily due to increased costs related to technology, strategic and product offering initiatives.

#### FedEx Kinko's Segment Outlook

We expect increased revenue at FedEx Kinko's in 2008 primarily due to the new store openings associated with the multi-year network expansion, together with a sales force realignment and marketing and service initiatives. The network expansion program, combined with employee training and retention programs, is expected to negatively impact operating income and operating margin in 2008. These investments, however, are focused on long-term profit and margin growth. Initiatives in e-commerce technology such as Print Online and new service offerings, including our direct mail service, are expected to support additional growth opportunities for 2008 and beyond. Capital spending is expected to increase at FedEx Kinko's in 2008 primarily due to the multi-year network expansion and technology investments. FedEx Kinko's plans to open approximately 300 new centers in 2008, which will bring the total number of centers to approximately 2,000 by the end of the year.

## Financial Condition

### LIQUIDITY

Cash and cash equivalents totaled \$1.569 billion at May 31, 2007, compared to \$1.937 billion at May 31, 2006 and \$1.039 billion at May 31, 2005. The following table provides a summary of our cash flows for the years ended May 31 (in millions):

	2007	2006	2005
Operating activities:			
Net income	\$ 2,016	\$ 1,806	\$ 1,449
Noncash charges and credits	1,988	2,006	1,671
Changes in operating assets and liabilities	(441)	(136)	(3)
Cash provided by operating activities	3,563	3,676	3,117
Investing activities:			
Business acquisitions, net of cash acquired	(1,310)	—	(122)
Capital expenditures and other investing activities	(2,814)	(2,454)	(2,226)
Cash used in investing activities	(4,124)	(2,454)	(2,348)
Financing activities:			
Proceeds from debt issuances	1,054	—	—
Principal payments on debt	(906)	(369)	(791)
Dividends paid	(110)	(97)	(84)
Other financing activities	155	142	99
Cash provided by (used in) financing activities	193	(324)	(776)
Net (decrease) increase in cash and cash equivalents	\$ (368)	\$ 898	\$ (7)

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.

*Cash Provided by Operating Activities.* Cash flows from operating activities decreased \$113 million in 2007 primarily due to an increase in income tax payments of \$184 million, partially offset by increased earnings. The \$559 million increase in cash flows from operating activities in 2006 was principally due to increased earnings. During 2007, we made tax-deductible voluntary contributions to our principal U.S. domestic pension plans of \$482 million, compared to \$456 million during 2006 and \$460 million during 2005.

*Cash Used in Investing Activities.* During 2007, \$1.3 billion of cash was used for the FedEx National LTL, ANC, DTW Group and other immaterial acquisitions. See Note 3 of the accompanying audited financial statements for further discussion of these acquisitions. See "Capital Resources" for a discussion of capital expenditures during 2007 and 2006.

*Financing Activities.* On August 2, 2006, we filed an updated shelf registration statement with the SEC. The new registration statement does not limit the amount of any future offering. By using this shelf registration statement, we may sell, in one or more future offerings, any combination of our unsecured debt securities and common stock.

On August 8, 2006, under the new shelf registration statement, we issued \$1 billion of senior unsecured debt, comprised of floating-rate notes totaling \$500 million due in August 2007 and fixed-rate notes totaling \$500 million due in August 2009. The floating-rate notes bear interest at the three-month London Interbank Offered Rate ("LIBOR") plus 0.08%, reset on a quarterly basis. As of May 31, 2007, the floating interest rate was 5.44%. The fixed-rate notes bear interest at an annual rate of 5.5%, payable semi-annually. The net proceeds were used for working capital and general corporate purposes, including the funding of the acquisitions referenced above.

During 2007, \$700 million of senior unsecured notes and \$18 million of medium-term notes matured and were repaid. During 2006, \$250 million of senior unsecured notes matured and were repaid. In addition, other debt was reduced by \$118 million as a result of the purchase by FedEx Express of two MD11 aircraft in March 2007. In 2001, FedEx Express entered into a lease for the two MD11 aircraft from a separate entity, which we were required to consolidate under FIN 46. The purchase of these aircraft extinguished this liability.

A \$1.0 billion revolving credit facility 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. Our leverage ratio of adjusted debt to capital was 0.6 at May 31, 2007. 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 May 31, 2007, no commercial paper was outstanding and the entire \$1.0 billion under the revolving credit facility was available for future borrowings.

The \$500 million of floating-rate notes issued in 2007 will become due in August 2007. The timing of cash requirements in the first half of 2008 may dictate that we refinance a portion of this debt through our commercial paper program.

As discussed in Note 1 of the accompanying consolidated financial statements, we adopted SFAS 158 on May 31, 2007. Our adoption of this standard did not impact our compliance with any current loan covenants or affect our debt ratings, pension funding requirements or our overall liquidity.

*Dividends.* Dividends paid were \$110 million in 2007, \$97 million in 2006 and \$84 million in 2005. On May 25, 2007, our Board of Directors declared a dividend of \$0.10 per share of common stock, an increase of \$0.01 per share. The dividend was paid on July 2, 2007 to stockholders of record as of the close of business on June 11, 2007. Each quarterly dividend payment is subject to review and approval by our Board of Directors, and we intend to evaluate our dividend payment amount on an annual basis at the end of each fiscal year.

*Other Liquidity Information.* 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 characterizes our ratings outlook as "stable," while Standard & Poor's characterizes our ratings outlook as "positive." 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 more limited.

### CAPITAL RESOURCES

Our operations are capital intensive, characterized by significant investments in aircraft, vehicles, technology, 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 years ended May 31 (in millions):

	2007	2006	2005	Percent Change	
				2007/ 2006	2006/ 2005
Aircraft and related equipment	\$1,107	\$1,033	\$ 990	7	4
Facilities and sort equipment	674	507	496	33	2
Vehicles	445	413	261	8	58
Information and technology investments	431	394	331	9	19
Other equipment	225	171	158	32	8
Total capital expenditures	\$2,882	\$2,518	\$2,236	14	13
FedEx Express segment	\$1,672	\$1,408	\$1,195	19	18
FedEx Ground segment	489	487	456	—	7
FedEx Freight segment	287	274	217	5	26
FedEx Kinko's segment	157	94	152	67	(38)
Other, principally FedEx Services	277	255	216	9	18
Total capital expenditures	\$2,882	\$2,518	\$2,236	14	13

Capital expenditures increased during 2007 primarily due to increased spending at FedEx Express for facility expansion and aircraft and related equipment and expenditures at FedEx Kinko's

associated with its multi-year expansion program. Capital expenditures during 2006 were higher than the prior year primarily due to the purchase of vehicles at FedEx Express and FedEx Freight and information technology investments at FedEx Services. In addition, investments were made in the FedEx Ground and FedEx Freight networks in 2006 to support growth in customer demand.

While we pursue market opportunities to purchase aircraft when they become available, we must make commitments regarding our airlift requirements years before aircraft are actually needed because of substantial lead times associated with the manufacture and modification of aircraft. 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.

During 2007, FedEx Express announced two aircraft acquisition programs designed to meet future capacity needs. The first is a \$2.6 billion multi-year program to acquire and modify approximately 90 Boeing 757-200 aircraft to replace our narrow-body fleet of Boeing 727-200 aircraft. The second is an agreement to acquire 15 new Boeing 777F ("B777F") aircraft and an option to purchase an additional 15 B777F aircraft. The B777F aircraft will provide us with non-stop, point-to-point transoceanic routes with shorter flight times. See Note 16 of the accompanying consolidated financial statements for further discussion of our aircraft purchase commitments.

Our capital expenditures are expected to be approximately \$3.5 billion in 2008, with much of the year-over-year increase due to spending for facilities and sort equipment at FedEx Express and FedEx Ground and network expansion at FedEx Kinko's. We also continue to invest in productivity-enhancing technologies. Aircraft-related capital and expense outlays, including support of the narrow-body aircraft replacement program and the B777F fleet, are expected to approximate 2007 aircraft spending levels. We currently expect to fund our 2008 capital requirements with cash from operations.

### CONTRACTUAL CASH OBLIGATIONS

The following table sets forth a summary of our contractual cash obligations as of May 31, 2007. 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 May 31, 2007. Accordingly, this table is not meant to represent a forecast of our total cash expenditures for any of the periods presented.

(in millions)	Payments Due by Fiscal Year						Total
	2008	2009	2010	2011	2012	Thereafter	
<b>Amounts reflected in Balance Sheet:</b>							
Long-term debt	\$ 521	\$ 530	\$ 500	\$ 250	\$ —	\$ 539	\$ 2,340
Capital lease obligations <sup>(1)</sup>	103	13	97	8	8	137	366
<b>Other cash obligations not reflected in Balance Sheet:</b>							
Unconditional purchase obligations <sup>(2)</sup>	1,282	1,111	1,150	704	86	164	4,497
Interest on long-term debt	118	111	79	65	47	1,553	1,973
Operating leases	1,680	1,481	1,297	1,143	1,010	6,752	13,363
Total	\$3,704	\$3,246	\$3,123	\$2,170	\$1,151	\$9,145	\$22,539

(1) Capital lease obligations represent principal and interest payments.

(2) See Note 16 to the accompanying consolidated financial statements.

We have certain contingent liabilities that are not accrued in our balance sheets in accordance with accounting principles generally accepted in the United States. These contingent liabilities are not included in the table above.

#### **Amounts Reflected in Balance Sheet**

We have certain financial instruments representing potential commitments, not reflected in the table above, that were incurred in the normal course of business to support our operations, including surety bonds and standby letters of credit. These instruments are generally required under certain U.S. self-insurance programs and are also used in the normal course of international operations. The underlying liabilities insured by these instruments are reflected in our balance sheets, where applicable. Therefore, no additional liability is reflected for the surety bonds and letters of credit themselves.

We have other long-term liabilities reflected in our balance sheet, including deferred income taxes, qualified and nonqualified pension and postretirement healthcare 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 that are included in current liabilities.

#### **Other Cash Obligations Not Reflected in Balance Sheet**

The amounts reflected in the table above for purchase commitments represent non-cancelable agreements to purchase goods or services. Such contracts include those for certain purchases of aircraft, aircraft modifications, vehicles, facilities, computers, printing and other equipment and advertising and promotions contracts. In addition, we have committed to modify our DC10 aircraft for two-man cockpit configurations, which is reflected in the table above. 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 a non-cancelable commitment. Open purchase orders that are cancelable are not considered unconditional purchase obligations for financial reporting purposes and are not included in the table above. Such purchase orders often represent authorizations to purchase rather than binding agreements.

The amounts reflected in the table above for interest on long-term debt represent future interest payments due on our long-term debt, which are primarily fixed rate.

The amounts reflected in the table above for operating leases represent future minimum lease payments under non-cancelable operating leases (principally aircraft and facilities) with an initial or remaining term in excess of one year at May 31, 2007. In the past, we financed a significant portion of our aircraft needs (and certain other equipment needs) using operating leases (a type of "off-balance sheet financing"). At the time that the decision to lease was made, we determined that these operating leases would provide economic benefits favorable to ownership with respect to market values, liquidity or after-tax cash flows.

In accordance with accounting principles generally accepted in the United States, our operating leases are not recorded in our balance sheet. Credit rating agencies routinely use information concerning minimum lease payments required for our operating leases to calculate our debt capacity. In addition, we have guarantees under certain operating leases, amounting to \$17 million as of May 31, 2007, for the residual values of vehicles and facilities at the end of the respective operating lease periods. Although some of these leased assets may have a residual value at the end of the lease term that is less than the value specified in the related operating lease agreement, we do not believe it is probable that we will be required to fund material amounts under the terms of these guarantee arrangements. Accordingly, no material accruals have been recognized for these guarantees.

## **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.

The estimates discussed below include the financial statement elements that are either the most judgmental or involve the selection or application of alternative accounting policies and are material to our financial statements. 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.

As discussed in the notes to our financial statements and previously in this MD&A, we are required to adopt new accounting rules for income taxes under FIN 48, commencing in 2008. While the adoption of FIN 48 will not have a material effect on our financial statements, its application substantially increases the sensitivities of the estimation process used in the accounting and reporting for tax contingencies. Therefore, we will add a "Contingencies, including Income Taxes" category to our critical accounting estimates in the first quarter of 2008.

Over the past several years, we have substantially improved and automated the rating and billing processes for our package businesses. As a result, our experience with invoice corrections and bad debts has improved markedly, as has the accuracy of our revenue estimates for shipments not yet billed at period end. Therefore, substantially less judgment is required in the reporting of revenue and we have concluded that revenue recognition will no longer be considered a critical accounting estimate commencing in 2008.

## RETIREMENT PLANS

*Overview.* We sponsor programs that provide retirement benefits to most of our employees. These programs include defined benefit pension plans, defined contribution plans and retiree healthcare plans. The accounting for pension and healthcare plans includes numerous assumptions, such as: discount rates; expected long-term investment returns on plan assets; future salary increases; employee turnover; mortality; and retirement ages. These assumptions most significantly impact our U.S. domestic pension plan.

A summary of our retirement plans costs over the past three years is as follows (in millions):

	2007	2006	2005
U.S. domestic pension plans	\$442	\$400	\$337
International pension and defined contribution plans	49	45	41
U.S. domestic defined contribution plans	152	147	136
Retiree healthcare plans	55	73	68
	<b>\$698</b>	<b>\$665</b>	<b>\$582</b>

The determination of our annual retirement plans cost is highly sensitive to changes in the assumptions discussed above because we have a large active workforce, a significant amount of assets in the pension plans, and the payout of benefits will occur over an extended period in the future. Total retirement plans cost increased approximately \$33 million in 2007, \$83 million in 2006 and \$37 million in 2005, primarily due to changes to these assumptions.

In February 2007, we announced changes to modernize certain of our retirement programs over the next two fiscal years. Effective January 1, 2008, we will increase the annual company matching contribution under the largest of our 401(k) plans covering most employees from \$500 to a maximum of 3.5% of eligible compensation. Employees not participating in the 401(k) plan as of January 1, 2008 will be automatically enrolled at 3% of eligible pay with a company match of 2% of eligible pay. Effective May 31, 2008, benefits previously accrued under our primary pension plans using a traditional pension benefit formula will be capped for most employees, and those benefits will be payable beginning at retirement. Beginning June 1, 2008, future pension benefits for most employees will be accrued under a cash balance formula we call the Portable Pension Account. These changes will not affect the benefits of current retirees.

Under the Portable Pension Account, the retirement benefit is expressed as a dollar amount in a notional account that grows with annual credits based on pay, age and years of credited service and interest on the notional account balance. An employee's pay credits are determined each year under a graded formula that combines age with years of service for points. The plan interest credit rate will vary from year to year based on the selected U.S. Treasury index, with a minimum rate of 4% or the one-year Treasury Constant Maturities rate and a maximum rate based on the average 30-year Treasury rate.

Under the new programs, we expect the long-term costs and funding for our retirement plans will approximate those under the current design. However, we expect that the costs of our retirement plans will become more predictable, as we reduce highly volatile pension costs in favor of more predictable 401(k) costs associated with our matching contributions. These retirement plan changes were contemplated in our February 28, 2007 actuarial measurement and reduced the impact on shareholders' equity of adopting SFAS 158 by \$1 billion. Because it will take several years to fully implement the increases to our 401(k) plan contributions, we will realize a net retirement plans cost reduction in the near term from these changes.

Retirement plans cost in 2008 is expected to be approximately \$615 million, a decrease of \$83 million from 2007. This expected decrease in cost is due to the retirement plan design changes described above, which will be partially offset by changes in assumptions related to plan asset rate of return, mortality, benefit age for deferred vested participants and pilot-specific benefit formula and salary increases. Retirement plans cost is included in the "Salaries and Employee Benefits" caption in our consolidated income statements.

As part of our strategy to manage future pension costs and net funded status volatility, we are also in the process of re-evaluating our pension investment strategy. We have decided to move certain equity investments out of actively managed funds and into index funds. Also, we are currently evaluating the mix of investments between equities and fixed income securities, whose cash flows will more closely align with the cash flows of our pension obligations. Based on these considerations, we have reduced our estimated long-term rate of return on plan assets from 9.1% to 8.5% for 2008.

*Pension Cost.* Of all of our retirement plans, our largest qualified U.S. domestic pension plan is the most significant and subjective. The components of pension cost for all pension plans recognized in our income statements are as follows (in millions):

	2007	2006	2005
Service cost	\$ 540	\$ 473	\$ 417
Interest cost	707	642	579
Expected return on plan assets	(930)	(811)	(707)
Recognized actuarial losses and other	150	121	72
	<b>\$ 467</b>	<b>\$ 425</b>	<b>\$ 361</b>

Following is a discussion of the key estimates we consider in determining our pension costs:

*Discount Rate.* This is the interest rate used to discount the estimated future benefit payments that have been accrued to date (the projected benefit obligation, or PBO) to their net present value. The discount rate is determined each year at the plan measurement date (February 28) and affects the succeeding year's pension cost. A decrease in the discount rate increases pension expense.

This assumption is highly sensitive, as the following table illustrates:

	Discount Rate <sup>(1)</sup>	Sensitivity (in millions) <sup>(2)</sup>	
		Expense	PBO
2008	n/a	\$2.1	n/a
2007	6.012%	2.5	\$19
2006	5.912%	2.1	21
2005	6.285%	1.8	16

(1) The discount rate in effect at the end of a given fiscal year affects the current year's projected benefit obligation (PBO) and the succeeding year's pension expense.

(2) Sensitivities show the impact on expense and the PBO of a one-basis-point change in the discount rate.

We determine the discount rate (which is required to be the rate at which the projected benefit obligation could be effectively settled as of the measurement date) with the assistance of actuaries, who calculate the yield on a theoretical portfolio of high-grade corporate bonds (rated Aa or better) with cash flows that generally match our expected benefit payments in future years. This bond modeling technique allows for the use of non-callable and make-whole bonds that meet certain screening criteria to ensure that the selected bonds with a call feature have a low probability of being called. To the extent scheduled bond proceeds exceed the estimated benefit payments in a given period, the yield calculation assumes those excess proceeds are reinvested at the one-year forward rates implied by the Citigroup Pension Discount Curve. The trend of declines in the discount rate negatively affected our primary domestic pension plan expense by \$89 million in 2007, \$101 million in 2006 and \$32 million in 2005. Pension costs will be favorably affected in 2008 by approximately \$27 million due to the slight increase in the discount rate.

**Plan Assets.** Pension plan assets are invested primarily in listed securities. Our pension plans hold only a minimal investment in FedEx common stock that is entirely at the discretion of third-party pension fund investment managers. The estimated average rate of return on plan assets is a long-term, forward-looking assumption that also materially affects our pension cost. It is required to be the expected future long-term rate of earnings on plan assets. At February 28, 2007, with approximately \$11.3 billion of plan assets, a one-basis-point change in this assumption for our domestic pension plans affects pension cost by approximately \$1.1 million. We have assumed an 8.5% compound geometric long-term rate of return on our principal U.S. domestic pension plan assets for 2008, down from 9.1% in 2007, as discussed above.

Establishing the expected future rate of investment return on our pension assets is a judgmental matter. Management considers the following factors in determining this assumption:

- the duration of our pension plan liabilities, which drives the investment strategy we can employ with our pension plan assets;
- the types of investment classes in which we invest our pension plan assets and the expected compound geometric return we can reasonably expect those investment classes to earn over the next 10- to 15-year time period (or such other time period that may be appropriate); and

- the investment returns we can reasonably expect our active investment management program to achieve in excess of the returns we could expect if investments were made strictly in indexed funds.

As noted above, we have refined our investment strategy and lowered the long-term rate of return for 2008. To support our conclusions, we periodically commission asset/liability studies performed by third-party professional investment advisors and actuaries to assist us in our reviews. These studies project our estimated future pension payments and evaluate the efficiency of the allocation of our pension plan assets into various investment categories. These studies also generate probability-adjusted expected future returns on those assets. The following table summarizes our current asset allocation strategy:

Asset Class	Percent of Plan Assets at Measurement Date			
	2007		2006	
	Actual	Target	Actual	Target
Domestic equities	52%	53%	54%	53%
International equities	21	17	20	17
Private equities	3	5	3	5
Total equities	76	75	77	75
Long duration fixed income securities	15	15	14	15
Other fixed income securities	9	10	9	10
	100%	100%	100%	100%

The actual historical return on our U.S. pension plan assets, calculated on a compound geometric basis, was 9.8%, net of investment manager fees, for the 15-year period ended February 28, 2007. In addition, our actual return on plan assets exceeded the estimated return in each of the past four fiscal years.

Pension expense is also affected by the accounting policy used to determine the value of plan assets at the measurement date. We use a calculated-value method to determine the value of plan assets, which helps mitigate short-term volatility in market performance (both increases and decreases). Another method used in practice applies the market value of plan assets at the measurement date. The application of the calculated-value method equaled the result from applying the market-value method for 2005 through 2007.

**Salary Increases.** The assumed future increase in salaries and wages is also a key estimate in determining pension cost. Generally, we correlate changes in estimated future salary increases to changes in the discount rate (since that is an indicator of general inflation and cost of living adjustments) and general estimated levels of profitability (since most incentive compensation is a component of pensionable wages). Our average future salary increases based on age and years of service were 3.46% for 2007 and 3.15% for 2006 and 2005. Future salary increases are estimated to be 4.47% for our 2008 pension costs, reflecting the impact of the modernization of our retirement plans (discussed above). In the future, a one-basis-point across-the-board change in the rate of estimated future salary increases will have an immaterial impact on our pension costs.

Following is information concerning the funded status of our pension plans as of May 31 (in millions):

	2007 <sup>(1)</sup>	2006
<b>Funded Status of Plans:</b>		
Projected benefit obligation (PBO)	<b>\$12,209</b>	\$12,153
Fair value of plan assets	<b>11,506</b>	10,130
PBO in excess of plan assets	<b>(703)</b>	(2,023)
Unrecognized actuarial losses and other	<b>22<sup>(2)</sup></b>	3,119 <sup>(3)</sup>
Net amount recognized	<b>\$ (681)</b>	\$ 1,096
<b>Components of Amounts Included in Balance Sheets:</b>		
Prepaid pension cost	<b>\$ —<sup>(4)</sup></b>	\$ 1,349
Noncurrent pension assets	<b>1</b>	—
Current pension, postretirement healthcare and other benefit obligations	<b>(24)</b>	—
Accrued pension liability	<b>—<sup>(4)</sup></b>	(253)
Minimum pension liability	<b>—<sup>(4)</sup></b>	(122)
Noncurrent pension, postretirement healthcare and other benefit obligations	<b>(658)</b>	—
Accumulated other comprehensive income	<b>—<sup>(4)</sup></b>	112
Intangible asset and other	<b>—<sup>(4)</sup></b>	10
Net amount recognized	<b>\$ (681)</b>	\$ 1,096
<b>Cash Amounts:</b>		
Cash contributions during the year	<b>\$ 524</b>	\$ 492
Benefit payments during the year	<b>\$ 261</b>	\$ 228

(1) Incorporates the provisions of SFAS 158 adopted on May 31, 2007.

(2) Amounts for 2007 represent only employer contributions after measurement date, as unrecognized net actuarial loss, unamortized prior service cost and unrecognized net transition amount were not applicable in 2007 due to adoption of SFAS 158.

(3) Amounts for 2006 consist of unrecognized net actuarial loss, unamortized prior service cost, unrecognized net transition amount and employer contributions after measurement date.

(4) Not applicable for 2007 due to adoption of SFAS 158.

The funded status of the plans reflects a snapshot of the state of our long-term pension liabilities at the plan measurement date. Our plans remain adequately funded to provide benefits to our employees as they come due and current benefit payments are nominal compared to our total plan assets (benefit payments for 2007 were approximately 2% of plan assets). As described previously in this MD&A, the adoption of SFAS 158 resulted in a \$982 million charge to shareholders' equity in accumulated other comprehensive income from the elimination of our prepaid pension asset of \$1.4 billion and an increase in other postretirement benefit liabilities of \$120 million, net of tax. Under SFAS 158 we are required to recognize the funded status of the PBO and cannot defer actuarial gains and losses even though such items continue to be deferred for the determination of pension expense.

We made tax-deductible voluntary contributions of \$482 million in 2007 and \$456 million in 2006 to our qualified U.S. domestic pension plans. We expect approximately \$10 million of contributions to such plans to be legally required in 2008, and we currently expect to make tax-deductible voluntary contributions to our qualified plans in 2008 at levels approximating those in 2007.

Cumulative unrecognized actuarial losses for pension plans expense determination were approximately \$3.3 billion through February 28, 2007, compared to \$3.0 billion at February 28, 2006. These unrecognized losses primarily reflect the declining discount rate from 2002 through 2006 and other changes in assumptions. A portion is also attributable to the differences

between expected and actual asset returns, which are being amortized over future periods. These unrecognized losses may be recovered in future periods through actuarial gains. However, unless they are below a corridor amount, these unrecognized actuarial losses are required to be amortized and recognized in future periods. For example, projected U.S. domestic plan pension expense for 2008 includes \$162 million of amortization of these actuarial losses versus \$136 million in 2007, \$107 million in 2006 and \$60 million in 2005.

## SELF-INSURANCE ACCRUALS

We are self-insured up to certain limits for costs associated with workers' compensation claims, vehicle accidents and general business liabilities, and benefits paid under employee healthcare and long-term disability programs. At May 31, 2007 there were approximately \$1.3 billion of self-insurance accruals reflected in our balance sheet (\$1.2 billion at May 31, 2006). In 2007 approximately 41% of these accruals were classified as current liabilities and in 2006 approximately 43% of self-insurance accruals were classified as current liabilities.

The measurement of these costs requires the consideration of historical cost experience, judgments about the present and expected levels of cost per claim and retention levels. We account for these costs primarily through actuarial methods, which develop estimates of the undiscounted liability for claims incurred, including those claims incurred but not reported, on a quarterly basis for material accruals. These methods provide estimates of future ultimate claim costs based on claims incurred as of the balance sheet date. We self-insure up to certain limits that vary by operating company and type of risk. Periodically, we evaluate the level of insurance coverage and adjust insurance levels based on risk tolerance and premium expense. Historically, it has been infrequent that incurred claims exceeded our self-insured limits. Other acceptable methods of accounting for these accruals include measurement of claims outstanding and projected payments based on historical development factors.

We believe the use of actuarial methods to account for these liabilities provides a consistent and effective way to measure these highly judgmental accruals. However, the use of any estimation technique in this area is inherently sensitive given the magnitude of claims involved and the length of time until the ultimate cost is known. We believe our recorded obligations for these expenses are consistently measured on a conservative basis. Nevertheless, changes in healthcare costs, accident frequency and severity, insurance retention levels and other factors can materially affect the estimates for these liabilities.

## LONG-LIVED ASSETS

**Property and Equipment.** Our key businesses are capital intensive, with more than 53% of our total assets invested in our transportation and information systems infrastructures. We capitalize only those costs that meet the definition of capital assets under accounting standards. Accordingly, repair and maintenance costs that do not extend the useful life of an asset or are not part of the cost of acquiring the asset are expensed as incurred. However, consistent with industry practice, we capitalize certain aircraft-related major maintenance costs on one of our aircraft fleet types and amortize these costs over their estimated service lives.

The depreciation or amortization of our capital assets over their estimated useful lives, and the determination of any salvage values, requires management to make judgments about future events. Because we utilize many of our capital assets over relatively long periods (the majority of aircraft costs are depreciated over 15 to 18 years), we periodically evaluate whether adjustments to our estimated service lives or salvage values are necessary to ensure these estimates properly match the economic use of the asset. This evaluation may result in changes in the estimated lives and residual values used to depreciate our aircraft and other equipment. These estimates affect the amount of depreciation expense recognized in a period and, ultimately, the gain or loss on the disposal of the asset. Historically, gains and losses on operating equipment have not been material (typically less than \$15 million annually). However, such amounts may differ materially in the future due to technological obsolescence, accident frequency, regulatory changes and other factors beyond our control.

Because of the lengthy lead times for aircraft manufacture and modifications, we must anticipate volume levels and plan our fleet requirements years in advance, and make commitments for aircraft based on those projections. These activities create risks that asset capacity may exceed demand and that an impairment of our assets may occur. In addition, aircraft purchases (primarily aircraft in passenger configuration) that have not been placed in service totaled \$71 million at May 31, 2007 and \$208 million at May 31, 2006. We plan to modify these assets in the future to place them into operation.

The accounting test for whether an asset held for use is impaired involves first comparing the carrying value of the asset with its estimated future undiscounted cash flows. If the cash flows do not exceed the carrying value, the asset must be adjusted to its current fair value. Because the cash flows of our transportation networks cannot be identified to individual assets, and based on the ongoing profitability of our operations, we have not experienced any significant impairment of assets to be held and used. However, from time to time we make decisions to remove certain long-lived assets from service based on projections of reduced capacity needs and those decisions may result in an impairment charge. Assets held for disposal must be adjusted to their estimated fair values when the decision is made to dispose of the asset and certain other criteria are met. There were no material asset impairment charges recognized in 2007, 2006 or 2005.

*Leases.* We utilize operating leases to finance certain of our aircraft, facilities and equipment. Such arrangements typically shift the risk of loss on the residual value of the assets at the end of the lease period to the lessor. As disclosed in "Contractual Cash Obligations" and Note 7 to the accompanying consolidated financial statements, at May 31, 2007 we had approximately \$13 billion (on an undiscounted basis) of future commitments for payments under operating leases. The weighted-average remaining lease term of all operating leases outstanding at May 31, 2007 was approximately seven years.

The future commitments for operating leases are not reflected as a liability in our balance sheet because these leases do not meet the accounting definition of capital leases. The determination of whether a lease is accounted for as a capital lease or an operating lease requires management to make estimates primarily about the

fair value of the asset and its estimated economic useful life. We believe we have well-defined and controlled processes for making this evaluation, including obtaining third-party appraisals for material transactions to assist us in making these evaluations.

*Goodwill.* We have approximately \$3.5 billion of goodwill in our balance sheet resulting from business acquisitions. Our business acquisitions in 2007 contributed approximately \$670 million in goodwill, as follows:

Segment	Acquisition	Goodwill (in millions)
FedEx Express	DTW Group	\$ 348
FedEx Express	ANC	168
FedEx Freight	FedEx National LTL	121
FedEx Express	Other	33
		<u>\$ 670</u>

The annual evaluation of goodwill impairment requires the use of estimates and assumptions to determine the fair value of our reporting units using a discounted cash flow methodology, such as: revenue growth rates; operating margins; discount rates and expected capital expenditures. Estimates used by management can significantly affect the outcome of the impairment test. Each year, independent of our goodwill impairment test, we update our weighted-average cost of capital calculation and perform a long-range planning analysis to project expected results of operations. Using this data, we complete a separate fair-value analysis for each of our reporting units. Changes in forecasted operations and other assumptions could materially affect these estimates. We compare the fair value of our reporting units to the carrying value, including goodwill, of each of those units. We performed our annual impairment tests in the fourth quarter of 2007. Because the fair value of each of our reporting units exceeded its carrying value, including goodwill, no additional testing or impairment charge was necessary.

*Intangible Asset with an Indefinite Life.* We have an intangible asset of \$567 million associated with the Kinko's trade name. This intangible asset is not amortized because it has an indefinite remaining useful life. We must review this asset for impairment on at least an annual basis. This annual evaluation requires the use of estimates about the future cash flows attributable to the Kinko's trade name to determine the estimated fair value of the trade name. Changes in forecasted operations and changes in discount rates can materially affect this estimate. However, once an impairment of this intangible asset has been recorded, it cannot be reversed. We performed our annual impairment test in the fourth quarter of 2007. Because the fair value of the trade name exceeded its carrying value, no impairment charge was necessary.

While FedEx Kinko's experienced a slight revenue decline in 2007 and decreased profitability in 2007 and 2006, we believe that our long-term growth and expansion strategies support our fair value conclusions. For both goodwill and recorded intangible assets at FedEx Kinko's, the recoverability of these amounts is dependent on execution of key initiatives related to revenue growth, location expansion and improved profitability.

## REVENUE RECOGNITION

Historically, the policies adopted to recognize revenue have been deemed critical because an understanding of the accounting applied in this area is fundamental to assessing our overall financial performance and because revenue and revenue growth are key measures of financial performance in the marketplace. Revenue recognition will no longer be considered a critical accounting estimate category for 2008 due to the improvements we have made in our rating and billing processes, which have significantly reduced the level of management judgment applied in these areas.

Our businesses are primarily involved in the direct pickup and delivery of commercial package and freight shipments, as well as providing document solutions and business services. Our employees, independent contractors and agents are involved throughout the process and our operational, billing and accounting systems directly capture and control all relevant information necessary to record revenue, bill customers and collect amounts due to us. Certain of our transportation services are provided through independent contractors. FedEx is the principal to the transaction in most instances and in these cases revenue from these transactions is recognized on a gross basis. Costs associated with independent contractor settlements are recognized as incurred and included in the purchased transportation caption in the accompanying income statements.

We recognize revenue upon delivery of shipments for our transportation businesses and upon completion of services for our business services, logistics and trade services businesses. Transportation industry practice includes four acceptable methods for revenue recognition for shipments in process at the end of an accounting period, two of which are predominant: (1) recognize all revenue and the related delivery costs when shipments are delivered or (2) recognize a portion of the revenue earned for shipments that have been picked up but not yet delivered at period end and accrue delivery costs as incurred. We use the second method and recognize the portion of revenue earned at the balance sheet date for shipments in transit and accrue all delivery costs as incurred. We believe this accounting policy effectively and consistently matches revenue with expenses and recognizes liabilities as incurred.

Our contract logistics, global trade services and certain transportation businesses engage in some transactions wherein they act as agents. Revenue from these transactions is recorded on a net basis. Net revenue includes billings to customers less third-party charges, including transportation or handling costs, fees, commissions, taxes and duties. These amounts are not material.

There are three key estimates that are included in the recognition and measurement of our revenue and related accounts receivable under the policies described above: (1) estimates for unbilled revenue on shipments that have been delivered; (2) estimates for revenue associated with shipments in transit; and (3) estimates for future adjustments to revenue or accounts receivable for billing adjustments and bad debts.

*Unbilled Revenue.* There is a time lag between the completion of a shipment and the generation of an invoice that varies by customer and operating company. Accordingly, unbilled revenue is

recognized through estimates using actual shipment volumes and historical trends of shipment size and length of haul. These estimates are adjusted in subsequent months to the actual amounts invoiced. Due to strong system controls and shipment visibility, there is a low level of subjectivity inherent in these accrual processes and the estimates have historically not varied significantly from actual amounts subsequently invoiced.

*Shipments in Process.* Because the majority of our shipments have short cycle times, less than 5% of a total month's revenue is typically in transit at the end of a period. We periodically perform studies to measure the percentage of completion for shipments in process. At month end, we estimate the amount of revenue earned on shipments in process based on actual shipments picked up, the scheduled day of delivery, the day of the week on which the month ends (which affects the percentage of completion) and current trends in our average price for the respective services. We believe these estimates provide a reasonable approximation of the actual revenue earned at the end of a period.

*Future Adjustments to Revenue and Accounts Receivable.* In the transportation industry, pricing that is put in place may be subsequently adjusted due to continued negotiation of contract terms, earned discounts triggered by certain shipment volume thresholds, and/or no-fee money-back guarantee refunds caused by on-time service failures. We account for estimated future revenue adjustments through a reserve against accounts receivable that takes into consideration historical experience and current trends. For 2007, 2006 and 2005, revenue adjustments as a percentage of total revenue averaged approximately 1%. Due to our reliable on-time service, close communication with customers, strong revenue systems and minimal volume discounts in place, we have maintained a consistently low revenue adjustment percentage. A one-basis-point change in the revenue adjustment percentage would increase or decrease revenue adjustments by approximately \$2 million.

While write-offs related to bad debts do occur from time to time, they are small compared to our total revenue and accounts receivable balances due to the small value of individual shipping transactions spread over a large customer base, our short credit terms and our strong credit and collection practices. Bad debt expense associated with credit losses has averaged approximately 0.3% in 2007, 0.4% in 2006 and 0.3% in 2005 of total revenue and reflects our strong credit management processes.

## Market Risk Sensitive Instruments and Positions

*Interest Rates.* While we currently have market risk sensitive instruments related to interest rates, we have no significant exposure to changing interest rates on our long-term debt because the interest rates are fixed on the majority of our long-term debt. At May 31, 2007, we had approximately \$500 million of outstanding floating-rate senior unsecured debt issued in August 2006. This floating-rate debt matures in August 2007. We have not employed interest rate hedging to mitigate the risks with respect to this borrowing. A hypothetical 10% increase in the interest rate on our outstanding floating-rate debt would not have a material effect on our results of operations. In 2006, we had approximately \$118 million of outstanding floating-rate borrowings related to leases for two MD-11 aircraft that were consolidated under the provisions of FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FedEx Express purchased these aircraft in March 2007, extinguishing this debt. As disclosed in Note 6 to the accompanying consolidated financial statements, we had outstanding fixed-rate, long-term debt (exclusive of capital leases) with an estimated fair value of \$2.4 billion at May 31, 2007 and \$2.2 billion at May 31, 2006. Market risk for fixed-rate, long-term debt is estimated as the potential decrease in fair value resulting from a hypothetical 10% increase in interest rates and amounts to approximately \$36 million as of May 31, 2007 and \$42 million as of May 31, 2006. The underlying fair values of our long-term debt were estimated based on quoted market prices or on the current rates offered for debt with similar terms and maturities.

*Foreign Currency.* 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 currency declines in some areas of the world are often offset by 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, Great Britain pound and Japanese yen. During 2007 and 2006, we believe operating income was positively impacted due to foreign currency fluctuations. However, favorable foreign currency fluctuations also may have had an offsetting impact on the price we obtained or the demand for our services. At May 31, 2007, the result of a uniform 10% strengthening in the value of the dollar relative to the currencies in which our transactions are denominated would result in a decrease in operating income of approximately \$151 million for 2008 (the comparable amount in the prior year was approximately \$135 million). This theoretical calculation assumes that each exchange rate would change in the same direction relative to the U.S. dollar.

In practice, our experience is that exchange rates in the principal foreign markets where we have foreign currency denominated transactions tend to have offsetting fluctuations. Therefore, the calculation above is not indicative of our actual experience in foreign currency transactions. In addition to the direct effects of changes in exchange rates, fluctuations in exchange rates also affect the volume of sales or the foreign currency sales price as competitors' services become more or less attractive. The

sensitivity analysis of the effects of changes in foreign currency exchange rates does not factor in a potential change in sales levels or local currency prices.

*Commodity.* We have market risk for changes in the price of jet and diesel fuel; however, this risk is largely mitigated by our fuel surcharges. Our fuel surcharges are closely linked to market prices for fuel. Therefore, a hypothetical 10% change in the price of fuel would not be expected to materially affect our earnings. However, our fuel surcharges have a lag that exists before they are adjusted for changes in fuel prices and fuel prices can fluctuate within certain ranges before resulting in a change in our fuel surcharges. 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 a change in our fuel surcharges.

*Other.* We do not purchase or hold any derivative financial instruments for trading purposes.

## Risk Factors

Our financial and operating results are subject to many risks and uncertainties, as described below.

*Our businesses depend on our strong reputation and the value of the FedEx brand.* The FedEx brand name symbolizes high-quality service, reliability and speed. FedEx is one of the most widely recognized, trusted and respected brands in the world, and the FedEx brand is one of our most important and valuable assets. In addition, we have a strong reputation among customers and the general public for high standards of social and environmental responsibility and corporate governance and ethics. The FedEx brand name and our corporate reputation are powerful sales and marketing tools, and we devote significant resources to promoting and protecting them. Adverse publicity (whether or not justified) relating to activities by our employees, contractors or agents could tarnish our reputation and reduce the value of our brand. Damage to our reputation and loss of brand equity could reduce demand for our services and thus have an adverse effect on our financial condition, liquidity and results of operations, as well as require additional resources to rebuild our reputation and restore the value of our brand.

*We rely heavily on technology to operate our transportation and business networks, and any disruption to our technology infrastructure or the Internet could harm our operations and our reputation among customers.* Our ability to attract and retain customers and to compete effectively depends in part upon the sophistication and reliability of our technology network, including our ability to provide features of service that are important to our customers. Any disruption to the Internet or our technology infrastructure, including those impacting our computer systems and Web site, could adversely impact our customer service and our volumes and revenues and result in increased costs. While we have invested and continue to invest in technology security initiatives and disaster recovery plans, these measures cannot fully insulate us from technology disruptions and the resulting adverse effect on our operations and financial results.

*Our businesses are capital intensive, and we must make capital expenditures based upon projected volume levels.* We make significant investments in aircraft, vehicles, technology, package handling facilities, sort equipment, copy equipment and other capital to support our transportation and business networks. We also make significant investments to rebrand, integrate and grow the companies that we acquire. The amount and timing of capital investments depend on various factors, including our anticipated volume growth. For example, we must make commitments to purchase or modify aircraft years before the aircraft are actually needed. We must predict volume levels and fleet requirements and make commitments for aircraft based on those projections. If we miss our projections, we could end up with too much or too little capacity relative to our shipping volumes.

*We face intense competition.* The transportation and business services markets are both highly competitive and sensitive to price and service. Some of our competitors have more financial resources than we do, or they are controlled or subsidized by foreign governments, which enables them to raise capital more easily. We believe we compete effectively with these companies – for example, by providing more reliable service at compensatory prices. However, our competitors determine the charges for their services. If the pricing environment becomes irrational, it could limit 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. In addition, maintaining a broad portfolio of services is important to keeping and attracting customers. While we believe we compete effectively through our current service offerings, if our competitors offer a broader range of services or more effectively bundle their services, it could impede our ability to maintain or grow our market share.

*If we do not effectively operate, integrate, leverage and grow acquired businesses, our financial results and reputation may suffer.* Our strategy for long-term growth, productivity and profitability depends in part on our ability to make prudent strategic acquisitions and to realize the benefits we expect when we make those acquisitions. In furtherance of this strategy, during 2007 we acquired the LTL freight operations of Watkins Motor Lines (renamed FedEx National LTL) and made strategic acquisitions in China, the United Kingdom and India. While we expect these acquisitions to enhance our value proposition to customers and improve our long-term profitability, there can be no assurance that we will realize our expectations within the time frame we have established, if at all. We acquired FedEx Kinko's in February 2004 to expand our portfolio of business services and enhance our ability to provide package-shipping services to small- and medium-sized business customers through its network of retail locations. However, FedEx Kinko's financial performance has not yet met our expectations. Accordingly, we have undertaken key initiatives at FedEx Kinko's relating to revenue growth, network expansion and improved profitability. There can be no assurance that our acquisitions will be successful or that we can continue to support the value we allocate to these acquired businesses, including their goodwill or other intangible assets.

*Our transportation businesses may be impacted by the price and availability of fuel.* We must purchase large quantities of fuel to operate our aircraft and vehicles, and the price and availability

of fuel can be unpredictable and beyond our control. To date, we have been successful in mitigating the impact of higher fuel costs through our indexed fuel surcharges, as the amount of the surcharges is closely linked to the market prices for fuel. If we are unable to maintain or increase our fuel surcharges because of competitive pricing pressures or some other reason, fuel costs could adversely impact our operating results. In addition, disruptions in the supply of fuel could have a negative impact on our ability to operate our transportation networks.

*FedEx Ground relies on owner-operators to conduct its operations, and the status of these owner-operators as independent contractors, rather than employees, is being challenged.* FedEx Ground's use of independent contractors is well suited to the needs of the ground delivery business and its customers. We are involved in numerous purported class-action lawsuits and other proceedings, however, that claim that these owner-operators should be treated as employees and not independent contractors. We expect to incur certain costs, including legal fees, in defending the status of FedEx Ground's owner-operators as independent contractors. We strongly believe that the owner-operators are properly classified as independent contractors and that we will prevail in our defense. However, adverse determinations in these matters could, among other things, entitle some of our contractors to the reimbursement of certain expenses and to the benefit of wage-and-hour laws and result in employment and withholding tax liability for FedEx Ground. Moreover, if FedEx Ground is compelled to convert its independent contractors to employees, our operating costs could increase and we could incur significant capital outlays.

*Increased security requirements could impose substantial costs on us, especially at FedEx Express.* As a result of concerns about global terrorism and homeland security, governments around the world are adopting or are considering adopting stricter security requirements that will increase operating costs for businesses, including those in the transportation industry. For example, in May 2006, the U.S. Transportation Security Administration ("TSA") adopted new rules enhancing many of the security requirements for air cargo on both passenger and all-cargo aircraft, and in May 2007, the TSA issued a revised model all-cargo aircraft security program for implementing the new rules. Together with other all-cargo aircraft operators, we have filed comments with the TSA requesting clarification regarding several provisions in the revised model program. Until the requirements for our security program under the new rules are finalized, we cannot determine the effect that these new rules will have on our cost structure or our operating results. It is reasonably possible, however, that these rules or other future security requirements for air cargo carriers could impose material costs on us.

*The regulatory environment for global aviation rights may impact our air operations.* Our extensive air network is critical to our success. Our right to serve foreign points is subject to the approval of the Department of Transportation and generally requires a bilateral agreement between the United States and foreign governments. In addition, we must obtain the permission of foreign governments to provide specific flights and services. Regulatory actions affecting global aviation rights or a failure to obtain or maintain aviation rights in important international markets could impair our ability to operate our air network.

*We are also subject to risks and uncertainties that affect many other businesses, including:*

- 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;
- any impacts on our businesses resulting from new domestic or international government laws and regulation, including tax, accounting, labor or environmental rules;
- our ability to manage our cost structure for capital expenditures and operating expenses and match them to shifting customer volume levels;
- changes in foreign currency exchange rates, especially in the euro, Chinese yuan, Canadian dollar, Great Britain pound and Japanese yen, which can affect our sales levels and foreign currency sales prices;
- 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;
- a shortage of qualified labor and our ability to mitigate this shortage through recruiting and retention efforts and productivity gains;
- increasing costs 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;
- any liability resulting from and the costs of defending against class-action litigation, such as wage-and-hour claims, and any other legal proceedings;
- the impact of technology developments on our operations and on demand for our services (for example, the impact that low-cost home copiers and printers are having on demand for FedEx Kinko's copy 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; and
- 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.

*We are directly affected by the state of the economy.* While the global, or macro-economic, risks listed above apply to most companies, we are particularly vulnerable. The transportation industry is highly cyclical and especially susceptible to trends in economic activity. Our primary business is to transport goods, so our business levels are directly tied to the purchase and production of goods — key macro-economic measurements. When individuals and companies purchase and produce fewer goods, we transport fewer goods. In addition, we have a relatively high fixed-cost structure, which is difficult to adjust to match shifting volume levels. Moreover, as we grow our international business, we are increasingly affected by the health of the global economy.

## Forward-Looking Statements

Certain statements in this report, including (but not limited to) those contained in "Outlook (including segment outlooks)," "Liquidity," "Capital Resources," "Contractual Cash Obligations" and "Critical Accounting Estimates," and the "Retirement Plans" note to the consolidated financial statements, 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," "estimates," "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, the risk factors identified above and the other risks and uncertainties you can find in our press releases and other SEC filings.

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 the forward-looking statements, which speak only as of the date of this report. We are under no obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

## Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended). Our internal control over financial reporting includes, among other things, defined policies and procedures for conducting and governing our business, sophisticated information systems for processing transactions and a properly staffed, professional internal audit department. Mechanisms are in place to monitor the effectiveness of our internal control over financial reporting and actions are taken to correct deficiencies identified. Our procedures for financial reporting include the active involvement of senior management, our Audit Committee and our staff of highly qualified financial and legal professionals.

Management, with the participation of our principal executive and financial officers, assessed our internal control over financial reporting as of May 31, 2007, the end of our fiscal year. Management based its assessment on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria).

Based on this assessment, management has concluded that our internal control over financial reporting was effective as of May 31, 2007.

Our independent registered public accounting firm, Ernst & Young LLP, audited management's assessment and the effectiveness of our internal control over financial reporting. Ernst & Young LLP has issued their report concurring with management's assessment, which is included in this Annual Report.

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
FedEx Corporation

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that FedEx Corporation maintained effective internal control over financial reporting as of May 31, 2007, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). FedEx Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that FedEx Corporation maintained effective internal control over financial reporting as of May 31, 2007, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, FedEx Corporation maintained, in all material respects, effective internal control over financial reporting as of May 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of FedEx Corporation as of May 31, 2007 and 2006, and related consolidated statements of income, changes in stockholders' investment and comprehensive income, and cash flows for each of the three years in the period ended May 31, 2007 of FedEx Corporation and our report dated July 9, 2007 expressed an unqualified opinion thereon.

Memphis, Tennessee  
July 9, 2007

The signature of Ernst & Young LLP is written in a cursive, handwritten style in black ink.

## Consolidated Statements of Income

(In millions, except per share amounts)	Years ended May 31,		
	2007	2006	2005
<b>REVENUES</b>	<b>\$35,214</b>	<b>\$32,294</b>	<b>\$29,363</b>
<b>Operating Expenses:</b>			
Salaries and employee benefits	13,740	12,571	11,963
Purchased transportation	3,873	3,251	2,935
Rentals and landing fees	2,343	2,390	2,299
Depreciation and amortization	1,742	1,550	1,462
Fuel	3,533	3,256	2,317
Maintenance and repairs	1,952	1,777	1,695
Other	4,755	4,485	4,221
	<b>31,938</b>	<b>29,280</b>	<b>26,892</b>
<b>OPERATING INCOME</b>	<b>3,276</b>	<b>3,014</b>	<b>2,471</b>
<b>Other Income (Expense):</b>			
Interest expense	(136)	(142)	(160)
Interest income	83	38	21
Other, net	(8)	(11)	(19)
	<b>(61)</b>	<b>(115)</b>	<b>(158)</b>
<b>Income Before Income Taxes</b>	<b>3,215</b>	<b>2,899</b>	<b>2,313</b>
<b>Provision for Income Taxes</b>	<b>1,199</b>	<b>1,093</b>	<b>864</b>
<b>NET INCOME</b>	<b>\$ 2,016</b>	<b>\$ 1,806</b>	<b>\$ 1,449</b>
<b>BASIC EARNINGS PER COMMON SHARE</b>	<b>\$ 6.57</b>	<b>\$ 5.94</b>	<b>\$ 4.81</b>
<b>DILUTED EARNINGS PER COMMON SHARE</b>	<b>\$ 6.48</b>	<b>\$ 5.83</b>	<b>\$ 4.72</b>

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

## Consolidated Balance Sheets

(In millions, except per share data)	May 31,	
	2007	2006
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 1,569	\$ 1,937
Receivables, less allowances of \$136 and \$144	3,942	3,516
Spare parts, supplies and fuel, less allowances of \$156 and \$150	338	308
Deferred income taxes	536	539
Prepaid expenses and other	244	164
Total current assets	6,629	6,464
<b>Property and Equipment, at Cost</b>		
Aircraft and related equipment	9,593	8,611
Package handling and ground support equipment	3,889	3,558
Computer and electronic equipment	4,685	4,331
Vehicles	2,561	2,203
Facilities and other	6,362	5,371
	27,090	24,074
Less accumulated depreciation and amortization	14,454	13,304
Net property and equipment	12,636	10,770
<b>Other Long-Term Assets</b>		
Goodwill	3,497	2,825
Prepaid pension cost	—	1,349
Intangible and other assets	1,238	1,282
Total other long-term assets	4,735	5,456
	<b>\$24,000</b>	<b>\$22,690</b>
<b>LIABILITIES AND STOCKHOLDERS' INVESTMENT</b>		
<b>Current Liabilities</b>		
Current portion of long-term debt	\$ 639	\$ 850
Accrued salaries and employee benefits	1,354	1,325
Accounts payable	2,016	1,908
Accrued expenses	1,419	1,390
Total current liabilities	5,428	5,473
<b>Long-Term Debt, Less Current Portion</b>	<b>2,007</b>	<b>1,592</b>
<b>Other Long-Term Liabilities</b>		
Deferred income taxes	897	1,367
Pension, postretirement healthcare and other benefit obligations	1,164	944
Self-insurance accruals	759	692
Deferred lease obligations	655	658
Deferred gains, principally related to aircraft transactions	343	373
Other liabilities	91	80
Total other long-term liabilities	3,909	4,114
<b>Commitments and Contingencies</b>		
<b>Common Stockholders' Investment</b>		
Common stock, \$0.10 par value; 800 million shares authorized; 308 million shares issued for 2007 and 306 million shares issued for 2006	31	31
Additional paid-in capital	1,689	1,438
Retained earnings	11,970	10,068
Accumulated other comprehensive loss	(1,030)	(24)
Treasury stock	(4)	(2)
Total common stockholders' investment	12,656	11,511
	<b>\$24,000</b>	<b>\$22,690</b>

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

## Consolidated Statements of Cash Flows

(In millions)	Years ended May 31,		
	2007	2006	2005
<b>OPERATING ACTIVITIES</b>			
Net income	<b>\$ 2,016</b>	<b>\$1,806</b>	<b>\$1,449</b>
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	<b>1,742</b>	<b>1,548</b>	<b>1,462</b>
Provision for uncollectible accounts	<b>106</b>	<b>121</b>	<b>101</b>
Deferred income taxes and other noncash items	<b>37</b>	<b>159</b>	<b>40</b>
Lease accounting charge	<b>—</b>	<b>79</b>	<b>—</b>
Excess tax benefits on the exercise of stock options	<b>—</b>	<b>62</b>	<b>36</b>
Stock-based compensation	<b>103</b>	<b>37</b>	<b>32</b>
Changes in operating assets and liabilities, net of the effects of businesses acquired:			
Receivables	<b>(323)</b>	<b>(319)</b>	<b>(235)</b>
Other current assets	<b>(85)</b>	<b>(38)</b>	<b>(26)</b>
Pension assets and liabilities, net	<b>(69)</b>	<b>(71)</b>	<b>(118)</b>
Accounts payable and other operating liabilities	<b>66</b>	<b>346</b>	<b>365</b>
Other, net	<b>(30)</b>	<b>(54)</b>	<b>11</b>
Cash provided by operating activities	<b>3,563</b>	<b>3,676</b>	<b>3,117</b>
<b>INVESTING ACTIVITIES</b>			
Capital expenditures	<b>(2,882)</b>	<b>(2,518)</b>	<b>(2,236)</b>
Business acquisitions, net of cash acquired	<b>(1,310)</b>	<b>—</b>	<b>(122)</b>
Proceeds from asset dispositions	<b>68</b>	<b>64</b>	<b>12</b>
Other, net	<b>—</b>	<b>—</b>	<b>(2)</b>
Cash used in investing activities	<b>(4,124)</b>	<b>(2,454)</b>	<b>(2,348)</b>
<b>FINANCING ACTIVITIES</b>			
Principal payments on debt	<b>(906)</b>	<b>(369)</b>	<b>(791)</b>
Proceeds from debt issuances	<b>1,054</b>	<b>—</b>	<b>—</b>
Proceeds from stock issuances	<b>115</b>	<b>144</b>	<b>99</b>
Excess tax benefits on the exercise of stock options	<b>45</b>	<b>—</b>	<b>—</b>
Dividends paid	<b>(110)</b>	<b>(97)</b>	<b>(84)</b>
Other, net	<b>(5)</b>	<b>(2)</b>	<b>—</b>
Cash provided by (used in) financing activities	<b>193</b>	<b>(324)</b>	<b>(776)</b>
<b>CASH AND CASH EQUIVALENTS</b>			
Net (decrease) increase in cash and cash equivalents	<b>(368)</b>	<b>898</b>	<b>(7)</b>
Cash and cash equivalents at beginning of period	<b>1,937</b>	<b>1,039</b>	<b>1,046</b>
Cash and cash equivalents at end of period	<b>\$ 1,569</b>	<b>\$1,937</b>	<b>\$1,039</b>

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

## Consolidated Statements of Changes in Stockholders' Investment and Comprehensive Income

(In millions, except share data)	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
<b>BALANCE AT MAY 31, 2004</b>	\$30	\$1,051	\$ 7,001	\$ (46)	\$ –	\$ 8,036
Net income	–	–	1,449	–	–	1,449
Foreign currency translation adjustment, net of deferred taxes of \$5	–	–	–	27	–	27
Minimum pension liability adjustment, net of deferred taxes of \$1	–	–	–	2	–	2
<b>Total comprehensive income</b>						<b>1,478</b>
Cash dividends declared (\$0.29 per share)	–	–	(87)	–	–	(87)
Employee incentive plans and other (2,767,257 shares issued)	–	162	–	–	(1)	161
<b>BALANCE AT MAY 31, 2005</b>	30	1,213	8,363	(17)	(1)	9,588
Net income	–	–	1,806	–	–	1,806
Foreign currency translation adjustment, net of deferred taxes of \$3	–	–	–	29	–	29
Minimum pension liability adjustment, net of deferred taxes of \$24	–	–	–	(36)	–	(36)
<b>Total comprehensive income</b>						<b>1,799</b>
Cash dividends declared (\$0.33 per share)	–	–	(101)	–	–	(101)
Employee incentive plans and other (3,579,766 shares issued)	1	225	–	–	(1)	225
<b>BALANCE AT MAY 31, 2006</b>	31	1,438	10,068	(24)	(2)	11,511
Net income	–	–	2,016	–	–	2,016
Foreign currency translation adjustment, net of deferred taxes of \$8	–	–	–	26	–	26
Minimum pension liability adjustment, net of deferred taxes of \$24	–	–	–	(50)	–	(50)
<b>Total comprehensive income</b>						<b>1,992</b>
Retirement plans adjustment in connection with the adoption of SFAS 158, net of deferred taxes of \$582	–	–	–	(982)	–	(982)
Cash dividends declared (\$0.37 per share)	–	–	(114)	–	–	(114)
Employee incentive plans and other (2,508,850 shares issued)	–	251	–	–	(2)	249
<b>BALANCE AT MAY 31, 2007</b>	<b>\$31</b>	<b>\$1,689</b>	<b>\$11,970</b>	<b>\$ (1,030)</b>	<b>\$ (4)</b>	<b>\$12,656</b>

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

## Note 1: Description of Business and Summary of Significant Accounting Policies

### DESCRIPTION OF BUSINESS

FedEx Corporation ("FedEx") provides a broad portfolio of transportation, e-commerce and business services through companies competing collectively, operating independently and managed collaboratively, under the respected FedEx brand. These operating companies are primarily represented by 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; FedEx Freight Corporation, a leading U.S. provider of less-than-truckload ("LTL") freight services; and FedEx Kinko's Office and Print Services, Inc. ("FedEx Kinko's"), a leading provider of document solutions and business services. These companies represent our major service lines and form the core of our reportable segments.

Other business units in the FedEx portfolio are FedEx Trade Networks, Inc. ("FedEx Trade Networks"), a global trade services company; FedEx SmartPost, Inc. ("FedEx SmartPost"), a small-parcel consolidator; FedEx Global Supply Chain Services, Inc. ("FedEx Supply Chain Services"), a contract logistics provider; FedEx Custom Critical, Inc. ("FedEx Custom Critical"), a critical-shipment carrier; Caribbean Transportation Services, Inc. ("Caribbean Transportation Services"), a provider of airfreight forwarding services, and FedEx Corporate Services, Inc. ("FedEx Services"), a provider of customer-facing sales, marketing and information technology functions, primarily for FedEx Express and FedEx Ground.

### FISCAL YEARS

Except as otherwise specified, references to years indicate our fiscal year ended May 31, 2007 or ended May 31 of the year referenced.

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of FedEx and its subsidiaries, substantially all of which are wholly owned. All significant intercompany accounts and transactions have been eliminated.

### REVENUE RECOGNITION

We recognize revenue upon delivery of shipments for our transportation businesses and upon completion of services for our business services, logistics and trade services businesses. Certain of our transportation services are provided with the use of independent contractors. FedEx is the principal to the transaction in most instances and in those cases revenue from these transactions is recognized on a gross basis. Costs associated with independent contractor settlements are recognized as incurred and included in the caption "Purchased transportation" in the accompanying consolidated statements of income. For shipments in transit, revenue is recorded based on the percentage of service completed at the balance sheet date. Estimates for future billing adjustments to revenue and accounts receivable are recognized

at the time of shipment for money-back service guarantees and billing corrections. Delivery costs are accrued as incurred.

Our contract logistics, global trade services and certain transportation businesses engage in some transactions wherein they act as agents. Revenue from these transactions is recorded on a net basis. Net revenue includes billings to customers less third-party charges, including transportation or handling costs, fees, commissions, and taxes and duties. These amounts are not material.

Certain of our revenue-producing transactions are subject to taxes assessed by governmental authorities, such as sales tax. We present these taxes on a net basis.

### CREDIT RISK

We routinely grant credit to many of our customers for transportation and business services without collateral. The risk of credit loss in our trade receivables is substantially mitigated by our credit evaluation process, short collection terms and sales to a large number of customers, as well as the low revenue per transaction for most of our services. Allowances for potential credit losses are determined based on historical experience and current evaluation of the composition of accounts receivable. Historically, credit losses have been within management's expectations.

### ADVERTISING

Advertising and promotion costs are expensed as incurred and are classified in other operating expenses. Advertising and promotion expenses were \$406 million in 2007, \$376 million in 2006 and \$326 million in 2005.

### CASH EQUIVALENTS

Cash in excess of current operating requirements is invested in short-term, interest-bearing instruments with maturities of three months or less at the date of purchase and is stated at cost, which approximates market value.

### SPARE PARTS, SUPPLIES AND FUEL

Spare parts (principally aircraft related) are reported at weighted-average cost. Supplies and fuel are reported at standard cost, which approximates actual cost on a first-in, first-out basis. Allowances for obsolescence are provided for spare parts expected to be on hand at the date the aircraft are retired from service over the estimated useful life of the related aircraft and engines. Additionally, allowances for obsolescence are provided for spare parts currently identified as excess or obsolete. These allowances are based on management estimates, which are subject to change.

### PROPERTY AND EQUIPMENT

Expenditures for major additions, improvements, flight equipment modifications and certain equipment overhaul costs are capitalized when such costs are determined to extend the useful life of the asset or are part of the cost of acquiring the asset. Maintenance and repairs are charged to expense as incurred, except for certain aircraft-related major maintenance costs on one of our aircraft fleet types, which are capitalized as incurred and amortized over the estimated remaining useful lives of the aircraft. We capitalize certain direct internal and external costs associated with the development of internal use software. Gains

and losses on sales of property used in operations are classified with depreciation and amortization.

For financial reporting purposes, we record depreciation and amortization of property and equipment on a straight-line basis over the asset's service life or related lease term. For income tax purposes, depreciation is generally computed using accelerated methods. The depreciable lives and net book value of our property and equipment are as follows (dollars in millions):

	Range	Net Book Value at May 31,	
		2007	2006
Wide-body aircraft and related equipment	15 to 25 years	\$5,391	\$4,669
Narrow-body and feeder aircraft and related equipment	5 to 15 years	352	369
Package handling and ground support equipment	2 to 30 years	1,420	1,255
Computer and electronic equipment	2 to 10 years	1,021	928
Vehicles	3 to 15 years	957	743
Facilities and other	2 to 40 years	3,495	2,806

Substantially all property and equipment have no material residual values. The majority of aircraft costs are depreciated on a straight-line basis over 15 to 18 years. We periodically evaluate the estimated service lives and residual values used to depreciate our property and equipment. This evaluation may result in changes in the estimated lives and residual values. Such changes did not materially affect depreciation expense in any period presented. Depreciation expense, excluding gains and losses on sales of property and equipment used in operations, was \$1.7 billion in 2007, \$1.5 billion in 2006 and \$1.4 billion in 2005. Depreciation and amortization expense includes amortization of assets under capital lease.

#### CAPITALIZED INTEREST

Interest on funds used to finance the acquisition and modification of aircraft, construction of certain facilities and development of certain software up to the date the asset is ready for its intended use is capitalized and included in the cost of the asset if the asset is actively under construction. Capitalized interest was \$34 million in 2007, \$33 million in 2006 and \$22 million in 2005.

#### IMPAIRMENT OF LONG-LIVED ASSETS

Long-lived assets are reviewed for impairment when circumstances indicate the carrying value of an asset may not be recoverable. For assets that are to be held and used, an impairment is recognized when the estimated undiscounted cash flows associated with the asset or group of assets is less than their carrying value. If impairment exists, an adjustment is made to write the asset down to its fair value, and a loss is recorded as the difference between the carrying value and fair value. Fair values are determined based on quoted market values, discounted cash flows or internal and external appraisals, as applicable. Assets to be disposed of are carried at the lower of carrying value or estimated net realizable value. We operate integrated transportation networks, and accordingly, cash flows cannot be associated with an individual asset for our analysis of impairment.

#### GOODWILL

Goodwill is recognized for the excess of the purchase price over the fair value of tangible and identifiable intangible net assets of businesses acquired. Goodwill is reviewed at least annually for impairment by comparing the fair value of each reporting unit with its carrying value (including attributable goodwill). Fair value is determined using a discounted cash flow methodology and includes management's assumptions on revenue growth rates, operating margins, discount rates and expected capital expenditures. Unless circumstances otherwise dictate, we perform our annual impairment testing in the fourth quarter.

#### INTANGIBLE ASSETS

Amortizable intangible assets include customer relationships, technology assets and contract-based intangibles acquired in business combinations. Amortizable intangible assets are amortized over periods ranging from 2 to 15 years, either on a straight-line basis or an accelerated basis depending upon the pattern in which the economic benefits are realized. Our only non-amortizing intangible asset is the Kinko's trade name. Non-amortizing intangibles are reviewed at least annually for impairment. Unless circumstances otherwise dictate, we perform our annual impairment testing in the fourth quarter.

#### PENSION AND POSTRETIREMENT HEALTHCARE PLANS

On May 31, 2007, we adopted Statement of Financial Accounting Standards ("SFAS") 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," which amended several other Financial Accounting Standards Board ("FASB") Statements. SFAS 158 requires recognition in the balance sheet of the funded status of defined benefit pension and other post-retirement benefit plans, and the recognition in accumulated other comprehensive income ("AOCI") of unrecognized gains or losses and prior service costs or credits existing at the time of adoption. Additionally, SFAS 158 requires the measurement date for plan assets and liabilities to coincide with the sponsor's year-end. We currently use a February 28 measurement date for our plans; therefore, this standard will require us to change our measurement date to May 31 (beginning in 2009). The impact of adopting the measurement date provision on our financial statements will depend on the funded status of the plans at the date of adoption.

The adoption of SFAS 158 resulted in a \$982 million charge to shareholders' equity at May 31, 2007 through AOCI. Under SFAS 158, we were required to write off our prepaid pension asset of \$1.4 billion and increase our pension and other postretirement benefit liabilities by \$120 million. These adjustments, net of deferred taxes of \$582 million, were required to recognize the unfunded projected benefit obligation in our balance sheet. SFAS 158 has no impact on the determination of expense for our pension and other postretirement benefit plans.

In February 2007, we announced changes to modernize certain of our retirement programs over the next two fiscal years. Effective May 31, 2008, all benefits previously accrued under our primary pension plans using a traditional pension benefit formula will be capped for most employees, and those benefits will be payable beginning at retirement. Beginning June 1, 2008, future pension

benefits for most employees will be accrued under a cash balance formula we call the Portable Pension Account (as described in Note 12). These retirement plan changes were contemplated in our February 28, 2007 actuarial measurement. These changes will not affect the benefits of current retirees.

Currently, our defined benefit plans are measured using actuarial techniques that reflect management's assumptions for discount rate, rate of return, salary increases, expected retirement, mortality, employee turnover and future increases in healthcare costs. We determine the discount rate (which is required to be the rate at which the projected benefit obligation could be effectively settled as of the measurement date) with the assistance of actuaries, who calculate the yield on a theoretical portfolio of high-grade corporate bonds (rated Aa or better) with cash flows that generally match our expected benefit payments. A calculated-value method is employed for purposes of determining the expected return on the plan asset component of net periodic pension cost for our qualified U.S. pension plans. Generally, we do not fund defined benefit plans when such funding provides no current tax deduction or when such funding would be deemed current compensation to plan participants.

#### **INCOME TAXES**

Deferred income taxes are provided for the tax effect of temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. The liability method is used to account for income taxes, which requires deferred taxes to be recorded at the statutory rate expected to be in effect when the taxes are paid.

We have not recognized deferred taxes for U.S. federal income taxes on foreign subsidiaries' earnings that are deemed to be permanently reinvested and such taxes associated with these earnings are not material. Pretax earnings of foreign operations were approximately \$648 million in 2007, \$606 million in 2006 and \$636 million in 2005, which represent only a portion of total results associated with international shipments.

#### **SELF-INSURANCE ACCRUALS**

We are primarily self-insured for workers' compensation claims, vehicle accidents and general liabilities, benefits paid under employee healthcare programs and long-term disability benefits. Accruals are primarily based on the actuarially estimated, undiscounted cost of claims, which includes incurred-but-not-reported claims. Current workers' compensation claims, vehicle and general liability, employee healthcare claims and long-term disability are included in accrued expenses. We self-insure up to certain limits that vary by operating company and type of risk. Periodically, we evaluate the level of insurance coverage and adjust insurance levels based on risk tolerance and premium expense.

#### **LEASES**

We lease certain aircraft, facilities, equipment and vehicles under capital and operating leases. The commencement date of all leases is the earlier of the date we become legally obligated to make rent payments or the date we may exercise control over the use of the property. In addition to minimum rental payments, certain leases provide for contingent rentals based on equipment usage principally related to aircraft leases at FedEx Express and

copier usage at FedEx Kinko's. Rent expense associated with contingent rentals is recorded as incurred. Certain of our leases contain fluctuating or escalating payments and rent holiday periods. The related rent expense is recorded on a straight-line basis over the lease term. The cumulative excess of rent payments over rent expense is accounted for as a deferred lease asset and recorded in "Intangible and other assets" in the accompanying consolidated balance sheets. The cumulative excess of rent expense over rent payments is accounted for as a deferred lease obligation. Leasehold improvements associated with assets utilized under capital or operating leases are amortized over the shorter of the asset's useful life or the lease term.

#### **DEFERRED GAINS**

Gains on the sale and leaseback of aircraft and other property and equipment are deferred and amortized ratably over the life of the lease as a reduction of rent expense. Substantially all of these deferred gains are related to aircraft transactions.

#### **FOREIGN CURRENCY TRANSLATION**

Translation gains and losses of foreign operations that use local currencies as the functional currency are accumulated and reported, net of applicable deferred income taxes, as a component of accumulated other comprehensive loss within common stockholders' investment. Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the local currency are included in the caption "Other, net" in the accompanying consolidated statements of income. Cumulative net foreign currency translation gains in accumulated other comprehensive loss were \$69 million at May 31, 2007, \$43 million at May 31, 2006 and \$14 million at May 31, 2005.

#### **AIRLINE STABILIZATION ACT CHARGE**

In 2005, the United States Department of Transportation ("DOT") issued a final order in its administrative review of the FedEx Express claim for compensation under the Air Transportation Safety and System Stabilization Act. We recorded a charge of \$48 million in 2005, representing the repayment of \$29 million that we had previously received and the write-off of a \$19 million receivable that we concluded was no longer collectible.

#### **EMPLOYEES UNDER COLLECTIVE BARGAINING ARRANGEMENTS**

The pilots of FedEx Express, which represent a small number of our total employees, are employed under a collective bargaining agreement. In October 2006, the pilots ratified a new four-year labor contract that included signing bonuses and other upfront compensation of approximately \$143 million, as well as pay increases and other benefit enhancements. These costs were partially mitigated by reductions in variable incentive compensation. The effect of this new agreement on second quarter 2007 net income was approximately \$78 million after tax, or \$0.25 per diluted share.

#### **STOCK-BASED COMPENSATION**

On June 1, 2006, we adopted the provisions of SFAS 123R, "Share-Based Payment," which requires recognition of compensation expense for stock-based awards using a fair value method.

SFAS 123R is a revision of SFAS 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board Opinion No. ("APB") 25, "Accounting for Stock Issued to Employees." Prior to the adoption of SFAS 123R, we applied APB 25 and its related interpretations to measure compensation expense for stock-based compensation plans. As a result, no compensation expense was recorded for stock options, as the exercise price was equal to the market price of our common stock at the date of grant.

We adopted SFAS 123R using the modified prospective method, which resulted in prospective recognition of compensation expense for all outstanding unvested share-based payments based on the fair value on the original grant date. Under this method of adoption, our financial statement amounts for the prior period presented have not been restated.

Our total share-based compensation expense was \$103 million in 2007, \$37 million in 2006 and \$32 million in 2005. The impact of adopting SFAS 123R for the year ended May 31, 2007 was approximately \$71 million (\$52 million, net of tax), or \$0.17 per basic and diluted share.

Stock option compensation expense, pro forma net income and basic and diluted earnings per common share, if determined under SFAS 123 at fair value using the Black-Scholes method, would have been as follows (in millions, except for per share amounts) for the years ended May 31:

	2006	2005
Net income, as reported	\$1,806	\$1,449
Add: Stock option compensation included in reported net income, net of tax	5	4
Deduct: Total stock option compensation expense determined under fair value based method for all awards, net of tax benefit	46	40
Pro forma net income	\$1,765	\$1,413
Earnings per common share:		
Basic – as reported	\$ 5.94	\$ 4.81
Basic – pro forma	\$ 5.81	\$ 4.69
Diluted – as reported	\$ 5.83	\$ 4.72
Diluted – pro forma	\$ 5.70	\$ 4.60

#### DIVIDENDS DECLARED PER COMMON SHARE

On May 25, 2007, our Board of Directors declared a dividend of \$0.10 per share of common stock. The dividend was paid on July 2, 2007 to stockholders of record as of the close of business on June 11, 2007. 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.

#### USE OF ESTIMATES

The preparation of our consolidated financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the reported amounts of revenues and expenses and the disclosure of contingent liabilities. Management makes its best estimate of the ultimate outcome for these items based on historical trends and other information available when the financial statements are prepared. Changes

in estimates are recognized in accordance with the accounting rules for the estimate, which is typically in the period when new information becomes available to management. Areas where the nature of the estimate makes it reasonably possible that actual results could materially differ from amounts estimated include: self-insurance accruals; retirement plan obligations; long-term incentive accruals; tax liabilities; obsolescence of spare parts; contingent liabilities; and impairment assessments on long-lived assets (including goodwill and indefinite lived intangible assets).

## Note 2: Recent Accounting Pronouncements

New accounting rules and disclosure requirements can significantly impact the comparability of our financial statements. We believe the following new accounting pronouncements, which were issued or became effective for us during 2007, are relevant to the readers of our financial statements.

In July 2006, the FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes." This interpretation establishes new standards for the financial statement recognition, measurement and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. The new rules will be effective for FedEx in the first quarter of 2008. The adoption of this interpretation will not have a material effect on our financial statements.

In September 2006, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," which eliminates the diversity in practice surrounding the quantification and evaluation of financial statement errors. The guidance outlined in SAB 108 was effective for FedEx in the fourth quarter of 2007 and is consistent with our historical practices for assessing such matters when circumstances have required such an evaluation.

### Note 3: Business Combinations

On September 3, 2006, we acquired the assets and assumed certain obligations of the LTL operations of Watkins Motor Lines ("Watkins"), a privately held company, and certain affiliates for \$787 million in cash. Watkins, a leading provider of long-haul LTL services, was renamed FedEx National LTL and meaningfully extends our leadership position in the heavyweight LTL freight sector. The financial results of FedEx National LTL are included in the FedEx Freight segment from the date of acquisition.

On December 16, 2006, we acquired all of the outstanding capital stock of ANC Holdings Ltd. ("ANC"), a United Kingdom domestic express transportation company, for \$241 million, predominantly in cash. This acquisition allows FedEx Express to better serve the United Kingdom domestic market, which we previously served primarily through independent agents.

On March 1, 2007, FedEx Express acquired Tianjin Datian W. Group Co., Ltd.'s ("DTW Group") 50% share of the FedEx-DTW International Priority express joint venture and assets relating to DTW Group's domestic express network in China for \$427 million in cash. This acquisition converts our joint venture with DTW Group into a wholly owned subsidiary and increases our presence in China in the international and domestic express businesses. Prior to the fourth quarter of 2007, we accounted for our investment in the joint venture under the equity method.

The financial results of the ANC and DTW Group acquisitions, as well as other immaterial business acquisitions during 2007, are included in the FedEx Express segment from the date of acquisition. These acquisitions were not material to our results of operations or financial condition. The portion of the purchase price allocated to goodwill and other identified intangible assets for the FedEx National LTL, ANC and DTW Group acquisitions will generally be deductible for U.S. tax purposes over 15 years.

Pro forma results of these acquisitions, individually or in the aggregate, would not differ materially from reported results in any of the periods presented. Our accompanying consolidated balance sheet reflects the following preliminary allocations of the purchase price for the FedEx National LTL, ANC and DTW Group acquisitions (in millions):

	FedEx National LTL	ANC	DTW Group
Current assets	\$121	\$ 68	\$ 54
Property and equipment	525	20	16
Intangible assets	77	49	17
Goodwill	121	168	348
Other assets	3	2	10
Current liabilities	(60)	(56)	(18)
Long-term liabilities	—	(10)	—
Total purchase price	\$787	\$241	\$427

While the purchase price allocations are substantially complete and we do not expect any material adjustments, we may make adjustments to the purchase price allocations as refinements to estimates are deemed necessary. Our ANC and DTW Group acquisitions included the impact of foreign currency fluctuations from the execution of the purchase agreement to the actual closing date. The impact of these foreign currency fluctuations was immaterial to these transactions.

The intangible assets acquired in the FedEx National LTL and ANC acquisitions consist primarily of customer-related intangible assets, which will be amortized on an accelerated basis over their average estimated useful lives of seven years for FedEx National LTL and up to 12 years for ANC, with the majority of the amortization recognized during the first four years. The intangible assets acquired in the DTW Group acquisition relate to the reacquired rights for the use of certain FedEx technology and service marks. These intangible assets will be amortized over their estimated useful lives of approximately two years.

We paid the purchase price for these acquisitions from available cash balances, which included the net proceeds from our \$1 billion senior unsecured debt offering completed during 2007. See Note 6 for further discussion of this debt offering.

On September 12, 2004, we acquired the assets and assumed certain liabilities of FedEx SmartPost (formerly known as Parcel Direct), a division of a privately held company, for \$122 million in cash. FedEx SmartPost is a leading small-parcel consolidator and broadens our portfolio of services by allowing us to offer a cost-effective option for delivering low-weight, less time-sensitive packages to U.S. residences through the U.S. Postal Service. The financial results of FedEx SmartPost are included in the FedEx Ground segment from the date of its acquisition and are not material to reported or pro forma results of operations of any period.

The purchase price was allocated as follows (in millions):

Current assets, primarily accounts receivable	\$ 10
Property and equipment	91
Intangible assets	10
Goodwill	20
Current liabilities	(9)
Total purchase price	\$122

The excess cost over the estimated fair value of the assets acquired and liabilities assumed (approximately \$20 million) has been recorded as goodwill, which is entirely attributed to FedEx Ground.

## Note 4: Goodwill and Intangibles

The FedEx National LTL, ANC and DTW Group acquisitions, as well as other immaterial business acquisitions during 2007, contributed approximately \$670 million in goodwill for the year ended May 31, 2007. The carrying amount of goodwill attributable to each reportable operating segment and changes therein follows (in millions):

	May 31, 2005	Purchase Adjustments and Other	May 31, 2006	Goodwill Acquired	Purchase Adjustments and Other	May 31, 2007
FedEx Express segment	\$ 528	\$ 2	\$ 530	\$549	\$9	\$1,088
FedEx Ground segment	90	—	90	—	—	90
FedEx Freight segment	666	(10)	656	121	—	777
FedEx Kinko's segment	1,551	(2)	1,549	—	(7)	1,542
	<b>\$2,835</b>	<b>\$(10)</b>	<b>\$2,825</b>	<b>\$670</b>	<b>\$2</b>	<b>\$3,497</b>

The FedEx National LTL, ANC and DTW Group acquisitions, as well as other immaterial business acquisitions during 2007, contributed approximately \$147 million in intangible assets for the year ended May 31, 2007. The components of our intangible assets were as follows (in millions):

	May 31, 2007			May 31, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
<b>Amortizable intangible assets</b>						
Customer relationships	\$206	\$ (58)	\$148	\$ 77	\$ (29)	\$ 48
Contract related	79	(62)	17	79	(57)	22
Technology related and other	74	(39)	35	54	(30)	24
Total	<b>\$359</b>	<b>\$(159)</b>	<b>\$200</b>	<b>\$210</b>	<b>\$(116)</b>	<b>\$ 94</b>
<b>Non-amortizing intangible asset</b>						
Kinko's trade name	<b>\$567</b>	<b>\$ —</b>	<b>\$567</b>	<b>\$567</b>	<b>\$ —</b>	<b>\$567</b>

The recoverability of the amounts recorded for FedEx Kinko's goodwill and trade name is dependent on execution of key initiatives related to revenue growth, network expansion and improved profitability.

Amortization expense for intangible assets was \$42 million in 2007, \$25 million in 2006 and \$26 million in 2005. Estimated amortization expense for the next five years is as follows (in millions):

2008	\$55
2009	47
2010	35
2011	22
2012	12

## Note 5: Selected Current Liabilities

The components of selected current liability captions were as follows (in millions):

	May 31,	
	2007	2006
Accrued Salaries and Employee Benefits		
Salaries	\$ 283	\$ 236
Employee benefits	599	655
Compensated absences	472	434
	<b>\$1,354</b>	<b>\$1,325</b>
Accrued Expenses		
Self-insurance accruals	\$ 548	\$ 523
Taxes other than income taxes	310	305
Other	561	562
	<b>\$1,419</b>	<b>\$1,390</b>

## Note 6: Long-Term Debt and Other Financing Arrangements

The components of long-term debt (net of discounts) were as follows (in millions):

	May 31,	
	2007	2006
Senior unsecured debt		
Interest rate of 7.80%, due in 2007	\$ —	\$ 200
Interest rate of 2.65%, due in 2007	—	500
Interest rate of three-month LIBOR plus 0.08% (5.44% at May 31, 2007) due in 2008	500	—
Interest rate of 3.50%, due in 2009	500	500
Interest rate of 5.50%, due in 2010	499	—
Interest rate of 7.25%, due in 2011	249	249
Interest rate of 9.65%, due in 2013	300	300
Interest rate of 7.60%, due in 2098	239	239
Other notes, due in 2007	—	18
	<b>2,287</b>	<b>2,006</b>
Capital lease obligations	<b>308</b>	<b>310</b>
Other debt, interest rates of 3.89% to 9.98% due through 2009	<b>51</b>	<b>126</b>
	<b>2,646</b>	<b>2,442</b>
Less current portion	<b>639</b>	<b>850</b>
	<b>\$2,007</b>	<b>\$1,592</b>

Scheduled annual principal maturities of debt, exclusive of capital leases, for the five years subsequent to May 31, 2007, are as follows (in millions):

2008	\$521
2009	530
2010	500
2011	250
2012	—

On August 2, 2006, we filed an updated shelf registration statement with the SEC. The new registration statement does not limit the amount of any future offering. By using this shelf registration statement, we may sell, in one or more future offerings, any combination of our unsecured debt securities and common stock.

On August 8, 2006, under the new shelf registration statement, we issued \$1 billion of senior unsecured debt, comprised of floating-rate notes totaling \$500 million due in August 2007 and fixed-rate notes totaling \$500 million due in August 2009. The net proceeds were used for working capital and general corporate purposes, including the funding of acquisitions (see Note 3).

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 May 31, 2007, no commercial paper borrowings were outstanding and the entire amount under the credit facility was available.

Long-term debt, exclusive of capital leases, had carrying values of \$2.3 billion compared with an estimated fair value of approximately \$2.4 billion at May 31, 2007, and \$2.1 billion compared with an estimated fair value of \$2.2 billion at May 31, 2006. The estimated fair values were determined based on quoted market prices or on the current rates offered for debt with similar terms and maturities.

Our other debt at May 31, 2006 included \$118 million related to leases for two MD-11 aircraft that were consolidated under the provisions of FIN 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." These assets were held by a separate entity, which was established to lease these aircraft to FedEx Express, and was owned by independent third parties who provide financing through debt and equity participation. FedEx Express purchased these aircraft in March 2007, extinguishing this debt.

We issue other financial instruments in the normal course of business to support our operations. Letters of credit at May 31, 2007 were \$694 million. The amount unused under our letter of credit facility totaled approximately \$30 million at May 31, 2007. This facility expires in July of 2010. These instruments are generally required under certain U.S. self-insurance programs and are used in the normal course of international operations. The underlying liabilities insured by these instruments are reflected in the balance sheets, where applicable. Therefore, no additional liability is reflected for the letters of credit.

Our capital lease obligations include leases for aircraft and facilities. Our facility leases include leases that guarantee the repayment of certain special facility revenue bonds that have been issued by municipalities primarily to finance the acquisition and construction of various airport facilities and equipment. These bonds require interest payments at least annually, with principal payments due at the end of the related lease agreement.

## Note 7: Leases

We utilize certain aircraft, land, facilities and equipment under capital and operating leases that expire at various dates through 2039. We leased approximately 15% of our total aircraft fleet under capital or operating leases as of May 31, 2007. In addition, supplemental aircraft are leased by us under agreements that generally provide for cancellation upon 30 days' notice. Our leased facilities include national, regional and metropolitan sorting facilities, retail facilities and administrative buildings.

The components of property and equipment recorded under capital leases were as follows (in millions):

	May 31,	
	2007	2006
Aircraft	<b>\$115</b>	<b>\$114</b>
Package handling and ground support equipment	<b>165</b>	<b>167</b>
Vehicles	<b>20</b>	<b>34</b>
Other, principally facilities	<b>151</b>	<b>166</b>
	<b>451</b>	<b>481</b>
Less accumulated amortization	<b>306</b>	<b>331</b>
	<b>\$145</b>	<b>\$150</b>

Rent expense under operating leases was as follows (in millions):

	For years ended May 31,		
	2007	2006	2005
Minimum rentals	<b>\$1,916</b>	\$1,919	\$1,793
Contingent rentals <sup>(1)</sup>	<b>241</b>	245	235
	<b>\$2,157</b>	<b>\$2,164</b>	<b>\$2,028</b>

(1) Contingent rentals are based on equipment usage.

A summary of future minimum lease payments under capital leases at May 31, 2007 is as follows (in millions):

2008	<b>\$103</b>
2009	<b>13</b>
2010	<b>97</b>
2011	<b>8</b>
2012	<b>8</b>
Thereafter	<b>137</b>
	<b>366</b>
Less amount representing interest	<b>58</b>
Present value of net minimum lease payments	<b>\$308</b>

A summary of future minimum lease payments under non-cancelable operating leases with an initial or remaining term in excess of one year at May 31, 2007 is as follows (in millions):

	Aircraft and Related Equipment	Facilities and Other	Total
2008	<b>\$ 602</b>	<b>\$1,078</b>	<b>\$ 1,680</b>
2009	<b>555</b>	<b>926</b>	<b>1,481</b>
2010	<b>544</b>	<b>753</b>	<b>1,297</b>
2011	<b>526</b>	<b>617</b>	<b>1,143</b>
2012	<b>504</b>	<b>506</b>	<b>1,010</b>
Thereafter	<b>3,430</b>	<b>3,322</b>	<b>6,752</b>
	<b>\$6,161</b>	<b>\$7,202</b>	<b>\$13,363</b>

The weighted-average remaining lease term of all operating leases outstanding at May 31, 2007 was approximately seven years. 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.

Our results for 2006 included a noncash charge of \$79 million (\$49 million after tax or \$0.16 per diluted share) to adjust the accounting for certain facility leases, predominantly at FedEx Express. This charge, which included the impact on prior years, related primarily to rent escalations in on-airport facility leases that were not being recognized appropriately.

## Note 8: Preferred Stock

Our Certificate of Incorporation authorizes the Board of Directors, at its discretion, to issue up to 4,000,000 shares of preferred stock. The stock is issuable in series, which may vary as to certain rights and preferences, and has no par value. As of May 31, 2007, none of these shares had been issued.

## Note 9: Stock-Based Compensation

We have two types of equity-based compensation: stock options and restricted stock.

### STOCK OPTIONS

Under the provisions of our incentive stock plans, key employees and non-employee directors may be granted options to purchase shares of common stock at a price not less than its fair market value at the date of grant. Options granted have a maximum term of 10 years. Vesting requirements are determined at the discretion of the Compensation Committee of our Board of Directors. Option-vesting periods range from one to four years, with approximately 90% of options granted vesting ratably over four years.

### RESTRICTED STOCK

Under the terms of our incentive stock plans, restricted shares of common stock are awarded to key employees. All restrictions on the shares expire ratably over a four-year period. Shares are valued at the market price at the date of award. Compensation related to these awards is recognized as expense over the explicit service period.

For unvested stock options granted prior to June 1, 2006 and all restricted stock awards, the terms of these awards provide for continued vesting subsequent to the employee's retirement. Compensation expense associated with these awards is recognized on a straight-line basis over the shorter of the remaining service or vesting period. This postretirement vesting provision was removed from all stock option awards granted subsequent to May 31, 2006.

### VALUATION AND ASSUMPTIONS

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 stock price of the award 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 in the accompanying consolidated statements of income.

The key assumptions for the Black-Scholes valuation method include the expected life of the option, stock price volatility, risk-free interest rate, dividend yield and exercise price. Many of these assumptions are judgmental and highly sensitive. The following table describes each assumption, as well as the results of increases in the various assumptions:

Assumption	Change in Assumption	Impact on Fair Value of Option
<b>Expected life of the option</b> – This is the period of time over which the options granted are expected to remain outstanding. Generally, options granted have a maximum term of 10 years. We examine actual stock option exercises to determine the expected life of the options.	Increase	Increase
<b>Expected volatility</b> – Actual changes in the market value of our stock are used to calculate the volatility assumption. We calculate daily market value changes from the date of grant over a past period equal to the expected life of the options to determine volatility.	Increase	Increase
<b>Risk-free interest rate</b> – This is the U.S. Treasury Strip rate posted at the date of grant having a term equal to the expected life of the option.	Increase	Increase
<b>Expected dividend yield</b> – This is the annual rate of dividends per share over the exercise price of the option.	Increase	Decrease

Following is a table of the key weighted-average assumptions used in the valuation calculations for the options granted during the years ended May 31:

	2007	2006	2005
Expected lives	<b>5 years</b>	5 years	4 years
Expected volatility	<b>22%</b>	25%	27%
Risk-free interest rate	<b>4.879%</b>	3.794%	3.559%
Dividend yield	<b>0.3023%</b>	0.3229%	0.3215%

The weighted-average Black-Scholes value of our stock option grants using the assumptions indicated above was \$31.60 per option in 2007, \$25.78 per option in 2006 and \$20.37 per option in 2005. The intrinsic value of options exercised was \$145 million in 2007, \$191 million in 2006 and \$126 million in 2005.

The following table summarizes information about stock option activity for the year ended May 31, 2007:

	Stock Options			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (in millions)
Outstanding at June 1, 2006	17,099,526	\$ 60.82		
Granted	2,094,873	110.25		
Exercised	(2,333,845)	49.55		
Forfeited	(270,153)	89.12		
<b>Outstanding at May 31, 2007</b>	<b>16,590,401</b>	<b>\$ 68.22</b>	<b>5.9 years</b>	<b>\$ 696</b>
Exercisable	10,418,072	\$ 54.75	4.6 years	\$ 577
Expected to Vest	5,678,543	\$ 90.97	8.0 years	\$ 109

The following table summarizes information about vested and unvested restricted stock for the year ended May 31, 2007:

	Restricted Stock	
	Shares	Weighted-Average Grant Date Fair Value
Unvested at June 1, 2006	583,106	\$ 76.97
Granted	175,005	109.90
Vested	(260,821)	69.92
Forfeited	(15,943)	88.69
<b>Unvested at May 31, 2007</b>	<b>481,347</b>	<b>\$ 92.37</b>

During the year ended May 31, 2006, there were 233,939 shares of restricted stock granted with a weighted-average fair value of \$90.12. During the year ended May 31, 2005, there were 218,273 shares of restricted stock granted with a weighted-average fair value of \$80.24.

The following table summarizes information about stock option vesting during the years ended May 31:

	Stock Options	
	Vested during the year	Fair value (in millions)
2005	3,498,853	\$56
2006	3,366,273	59
2007	3,147,642	65

As of May 31, 2007, there was \$129 million of total unrecognized compensation cost, net of estimated forfeitures, related to unvested share-based compensation arrangements. This compensation expense is expected to be recognized on a straight-line basis over the remaining weighted-average vesting period of approximately two years.

At May 31, 2007, there were 7,088,052 shares authorized and available for future grants under our incentive stock plans. The options granted during the year ended May 31, 2007 are primarily related to our principal annual stock option grant in June 2006.

Total shares outstanding or available for grant related to equity compensation at May 31, 2007 represented 7.3% of the total outstanding common and equity compensation shares and equity compensation shares available for grant.

## Note 10: Computation of Earnings Per Share

The calculation of basic and diluted earnings per common share for the years ended May 31 was as follows (in millions, except per share amounts):

	2007	2006	2005
Net income	\$2,016	\$1,806	\$1,449
Weighted-average shares of common stock outstanding	307	304	301
Common equivalent shares:			
Assumed exercise of outstanding dilutive options	18	19	18
Less shares repurchased from proceeds of assumed exercise of options	(14)	(13)	(12)
Weighted-average common and common equivalent shares outstanding	311	310	307
Basic earnings per common share	\$ 6.57	\$ 5.94	\$ 4.81
Diluted earnings per common share	\$ 6.48	\$ 5.83	\$ 4.72

We have excluded from the calculation of diluted earnings per share approximately 368,185 antidilutive options for the year ended May 31, 2007, as the exercise price of each of these options was greater than the average market price of our common stock for the period.

## Note 11: Income Taxes

The components of the provision for income taxes for the years ended May 31 were as follows (in millions):

	2007	2006	2005
Current provision			
Domestic:			
Federal	\$ 829	\$ 719	\$ 634
State and local	72	79	65
Foreign	174	132	103
	1,075	930	802
Deferred provision (benefit)			
Domestic:			
Federal	90	151	67
State and local	27	13	(4)
Foreign	7	(1)	(1)
	124	163	62
	\$1,199	\$1,093	\$864

A reconciliation of the statutory federal income tax rate to the effective income tax rate for the years ended May 31 was as follows:

	2007	2006	2005
Statutory U.S. income tax rate	35.0%	35.0%	35.0%
Increase resulting from:			
State and local income taxes, net of federal benefit	2.0	2.1	1.7
Other, net	0.3	0.6	0.7
Effective tax rate	37.3%	37.7%	37.4%

Our 2007 tax rate of 37.3% was favorably impacted by the conclusion of various state and federal tax audits and appeals. The 2007 rate reduction was partially offset by tax charges incurred as a result of a reorganization in Asia associated with our acquisition in China, as described in Note 3. The 37.4% effective tax rate in 2005 was favorably impacted by the reduction of a valuation allowance on foreign tax credits arising from certain of our international operations as a result of the passage of the American Jobs Creation Act of 2004 and by a lower effective state tax rate.

The significant components of deferred tax assets and liabilities as of May 31 were as follows (in millions):

	2007		2006	
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
Property, equipment, leases and intangibles	\$ 328	\$1,655	\$ 329	\$1,559
Employee benefits	406	53	413	648
Self-insurance accruals	350	—	339	—
Other	346	95	360	78
Net operating loss/credit carryforwards	61	—	64	—
Valuation allowance	(49)	—	(48)	—
	\$1,442	\$1,803	\$1,457	\$2,285

The net deferred tax liabilities as of May 31 have been classified in the balance sheets as follows (in millions):

	2007	2006
Current deferred tax asset	\$ 536	\$ 539
Noncurrent deferred tax liability <sup>(1)</sup>	(897)	(1,367)
	<b>\$ (361)</b>	<b>\$ (828)</b>

*(1) The significant reduction in the noncurrent deferred tax liability in 2007 was primarily related to the impact of our adoption of SFAS 158 discussed in Note 12.*

The valuation allowance primarily represents amounts reserved for operating loss and tax credit carryforwards, which expire over varying periods starting in 2008. As a result of this and other factors, we believe that a substantial portion of these deferred tax assets may not be realized.

## Note 12: 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 retiree healthcare plans. The accounting for pension and healthcare plans includes numerous assumptions, such as: discount rates; expected long-term investment returns on plan assets; future salary increases; employee turnover; mortality; and retirement ages. These assumptions most significantly impact our U.S. domestic pension plan.

In February 2007, we announced changes to modernize certain of our retirement programs over the next two fiscal years. Effective January 1, 2008, we will increase the annual company matching contribution under the largest of our 401(k) plans covering most employees from \$500 to a maximum of 3.5% of eligible compensation. Employees not participating in the 401(k) plan as of January 1, 2008 will be automatically enrolled at 3% of eligible pay with a company match of 2% of eligible pay. Effective May 31, 2008, benefits previously accrued under our primary pension plans using a traditional pension benefit formula will be capped for most employees, and those benefits will be payable beginning at retirement. Beginning June 1, 2008, future pension benefits for most employees will be accrued under a cash balance formula we call the Portable Pension Account. These retirement plan changes were contemplated in our February 28, 2007 actuarial measurement. These changes will not affect the benefits of current retirees. In addition, these pension plans will be modified to accelerate vesting from five years to three years effective June 1, 2008.

A summary of our retirement plans costs over the past three years is as follows (in millions):

	2007	2006	2005
U.S. domestic pension plans	\$442	\$400	\$337
International pension and defined contribution plans	49	45	41
U.S. domestic defined contribution plans	152	147	136
Retiree healthcare plans	55	73	68
	<b>\$698</b>	<b>\$665</b>	<b>\$582</b>

## PENSION PLANS

The largest pension plan covers certain U.S. employees age 21 and over, with at least one year of service. Eligible employees as of May 31, 2003 were given the opportunity to make a one-time election to accrue future pension benefits under either the Portable Pension Account, or a traditional pension benefit formula. Benefits provided under the traditional formula are based on average earnings and years of service. Under the Portable Pension Account, the retirement benefit is expressed as a dollar amount in a notional account that grows with annual credits based on pay, age and years of credited service, and interest on the notional account balance. Eligible employees hired after May 31, 2003 accrue benefits exclusively under the Portable Pension Account. We also sponsor or participate in nonqualified benefit plans covering certain of our U.S. employee groups and other pension plans covering certain of our international employees. The international defined benefit pension plans provide benefits primarily based on final earnings and years of service and are funded in accordance with local practice. Where plans are funded, they are in compliance with local laws.

## DEFINED CONTRIBUTION PLANS

Defined contribution plans are in place covering a majority of U.S. employees and certain international employees. Expense under these plans was \$176 million in 2007, \$167 million in 2006 and \$153 million in 2005.

## POSTRETIREMENT HEALTHCARE PLANS

Certain of our subsidiaries offer medical, dental and vision coverage to eligible U.S. retirees and their eligible dependents. U.S. employees covered by the principal plan become eligible for these benefits at age 55 and older, if they have permanent, continuous service of at least 10 years after attainment of age 45 if hired prior to January 1, 1988, or at least 20 years after attainment of age 35 if hired on or after January 1, 1988. Postretirement healthcare benefits are capped at 150% of the 1993 per capita projected employer cost, which has been reached and, therefore, these benefits are not subject to additional future inflation.

## NEW ACCOUNTING PRONOUNCEMENT

As discussed in Note 1, we adopted the recognition and disclosure provisions of SFAS 158 on May 31, 2007. The adoption of 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 AOCI of unrecognized gains or losses, prior service costs or credits and transition assets or obligations existing at the time of adoption. The funded status is measured as the difference between the fair value of the plan's assets and the projected benefit obligation ("PBO") of the plan. Additionally, SFAS 158 requires the measurement date for plan assets and liabilities to coincide with the sponsor's year-end. We currently use a February 28 measurement date for our plans; therefore, this standard will require us to change our measurement date to May 31. The requirement to measure plan assets and benefit obligations as of our fiscal year-end is effective for FedEx no later than 2009.

As discussed in Note 1, upon adoption of SFAS 158, we recognized assets of \$1 million for our overfunded plans and liabilities of \$1.2 billion for our underfunded plans in our balance sheet at May 31, 2007. In addition, we eliminated the minimum pension liability balance of \$191 million and intangible assets of \$3 million related to our plans that had been recorded prior to adoption. The adoption of SFAS 158 did not affect our operating results in the current period and will not have any effect on operating results in future periods.

We have presented below the incremental effects of adopting SFAS 158 to our balance sheet for the individual line items impacted from this adoption, as of May 31, 2007 (in millions).

	Prior to Adopting SFAS 158	Effect of Adopting SFAS 158	As Reported Under SFAS 158
Prepaid pension cost	\$1,442	\$(1,442)	\$ —
Intangible and other assets	1,240	(2)	1,238
Accrued salaries and employee benefits	1,300	54	1,354
Minimum pension liability	191	(191)	—
Pension, postretirement healthcare and other benefit obligations	907	257	1,164
Deferred income taxes	1,479	(582)	897
Accumulated other comprehensive loss	(48)	(982)	(1,030)

## PENSION PLAN ASSUMPTIONS

Our pension cost is materially affected by the discount rate used to measure pension obligations, the level of plan assets available to fund those obligations and the expected long-term rate of return on plan assets.

We currently use a measurement date of February 28 for our pension and postretirement healthcare plans. Management reviews the assumptions used to measure pension costs on an annual basis. Economic and market conditions at the measurement date impact these assumptions from year to year and it is reasonably possible that material changes in pension cost may be experienced in the future. Additional information about our pension plan can be found in the Critical Accounting Estimates section of Management's Discussion and Analysis.

Actuarial gains or losses are generated for changes in assumptions and to the extent that actual results differ from those assumed. These actuarial gains and losses are amortized over the remaining average service lives of our active employees if they exceed a corridor amount in the aggregate.

Substantially all plan assets are actively managed. The investment strategy for pension plan assets is to utilize a diversified mix of global public and private equity portfolios, together with public and private fixed income portfolios, to earn a long-term investment return that meets our pension plan obligations. Active management strategies are utilized within the plan in an effort to realize investment returns in excess of market indices.

The weighted-average asset allocations for our primary pension plan at February 28 were as follows:

	2007		2006	
	Actual	Target	Actual	Target
Domestic equities	52%	53%	54%	53%
International equities	21	17	20	17
Private equities	3	5	3	5
Total equities	76	75	77	75
Long duration fixed income securities	15	15	14	15
Other fixed income securities	9	10	9	10
	100%	100%	100%	100%

Establishing the expected future rate of investment return on our pension assets is a judgmental matter. Management considers the following factors in determining this assumption:

- the duration of our pension plan liabilities, which drives the investment strategy we can employ with our pension plan assets;
- the types of investment classes in which we invest our pension plan assets and the expected compound return we can reasonably expect those investment classes to earn over the next 10- to 15-year time period (or such other time period that may be appropriate); and
- the investment returns we can reasonably expect our active investment management program to achieve in excess of the returns we could expect if investments were made strictly in indexed funds.

We review the expected long-term rate of return on an annual basis and revise it as appropriate. As part of our strategy to manage future pension cost and net funded status volatility, we are also in the process of re-evaluating our pension investment strategy. Initially, we have decided to move some equity investments out of actively managed funds and into index funds. Also, we are currently evaluating the mix of investments between equities and fixed income securities, the cash flows of which will more closely align with the cash flows of our pension obligations. Based on these considerations, we will reduce our estimated long-term rate of return on plan assets from 9.1% to 8.5% for 2008.

We periodically commission asset/liability studies performed by third-party professional investment advisors and actuaries to assist us in our reviews. These studies project our estimated future pension payments and evaluate the efficiency of the allocation of our pension plan assets into various investment categories. These studies also generate probability-adjusted expected future returns on those assets. The studies performed or updated supported the reasonableness of our expected rate of return of 9.1% for 2007, 2006 and 2005. Our actual returns exceeded this assumption in each of the last three years and for the 15-year period ended February 28, 2007.

The following table provides a reconciliation of the changes in the pension and postretirement healthcare plans' benefit obligations and fair value of assets over the two-year period ended May 31, 2007 and a statement of the funded status as of May 31, 2007 and 2006 (in millions):

	Pension Plans		Postretirement Healthcare Plans	
	2007 <sup>(1)</sup>	2006	2007 <sup>(1)</sup>	2006
<b>Accumulated Benefit Obligation ("ABO")</b>	<b>\$11,559</b>	<b>\$10,090</b>		
<b>Changes in Projected Benefit Obligation ("PBO")</b>				
Projected benefit obligation at the beginning of year	\$12,153	\$10,401	\$ 475	\$ 537
Service cost	540	473	31	42
Interest cost	707	642	28	32
Actuarial loss (gain)	590	858	9	(109)
Benefits paid	(261)	(228)	(40)	(39)
Amendments	(1,551)	1	5	—
Other	31	6	17	12
Projected benefit obligation at the end of year	\$12,209	\$12,153	\$ 525	\$ 475
<b>Change in Plan Assets</b>				
Fair value of plan assets at beginning of year	\$10,130	\$ 8,826	\$ —	\$ —
Actual return on plan assets	1,086	1,034	—	—
Company contributions	524	492	23	27
Benefits paid	(261)	(228)	(40)	(39)
Other	27	6	17	12
Fair value of plan assets at end of year	\$11,506	\$10,130	\$ —	\$ —
<b>Funded Status of the Plans</b>	<b>\$ (703)</b>	<b>\$ (2,023)</b>	<b>\$ (525)</b>	<b>\$ (475)</b>
Unrecognized net actuarial loss (gain)	— <sup>(2)</sup>	3,026	— <sup>(2)</sup>	(110)
Unamortized prior service cost (credit)	— <sup>(2)</sup>	88	— <sup>(2)</sup>	(3)
Unrecognized net transition amount	— <sup>(2)</sup>	(3)	— <sup>(2)</sup>	—
Employer contributions after measurement date	22	8	4	5
Net amount recognized	\$ (681)	\$ 1,096	\$ (521)	\$ (583)
<b>Amount Recognized in the Balance Sheet at May 31:</b>				
Prepaid benefit cost	\$ — <sup>(2)</sup>	\$ 1,349	\$ — <sup>(2)</sup>	\$ —
Noncurrent pension assets	1	—	—	—
Current pension, postretirement healthcare and other benefit obligations	(24)	—	(30)	—
Accrued benefit liability	— <sup>(2)</sup>	(253)	— <sup>(2)</sup>	(583)
Minimum pension liability	— <sup>(2)</sup>	(122)	— <sup>(2)</sup>	—
Noncurrent pension, postretirement healthcare and other benefit obligations	(658)	—	(491)	—
Accumulated other comprehensive income	— <sup>(2)</sup>	112 <sup>(3)</sup>	— <sup>(2)</sup>	—
Intangible asset	— <sup>(2)</sup>	10	— <sup>(2)</sup>	—
Net amount recognized	\$ (681)	\$ 1,096	\$ (521)	\$ (583)
<b>Amounts Recognized in AOCI and not yet reflected in Net Periodic Benefit Cost:</b>				
Net actuarial loss (gain)	\$ 3,324		\$ (97)	
Prior service (credit) cost	(1,475)		2	
Transition amount	(2)		—	
Total	\$ 1,847		\$ (95)	
<b>Amounts Recognized in AOCI and not yet reflected in Net Periodic Benefit Cost expected to be amortized in next year's Net Periodic Benefit Cost:</b>				
Net actuarial loss (gain)	\$ 167		\$ (3)	
Prior service credit	(113)		—	
Transition amount	(1)		—	
Total	\$ 53		\$ (3)	

(1) Incorporates the provisions of SFAS 158 adopted on May 31, 2007.

(2) Not applicable for 2007 due to adoption of SFAS 158.

(3) The minimum pension liability component of Accumulated Other Comprehensive Income for 2006 is shown in the Statement of Changes in Stockholders' Investment and Comprehensive Income, net of deferred taxes.

Our pension plans included the following components at May 31, 2007 and 2006 (in millions):

	ABO	PBO	Fair Value of Plan Assets	Funded Status	Other <sup>(2)</sup>	Net Amount Recognized
<b>2007<sup>(1)</sup></b>						
Qualified	\$10,926	\$11,487	\$11,300	\$ (187)	\$ —	\$ (187)
Nonqualified	314	326	—	(326)	16 <sup>(3)</sup>	(310)
International Plans	319	396	206	(190)	6 <sup>(3)</sup>	(184)
Total	\$11,559	\$12,209	\$11,506	\$ (703)	\$ 22 <sup>(3)</sup>	\$ (681)
<b>2006</b>						
Qualified	\$ 9,591	\$11,569	\$ 9,969	\$ (1,600)	\$ 2,932	\$ 1,332
Nonqualified	239	271	—	(271)	123	(148)
International Plans	260	313	161	(152)	64	(88)
Total	\$ 10,090	\$12,153	\$ 10,130	\$ (2,023)	\$ 3,119	\$ 1,096

(1) Incorporates the provisions of SFAS 158 adopted on May 31, 2007.

(2) Amounts in "Other" consist of unrecognized net actuarial loss, unamortized prior service cost, unrecognized net transition amount and employer contributions after measurement date.

(3) Amounts in "Other" for 2007 represent only employer contributions after measurement date, as unrecognized net actuarial loss, unamortized prior service cost and unrecognized net transition amount were not applicable in 2007 due to adoption of SFAS 158.

The PBO is the actuarial present value of benefits attributable to employee service rendered to date, including the effects of estimated future pay increases. The ABO also reflects the actuarial present value of benefits attributable to employee service rendered to date, but does not include the effects of estimated future pay increases. Therefore, the ABO as compared to plan assets is an indication of the assets currently available to fund vested and nonvested benefits accrued through May 31.

Prior to SFAS 158, the measure of whether a pension plan was underfunded for recognition of a liability under financial accounting requirements was based on a comparison of the ABO to the fair value of plan assets and amounts accrued for such benefits in the balance sheets. With the adoption of SFAS 158, the funded status is measured as the difference between the fair value of the plan's assets and the projected benefit obligation of the plan.

At May 31, 2007 and 2006, the projected benefit obligation, the accumulated benefit obligation, and the fair value of plan assets for pension plans with a projected benefit obligation in excess of plan assets, and for pension plans with an accumulated benefit obligation in excess of plan assets were as follows (in millions):

	PBO Exceeds the Fair Value of Plan Assets	
	2007	2006
Pension Benefits		
PBO	\$12,085	\$12,153
Fair Value of Plan Assets	11,381	10,130
	ABO Exceeds the Fair Value of Plan Assets	
	2007	2006
Pension Benefits		
PBO	\$727	\$584
ABO	637	498
Fair Value of Plan Assets	206	161

The accumulated postretirement benefit obligation exceeds plan assets for all of our postretirement healthcare plans.

Plan funding is actuarially determined and is subject to certain tax law limitations. International defined benefit pension plans provide benefits primarily based on final earnings or final average earnings and years of service and are funded in accordance with local practice. Where plans are funded, they are in compliance with local laws and income tax regulations. Amounts contributed to these plans are generally not recoverable by us. Although not legally required, we made \$482 million in tax-deductible voluntary contributions to our qualified U.S. pension plans in 2007 compared to total tax-deductible voluntary contributions of \$456 million in 2006. We expect approximately \$10 million of contributions to such plans to be legally required in 2008, and we currently expect to make tax-deductible voluntary contributions in 2008 at levels approximating those in 2007.

We have certain nonqualified defined benefit pension plans that are not funded because such funding provides no current tax deduction and would be deemed current compensation to plan participants. Primarily related to those plans and certain international plans, we have ABOs aggregating approximately \$632 million at May 31, 2007 and \$499 million at May 31, 2006 and PBOs aggregating approximately \$722 million at May 31, 2007 and \$584 million at May 31, 2006, with assets of \$206 million at May 31, 2007 and \$161 million at May 31, 2006. Plans with this funded status resulted in the recognition of a minimum pension liability in our balance sheets prior to adopting SFAS 158. This minimum liability was \$122 million at May 31, 2006.

At the end of 2007 and prior to our adoption of SFAS 158, we recorded a minimum pension liability on a plan-by-plan basis for many of our pension plans for the amount by which the ABO exceeded the fair value of the plan assets, after adjusting for previously recorded accrued or prepaid pension cost for the plan. We subsequently eliminated the minimum pension liability balance and intangible assets related to our plans that had been recorded prior to adoption. The minimum liability eliminated at May 31, 2007 was \$191 million.

Net periodic benefit cost for the three years ended May 31 and amounts recognized in other comprehensive income for 2007 were as follows (in millions):

	Pension Plans			Postretirement Healthcare Plans		
	2007	2006	2005	2007	2006	2005
Service cost	\$ 540	\$ 473	\$ 417	\$31	\$42	\$37
Interest cost	707	642	579	28	32	32
Expected return on plan assets	(930)	(811)	(707)	—	—	—
Recognized actuarial losses (gains) and other	150	121	72	(4)	(1)	(1)
	<b>\$ 467</b>	<b>\$ 425</b>	<b>\$ 361</b>	<b>\$55</b>	<b>\$73</b>	<b>\$68</b>

Increases in pension costs from the prior year are primarily the result of changes in discount rate.

Weighted-average actuarial assumptions for our primary U.S. plans, which comprise substantially all of our projected benefit obligations, are as follows:

	Pension Plans			Postretirement Healthcare Plans		
	2007	2006	2005	2007	2006	2005
Discount rate	6.012%	5.912%	6.285%	6.084%	6.080%	6.160%
Rate of increase in future compensation levels	4.47	3.46	3.15	—	—	—
Expected long-term rate of return on assets	9.10	9.10	9.10	—	—	—

Benefit payments, which reflect expected future service, are expected to be paid as follows for the years ending May 31 (in millions):

	Pension Plans	Postretirement Healthcare Plans
2008	\$ 303	\$ 30
2009	334	30
2010	407	32
2011	434	34
2012	510	35
2013-2017	3,910	213

These estimates are based on assumptions about future events. Actual benefit payments may vary significantly from these estimates.

Future medical benefit claims costs are estimated to increase at an annual rate of 11% during 2008, decreasing to an annual growth rate of 5% in 2019 and thereafter. Future dental benefit costs are estimated to increase at an annual rate of 6.25% during 2008, decreasing to an annual growth rate of 5% in 2013 and thereafter. A 1% change in these annual trend rates would not have a significant impact on the accumulated postretirement benefit obligation at May 31, 2007 or 2007 benefit expense because the level of these benefits is capped.

## Note 13: Business Segment Information

Our operations for the periods presented are primarily represented by FedEx Express, FedEx Ground, the FedEx Freight LTL Group and FedEx Kinko's. These businesses represent our major service lines and form the core of our reportable segments. Other business units in the FedEx portfolio are FedEx Trade Networks, FedEx SmartPost, FedEx Supply Chain Services, FedEx Custom Critical and Caribbean Transportation Services. Management evaluates segment financial performance based on operating income.

As of May 31, 2007, our reportable segments included 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 Kinko's Segment</b>	FedEx Kinko's (document solutions and business services)

FedEx Services provides customer-facing sales, marketing and information technology support, primarily for FedEx Express and FedEx Ground. The costs for these functions are allocated based on metrics such as relative revenues or estimated services provided. We also allocate costs for administrative functions provided between operating companies and certain other costs, such as those associated with services received for general corporate oversight, including executive officers and certain legal and finance functions. We believe these allocations approximate the cost of providing these functions.

In addition, 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 that 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. FedEx Kinko's segment revenues include package acceptance revenue, which represents the fee received by FedEx Kinko's from FedEx Express and FedEx Ground for accepting and handling packages at FedEx Kinko's locations on behalf of these operating companies. Package acceptance revenue does not include the external revenue associated with the actual shipments. All shipment revenues are reflected in the segment performing the transportation services. 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.

Effective June 1, 2006, we moved the credit, collections and customer service functions with responsibility for FedEx Express and FedEx Ground customer information from FedEx Express into a newly formed subsidiary of FedEx Services named FedEx Customer Information Services, Inc. Also, effective June 1, 2006, we moved FedEx Supply Chain Services, Inc., the results of which were previously reported in the FedEx Ground segment, into a new subsidiary of FedEx Services named FedEx Global Supply Chain Services, Inc. The costs of providing these customer service functions and the net operating costs of FedEx Global Supply Chain Services are allocated back to the FedEx Express and FedEx Ground segments. Prior year amounts have not been reclassified to conform to the current year segment presentation, as the financial results of all segments are materially comparable.

The following table provides a reconciliation of reportable segment revenues, depreciation and amortization, operating income and segment assets to consolidated financial statement totals for the years ended or as of May 31 (in millions):

	FedEx Express Segment	FedEx Ground Segment	FedEx Freight Segment <sup>(1)</sup>	FedEx Kinko's Segment	Other and Eliminations	Consolidated Total
<b>Revenues</b>						
<b>2007</b>	<b>\$22,681</b>	<b>\$6,043</b>	<b>\$4,586</b>	<b>\$2,040</b>	<b>\$ (136)</b>	<b>\$35,214</b>
2006	21,446	5,306	3,645	2,088	(191)	32,294
2005	19,485	4,680	3,217	2,066	(85)	29,363
<b>Depreciation and amortization</b>						
<b>2007</b>	<b>\$ 856</b>	<b>\$ 268</b>	<b>\$ 195</b>	<b>\$ 139</b>	<b>\$ 284</b>	<b>\$ 1,742</b>
2006	805	224	120	148	253	1,550
2005	798	176	102	138	248	1,462
<b>Operating income</b>						
<b>2007<sup>(2)</sup></b>	<b>\$ 1,955</b>	<b>\$ 813</b>	<b>\$ 463</b>	<b>\$ 45</b>	<b>\$ –</b>	<b>\$ 3,276</b>
2006 <sup>(3)</sup>	1,767	705	485	57	–	3,014
2005 <sup>(4)</sup>	1,414	604	354	100	(1)	2,471
<b>Segment assets<sup>(5)</sup></b>						
<b>2007</b>	<b>\$15,650</b>	<b>\$3,937</b>	<b>\$3,150</b>	<b>\$2,957</b>	<b>\$(1,694)</b>	<b>\$24,000</b>
2006	14,673	3,378	2,245	2,941	(547)	22,690
2005	13,130	2,776	2,047	2,987	(536)	20,404

(1) Includes the operations of FedEx National LTL from the date of acquisition, September 3, 2006.

(2) FedEx Express operating expenses include a \$143 million charge associated with upfront compensation and benefits under the new pilot labor contract.

(3) Includes a \$79 million one-time, noncash charge to adjust the accounting for certain facility leases (\$75 million at FedEx Express).

(4) Includes \$48 million related to the Airline Stabilization Act charge.

(5) Segment assets include intercompany receivables.

The following table provides a reconciliation of reportable segment capital expenditures to consolidated totals for the years ended May 31 (in millions):

	FedEx Express Segment	FedEx Ground Segment	FedEx Freight Segment	FedEx Kinko's Segment	Other	Consolidated Total
<b>2007</b>	<b>\$1,672</b>	<b>\$489</b>	<b>\$287</b>	<b>\$157</b>	<b>\$277</b>	<b>\$2,882</b>
2006	1,408	487	274	94	255	2,518
2005	1,195	456	217	152	216	2,236

The following table presents revenue by service type and geographic information for the years ended or as of May 31 (in millions):

Revenue by Service Type	2007	2006	2005
FedEx Express segment:			
Package:			
U.S. overnight box	\$ 6,485	\$ 6,422	\$ 5,969
U.S. overnight envelope	1,990	1,974	1,798
U.S. deferred	2,883	2,853	2,799
Total domestic package revenue	11,358	11,249	10,566
International Priority (IP) <sup>(1)</sup>	6,722	6,139	5,464
Total package revenue	18,080	17,388	16,030
Freight:			
U.S.	2,412	2,218	1,854
International priority freight <sup>(1)</sup>	1,045	840	670
International airfreight	394	434	381
Total freight revenue	3,851	3,492	2,905
Other <sup>(2)</sup>	750	566	550
Total FedEx Express segment	22,681	21,446	19,485
FedEx Ground segment	6,043	5,306	4,680
FedEx Freight segment <sup>(3)</sup>	4,586	3,645	3,217
FedEx Kinko's segment	2,040	2,088	2,066
Other and Eliminations	(136)	(191)	(85)
	\$35,214	\$32,294	\$29,363
<b>Geographical Information<sup>(4)</sup></b>			
Revenues:			
U.S.	\$26,132	\$24,172	\$22,146
International	9,082	8,122	7,217
	\$35,214	\$32,294	\$29,363
Noncurrent assets:			
U.S.	\$14,191	\$13,804	\$13,020
International	3,180	2,422	2,115
	\$17,371	\$16,226	\$15,135

(1) We reclassified certain prior period international priority freight service revenues previously included within IP package revenues to international priority freight revenues to conform to the current period presentation and more precisely present the nature of the services provided.

(2) Other revenues includes FedEx Trade Networks and our international domestic express businesses, such as ANC, DTW Group and our Canadian domestic express operations.

(3) Includes the operations of FedEx National LTL from the date of acquisition, September 3, 2006.

(4) International revenue includes shipments that either originate in or are destined to locations outside the United States. Noncurrent assets include property and equipment, goodwill and other long-term assets. Flight equipment is allocated between geographic areas based on usage.

## Note 14: Supplemental Cash Flow Information

Cash paid for interest expense and income taxes for the years ended May 31 was as follows (in millions):

	2007	2006	2005
Interest (net of capitalized interest)	\$ 136	\$145	\$162
Income taxes	1,064	880	824

## Note 15: Guarantees and Indemnifications

In conjunction with certain transactions, primarily the lease, sale or purchase of operating assets or services in the ordinary course of business, we may provide routine indemnifications (e.g., environmental, fuel, tax and software infringement), the terms of which range in duration and are often not limited. With the exception of residual value guarantees in certain operating leases (described below), a maximum obligation is generally not specified in our guarantees and indemnifications. As a result, the overall maximum potential amount of the obligation under such guarantees and indemnifications cannot be reasonably estimated. Historically, we have not been required to make significant payments under our guarantee or indemnification obligations and no amounts have been recognized in our financial statements for the underlying fair value of these obligations.

We have guarantees under certain operating leases, amounting to \$17 million as of May 31, 2007, for the residual values of vehicles and facilities at the end of the respective operating lease periods. Under these leases, if the fair market value of the leased asset at the end of the lease term is less than an agreed-upon value as set forth in the related operating lease agreement, we will be responsible to the lessor for the amount of such deficiency. Based upon our expectation that none of these leased assets will have a residual value at the end of the lease term that is materially less than the value specified in the related operating lease agreement, we do not believe it is probable that we will be required to fund material amounts under the terms of these guarantee arrangements. Accordingly, no material accruals have been recognized for these guarantees.

Special facility revenue bonds have been issued by certain municipalities primarily to finance the acquisition and construction of various airport facilities and equipment. These facilities were leased to us and are accounted for as either capital leases or operating leases. FedEx Express has unconditionally guaranteed \$755 million in principal of these bonds (with total future principal and interest payments of approximately \$1.1 billion as of May 31, 2007) through these leases. Of the \$755 million bond principal guaranteed, \$204 million was included in capital lease obligations in our balance sheet at May 31, 2007. The remaining \$551 million has been accounted for as operating leases.

## Note 16: Commitments

Annual purchase commitments under various contracts as of May 31, 2007 were as follows (in millions):

	Aircraft	Aircraft-Related <sup>(1)</sup>	Other <sup>(2)</sup>	Total
2008	\$482	\$150	\$650	\$1,282
2009	788	157	166	1,111
2010	907	146	97	1,150
2011	640	3	61	704
2012	31	—	55	86
Thereafter	—	—	164	164

(1) Primarily aircraft modifications.

(2) Primarily vehicles, facilities, computers and advertising and promotion contracts.

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 non-cancelable commitments to modify such aircraft. Open purchase orders that are cancelable are not considered unconditional purchase obligations for financial reporting purposes.

In September 2006, we announced a \$2.6 billion multi-year program to acquire and modify approximately 90 Boeing 757-200 ("B757") aircraft to replace our narrow-body fleet of Boeing 727-200 aircraft. We expect to bring the new aircraft into service during the eight-year period between calendar years 2008 and 2016 contingent upon identification and purchase of suitable B757 aircraft. As of May 31, 2007, we had entered into agreements to purchase 30 B757 aircraft under this program.

In November 2006, we entered into an agreement to acquire 15 new Boeing 777 Freighter ("B777F") aircraft and an option to purchase an additional 15 B777F aircraft. In connection with the decision to purchase these aircraft, we cancelled our order of 10 Airbus A380-800F aircraft. In March 2007, we entered into a separate settlement agreement with Airbus that, among other things, provides us with credit memoranda applicable to the purchase of goods and services in the future. The net impact of this settlement was immaterial to our 2007 results and was recorded as an operating gain during the fourth quarter of 2007.

Deposits and progress payments of \$109 million have been made toward aircraft purchases, options to purchase additional aircraft and other planned aircraft-related transactions. 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 May 31, 2007, with the year of expected delivery:

	A300	A310	B757	B777F	Total
2008	9	2	7	—	18
2009	3	—	13	—	16
2010	—	—	4	6	10
2011	—	—	3	9	12
2012	—	—	3	—	3
Thereafter	—	—	—	—	—
Total	12	2	30	15	59

## Note 17: Contingencies

*Wage-and-Hour.* We are a defendant in a number of lawsuits filed in federal or California state courts containing various class-action allegations under federal or California wage-and-hour laws. The plaintiffs in these lawsuits allege, among other things, that they were forced to work "off the clock," were not paid overtime and were not provided work breaks or other benefits. The plaintiffs generally seek unspecified monetary damages, injunctive relief, or both. We have denied any liability and intend to vigorously defend ourselves. Given the nature and preliminary status of these wage-and-hour claims, we cannot yet determine the amount or a reasonable range of potential loss in these matters, if any.

*Independent Contractor.* FedEx Ground is involved in numerous purported class-action lawsuits and other proceedings that claim that the company's owner-operators should be treated as employees, rather than independent contractors. These matters include *Estrada v. FedEx Ground*, a class action involving single work area contractors that was filed in California state court. Although the trial court granted some of the plaintiffs' claims for relief in *Estrada* (\$18 million, inclusive of attorney's fees, plus equitable relief), the appellate court has reversed the trial court's issuance of equitable relief. The plaintiffs petitioned the California Supreme Court for a review of the appellate court decision, and that petition was denied. The rest of the appeal is pending.

Adverse determinations in these matters could, among other things, entitle certain of our contractors to the reimbursement of certain expenses and to the benefit of wage-and-hour laws and result in employment and withholding tax liability for FedEx Ground. On August 10, 2005, the Judicial Panel on Multi-District Litigation granted our motion to transfer and consolidate the majority of the class-action lawsuits for administration of the pre-trial proceedings by a single federal court – the U.S. District Court for the Northern District of Indiana. We strongly believe that FedEx Ground's owner-operators are properly classified as independent contractors and that we will prevail in these proceedings. Given the nature and preliminary status of these claims, we cannot yet determine the amount or a reasonable range of potential loss in these matters, if any.

*Race Discrimination.* During the fourth quarter of 2007, we settled *Satchell v. FedEx Express*, a class-action lawsuit in California that alleged discrimination by FedEx Express in the Western region of the United States against certain current and former minority employees in pay and promotion. The settlement will require a payment of approximately \$55 million by FedEx Express, which is covered by insurance. The court has granted preliminary approval of the settlement, and a hearing is scheduled for August 2007 for the court to consider final approval of the settlement.

*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 materially adversely affect our financial position, results of operations or cash flows.

## Note 18: Related Party Transactions

Two of our sponsorships of professional sports venues involve related parties. Our Chairman, President and Chief Executive Officer, Frederick W. Smith, currently holds an approximate 10% ownership interest in the National Football League Washington Redskins professional football team ("Redskins") and is a member of its board of directors. FedEx has a multi-year naming rights agreement with the Redskins granting us certain marketing rights, including the right to name the Redskins' stadium "FedExField."

A member of our Board of Directors, J.R. Hyde, III, and his wife together own approximately 13% of HOOPS, L.P. ("HOOPS"), the owner of the NBA Memphis Grizzlies professional basketball team. FedEx has a naming rights agreement with HOOPS granting us certain marketing rights, including the right to name the Grizzlies' arena "FedEx Forum." Pursuant to a separate 25-year agreement with HOOPS, the City of Memphis and Shelby County, FedEx has agreed to pay \$2.5 million a year for the balance of the term if HOOPS terminates its lease for the arena after 17 years.

## Note 19: Summary of Quarterly Operating Results (Unaudited)

(in millions, except per share amounts)	First Quarter <sup>(1)</sup>	Second Quarter <sup>(2)</sup>	Third Quarter	Fourth Quarter
<b>2007</b>				
Revenues	<b>\$8,545</b>	<b>\$8,926</b>	<b>\$8,592</b>	<b>\$9,151</b>
Operating income	<b>784</b>	<b>839</b>	<b>641</b>	<b>1,012</b>
Net income	<b>475</b>	<b>511</b>	<b>420</b>	<b>610</b>
Basic earnings per common share	<b>1.55</b>	<b>1.67</b>	<b>1.37</b>	<b>1.98</b>
Diluted earnings per common share	<b>1.53</b>	<b>1.64</b>	<b>1.35</b>	<b>1.96</b>
<b>2006</b>				
Revenues	<b>\$7,707</b>	<b>\$8,090</b>	<b>\$8,003</b>	<b>\$8,494</b>
Operating income	<b>584</b>	<b>790</b>	<b>713</b>	<b>927</b>
Net income	<b>339</b>	<b>471</b>	<b>428</b>	<b>568</b>
Basic earnings per common share	<b>1.12</b>	<b>1.55</b>	<b>1.41</b>	<b>1.86</b>
Diluted earnings per common share	<b>1.10</b>	<b>1.53</b>	<b>1.38</b>	<b>1.82</b>

*(1) Results for the first quarter of 2006 include a \$79 million (\$49 million, net of tax, or \$0.16 per diluted share) charge to adjust the accounting for certain facility leases, predominantly at FedEx Express, as described in Note 7.*

*(2) Results for the second quarter of 2007 include a \$143 million charge at FedEx Express associated with upfront compensation and benefits under the new labor contract with our pilots. Additionally, FedEx National LTL's financial results have been included from September 3, 2006 (the date of acquisition).*

## Note 20: 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 be exempt from reporting under the Securities Exchange Act of 1934.

The guarantor subsidiaries, which are wholly owned by FedEx, guarantee approximately \$1.7 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):

### CONDENSED CONSOLIDATING BALANCE SHEETS

	May 31, 2007				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
<b>Current Assets</b>					
Cash and cash equivalents	\$ 1,212	\$ 124	\$ 233	\$ –	\$ 1,569
Receivables, less allowances	–	3,083	894	(35)	3,942
Spare parts, fuel, supplies, prepaid expenses and other, less allowances	7	500	75	–	582
Deferred income taxes	–	505	31	–	536
Total current assets	1,219	4,212	1,233	(35)	6,629
<b>Property and Equipment, at Cost</b>					
Less accumulated depreciation and amortization	14	13,422	1,018	–	14,454
Net property and equipment	8	11,259	1,369	–	12,636
Intercompany Receivable	–	511	952	(1,463)	–
Goodwill	–	2,667	830	–	3,497
Investment in Subsidiaries	14,588	3,340	–	(17,928)	–
Other Assets	670	457	755	(644)	1,238
	<b>\$16,485</b>	<b>\$22,446</b>	<b>\$5,139</b>	<b>\$(20,070)</b>	<b>\$24,000</b>
<b>LIABILITIES AND STOCKHOLDERS' INVESTMENT</b>					
<b>Current Liabilities</b>					
Current portion of long-term debt	\$ 551	\$ 85	\$ 3	\$ –	\$ 639
Accrued salaries and employee benefits	60	1,079	215	–	1,354
Accounts payable	37	1,563	448	(32)	2,016
Accrued expenses	36	1,197	189	(3)	1,419
Total current liabilities	684	3,924	855	(35)	5,428
Long-Term Debt, Less Current Portion	1,248	398	361	–	2,007
Intercompany Payable	1,463	–	–	(1,463)	–
<b>Other Liabilities</b>					
Deferred income taxes	–	1,262	279	(644)	897
Other liabilities	451	2,445	116	–	3,012
Total other long-term liabilities	451	3,707	395	(644)	3,909
Stockholders' Investment	12,639	14,417	3,528	(17,928)	12,656
	<b>\$16,485</b>	<b>\$22,446</b>	<b>\$5,139</b>	<b>\$(20,070)</b>	<b>\$24,000</b>

## CONDENSED CONSOLIDATING BALANCE SHEETS

	May 31, 2006				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
<b>Current Assets</b>					
Cash and cash equivalents	\$ 1,679	\$ 114	\$ 144	\$ –	\$ 1,937
Receivables, less allowances	–	2,864	681	(29)	3,516
Spare parts, fuel, supplies, prepaid expenses and other, less allowances	7	423	42	–	472
Deferred income taxes	–	522	17	–	539
Total current assets	1,686	3,923	884	(29)	6,464
<b>Property and Equipment, at Cost</b>	22	22,430	1,622	–	24,074
Less accumulated depreciation and amortization	12	12,410	882	–	13,304
Net property and equipment	10	10,020	740	–	10,770
<b>Intercompany Receivable</b>	–	680	1,399	(2,079)	–
<b>Goodwill</b>	–	2,675	150	–	2,825
<b>Prepaid Pension Cost</b>	1,310	18	21	–	1,349
<b>Investment in Subsidiaries</b>	12,301	2,070	–	(14,371)	–
<b>Other Assets</b>	69	571	675	(33)	1,282
	\$15,376	\$19,957	\$3,869	\$(16,512)	\$22,690
<b>LIABILITIES AND STOCKHOLDERS' INVESTMENT</b>					
<b>Current Liabilities</b>					
Current portion of long-term debt	\$ 700	\$ 150	\$ –	\$ –	\$ 850
Accrued salaries and employee benefits	50	1,107	168	–	1,325
Accounts payable	33	1,594	310	(29)	1,908
Accrued expenses	37	1,221	132	–	1,390
Total current liabilities	820	4,072	610	(29)	5,473
<b>Long-Term Debt, Less Current Portion</b>	749	843	–	–	1,592
<b>Intercompany Payable</b>	2,079	–	–	(2,079)	–
<b>Other Liabilities</b>					
Deferred income taxes	–	1,143	257	(33)	1,367
Other liabilities	226	2,447	74	–	2,747
Total other long-term liabilities	226	3,590	331	(33)	4,114
<b>Stockholders' Investment</b>	11,502	11,452	2,928	(14,371)	11,511
	\$15,376	\$19,957	\$3,869	\$(16,512)	\$22,690

## CONDENSED CONSOLIDATING STATEMENTS OF INCOME

	Year Ended May 31, 2007				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>REVENUES</b>	\$ –	\$29,894	\$5,671	\$ (351)	\$35,214
<b>Operating Expenses:</b>					
Salaries and employee benefits	103	11,632	2,005	–	13,740
Purchased transportation	–	2,964	944	(35)	3,873
Rentals and landing fees	3	2,082	261	(3)	2,343
Depreciation and amortization	2	1,513	227	–	1,742
Fuel	–	3,317	216	–	3,533
Maintenance and repairs	1	1,830	121	–	1,952
Intercompany charges, net	(193)	(170)	363	–	–
Other	84	4,133	851	(313)	4,755
	–	27,301	4,988	(351)	31,938
<b>Operating Income</b>	–	2,593	683	–	3,276
<b>Other Income (Expense):</b>					
Equity in earnings of subsidiaries	2,016	390	–	(2,406)	–
Interest, net	(22)	(29)	(2)	–	(53)
Intercompany charges, net	29	(34)	5	–	–
Other, net	(7)	–	(1)	–	(8)
<b>Income Before Income Taxes</b>	2,016	2,920	685	(2,406)	3,215
Provision for income taxes	–	971	228	–	1,199
<b>Net Income</b>	<b>\$2,016</b>	<b>\$ 1,949</b>	<b>\$ 457</b>	<b>\$(2,406)</b>	<b>\$ 2,016</b>

	Year Ended May 31, 2006				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>REVENUES</b>	\$ –	\$28,310	\$4,325	\$ (341)	\$32,294
<b>Operating Expenses:</b>					
Salaries and employee benefits	81	11,046	1,444	–	12,571
Purchased transportation	–	2,642	627	(18)	3,251
Rentals and landing fees	4	2,163	226	(3)	2,390
Depreciation and amortization	2	1,401	147	–	1,550
Fuel	–	3,128	128	–	3,256
Maintenance and repairs	1	1,709	67	–	1,777
Intercompany charges, net	(164)	(229)	393	–	–
Other	76	4,008	721	(320)	4,485
	–	25,868	3,753	(341)	29,280
<b>Operating Income</b>	–	2,442	572	–	3,014
<b>Other Income (Expense):</b>					
Equity in earnings of subsidiaries	1,806	327	–	(2,133)	–
Interest, net	(47)	(57)	–	–	(104)
Intercompany charges, net	55	(78)	23	–	–
Other, net	(8)	(4)	1	–	(11)
<b>Income Before Income Taxes</b>	1,806	2,630	596	(2,133)	2,899
Provision for income taxes	–	876	217	–	1,093
<b>Net Income</b>	<b>\$1,806</b>	<b>\$ 1,754</b>	<b>\$ 379</b>	<b>\$(2,133)</b>	<b>\$ 1,806</b>

## CONDENSED CONSOLIDATING STATEMENTS OF INCOME

	Year Ended May 31, 2005				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>REVENUES</b>	\$ –	\$25,859	\$3,927	\$ (423)	\$29,363
<b>Operating Expenses:</b>					
Salaries and employee benefits	86	10,523	1,354	–	11,963
Purchased transportation	–	2,388	583	(36)	2,935
Rentals and landing fees	3	2,088	211	(3)	2,299
Depreciation and amortization	1	1,324	137	–	1,462
Fuel	–	2,231	86	–	2,317
Maintenance and repairs	1	1,625	69	–	1,695
Intercompany charges, net	(172)	(132)	304	–	–
Other	81	3,804	720	(384)	4,221
	–	23,851	3,464	(423)	26,892
<b>Operating Income</b>	–	2,008	463	–	2,471
<b>Other Income (Expense):</b>					
Equity in earnings of subsidiaries	1,449	244	–	(1,693)	–
Interest, net	(79)	(58)	(2)	–	(139)
Intercompany charges, net	90	(98)	8	–	–
Other, net	(11)	(5)	(3)	–	(19)
<b>Income Before Income Taxes</b>	1,449	2,091	466	(1,693)	2,313
Provision for income taxes	–	695	169	–	864
<b>Net Income</b>	<b>\$1,449</b>	<b>\$ 1,396</b>	<b>\$ 297</b>	<b>\$(1,693)</b>	<b>\$ 1,449</b>

## CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

	Year Ended May 31, 2007				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>\$ (57)</b>	<b>\$ 2,741</b>	<b>\$ 879</b>	<b>\$ –</b>	<b>\$ 3,563</b>
<b>INVESTING ACTIVITIES</b>					
Capital expenditures	(1)	(2,631)	(250)	–	(2,882)
Business acquisitions, net of cash acquired	(175)	(36)	(1,099)	–	(1,310)
Proceeds from asset dispositions	–	47	21	–	68
Cash Used in Investing Activities	(176)	(2,620)	(1,328)	–	(4,124)
<b>FINANCING ACTIVITIES</b>					
Net transfers (to) from Parent	(578)	40	538	–	–
Principal payments on debt	(700)	(206)	–	–	(906)
Proceeds from debt issuance	999	55	–	–	1,054
Proceeds from stock issuances	115	–	–	–	115
Excess tax benefits on the exercise of stock options	45	–	–	–	45
Dividends paid	(110)	–	–	–	(110)
Other, net	(5)	–	–	–	(5)
Cash Provided by (Used in) Financing Activities	(234)	(111)	538	–	193
<b>CASH AND CASH EQUIVALENTS</b>					
Net (decrease) increase in cash and cash equivalents	(467)	10	89	–	(368)
Cash and cash equivalents at beginning of period	1,679	114	144	–	1,937
Cash and cash equivalents at end of period	<b>\$1,212</b>	<b>\$ 124</b>	<b>\$ 233</b>	<b>\$ –</b>	<b>\$ 1,569</b>

	Year Ended May 31, 2006				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>\$ (69)</b>	<b>\$ 3,418</b>	<b>\$ 327</b>	<b>\$ –</b>	<b>\$ 3,676</b>
<b>INVESTING ACTIVITIES</b>					
Capital expenditures	(4)	(2,321)	(193)	–	(2,518)
Proceeds from asset dispositions	–	58	6	–	64
Cash Used in Investing Activities	(4)	(2,263)	(187)	–	(2,454)
<b>FINANCING ACTIVITIES</b>					
Net transfers (to) from Parent	1,215	(1,073)	(142)	–	–
Principal payments on debt	(250)	(119)	–	–	(369)
Proceeds from stock issuances	144	–	–	–	144
Dividends paid	(97)	–	–	–	(97)
Other, net	(2)	–	–	–	(2)
Cash (Used in) Provided by Financing Activities	1,010	(1,192)	(142)	–	(324)
<b>CASH AND CASH EQUIVALENTS</b>					
Net increase (decrease) in cash and cash equivalents	937	(37)	(2)	–	898
Cash and cash equivalents at beginning of period	742	151	146	–	1,039
Cash and cash equivalents at end of period	<b>\$1,679</b>	<b>\$ 114</b>	<b>\$ 144</b>	<b>\$ –</b>	<b>\$ 1,937</b>

**CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS**

	Year Ended May 31, 2005				
	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	\$ (5)	\$ 2,849	\$ 273	\$ –	\$ 3,117
<b>INVESTING ACTIVITIES</b>					
Capital expenditures	(3)	(2,049)	(184)	–	(2,236)
Business acquisitions, net of cash acquired	(122)	–	–	–	(122)
Proceeds from asset dispositions	–	10	2	–	12
Other, net	–	(2)	–	–	(2)
Cash Used in Investing Activities	(125)	(2,041)	(182)	–	(2,348)
<b>FINANCING ACTIVITIES</b>					
Net transfers (to) from Parent	717	(651)	(66)	–	–
Principal payments on debt	(600)	(191)	–	–	(791)
Proceeds from stock issuances	99	–	–	–	99
Dividends paid	(84)	–	–	–	(84)
Cash (Used in) Provided by Financing Activities	132	(842)	(66)	–	(776)
<b>CASH AND CASH EQUIVALENTS</b>					
Net (decrease) increase in cash and cash equivalents	2	(34)	25	–	(7)
Cash and cash equivalents at beginning of period	740	185	121	–	1,046
Cash and cash equivalents at end of period	\$ 742	\$ 151	\$ 146	\$ –	\$ 1,039

## Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders  
FedEx Corporation

We have audited the accompanying consolidated balance sheets of FedEx Corporation as of May 31, 2007 and 2006, and the related consolidated statements of income, changes in stockholders' investment and comprehensive income, and cash flows for each of the three years in the period ended May 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of FedEx Corporation at May 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended May 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, effective June 1, 2006, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment," and effective May 31, 2007 the Company adopted SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Benefit Plans – An Amendment of FASB Statements No. 87, 88, 106 and 132(R)."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of FedEx Corporation's internal control over financial reporting as of May 31, 2007, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated July 9, 2007 expressed an unqualified opinion thereon.

Memphis, Tennessee  
July 9, 2007

*Ernst + Young LLP*

## Selected Financial Data

The following table sets forth (in millions, except per share amounts and other operating data) certain selected consolidated financial and operating data for FedEx as of and for the five years ended May 31, 2007. This information should be read in conjunction with the Consolidated Financial Statements, Management's Discussion and Analysis of Results of Operations and Financial Condition and other financial data appearing elsewhere in this Report.

	2007 <sup>(1)</sup>	2006 <sup>(2)</sup>	2005 <sup>(3)</sup>	2004 <sup>(4)</sup>	2003
<b>Operating Results</b>					
Revenues	\$ 35,214	\$ 32,294	\$ 29,363	\$ 24,710	\$ 22,487
Operating income	3,276	3,014	2,471	1,440	1,471
Income before income taxes	3,215	2,899	2,313	1,319	1,338
Net income	\$ 2,016	\$ 1,806	\$ 1,449	\$ 838	\$ 830
<b>Per Share Data</b>					
Earnings per share:					
Basic	\$ 6.57	\$ 5.94	\$ 4.81	\$ 2.80	\$ 2.79
Diluted	\$ 6.48	\$ 5.83	\$ 4.72	\$ 2.76	\$ 2.74
Average shares of common stock outstanding	307	304	301	299	298
Average common and common equivalent shares outstanding	311	310	307	304	303
Cash dividends declared	\$ 0.37	\$ 0.33	\$ 0.29	\$ 0.29	\$ 0.15
<b>Financial Position</b>					
Property and equipment, net	\$ 12,636	\$ 10,770	\$ 9,643	\$ 9,037	\$ 8,700
Total assets	24,000	22,690	20,404	19,134	15,385
Long-term debt, less current portion	2,007	1,592	2,427	2,837	1,709
Common stockholders' investment	12,656	11,511	9,588	8,036	7,288
<b>Other Operating Data</b>					
FedEx Express aircraft fleet	669	671	670	645	643
Average full-time equivalent employees and contractors	238,935	221,677	215,838	195,838	190,918

(1) Results for 2007 include a \$143 million charge at FedEx Express associated with upfront compensation and benefits under the new labor contract with our pilots. See Note 1 to the accompanying consolidated financial statements. Additionally, results for 2007 include several acquisitions from the date of acquisition as described in Note 3 to the accompanying financial statements.

(2) Results for 2006 include a \$79 million (\$49 million, net of tax, or \$0.16 per diluted share) charge to adjust the accounting for certain facility leases, predominantly at FedEx Express. See Note 7 to the accompanying consolidated financial statements.

(3) Results for 2005 include a \$48 million (\$31 million, net of tax, or \$0.10 per diluted share) Airline Stabilization Act charge at FedEx Express (see Note 1 to the accompanying consolidated financial statements) and a \$12 million or \$0.04 per diluted share benefit from an income tax adjustment (see Note 11 to the accompanying consolidated financial statements).

(4) Results for 2004 include \$435 million (\$270 million, net of tax, or \$0.89 per diluted share) of business realignment costs and a \$37 million, or \$0.12 per diluted share, benefit related to a favorable ruling on an aircraft engine maintenance tax case and the reduction of our effective tax rate. Additionally, FedEx Kinko's financial results have been included from February 12, 2004 (the date of acquisition).

## Board of Directors

James L. Barksdale<sup>(3) (4)</sup>  
 Chairman and President  
 Barksdale Management Corporation  
*Investment management company*

August A. Busch IV<sup>(2)</sup>  
 President and Chief Executive Officer  
 Anheuser-Busch Companies, Inc.  
*Brewing organization*

John A. Edwardson<sup>(1\*)</sup>  
 Chairman and Chief Executive Officer  
 CDW Corporation  
*Technology products and services company*

Judith L. Estrin<sup>(3\*)</sup>  
 President and Chief Executive Officer  
 Packet Design, LLC  
*Internet technology company*

J. Kenneth Glass<sup>(2) (4)</sup>  
 Retired Chairman,  
 President and Chief Executive Officer  
 First Horizon National Corporation  
*Bank holding company*

Philip Greer<sup>(2\*)</sup>  
 Managing Director  
 Greer Family Consulting & Investments, LLC  
*Investment management firm*

J.R. Hyde, III<sup>(3)</sup>  
 Chairman  
 GTx, Inc.  
*Biopharmaceutical company*

Shirley A. Jackson<sup>(3) (4)</sup>  
 President  
 Rensselaer Polytechnic Institute  
*Technological university*

Steven R. Loranger<sup>(1)</sup>  
 Chairman, President and  
 Chief Executive Officer  
 ITT Corporation  
*Engineering and manufacturing company*

Charles T. Manatt<sup>(2)</sup>  
 Partner and Co-founder  
 Manatt, Phelps & Phillips, LLP  
*Law firm*

Frederick W. Smith  
 Chairman, President and  
 Chief Executive Officer  
*FedEx Corporation*

Joshua I. Smith<sup>(1)</sup>  
 Chairman and Managing Partner  
 Coaching Group, LLC  
*Consulting firm*

Paul S. Walsh<sup>(2)</sup>  
 Chief Executive Officer  
 Diageo plc  
*Beverage company*

Peter S. Willmott<sup>(1) (4\*)</sup>  
 Chairman and Chief Executive Officer  
 Willmott Services, Inc.  
*Retail and consulting firm*

(1) *Audit Committee*

(2) *Compensation Committee*

(3) *Information Technology Oversight Committee*

(4) *Nominating & Governance Committee*

\* *Committee Chair*

## Executive Officers and Senior Management

### FedEx Corporation

Frederick W. Smith  
Chairman, President and Chief Executive Officer

Alan B. Graf, Jr.  
Executive Vice President and Chief Financial Officer

Robert B. Carter  
Executive Vice President,  
FedEx Information Services and Chief Information Officer

Christine P. Richards  
Executive Vice President, General Counsel and Secretary

T. Michael Glenn  
Executive Vice President,  
Market Development and Corporate Communications

John L. Merino  
Corporate Vice President and Principal Accounting Officer

### FedEx Express

David J. Bronczek  
President and Chief Executive Officer

Michael L. Ducker  
Executive Vice President  
and President, International

William J. Logue  
Executive Vice President,  
Operations and Systems Support

### FedEx Ground

David F. Rebholz  
President and Chief Executive Officer

Rodger G. Marticke  
Executive Vice President and Chief Operating Officer

### FedEx Freight

Douglas G. Duncan  
President and Chief Executive Officer

Patrick L. Reed  
Executive Vice President and Chief Operating Officer

### FedEx Kinko's

Kenneth A. May  
President and Chief Executive Officer

Brian D. Philips  
Executive Vice President and Chief Operating Officer

Thomas J. Leverton  
Executive Vice President and Chief Development Officer

### FedEx Trade Networks

G. Edmond Clark  
President and Chief Executive Officer

### FedEx SmartPost

Ward B. Strang  
President and Chief Executive Officer

### FedEx Custom Critical

Virginia C. Albanese  
President and Chief Executive Officer

### FedEx Global Supply Chain Services

Thomas Schmitt  
President and Chief Executive Officer

### Caribbean Transportation Services

Rick A. Faieta  
President and Chief Executive Officer

## Corporate Information

**FedEx Corporation:** 942 South Shady Grove Road, Memphis, Tennessee 38120, (901) 818-7500, [fedex.com](http://fedex.com)

**Annual Meeting of Shareowners:** Monday, September 24, 2007, 10:00 a.m. local time, Hilton Hotel, Tennessee Grand Ballroom, 939 Ridge Lake Boulevard, Memphis, Tennessee 38120

**Stock Listing:** FedEx Corporation's common stock is listed on the New York Stock Exchange under the ticker symbol FDX.

**Shareowners:** As of July 9, 2007, there were 20,165 shareowners of record.

**Market Information:** Following are high and low sale prices and cash dividends paid, by quarter, for FedEx Corporation's common stock in 2007 and 2006:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>FY 2007</b>				
High	\$118.74	\$119.21	\$121.42	\$116.76
Low	97.79	99.34	106.63	104.01
Dividend	0.09	0.09	0.09	0.09
<b>FY 2006</b>				
High	\$ 91.43	\$ 98.81	\$108.83	\$120.01
Low	79.55	76.81	95.79	106.00
Dividend	0.08	0.08	0.08	0.08

**Financial Information:** Copies of FedEx Corporation's Annual Report on Form 10-K, other documents filed with the Securities and Exchange Commission (SEC) and other financial and statistical information are available through our Web site at [fedex.com](http://fedex.com). Company documents filed electronically with the SEC can also be found at the SEC's Web site at [www.sec.gov](http://www.sec.gov). You will be mailed a copy of the Form 10-K upon request to: FedEx Corporation Investor Relations, 942 South Shady Grove Road, Memphis, Tennessee 38120, (901) 818-7200, e-mail: [ir@fedex.com](mailto:ir@fedex.com).

**SEC and NYSE Certifications:** The most recent certifications by our principal executive and financial officers pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 are filed as exhibits to our Form 10-K. We have also filed with the New York Stock Exchange the most recent Annual CEO Certification as required by section 303A.12(a) of the NYSE Listed Company Manual.

**Independent Registered Public Accounting Firm:** Ernst & Young LLP, Memphis, Tennessee

**Customer Service:** Call 1-800-Go-FedEx or visit [fedex.com](http://fedex.com).

**Media Inquiries:** Jesse W. Bunn, Staff Director, Marketplace Communications, FedEx Corporation, 942 South Shady Grove Road, Memphis, Tennessee 38120, (901) 818-7463, e-mail: [mediarelations@fedex.com](mailto:mediarelations@fedex.com)

**Shareowner Account Services:** Computershare Investor Services, P.O. Box 43069, Providence, Rhode Island 02940-3069, (800) 446-2617, [www.computershare.com](http://www.computershare.com)

### Direct Stock Purchase and Dividend Reinvestment:

For information on the direct stock purchase and dividend reinvestment plan for FedEx Corporation common stock, call Computershare at (800) 446-2617 or visit their direct stock purchase plan Web site at [www.computershare.com](http://www.computershare.com). This plan provides an alternative to traditional retail brokerage methods of purchasing, holding and selling FedEx common stock. This plan also permits shareowners to automatically reinvest their dividends to purchase additional shares of FedEx common stock.

**Investor Relations:** Mickey Foster, Vice President, Investor Relations, FedEx Corporation, 942 South Shady Grove Road, Memphis, Tennessee 38120, (901) 818-7200, e-mail: [ir@fedex.com](mailto:ir@fedex.com)

**Equal Employment Opportunity:** Our greatest asset is our people. We are committed to providing a workplace where our employees and contractors feel respected, satisfied and appreciated. Our policies are designed to promote fairness and respect for everyone. We hire, evaluate and promote employees, and engage contractors, based on their skills and performance. With this in mind, we will not tolerate certain behaviors. These include harassment, violence, intimidation and discrimination of any kind involving race, color, religion, national origin, gender, sexual orientation, age, disability, veteran status or, where applicable, marital status.

**Service Marks:** The following are registered service marks of Federal Express Corporation, registered with the U.S. Patent & Trademark Office and in other countries: FedEx®, FedEx Express®, FedEx Ground®, FedEx Freight®, FedEx Freight Advance Notice®, FedEx Custom Critical®, FedEx Supply Chain Services®, FedEx SmartPost®, FedEx Home Delivery®, FedEx Trade Networks® and FedEx Services®. FedEx National LTL<sup>SM</sup>, Caribbean Transportation Services<sup>SM</sup>, and FedEx Global Supply Chain Services<sup>SM</sup> are service marks of Federal Express Corporation. FedEx Kinko's Office and Print Centers® is a registered service mark of Federal Express Corporation and Kinko's Ventures, Inc. FedEx Kinko's Ship Centers<sup>SM</sup> is a service mark of Federal Express Corporation and Kinko's Ventures, Inc.