

FEDEX CORP  
Form 10-K/A  
August 02, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K/A**

(Amendment No. 1)

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended May 31, 2006.
- OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.  
Commission file number 1-15829

**FEDEX CORPORATION**

*(Exact Name of Registrant as Specified in its Charter)*

**Delaware**  
*(State or Other Jurisdiction of  
Incorporation or Organization)*

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

**942 South Shady Grove Road, Memphis, Tennessee**  
*(Address of Principal Executive Offices)*

**38120**  
*(ZIP Code)*

**Registrant's telephone number, including area code: (901) 818-7500**

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of each class                      | Name of each exchange on which registered |
|--|---|
| Common Stock, par value \$0.10 per share | New York Stock Exchange                   |

**Securities registered pursuant to Section 12(g) of the Act:** None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Rule 13 or Section 15(d) of the Exchange Act.

Yes  No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any

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amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The aggregate market value of the common stock held by non-affiliates of the Registrant, computed by reference to the closing price as of the last business day of the Registrant's most recently completed second fiscal quarter, November 30, 2005, was approximately \$27.6 billion. The Registrant has no non-voting stock.

As of July 10, 2006, 306,410,446 shares of the Registrant's common stock were outstanding.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement to be delivered to stockholders in connection with the 2006 annual meeting of stockholders to be held on September 25, 2006 are incorporated by reference in response to Part III of this Report.

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### EXPLANATORY NOTE

FedEx Corporation ( FedEx ) hereby amends its Annual Report on Form 10-K for the fiscal year ended May 31, 2006 (the Form 10-K ) (filed on July 14, 2006) as set forth in this Annual Report on Form 10-K/A (Amendment No. 1) (this Form 10-K/A ).

This Form 10-K/A is being filed solely to correct an EDGAR conversion error in Item 8 of the Form 10-K. Specifically, the EDGAR filing agent inadvertently added an extra row entitled Kinko s trade name to the first table in Note 4: Goodwill and Intangibles of the Notes to Consolidated Financial Statements (on page 85 of the Form 10-K), which presents the carrying amount of goodwill attributable to each reportable operating segment and changes therein. Accordingly, we have deleted the extra row from the table.

No other changes are being made to the Form 10-K by means of this Form 10-K/A.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

FedEx's consolidated financial statements, together with the notes thereto and the report of Ernst & Young LLP dated July 11, 2006 thereon, are presented on pages 5 through 40 of this Form 10-K/A.

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

**(a)(1) and (2) Financial Statements; Financial Statement Schedules**

FedEx's consolidated financial statements, together with the notes thereto and the report of Ernst & Young LLP dated July 11, 2006 thereon, are presented on pages 5 through 40 of this Form 10-K/A.

**(a)(3) Exhibits**

See the Exhibit Index on page E-1 for a list of the exhibits being filed or furnished with or incorporated by reference into this Form 10-K/A.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

FEDEX CORPORATION

Dated: August 2, 2006

By:

/s/ JOHN L. MERINO  
John L. Merino  
Corporate Vice President and  
Principal Accounting Officer

**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, 2006 and 2005, 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, 2006. 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, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended May 31, 2006, in conformity with U.S. generally accepted accounting principles.

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, 2006, 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 11, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Memphis, Tennessee  
July 11, 2006

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

**ASSETS**

|  | <b>May 31,</b> |             |
|--|----------------|-------------|
|  | <b>2006</b>    | <b>2005</b> |
| <b>CURRENT ASSETS</b>  |                |             |
| Cash and cash equivalents  | \$ 1,937       | \$ 1,039    |
| Receivables, less allowances of \$144 and \$125                    | 3,516          | 3,297       |
| Spare parts, supplies and fuel, less allowances of \$150 and \$142 | 308            | 250         |
| Deferred income taxes  | 539            | 510         |
| Prepaid expenses and other   | 164            | 173         |
| Total current assets   | 6,464          | 5,269       |
| <b>PROPERTY AND EQUIPMENT, AT COST</b>                             |                |             |
| Aircraft and related equipment                                     | 8,611          | 7,610       |
| Package handling and ground support equipment                      | 3,558          | 3,366       |
| Computer and electronic equipment                                  | 4,331          | 3,893       |
| Vehicles   | 2,203          | 1,994       |
| Facilities and other   | 5,371          | 5,154       |
|  | 24,074         | 22,017      |
| Less accumulated depreciation and amortization                     | 13,304         | 12,374      |
| Net property and equipment   | 10,770         | 9,643       |
| <b>OTHER LONG-TERM ASSETS</b>                                      |                |             |
| Goodwill   | 2,825          | 2,835       |
| Prepaid pension cost   | 1,349          | 1,272       |
| Intangible and other assets  | 1,282          | 1,385       |
| Total other long-term assets                                       | 5,456          | 5,492       |
|  | \$ 22,690      | \$ 20,404   |

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

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

**LIABILITIES AND STOCKHOLDERS INVESTMENT**

|  | May 31,<br>2006 | 2005         |
|--|-----------------|--------------|
| <b>CURRENT LIABILITIES</b>   |                 |              |
| Current portion of long-term debt  | \$ 850          | \$ 369       |
| Accrued salaries and employee benefits   | 1,325           | 1,275        |
| Accounts payable   | 1,908           | 1,739        |
| Accrued expenses   | 1,390           | 1,351        |
| Total current liabilities  | 5,473           | 4,734        |
| <b>LONG-TERM DEBT, LESS CURRENT PORTION</b>  | <b>1,592</b>    | <b>2,427</b> |
| <b>OTHER LONG-TERM LIABILITIES</b>   |                 |              |
| Deferred income taxes  | 1,367           | 1,206        |
| Pension, postretirement healthcare and other benefit obligations   | 944             | 828          |
| Self-insurance accruals  | 692             | 621          |
| Deferred lease obligations   | 658             | 532          |
| Deferred gains, principally related to aircraft transactions   | 373             | 400          |
| Other liabilities  | 80              | 68           |
| Total other long-term liabilities  | 4,114           | 3,655        |
| <b>COMMITMENTS AND CONTINGENCIES</b>   |                 |              |
| <b>COMMON STOCKHOLDERS INVESTMENT</b>  |                 |              |
| Common stock, \$0.10 par value; 800 million shares authorized; 306 million shares issued for 2006 and 302 million shares issued for 2005 | 31              | 30           |
| Additional paid-in capital   | 1,468           | 1,241        |
| Retained earnings  | 10,068          | 8,363        |
| Accumulated other comprehensive loss   | (24 )           | (17 )        |
|  | 11,543          | 9,617        |
| Less deferred compensation and treasury stock, at cost   | 32              | 29           |
| Total common stockholders investment   | 11,511          | 9,588        |
|  | \$ 22,690       | \$ 20,404    |

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



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

|                                   | <b>Years ended May 31,</b> |             |             |
|-----------------------------------|----------------------------|-------------|-------------|
|                                   | <b>2006</b>                | <b>2005</b> | <b>2004</b> |
| REVENUES                          | \$ 32,294                  | \$ 29,363   | \$ 24,710   |
| OPERATING EXPENSES:               |                            |             |             |
| Salaries and employee benefits    | 12,571                     | 11,963      | 10,728      |
| Purchased transportation          | 3,251                      | 2,935       | 2,407       |
| Rentals and landing fees          | 2,390                      | 2,299       | 1,918       |
| Depreciation and amortization     | 1,550                      | 1,462       | 1,375       |
| Fuel                              | 3,256                      | 2,317       | 1,531       |
| Maintenance and repairs           | 1,777                      | 1,695       | 1,523       |
| Business realignment costs        |                            |             | 435         |
| Other                             | 4,485                      | 4,221       | 3,353       |
|                                   | 29,280                     | 26,892      | 23,270      |
| OPERATING INCOME                  | 3,014                      | 2,471       | 1,440       |
| OTHER INCOME (EXPENSE):           |                            |             |             |
| Interest expense                  | (142 )                     | (160 )      | (136 )      |
| Interest income                   | 38                         | 21          | 20          |
| Other, net                        | (11 )                      | (19 )       | (5 )        |
|                                   | (115 )                     | (158 )      | (121 )      |
| INCOME BEFORE INCOME TAXES        | 2,899                      | 2,313       | 1,319       |
| PROVISION FOR INCOME TAXES        | 1,093                      | 864         | 481         |
| NET INCOME                        | \$ 1,806                   | \$ 1,449    | \$ 838      |
| BASIC EARNINGS PER COMMON SHARE   | \$ 5.94                    | \$ 4.81     | \$ 2.80     |
| DILUTED EARNINGS PER COMMON SHARE | \$ 5.83                    | \$ 4.72     | \$ 2.76     |

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

**FEDEX CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(IN MILLIONS)**

|   | <b>Years ended May 31,</b> |             |             |
|---|----------------------------|-------------|-------------|
|   | <b>2006</b>                | <b>2005</b> | <b>2004</b> |
| <b>OPERATING ACTIVITIES</b>   |                            |             |             |
| Net income  | \$ 1,806                   | \$ 1,449    | \$ 838      |
| Adjustments to reconcile net income to cash provided by operating activities:           |                            |             |             |
| Lease accounting charge   | 79                         |             |             |
| Depreciation and amortization   | 1,548                      | 1,462       | 1,375       |
| Provision for uncollectible accounts  | 121                        | 101         | 106         |
| Deferred income taxes and other noncash items   | 187                        | 63          | (8)         |
| Tax benefit on the exercise of stock options  | 62                         | 36          | 43          |
| Changes in operating assets and liabilities, net of the effects of businesses acquired: |                            |             |             |
| Receivables   | (319)                      | (235)       | (307)       |
| Other current assets  | (38)                       | (26)        | 10          |
| Pension assets and liabilities, net   | (71)                       | (118)       | 155         |
| Accounts payable and other operating liabilities  | 346                        | 365         | 841         |
| Other, net  | (45)                       | 20          | (33)        |
| Cash provided by operating activities   | 3,676                      | 3,117       | 3,020       |
| <b>INVESTING ACTIVITIES</b>   |                            |             |             |
| Capital expenditures  | (2,518)                    | (2,236)     | (1,271)     |
| Business acquisitions, net of cash acquired   |                            | (122)       | (2,410)     |
| Proceeds from asset dispositions  | 64                         | 12          | 18          |
| Other, net  |                            | (2)         | 1           |
| Cash used in investing activities   | (2,454)                    | (2,348)     | (3,662)     |
| <b>FINANCING ACTIVITIES</b>   |                            |             |             |
| Principal payments on debt  | (369)                      | (791)       | (319)       |
| Proceeds from debt issuances  |                            |             | 1,599       |
| Proceeds from stock issuances   | 144                        | 99          | 115         |
| Dividends paid  | (97)                       | (84)        | (66)        |
| Purchase of treasury stock  |                            |             | (179)       |
| Other, net  | (2)                        |             |             |
| Cash (used in) provided by financing activities   | (324)                      | (776)       | 1,150       |
| <b>CASH AND CASH EQUIVALENTS</b>  |                            |             |             |
| Net increase (decrease) in cash and cash equivalents                                    | 898                        | (7)         | 508         |
| Cash and cash equivalents at beginning of period  | 1,039                      | 1,046       | 538         |
| Cash and cash equivalents at end of period  | \$ 1,937                   | \$ 1,039    | \$ 1,046    |

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

**FEDEX CORPORATION**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS**  
**INVESTMENT AND COMPREHENSIVE INCOME**  
**(IN MILLIONS, EXCEPT SHARE DATA)**

|  | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Treasury<br>Stock | Deferred<br>Compensation | Total        |
|--|-----------------|----------------------------------|----------------------|---|-------------------|--------------------------|--------------|
| BALANCE AT MAY 31, 2003  | \$ 30           | \$ 1,088                         | \$ 6,250             | \$ (30 )                                      | \$ (25 )          | \$ (25 )                 | \$ 7,288     |
| Net income   |                 |                                  | 838                  |   |                   |                          | 838          |
| Minimum pension liability<br>adjustment, net of deferred tax<br>benefit of \$12                          |                 |                                  |                      | (16 )   |                   |                          | (16 )        |
| Total comprehensive income   |                 |                                  |                      |   |                   |                          | <b>822</b>   |
| Purchase of treasury stock<br>(2,625,000 shares repurchased at an<br>average price of \$68.14 per share) |                 |                                  |                      |   | (179 )            |                          | (179 )       |
| Cash dividends declared (\$0.29 per<br>share)  |                 |                                  | (87 )                |   |                   |                          | (87 )        |
| Employee incentive plans and other<br>(4,013,182 shares issued)  |                 | (9 )                             |                      |   | 204               | (18 )                    | 177          |
| Amortization of<br>deferred compensation   |                 |                                  |                      |   |                   | 15                       | 15           |
| BALANCE AT MAY 31, 2004  | 30              | 1,079                            | 7,001                | (46 )   |                   | (28 )                    | 8,036        |
| Net income   |                 |                                  | 1,449                |   |                   |                          | 1,449        |
| Foreign currency translation<br>adjustment, net of deferred taxes<br>of \$5                              |                 |                                  |                      | 27  |                   |                          | 27           |
| Minimum pension liability<br>adjustment, net of deferred taxes of<br>\$1                                 |                 |                                  |                      | 2   |                   |                          | 2            |
| Total comprehensive income   |                 |                                  |                      |   |                   |                          | <b>1,478</b> |
| Cash dividends declared (\$0.29 per<br>share)  |                 |                                  | (87 )                |   |                   |                          | (87 )        |
| Employee incentive plans and other<br>(2,767,257 shares issued)  |                 | 162                              |                      |   | (1 )              | (16 )                    | 145          |
| Amortization of<br>deferred compensation   |                 |                                  |                      |   |                   | 16                       | 16           |
| BALANCE AT MAY 31, 2005  | 30              | 1,241                            | 8,363                | (17 )   | (1 )              | (28 )                    | 9,588        |
| Net income   |                 |                                  | 1,806                |   |                   |                          | 1,806        |
| Foreign currency translation<br>adjustment, net of deferred taxes<br>of \$3                              |                 |                                  |                      | 29  |                   |                          | 29           |
| Minimum pension liability<br>adjustment, net of deferred taxes of<br>\$24                                |                 |                                  |                      | (36 )   |                   |                          | (36 )        |
| Total comprehensive income   |                 |                                  |                      |   |                   |                          | <b>1,799</b> |
| Cash dividends declared (\$0.33 per<br>share)  |                 |                                  | (101 )               |   |                   |                          | (101 )       |
| Employee incentive plans and other<br>(3,579,766 shares issued)  | 1               | 227                              |                      |   | (1 )              | (19 )                    | 208          |
| Amortization of<br>deferred compensation   |                 |                                  |                      |   |                   | 17                       | 17           |
| BALANCE AT MAY 31, 2006  | \$ 31           | \$ 1,468                         | \$ 10,068            | \$ (24 )                                      | \$ (2 )           | \$ (30 )                 | \$ 11,511    |

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

**FEDEX CORPORATION**  
**NOTES TO 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 operating independently, competing collectively 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 ( FedEx Freight ), a leading U.S. provider of regional 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 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 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, 2006 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.

*RECLASSIFICATIONS.* Certain reclassifications have been made to prior year financial statements to conform to the current year presentation.

*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.

*REVENUE RECOGNITION.* Revenue is recognized upon delivery of shipments or the completion of the service for our office and print 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 purchased transportation caption in the accompanying income statements. 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



**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

revenue includes billings to customers less third-party charges, including transportation or handling costs, fees, commissions, and taxes and duties.

*ADVERTISING.* Advertising costs are expensed as incurred and are classified in other operating expenses. Advertising expenses were \$376 million in 2006, \$326 million in 2005 and \$284 million in 2004.

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

*SPARE PARTS, SUPPLIES AND FUEL.* Spare parts 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, over the estimated useful life of the related aircraft and engines, for spare parts expected to be on hand at the date the aircraft are retired from service, and 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, depreciation and amortization of property and equipment is provided 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 |          |
|---|----------------|-------------------|----------|
|   |                | 2006              | 2005     |
| Wide-body aircraft and related equipment              | 15 to 25 years | \$ 4,669          | \$ 3,948 |
| Narrow-body and feeder aircraft and related equipment | 5 to 15 years  | 369               | 330      |
| Package handling and ground support equipment         | 2 to 30 years  | 1,255             | 938      |
| Computer and electronic equipment                     | 2 to 10 years  | 928               | 758      |
| Vehicles  | 3 to 12 years  | 743               | 718      |
| Facilities and other                                  | 2 to 40 years  | 2,806             | 2,951    |

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 \$1.520 billion in 2006, \$1.438 billion in 2005 and \$1.361 billion in 2004. Depreciation and amortization expense includes amortization of assets under capital lease.



**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*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 \$33 million in 2006, \$22 million in 2005 and \$11 million in 2004.

*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. 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.

*PENSION AND POSTRETIREMENT HEALTHCARE PLANS.* Our defined benefit plans are measured as of the last day of our fiscal third quarter of each year 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.

*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. Non-amortizing intangible assets consist of 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.

*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 in effect when the taxes are paid.





**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

We have not recognized deferred taxes for U.S. federal income taxes on foreign subsidiaries' earnings that are deemed to be permanently reinvested and any related taxes associated with such earnings are not material. Pretax earnings of foreign operations were approximately \$606 million in 2006, \$636 million in 2005 and \$430 million in 2004, 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.* Certain of our aircraft, facility and retail location 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 balance sheets. The cumulative excess of rent expense over rent payments is accounted for as a deferred lease obligation. 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. 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. 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 results of operations. Cumulative net foreign currency translation gains and (losses) in accumulated other comprehensive loss were \$43 million at May 31, 2006, \$14 million at May 31, 2005 and (\$13) million at May 31, 2004.

*AIRLINE STABILIZATION ACT CHARGE.* During the second quarter of 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 ( Act ). Under its interpretation of the Act, the DOT determined that FedEx Express was entitled to \$72 million of compensation. Because we had previously received \$101 million under the Act, the DOT demanded repayment of \$29 million, which was made in December 2004. Because we could no longer conclude that collection of the entire \$119 million recorded in 2002 was probable, we recorded a charge of \$48 million in the second quarter of 2005, representing the DOT's repayment demand of \$29 million and the write-off of a \$19 million receivable.



**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*EMPLOYEES UNDER COLLECTIVE BARGAINING ARRANGEMENTS.* The pilots of FedEx Express, which represent a small number of FedEx Express total employees, are employed under a collective bargaining agreement that became amendable on May 31, 2004. In accordance with applicable labor law, we will continue to operate under our current agreement while we negotiate with our pilots. Contract negotiations with the pilots union began in March 2004. These negotiations are ongoing and are being mediated through the National Mediation Board. We cannot estimate the financial impact, if any, the results of these negotiations may have on our future results of operations.

*STOCK COMPENSATION.* We currently apply Accounting Principles Board Opinion No. ( APB ) 25, Accounting for Stock Issued to Employees, and its related interpretations to measure compensation expense for stock-based compensation plans. As a result, no compensation expense is recorded for stock options when the exercise price is equal to or greater than the market price of our common stock at the date of grant. For awards of restricted stock and to determine the pro forma effects of stock options set forth below, we recognize the fair value of the awards ratably over their explicit service period.

If compensation cost for stock-based compensation plans had been determined under Statement of Financial Accounting Standards No. ( SFAS ) 123, Accounting for Stock Based Compensation, stock option compensation expense, pro forma net income and basic and diluted earnings per common share for 2006, 2005 and 2004 assuming all options granted in 1996 and thereafter were valued at fair value using the Black-Scholes method, would have been as follows (in millions, except per share amounts):

|   | Years ended May 31, |          |         |
|---|---------------------|----------|---------|
|   | 2006                | 2005     | 2004    |
| Net income, as reported   | \$ 1,806            | \$ 1,449 | \$ 838  |
| Add: Stock compensation included in reported net income, net of tax   | 5                   | 4        | 10      |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax benefit | 46                  | 40       | 37      |
| Pro forma net income  | \$ 1,765            | \$ 1,413 | \$ 811  |
| Earnings per common share:  |                     |          |         |
| Basic as reported   | \$ 5.94             | \$ 4.81  | \$ 2.80 |
| Basic pro forma   | \$ 5.81             | \$ 4.69  | \$ 2.71 |
| Diluted as reported   | \$ 5.83             | \$ 4.72  | \$ 2.76 |
| Diluted pro forma   | \$ 5.70             | \$ 4.60  | \$ 2.68 |

See Note 10 for a discussion of the assumptions underlying the pro forma calculations above.

For unvested stock options and restricted stock awards granted prior to May 31, 2006, the terms of these awards provide for continued vesting subsequent to the employee's retirement. Compensation expense associated with these awards has been recognized on a straight-line basis over the vesting period. This provision was removed from all stock option awards granted subsequent to May 31, 2006. For restricted stock grants made subsequent to May 31, 2006, compensation expense will be accelerated for grants made to employees who are or will become retirement eligible during the stated vesting period of the award.

*DIVIDENDS DECLARED PER COMMON SHARE.* On May 26, 2006, our Board of Directors declared a dividend of \$0.09 per share of common stock. The dividend was paid on July 3, 2006 to stockholders of record as of the close of business on June 12, 2006. Each quarterly dividend payment is subject to review

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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; employee retirement plan obligations; long-term incentive accruals; tax liabilities; accounts receivable allowances; 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**

In December 2004, the Financial Accounting Standards Board ( FASB ) issued SFAS 123R, Share-Based Payment. The new standard requires companies to record compensation expense for stock-based awards using a fair value method. Compensation expense will be recorded over the requisite service period, which is typically the vesting period of the award.

We will adopt this standard using the modified prospective basis as of June 1, 2006. We expect the adoption of this standard to result in a reduction of diluted earnings per share of approximately \$0.15 in 2007. This estimate is impacted by the levels of share-based payments granted in the future, assumptions used in the fair value calculation and the market price of our common stock. Accordingly, the actual effect per diluted share could differ from this estimate.

The FASB issued FASB Interpretation No. ( FIN ) 48, Accounting for Uncertainty in Income Taxes, on July 13, 2006. The new rules will most likely be effective for FedEx in 2008. At this time, we have not completed our review and assessment of the impact of adoption of FIN 48.

**NOTE 3: BUSINESS COMBINATIONS**

*FEDEX SMARTPOST.* 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 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. Management relied primarily on internal estimates and the assistance of third-party appraisals to allocate the purchase price to the fair value of the assets acquired, liabilities assumed and goodwill.

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 |

*FEDEX KINKO S.* On February 12, 2004, we acquired FedEx Kinko s for approximately \$2.4 billion in cash. We also assumed \$39 million of capital lease obligations. FedEx Kinko s is a leading provider of document solutions and business services. Its network of worldwide locations offers access to color printing, finishing and presentation services, Internet access, videoconferencing, outsourcing, managed services, Web-based printing and document management solutions.

The allocation of the purchase price to the fair value of the assets acquired, liabilities assumed and goodwill, as well as the assignment of goodwill to our reportable segments, was based primarily on internal estimates of cash flows, supplemented by third-party appraisals. We used third-party appraisals to assist management in its determination of the fair value of certain assets and liabilities, primarily property and equipment and acquired intangible assets, including the value of the Kinko s trade name, customer-related intangibles, technology assets and contract-based intangibles.

Approximately \$1.8 billion was recorded as goodwill, as the acquisition expands our portfolio of business services, while providing a substantially enhanced capability to provide package-shipping services to small- and medium-sized business customers through FedEx Kinko s network of retail locations. Because this was an acquisition of stock, goodwill is not deductible for tax purposes. Approximately \$130 million of the goodwill was attributed to the FedEx Express segment and \$70 million was attributed to the FedEx Ground segment based on the expected increase in each segment s fair value as a result of the acquisition.

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

|   |          |
|---|----------|
| Current assets, primarily accounts receivable and inventory         | \$ 241   |
| Property and equipment  | 328      |
| Goodwill  | 1,751    |
| Intangible asset with an indefinite life                            | 567      |
| Amortizable intangible assets                                       | 82       |
| Other long-term assets  | 52       |
| Total assets acquired   | 3,021    |
| Current liabilities   | (298 )   |
| Deferred income taxes   | (267 )   |
| Long-term capital lease obligations and other long-term liabilities | (36 )    |
| Total liabilities assumed   | (601 )   |
| Total purchase price  | \$ 2,420 |

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Indefinite lived intangible asset.* This intangible asset represents the estimated fair value allocated to the Kinko's trade name. This intangible asset will not be amortized because it has an indefinite remaining useful life based on the length of time that the Kinko's name had been in use, the Kinko's brand awareness and market position and our plans for continued use of the Kinko's brand.

*Amortizable intangible assets.* These intangible assets represent the fair value associated with the business expected to be generated from existing customer relationships and contracts as of the acquisition date. Substantially all of these assets are being amortized on an accelerated basis over an estimated useful life of approximately seven years. While the useful life of these customer-relationship assets is not limited by contract or any other economic, regulatory or other known factors, a useful life of seven years was determined at the acquisition date based on customer attrition patterns.

The following unaudited pro forma consolidated financial information presents the combined results of operations of FedEx and FedEx Kinko's as if the acquisition had occurred at the beginning of 2004. The unaudited pro forma results have been prepared for comparative purposes only. Adjustments were made to the combined results of operations, primarily related to higher depreciation and amortization expense resulting from higher property and equipment values and acquired intangible assets and additional interest expense resulting from acquisition debt. Accounting literature establishes firm guidelines around how this pro forma information is presented, which precludes the assumption of business synergies. Therefore, this unaudited pro forma information is not intended to represent, nor do we believe it is indicative of the consolidated results of operations of FedEx that would have been reported had the acquisition been completed as of the beginning of 2004. Furthermore, this pro forma information is not representative of the future consolidated results of operations of FedEx.

Pro forma unaudited results for the year ended May 31, 2004 were as follows (in millions, except per share data):

|                                      |           |
|--------------------------------------|-----------|
| Revenues                             | \$ 26,056 |
| Net income(1)                        | 836       |
| Basic earnings per common share(1)   | 2.80      |
| Diluted earnings per common share(1) | 2.75      |

(1) Includes \$27 million, net of tax, of nonrecurring expenses at FedEx Kinko's, primarily in anticipation of the acquisition. Also includes \$270 million, net of tax, of business realignment costs and a \$37 million, net of tax, nonrecurring tax benefit at FedEx.

We paid a portion of the purchase price from available cash balances. To finance the remainder of the purchase price, we issued commercial paper backed by a six-month \$2 billion credit facility. In March 2004, we issued \$1.6 billion of senior unsecured notes in three maturity tranches: one, three and five years at \$600 million, \$500 million and \$500 million, respectively. Net proceeds from the borrowings were used to repay the commercial paper backed by the six-month credit facility. We canceled the six-month credit facility in March 2004. See Note 7 for further discussion.

The FedEx SmartPost and FedEx Kinko's acquisitions were accounted for under the purchase method of accounting. The operating results of the acquired businesses are included in our consolidated results of operations from the date of acquisition.

*OTHER BUSINESS COMBINATIONS.* On May 26, 2006, we announced an agreement to acquire the LTL operations of Watkins Motor Lines ( Watkins ), a privately held company, and certain affiliates for approximately \$780 million, payable in cash. Watkins is a leading provider of long-haul LTL services.

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Watkins will be rebranded as FedEx National LTL and will be included in the FedEx Freight segment from the date of acquisition, which is expected to occur during the first half of 2007, subject to customary closing conditions.

On January 24, 2006, FedEx Express entered into an agreement with Tianjin Datian W. Group Co., Ltd. ( DTW Group ) to acquire DTW Group's 50% share of the FedEx-DTW International Priority express joint venture ( FedEx-DTW ) and DTW Group's domestic express network in China for approximately \$400 million in cash. This acquisition will convert our joint venture with DTW Group, formed in 1999 and currently accounted for under the equity method, into a wholly owned subsidiary and increase our presence in China in the international and domestic express businesses. The acquisition is expected to be completed in the first half of 2007, subject to customary closing conditions. The financial results of this transaction will be included in the FedEx Express segment from the date of acquisition.

**NOTE 4: GOODWILL AND INTANGIBLES**

The carrying amount of goodwill attributable to each reportable operating segment and changes therein follows (in millions):

|                       | May 31,<br>2004 | Goodwill<br>Acquired | Purchase<br>Adjustments<br>and Other | May 31,<br>2005 | Purchase<br>Adjustments<br>and Other | May 31,<br>2006 |
|-----------------------|-----------------|----------------------|--------------------------------------|-----------------|--------------------------------------|-----------------|
| FedEx Express segment | \$ 527          | \$                   | \$ 1                                 | \$ 528          | \$ 2                                 | \$ 530          |
| FedEx Ground segment  | 70              | 20                   | (1)                                  | 90              |                                      | 90              |
| FedEx Freight segment | 666             |                      |                                      | 666             | (10 )                                | 656             |
| FedEx Kinko's segment | 1,539           |                      | 12                                   | 1,551           | (2 )                                 | 1,549           |
|                       | \$ 2,802        | \$ 20                | \$ 13                                | \$ 2,835        | \$ (10 )                             | \$ 2,825        |

(1) FedEx SmartPost acquisition.

The components of our intangible assets were as follows (in millions):

|                                      | May 31, 2006                |                             |                   | May 31, 2005                |                             |                   |
|--------------------------------------|-----------------------------|-----------------------------|-------------------|-----------------------------|-----------------------------|-------------------|
|                                      | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net Book<br>Value | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net Book<br>Value |
| <b>Amortizable intangible assets</b> |                             |                             |                   |                             |                             |                   |
| Customer relationships               | \$ 77                       | \$ (29 )                    | \$ 48             | \$ 77                       | \$ (16 )                    | \$ 61             |
| Contract related                     | 79                          | (57 )                       | 22                | 79                          | (50 )                       | 29                |
| Technology related and other         | 54                          | (30 )                       | 24                | 51                          | (23 )                       | 28                |
| Total                                | \$ 210                      | \$ (116 )                   | \$ 94             | \$ 207                      | \$ (89 )                    | \$ 118            |

**Non-amortizing intangible asset**

|                    |        |    |        |        |    |        |
|--------------------|--------|----|--------|--------|----|--------|
| Kinko's trade name | \$ 567 | \$ | \$ 567 | \$ 567 | \$ | \$ 567 |
|--------------------|--------|----|--------|--------|----|--------|

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.



**FEDEX CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Amortization expense for intangible assets was \$25 million in 2006, \$26 million in 2005 and \$14 million in 2004. Estimated amortization expense for the next five years is as follows (in millions):

|      |       |
|------|-------|
| 2007 | \$ 23 |
| 2008 | 21    |
| 2009 | 18    |
| 2010 | 16    |
| 2011 | 8     |

**NOTE 5: BUSINESS REALIGNMENT COSTS**

During the first half of 2004, voluntary early retirement incentives with enhanced pension and postretirement healthcare benefits were offered to certain groups of employees at FedEx Express who were age 50 or older. Voluntary cash severance incentives were also offered to eligible employees at FedEx Express. Approximately 3,600 employees accepted offers under these programs. Costs were also incurred for the elimination of certain management positions, primarily at FedEx Express and FedEx Services. We recognized \$435 million of business realignment costs during 2004 (\$428 million related to the FedEx Express Segment). No material costs for these programs were incurred in 2006 or 2005. At both May 31, 2006 and May 31, 2005, business realignment related accruals were immaterial.

**NOTE 6: SELECTED CURRENT LIABILITIES**

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

|  | May 31,<br>2006 | 2005     |
|--|-----------------|----------|
| Accrued Salaries and Employee Benefits |                 |          |
| Salaries                               | \$ 236          | \$ 202   |
| Employee benefits                      | 655             | 658      |
| Compensated absences                   | 434             | 415      |
|  | \$ 1,325        | \$ 1,275 |
| Accrued Expenses                       |                 |          |
| Self-insurance accruals                | \$ 523          | \$ 483   |
| Taxes other than income taxes          | 305             | 288      |
| Other                                  | 562             | 580      |
|  | \$ 1,390        | \$ 1,351 |

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 7: LONG-TERM DEBT AND OTHER FINANCING ARRANGEMENTS**

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

|   | <b>May 31,<br/>2006</b> | <b>2005</b> |
|---|-------------------------|-------------|
| Unsecured debt  | \$ 2,006                | \$ 2,255    |
| Capital lease obligations                                     | 310                     | 401         |
| Other debt, interest rates of 4.03% to 9.98% due through 2008 | 126                     | 140         |
|   | 2,442                   | 2,796       |
| Less current portion  | 850                     | 369         |
|   | \$ 1,592                | \$ 2,427    |

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. In July 2005, we executed a new \$1.0 billion five-year revolving credit facility, which replaced and consolidated our prior revolving credit facilities. Borrowings under the credit facility will bear interest at short-term interest rates (based on the London Interbank Offered Rate ( LIBOR ), the Prime Rate or the Federal Funds Rate) plus a margin dependent upon our senior unsecured long-term debt ratings. 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, 2006, no commercial paper borrowings were outstanding and the entire amount under the credit facility was available.

The components of unsecured debt (net of discounts) were as follows (in millions):

|                                     | <b>May 31,<br/>2006</b> | <b>2005</b> |
|-------------------------------------|-------------------------|-------------|
| Senior unsecured debt               |                         |             |
| Interest rate of 7.80%, due in 2007 | \$ 200                  | \$ 200      |
| Interest rate of 2.65%, due in 2007 | 500                     | 500         |
| Interest rate of 3.50%, due in 2009 | 500                     | 499         |
| Interest rate of 7.25%, due in 2011 | 249                     | 499         |
| Interest rate of 9.65%, due in 2013 | 300                     | 299         |
| Interest rate of 7.60%, due in 2098 | 239                     | 239         |
| Other notes, due in 2007            | 18                      | 19          |
|                                     | \$ 2,006                | \$ 2,255    |

Our capital lease obligations include leases for aircraft, as well as 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.

Our other debt includes \$118 million related to leases for aircraft that are consolidated under the provisions of FIN 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. The

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

debt accrues interest at LIBOR plus a margin and is due in installments through March 30, 2007. See Note 17 for further discussion.

We issue other financial instruments in the normal course of business to support our operations. Letters of credit at May 31, 2006 were \$586 million. The amount unused under our letter of credit facility totaled approximately \$63 million at May 31, 2006. 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 sheet, where applicable. Therefore, no additional liability is reflected for the letters of credit.

Scheduled annual principal maturities of debt, exclusive of capital leases, for the five years subsequent to May 31, 2006, are as follows (in millions):

|      |        |
|------|--------|
| 2007 | \$ 844 |
| 2008 |        |
| 2009 | 500    |
| 2010 |        |
| 2011 | 250    |

Long-term debt, exclusive of capital leases, had carrying values of \$2.1 billion compared with an estimated fair value of approximately \$2.2 billion at May 31, 2006, and \$2.4 billion compared with an estimated fair value of \$2.6 billion at May 31, 2005. The estimated fair values were determined based on quoted market prices or on the current rates offered for debt with similar terms and maturities.

We have a \$1 billion shelf registration statement with the SEC to provide flexibility and efficiency when obtaining financing. Under this shelf registration statement we may issue, in one or more offerings, either unsecured debt securities, common stock or a combination of such instruments. The entire \$1 billion is available for future financings.

**NOTE 8: LEASES**

We utilize certain aircraft, land, facilities, retail locations and equipment under capital and operating leases that expire at various dates through 2039. We leased approximately 16% of our total aircraft fleet under capital or operating leases as of May 31, 2006. 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 and administrative buildings.

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

|   | May 31,<br>2006 | 2005   |
|---|-----------------|--------|
| Aircraft                                      | \$ 114          | \$ 232 |
| Package handling and ground support equipment | 167             | 167    |
| Vehicles                                      | 34              | 36     |
| Other, principally facilities                 | 166             | 167    |
|   | 481             | 602    |
| Less accumulated amortization                 | 331             | 329    |
|   | \$ 150          | \$ 273 |

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

|                    | For years ended May 31, |          |          |
|--------------------|-------------------------|----------|----------|
|                    | 2006                    | 2005     | 2004     |
| Minimum rentals    | \$ 1,919                | \$ 1,793 | \$ 1,560 |
| Contingent rentals | 245                     | 235      | 143      |
|                    | \$ 2,164                | \$ 2,028 | \$ 1,703 |

Contingent rentals are based on equipment usage.

A summary of future minimum lease payments under capital leases at May 31, 2006 is as follows (in millions):

|   |        |
|---|--------|
| 2007  | \$ 24  |
| 2008  | 100    |
| 2009  | 12     |
| 2010  | 96     |
| 2011  | 8      |
| Thereafter                                  | 144    |
|   | 384    |
| Less amount representing interest           | 74     |
| Present value of net minimum lease payments | \$ 310 |

A summary of future minimum lease payments under noncancelable operating leases (principally aircraft, retail locations and facilities) with an initial or remaining term in excess of one year at May 31, 2006 is as follows (in millions):

|            | Aircraft and Related<br>Equipment | Facilities and<br>Other | Total     |
|------------|-----------------------------------|-------------------------|-----------|
| 2007       | \$ 632                            | \$ 1,040                | \$ 1,672  |
| 2008       | 586                               | 892                     | 1,478     |
| 2009       | 555                               | 735                     | 1,290     |
| 2010       | 544                               | 576                     | 1,120     |
| 2011       | 526                               | 458                     | 984       |
| Thereafter | 3,934                             | 2,846                   | 6,780     |
|            | \$ 6,777                          | \$ 6,547                | \$ 13,324 |

The weighted-average remaining lease term of all operating leases outstanding at May 31, 2006 was approximately six 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.

**FEDEX CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During the first quarter of 2006, a one-time, noncash charge of \$79 million (\$49 million after tax or \$0.16 per diluted share) was recorded, which represented the impact on prior years to adjust the accounting for certain facility leases, predominantly at FedEx Express. The charge related primarily to rent escalations in on-airport facility leases. Because the amounts involved were not material to our financial statements in any individual prior period or to 2006 results, we recorded the cumulative adjustment in the first quarter, which increased operating expenses by \$79 million.

**NOTE 9: 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, 2006, none of these shares had been issued.

**NOTE 10: STOCK COMPENSATION PLANS**

*STOCK OPTION PLANS.* Under the provisions of our stock incentive 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 stock option grants vesting ratably over four years. At May 31, 2006, there were 7,998,267 shares available for future grants under these plans.

The weighted-average fair value of these grants, calculated using the Black-Scholes valuation method under the assumptions indicated below, was \$25.78 per option in 2006, \$20.37 per option in 2005 and \$18.02 per option in 2004.

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, forfeiture rate and exercise price. Many of these assumptions are judgmental and highly sensitive. Following is a table of the key weighted-average assumptions used in the option valuation calculations for the options granted in the three years ended May 31, and a discussion of our methodology for developing each of the assumptions used in the valuation model:

|                         | <b>2006</b> |   | <b>2005</b> |   | <b>2004</b> |
|-------------------------|-------------|---|-------------|---|-------------|
| Expected lives          | 5 years     |   | 4 years     |   | 4 years     |
| Expected volatility     | 25          | % | 27          | % | 32          |
| Risk-free interest rate | 3.794       | % | 3.559       | % | 2.118       |
| Dividend yield          | 0.3229      | % | 0.3215      | % | 0.3102      |

*Expected Lives.* 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. An increase in the expected term will increase compensation expense.

*Expected Volatility.* 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

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

expected life of the options to determine volatility. An increase in the expected volatility will increase compensation expense.

*Risk-Free Interest Rate.* 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. An increase in the risk-free interest rate will increase compensation expense.

*Dividend Yield.* This is the annual rate of dividends per share over the exercise price of the option. An increase in the dividend yield will decrease compensation expense.

*Forfeiture Rate.* This is the estimated percentage of options granted that are expected to be forfeited or canceled before becoming fully vested. This percentage is derived from historical experience. An increase in the forfeiture rate will decrease compensation expense. Our forfeiture rate is approximately 8%.

The following table summarizes information about our stock option plans for the years ended May 31:

|                                  | 2006         |                                 | 2005         |                                 | 2004         |                                 |
|----------------------------------|--------------|---------------------------------|--------------|---------------------------------|--------------|---------------------------------|
|                                  | Shares       | Weighted-Average Exercise Price | Shares       | Weighted-Average Exercise Price | Shares       | Weighted-Average Exercise Price |
| Outstanding at beginning of year | 17,359,382   | \$ 51.96                        | 17,349,307   | \$ 46.39                        | 17,315,116   | \$ 38.88                        |
| Granted                          | 3,324,135    | 90.82                           | 2,718,651    | 76.21                           | 3,937,628    | 64.96                           |
| Exercised                        | (3,345,827 ) | 43.33                           | (2,540,324 ) | 39.14                           | (3,724,605 ) | 31.05                           |
| Forfeited                        | (238,164 )   | 79.25                           | (168,252 )   | 63.27                           | (178,832 )   | 46.71                           |
| Outstanding at end of year       | 17,099,526   | 60.82                           | 17,359,382   | 51.96                           | 17,349,307   | 46.39                           |
| Exercisable at end of year       | 9,657,410    | 47.79                           | 9,660,334    | 42.34                           | 8,747,523    | 38.28                           |

The following table summarizes information about stock options outstanding at May 31, 2006:

| Range of Exercise Prices | Options Outstanding |   |                                 | Options Exercisable |                                 |                                 |
|--------------------------|---------------------|---|---------------------------------|---------------------|---------------------------------|---------------------------------|
|                          | Number Outstanding  | Weighted-Average Remaining Contractual Life | Weighted-Average Exercise Price | Number Exercisable  | Weighted-Average Exercise Price | Weighted-Average Exercise Price |
| \$15.34 - 22.16          | 96,674              | 1.4 years                                   | \$ 17.70                        | 96,674              | \$ 17.70                        |                                 |
| 23.81 - 35.69            | 1,671,125           | 1.8 years                                   | 30.14                           | 1,671,125           | 30.14                           |                                 |
| 35.89 - 53.77            | 5,450,650           | 5.2 years                                   | 44.81                           | 4,820,318           | 43.65                           |                                 |
| 55.94 - 83.73            | 6,428,018           | 6.9 years                                   | 66.67                           | 2,911,443           | 63.42                           |                                 |
| 84.57 - 117.52           | 3,453,059           | 9.0 years                                   | 91.28                           | 157,850             | 91.59                           |                                 |
| 15.34 - 117.52           | 17,099,526          | 6.2 years                                   | \$ 60.82                        | 9,657,410           | \$ 47.79                        |                                 |

Total equity compensation shares outstanding or available for grant represented approximately 8.1% at May 31, 2006 and 6.8% at May 31, 2005, of the total common and equity compensation shares outstanding and equity compensation shares available for grant.

*RESTRICTED STOCK PLANS.* Under the terms of our restricted stock plans, 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 plans is recorded as a reduction of common stockholders investment and is amortized to expense over the explicit service



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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

period. Annual compensation cost for the restricted stock plans was approximately \$29 million for 2006, \$26 million for 2005 and \$25 million for 2004.

The following table summarizes information about restricted stock awards for the years ended May 31:

|           | 2006    |                             | 2005    |                             | 2004    |                             |
|-----------|---------|-----------------------------|---------|-----------------------------|---------|-----------------------------|
|           | Shares  | Weighted-Average Fair Value | Shares  | Weighted-Average Fair Value | Shares  | Weighted-Average Fair Value |
| Awarded   | 233,939 | \$ 90.12                    | 218,273 | \$ 80.24                    | 282,423 | \$ 67.11                    |
| Forfeited | 13,791  | 78.42                       | 21,354  | 55.41                       | 10,000  | 43.41                       |

At May 31, 2006, there were 1,076,617 shares available for future awards under these plans.

**NOTE 11: COMPUTATION OF EARNINGS PER SHARE**

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

|  | 2006     | 2005     | 2004    |
|--|----------|----------|---------|
| Net income   | \$ 1,806 | \$ 1,449 | \$ 838  |
| Weighted-average shares of common stock outstanding                  | 304      | 301      | 299     |
| Common equivalent shares:  |          |          |         |
| Assumed exercise of outstanding dilutive options                     | 19       | 18       | 19      |
| Less shares repurchased from proceeds of assumed exercise of options | (13 )    | (12 )    | (14 )   |
| Weighted-average common and common equivalent shares outstanding     | 310      | 307      | 304     |
| Basic earnings per common share                                      | \$ 5.94  | \$ 4.81  | \$ 2.80 |
| Diluted earnings per common share                                    | \$ 5.83  | \$ 4.72  | \$ 2.76 |

**NOTE 12: INCOME TAXES**

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

|                              | 2006     | 2005   | 2004   |
|------------------------------|----------|--------|--------|
| Current provision            |          |        |        |
| Domestic:                    |          |        |        |
| Federal                      | \$ 719   | \$ 634 | \$ 371 |
| State and local              | 79       | 65     | 54     |
| Foreign                      | 132      | 103    | 85     |
|                              | 930      | 802    | 510    |
| Deferred provision (benefit) |          |        |        |
| Domestic:                    |          |        |        |
| Federal                      | 151      | 67     | (22 )  |
| State and local              | 13       | (4 )   | (7 )   |
| Foreign                      | (1 )     | (1 )   |        |
|                              | 163      | 62     | (29 )  |
|                              | \$ 1,093 | \$ 864 | \$ 481 |





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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

|  | 2006   | 2005   | 2004   |
|--|--------|--------|--------|
| Statutory U.S. income tax rate                       | 35.0 % | 35.0 % | 35.0 % |
| Increase resulting from:                             |        |        |        |
| State and local income taxes, net of federal benefit | 2.1    | 1.7    | 2.3    |
| Other, net   | 0.6    | 0.7    | (0.8 ) |
| Effective tax rate                                   | 37.7 % | 37.4 % | 36.5 % |

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 (\$12 million tax benefit or \$0.04 per diluted share) and by a lower effective state tax rate. The 36.5% effective tax rate in 2004 was favorably impacted by a reduction of accruals relating to the tax treatment of jet engine maintenance costs, stronger than anticipated international results and the results of tax audits during 2004.

In 2004, we received a favorable ruling regarding the tax treatment of jet engine maintenance costs, which was affirmed by the appellate court in February of 2005, and became final in May of 2005, when the period for appeal lapsed. As a result we recognized a one-time benefit of \$26 million, net of tax, or \$0.08 per diluted share in 2004. These adjustments affected both net interest expense (\$30 million pretax) and income tax expense (\$7 million).

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

|   | 2006<br>Deferred<br>Tax Assets | Deferred<br>Tax Liabilities | 2005<br>Deferred<br>Tax Assets | Deferred<br>Tax Liabilities |
|---|--------------------------------|-----------------------------|--------------------------------|-----------------------------|
| Property, equipment, leases and intangibles | \$ 329                         | \$ 1,559                    | \$ 301                         | \$ 1,506                    |
| Employee benefits                           | 413                            | 648                         | 397                            | 453                         |
| Self-insurance accruals                     | 339                            |                             | 311                            |                             |
| Other                                       | 360                            | 78                          | 319                            | 77                          |
| Net operating loss/credit carryforwards     | 64                             |                             | 54                             |                             |
| Valuation allowance                         | (48 )                          |                             | (42 )                          |                             |
|   | \$ 1,457                       | \$ 2,285                    | \$ 1,340                       | \$ 2,036                    |

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

|                                    | 2006      | 2005      |
|------------------------------------|-----------|-----------|
| Current deferred tax asset         | \$ 539    | \$ 510    |
| Non-current deferred tax liability | (1,367 )  | (1,206 )  |
|                                    | \$ (828 ) | \$ (696 ) |

**FEDEX CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The valuation allowance primarily represents amounts reserved for operating loss and tax credit carryforwards, which expire over varying periods starting in 2007. As a result of this and other factors, we believe that a substantial portion of these deferred tax assets may not be realized.

**NOTE 13: EMPLOYEE BENEFIT PLANS**

**PENSION PLANS.** We sponsor defined benefit pension plans covering a majority of our employees. The largest 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 a cash balance formula which we call 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. In either case, employees retained all benefits previously accrued under the traditional pension benefit formula and continue to receive the benefit of future salary increases on benefits accrued as of May 31, 2003. Eligible employees hired after May 31, 2003 accrue benefits exclusively under the Portable Pension Account.

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 and years of service and are funded in accordance with local laws and income tax regulations. Substantially all plan assets are actively managed.

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

|                                       | 2006   |        | 2005   |        |
|---------------------------------------|--------|--------|--------|--------|
|                                       | Actual | Target | Actual | Target |
| Domestic equities                     | 54 %   | 53 %   | 53 %   | 53 %   |
| International equities                | 20     | 17     | 20     | 17     |
| Private equities                      | 3      | 5      | 2      | 5      |
| Total equities                        | 77     | 75     | 75     | 75     |
| Long duration fixed income securities | 14     | 15     | 15     | 15     |
| Other fixed income securities         | 9      | 10     | 10     | 10     |
|                                       | 100 %  | 100 %  | 100 %  | 100 %  |

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.

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 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.

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Actuarial gains or losses are generated 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.

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. Also, we periodically commission detailed asset/liability studies performed by third-party professional investment advisors and actuaries to assist us in this evaluation. 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 study performed for 2004 supported the reasonableness of our 9.10% return assumption used for 2004 based on our liability duration and market conditions at the time we set this assumption (in 2004). The results of this study were reaffirmed for 2005 and 2006 by our third-party professional investment advisors and actuaries.

*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.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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, 2006 and a statement of the funded status as of May 31, 2006 and 2005 (in millions):

|  | Pension Plans |             | Postretirement Healthcare Plans |           |
|--|---------------|-------------|---------------------------------|-----------|
|  | 2006          | 2005        | 2006                            | 2005      |
| <b>Accumulated Benefit Obligation ( ABO )</b>            | \$ 10,090     | \$ 8,933    |                                 |           |
| <b>Changes in Projected Benefit Obligation ( PBO )</b>   |               |             |                                 |           |
| Projected benefit obligation at the beginning of year    | \$ 10,401     | \$ 8,683    | \$ 537                          | \$ 496    |
| Service cost   | 473           | 417         | 42                              | 37        |
| Interest cost  | 642           | 579         | 32                              | 32        |
| Actuarial loss (gain)                                    | 858           | 907         | (109 )                          |           |
| Benefits paid  | (228 )        | (194 )      | (39 )                           | (36 )     |
| Amendments, benefit enhancements and other               | 7             | 9           | 12                              | 8         |
| Projected benefit obligation at the end of year          | \$ 12,153     | \$ 10,401   | \$ 475                          | \$ 537    |
| <b>Change in Plan Assets</b>                             |               |             |                                 |           |
| Fair value of plan assets at beginning of year           | \$ 8,826      | \$ 7,783    | \$                              | \$        |
| Actual return on plan assets                             | 1,034         | 746         |                                 |           |
| Company contributions                                    | 492           | 489         | 27                              | 28        |
| Benefits paid  | (228 )        | (194 )      | (39 )                           | (36 )     |
| Other  | 6             | 2           | 12                              | 8         |
| Fair value of plan assets at end of year                 | \$ 10,130     | \$ 8,826    | \$                              | \$        |
| <b>Funded Status of the Plans</b>                        | \$ (2,023 )   | \$ (1,575 ) | \$ (475 )                       | \$ (537 ) |
| Unrecognized actuarial loss (gain)                       | 3,026         | 2,500       | (110 )                          | (1 )      |
| Unamortized prior service cost and other                 | 96            | 104         | 2                               | 4         |
| Unrecognized transition amount                           | (3 )          | (4 )        |                                 |           |
| Prepaid (accrued) benefit cost                           | \$ 1,096      | \$ 1,025    | \$ (583 )                       | \$ (534 ) |
| <b>Amount Recognized in the Balance Sheet at May 31:</b> |               |             |                                 |           |
| Prepaid benefit cost                                     | \$ 1,349      | \$ 1,272    | \$                              | \$        |
| Accrued benefit liability                                | (253 )        | (247 )      | (583 )                          | (534 )    |
| Minimum pension liability                                | (122 )        | (63 )       |                                 |           |
| Accumulated other comprehensive income(1)                | 112           | 52          |                                 |           |
| Intangible asset   | 10            | 11          |                                 |           |
| Prepaid (accrued) benefit cost                           | \$ 1,096      | \$ 1,025    | \$ (583 )                       | \$ (534 ) |

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

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Our pension plans included the following components at May 31, 2006 and 2005 (in millions):

|                                   | U.S. Plans<br>Qualified |             | Nonqualified |           | International<br>Plans |           | Total       |             |
|-----------------------------------|-------------------------|-------------|--------------|-----------|------------------------|-----------|-------------|-------------|
|                                   | 2006                    | 2005        | 2006         | 2005      | 2006                   | 2005      | 2006        | 2005        |
| ABO                               | \$ 9,591                | \$ 8,534    | \$ 239       | \$ 166    | \$ 260                 | \$ 233    | \$ 10,090   | \$ 8,933    |
| PBO                               | \$ 11,569               | \$ 9,937    | \$ 271       | \$ 181    | \$ 313                 | \$ 283    | \$ 12,153   | \$ 10,401   |
| Fair Value of Plan Assets         | 9,969                   | 8,699       |              |           | 161                    | 127       | 10,130      | 8,826       |
| Funded Status                     | \$ (1,600 )             | \$ (1,238 ) | \$ (271 )    | \$ (181 ) | \$ (152 )              | \$ (156 ) | \$ (2,023 ) | \$ (1,575 ) |
| Unrecognized actuarial<br>loss    | 2,859                   | 2,414       | 109          | 27        | 58                     | 59        | 3,026       | 2,500       |
| Unamortized prior<br>service cost | 77                      | 86          | 14           | 14        | 5                      | 4         | 96          | 104         |
| Unrecognized transition<br>amount | (4 )                    | (5 )        |              |           | 1                      | 1         | (3 )        | (4 )        |
| Prepaid (accrued) benefit<br>cost | \$ 1,332                | \$ 1,257    | \$ (148 )    | \$ (140 ) | \$ (88 )               | \$ (92 )  | \$ 1,096    | \$ 1,025    |

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.

The measure of whether a pension plan is underfunded for financial accounting purposes is based on a comparison of the ABO to the fair value of plan assets and amounts accrued for such benefits in the balance sheets. Although not legally required, we made \$456 million in tax-deductible voluntary contributions to our qualified U.S. pension plans in 2006 compared to total tax-deductible voluntary contributions of \$460 million in 2005. Currently, we do not expect any contributions for 2007 will be legally required. However, we currently expect to make tax-deductible voluntary contributions in 2007 at levels approximating those in 2006.

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 \$499 million at May 31, 2006 and \$399 million at May 31, 2005, with assets of \$161 million at May 31, 2006 and \$127 million at May 31, 2005. Plans with this funded status resulted in the recognition of a minimum pension liability in our balance sheets. This minimum liability was \$122 million at May 31, 2006 and \$63 million at May 31, 2005.

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Net periodic benefit cost for the three years ended May 31 was as follows (in millions):

|                                       | Pension Plans |        |        | Postretirement<br>Healthcare Plans |       |       |
|---------------------------------------|---------------|--------|--------|------------------------------------|-------|-------|
|                                       | 2006          | 2005   | 2004   | 2006                               | 2005  | 2004  |
| Service cost                          | \$ 473        | \$ 417 | \$ 376 | \$ 42                              | \$ 37 | \$ 35 |
| Interest cost                         | 642           | 579    | 490    | 32                                 | 32    | 25    |
| Expected return on plan assets        | (811 )        | (707 ) | (597 ) |                                    |       |       |
| Recognized actuarial losses           | 110           | 60     | 62     |                                    |       |       |
| Amortization of transition obligation | (1 )          |        |        |                                    |       |       |
| Amortization of prior service cost    | 12            | 12     | 12     | (1 )                               | (1 )  |       |
|                                       | \$ 425        | \$ 361 | \$ 343 | \$ 73                              | \$ 68 | \$ 60 |

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<br>Healthcare Plans |        |        |
|--|---------------|---------|--------|------------------------------------|--------|--------|
|  | 2006          | 2005    | 2004   | 2006                               | 2005   | 2004   |
| Discount rate                                  | 5.912 %       | 6.285 % | 6.78 % | 6.08 %                             | 6.16 % | 6.57 % |
| Rate of increase in future compensation levels | 3.46          | 3.15    | 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<br>Healthcare Plans |  |
|-----------|---------------|--|------------------------------------|--|
|           |               |  |                                    |  |
| 2007      | \$ 289        |  | \$ 30                              |  |
| 2008      | 295           |  | 30                                 |  |
| 2009      | 342           |  | 32                                 |  |
| 2010      | 348           |  | 33                                 |  |
| 2011      | 390           |  | 34                                 |  |
| 2012-2016 | 2,759         |  | 196                                |  |

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

Future medical benefit costs are estimated to increase at an annual rate of 12% during 2007, 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 6.5% during 2007, 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, 2006 or 2006 benefit expense because the level of these benefits is capped.

**DEFINED CONTRIBUTION PLANS.** Profit sharing and other defined contribution plans are in place covering a majority of U.S. employees. The majority of U.S. employees are covered under 401(k) plans to

**FEDEX CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

which we provide discretionary matching contributions based on employee contributions. In addition, some employees are covered under profit sharing plans which provide for discretionary contributions, as determined annually by those business units. Expense under these plans was \$104 million in 2006, \$97 million in 2005 and \$89 million in 2004.

**NOTE 14: BUSINESS SEGMENT INFORMATION**

Our operations for the periods presented are primarily represented by FedEx Express, FedEx Ground, FedEx Freight and FedEx Kinko's. These businesses 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, 2006, our reportable segments included the following businesses:

|                              |   |
|------------------------------|---|
| <b>FedEx Express Segment</b> | FedEx Express<br>FedEx Trade Networks                                       |
| <b>FedEx Ground Segment</b>  | FedEx Ground<br>FedEx SmartPost<br>FedEx Supply Chain Services              |
| <b>FedEx Freight Segment</b> | FedEx Freight<br>FedEx Custom Critical<br>Caribbean Transportation Services |
| <b>FedEx Kinko's Segment</b> | FedEx Kinko's   |

FedEx Services provides customer-facing sales, marketing and information technology support, primarily for FedEx Express and FedEx Ground. The costs for these activities 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, are allocated based on metrics such as relative revenues or estimated services provided. 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, which we believe approximate fair value, and are reflected as revenues of the billing segment. 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 but are not separately identified in the following segment information as the amounts are not material.



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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

|                                      | <b>FedEx<br/>Express<br/>Segment</b> | <b>FedEx<br/>Ground<br/>Segment</b> | <b>FedEx<br/>Freight<br/>Segment</b> | <b>FedEx<br/>Kinko s<br/>Segment(1)</b> | <b>Other and<br/>Eliminations(2)</b> | <b>Consolidated<br/>Total</b> |
|--------------------------------------|--------------------------------------|-------------------------------------|--------------------------------------|---|--------------------------------------|-------------------------------|
| <b>Revenues</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                        |
| 2004                                 | 17,497                               | 3,910                               | 2,689                                | 521                                     | 93                                   | 24,710                        |
| <b>Depreciation and amortization</b> |                                      |                                     |                                      |   |                                      |                               |
| 2006                                 | \$ 805                               | \$ 224                              | \$ 120                               | \$ 148                                  | \$ 253                               | \$ 1,550                      |
| 2005                                 | 798                                  | 176                                 | 102                                  | 138                                     | 248                                  | 1,462                         |
| 2004                                 | 810                                  | 154                                 | 92                                   | 33                                      | 286                                  | 1,375                         |
| <b>Operating income</b>              |                                      |                                     |                                      |   |                                      |                               |
| 2006(3)                              | \$ 1,767                             | \$ 705                              | \$ 485                               | \$ 57                                   | \$                                   | \$ 3,014                      |
| 2005(4)                              | 1,414                                | 604                                 | 354                                  | 100                                     | (1 )                                 | 2,471                         |
| 2004(5)                              | 629                                  | 522                                 | 244                                  | 39                                      | 6                                    | 1,440                         |
| <b>Segment assets(6)</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                        |
| 2004                                 | 12,443                               | 2,248                               | 1,924                                | 2,903                                   | (384 )                               | 19,134                        |

(1) Includes the operations of FedEx Kinko s from the formation of the FedEx Kinko s segment on March 1, 2004.

(2) Includes the results of operations of FedEx Kinko s from February 12, 2004 (date of acquisition) through February 29, 2004 (approximately \$100 million of revenue and \$6 million of operating income).

(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) Includes business realignment costs of \$428 million in the FedEx Express segment, \$1 million in the FedEx Ground segment and \$6 million in Other and Eliminations.

(6) 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):

|      | <b>FedEx<br/>Express<br/>Segment</b> | <b>FedEx<br/>Ground<br/>Segment</b> | <b>FedEx<br/>Freight<br/>Segment</b> | <b>FedEx<br/>Kinko s<br/>Segment</b> | <b>Other</b> | <b>Consolidated<br/>Total</b> |
|------|--------------------------------------|-------------------------------------|--------------------------------------|--------------------------------------|--------------|-------------------------------|
| 2006 | \$ 1,408                             | \$ 487                              | \$ 274                               | \$ 94                                | \$ 255       | \$ 2,518                      |
| 2005 | 1,195                                | 456                                 | 217                                  | 152                                  | 216          | 2,236                         |
| 2004 | 592                                  | 314                                 | 130                                  | 36                                   | 199          | 1,271                         |

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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**

|                                | 2006      | 2005      | 2004      |
|--------------------------------|-----------|-----------|-----------|
| FedEx Express segment:         |           |           |           |
| Package:                       |           |           |           |
| U.S. overnight box             | \$ 6,422  | \$ 5,969  | \$ 5,558  |
| U.S. overnight envelope        | 1,974     | 1,798     | 1,700     |
| U.S. deferred                  | 2,853     | 2,799     | 2,592     |
| Total domestic package revenue | 11,249    | 10,566    | 9,850     |
| International Priority         | 6,979     | 6,134     | 5,131     |
| Total package revenue          | 18,228    | 16,700    | 14,981    |
| Freight:                       |           |           |           |
| U.S.                           | 2,218     | 1,854     | 1,609     |
| International                  | 434       | 381       | 393       |
| Total freight revenue          | 2,652     | 2,235     | 2,002     |
| Other                          | 566       | 550       | 514       |
| Total FedEx Express segment    | 21,446    | 19,485    | 17,497    |
| FedEx Ground segment           | 5,306     | 4,680     | 3,910     |
| FedEx Freight segment          | 3,645     | 3,217     | 2,689     |
| FedEx Kinko's segment(1)       | 2,088     | 2,066     | 521       |
| Other and Eliminations(2)      | (191)     | (85)      | 93        |
|                                | \$ 32,294 | \$ 29,363 | \$ 24,710 |

**GEOGRAPHICAL INFORMATION(3)**

|                           |           |           |           |
|---------------------------|-----------|-----------|-----------|
| <b>Revenues:</b>          |           |           |           |
| U.S.                      | \$ 24,172 | \$ 22,146 | \$ 18,643 |
| International             | 8,122     | 7,217     | 6,067     |
|                           | \$ 32,294 | \$ 29,363 | \$ 24,710 |
| <b>Noncurrent assets:</b> |           |           |           |
| U.S.                      | \$ 13,804 | \$ 13,020 | \$ 12,644 |
| International             | 2,422     | 2,115     | 1,520     |
|                           | \$ 16,226 | \$ 15,135 | \$ 14,164 |

(1) Includes the operations of FedEx Kinko's from the formation of the FedEx Kinko's segment on March 1, 2004.

(2) Includes the results of operations of FedEx Kinko's from February 12, 2004 (date of acquisition) through February 29, 2004 (approximately \$100 million of revenue).

(3) 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.

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 15: SUPPLEMENTAL CASH FLOW INFORMATION**

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

|  | 2006   | 2005   | 2004   |
|--|--------|--------|--------|
| Interest (net of capitalized interest) | \$ 145 | \$ 162 | \$ 151 |
| Income taxes                           | 880    | 824    | 364    |

FedEx Express amended two leases in 2004 for MD11 aircraft, which required FedEx Express to record \$110 million in 2004 in both fixed assets and long-term liabilities.

**NOTE 16: GUARANTEES AND INDEMNIFICATIONS**

We account for guarantees and indemnifications in accordance with FIN 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, which requires the recognition and measurement of certain guarantees and indemnifications.

With the exception of residual value guarantees in certain operating leases, 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 \$34 million as of May 31, 2006, 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 any amounts under the terms of these guarantee arrangements. Accordingly, no accruals have been recognized for these guarantees.

In conjunction with certain transactions, primarily the lease, sale or purchase of operating assets or services in the ordinary course of business, we sometimes provide routine indemnifications (e.g., environmental, fuel, tax and software infringement), the terms of which range in duration and are often not limited. The fair market value of these indemnifications is not believed to be significant.

FedEx's publicly held debt (approximately \$1.4 billion) is guaranteed by our subsidiaries. The guarantees are full and unconditional, joint and several, and any subsidiaries that are not guarantors are minor as defined by Securities and Exchange Commission (SEC) regulations. FedEx, as the parent company issuer of this debt, has no independent assets or operations. There are no significant restrictions on our ability or the ability of any guarantor to obtain funds from its subsidiaries by such means as a dividend or loan. Subsequent to May 31, 2006, through a consent solicitation process, we have obtained the ability to amend one of our public debt indentures to allow us at any time to cause the release and discharge of certain subsidiary guarantors from their respective 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

**FEDEX CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

guaranteed \$755 million in principal of these bonds (with total future principal and interest payments of approximately \$1.2 billion as of May 31, 2006) 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, 2006. The remaining \$551 million has been accounted for as operating leases.

**NOTE 17: VARIABLE INTEREST ENTITIES**

FedEx Express entered into a lease in July 2001 for two MD11 aircraft. These assets were held by a separate entity, which was established to lease these aircraft to FedEx Express and is owned by independent third parties who provide financing through debt and equity participation. The original cost of the assets under the lease was approximately \$150 million.

FIN 46 required us to consolidate the separate entity that owns the two MD11 aircraft. Since the entity was created before February 1, 2003, we measured the assets and liabilities at their carrying amounts (the amounts at which they would have been recorded in the consolidated financial statements if FIN 46 had been effective at the inception of the lease). As a result of this consolidation, the accompanying May 31, 2006 balance sheet includes an additional \$115 million of fixed assets and \$118 million of long-term debt. The May 31, 2005 balance sheet includes an additional \$120 million of fixed assets and \$125 million of long-term debt. In March 2006, FedEx Express provided notification to the lessor of our intent to purchase these aircraft in March 2007.

**NOTE 18: COMMITMENTS**

Annual purchase commitments under various contracts as of May 31, 2006 were as follows (in millions):

|            | Aircraft | Aircraft-<br>Related(1) | Other(2) | Total    |
|------------|----------|-------------------------|----------|----------|
| 2007       | \$ 179   | \$ 205                  | \$ 798   | \$ 1,182 |
| 2008       | 431      | 113                     | 130      | 674      |
| 2009       | 459      | 61                      | 93       | 613      |
| 2010       | 659      | 67                      | 65       | 791      |
| 2011       | 460      | 66                      | 56       | 582      |
| Thereafter | 157      | 8                       | 218      | 383      |

(1) Primarily aircraft modifications.

(2) Primarily vehicles, facilities, computers, printing and other equipment and advertising and promotions 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.

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

FedEx Express is committed to purchase certain aircraft. Deposits and progress payments of \$64 million have been made toward these purchases and other planned aircraft-related transactions. In addition, we have committed to modify our DC10 aircraft for passenger-to-freighter and 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 our aircraft purchase commitments as of May 31, 2006 with the year of expected delivery by type:

|            | A300 | A310 | A380 | Total |
|------------|------|------|------|-------|
| 2007       | 5    | 1    |      | 6     |
| 2008       | 10   |      |      | 10    |
| 2009       | 2    |      | 2    | 4     |
| 2010       |      |      | 4    | 4     |
| 2011       |      |      | 3    | 3     |
| Thereafter |      |      | 1    | 1     |
| Total      | 17   | 1    | 10   | 28    |

**NOTE 19: 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 are employees of FedEx operating companies who allege, among other things, that they were forced to work off the clock and were not provided work breaks or other benefits. The plaintiffs generally seek unspecified monetary damages, injunctive relief, or both.

To date, one of these wage-and-hour cases, *Foster v. FedEx Express*, has been certified as a class action. The plaintiffs in *Foster* represent a class of hourly FedEx Express employees in California from October 14, 1998 to present. The plaintiffs allege that hourly employees are routinely required to work off the clock and are not paid for this additional work. The court issued a ruling in December 2004 granting class certification on all issues. In February 2006, the parties reached a settlement that has been preliminarily approved by the court. FedEx Express continues to deny liability, but entered into the settlement to avoid the cost and uncertainty of further litigation. The amount of the proposed settlement was fully accrued at the end of the third quarter of 2006 and is not material to FedEx.

With respect to the other wage-and-hour cases, we have denied any liability and intend to vigorously defend ourselves. Given the nature and preliminary status of these other wage-and-hour claims, we cannot yet determine the amount or a reasonable range of potential loss in these other matters, if any.

*Race Discrimination.* On September 28, 2005, a California federal district court granted class certification in *Satchell v. FedEx Express*, a lawsuit alleging discrimination by FedEx Express in the Western region of the United States against certain current and former minority employees in pay and promotion. The district court's ruling on class certification is not a decision on the merits of the plaintiffs' claim and does not address whether we will be held liable. Trial is currently scheduled for February 2007. We have denied any liability and intend to vigorously defend ourselves in this case. Given the nature and preliminary status of the claim, we cannot yet determine the amount or a reasonable range of potential loss in this matter, if any. It is reasonably possible, however, that we could incur a material loss as this case develops.

On May 24, 2006, a jury ruled against FedEx Ground in *Issa & Rizkallah v. FedEx Ground*, a California state court lawsuit brought in July 2001 by two independent contractors who allege, among other things,

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

that a FedEx Ground manager harassed and discriminated against them based upon their national origin. The jury awarded the two plaintiffs a total of \$60 million (which includes \$50 million of punitive damages), plus attorney's fees and other litigation expenses in an amount to be determined later. We intend to vigorously contest the jury verdict, including the amount of the damages award. We cannot yet determine the amount or a range of probable loss, if any, in this matter. It is reasonably possible, however, that we could incur a material loss.

*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 is pending in California state court. Although the trial court has granted some of the plaintiffs' claims for relief in *Estrada* (\$18 million, inclusive of attorney's fees, plus equitable relief), we expect to prevail on appeal. 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.

*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 20: RELATED PARTY TRANSACTIONS**

In November 1999, FedEx entered into a multi-year naming rights agreement with the National Football League Washington Redskins professional football team. Under this agreement, FedEx has certain marketing rights, including the right to name the Redskins' stadium FedExField. In August 2003, Frederick W. Smith, Chairman, President and Chief Executive Officer of FedEx, personally acquired an approximate 10% ownership interest in the Washington Redskins and joined its board of directors.

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. Mr. Hyde, through one of his companies, also is the general partner of the minority limited partner of HOOPS. During 2002, FedEx entered into a \$90 million naming rights agreement with HOOPS that will be amortized to expense over the term of the agreement, which expires in 2024. Under this agreement, FedEx has 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. FedEx also purchased \$2 million of municipal bonds issued by the Memphis and Shelby County Sports Authority, the proceeds of which were used to finance a portion of the construction costs of the arena.

**FEDEX CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 21: SUMMARY OF QUARTERLY OPERATING RESULTS (UNAUDITED)**

| (in millions, except per share amounts) | First<br>Quarter(1) | Second<br>Quarter(2) | Third<br>Quarter | Fourth<br>Quarter |
|---|---------------------|----------------------|------------------|-------------------|
| <b>2006</b>                             |                     |                      |                  |                   |
| Revenues                                | \$ 7,707            | \$ 8,090             | \$ 8,003         | \$ 8,494          |
| Operating income                        | 584                 | 790                  | 713              | 927               |
| Net income                              | 339                 | 471                  | 428              | 568               |
| Basic earnings per common share(3)      | 1.12                | 1.55                 | 1.41             | 1.86              |
| Diluted earnings per common share(3)    | 1.10                | 1.53                 | 1.38             | 1.82              |
| <b>2005</b>                             |                     |                      |                  |                   |
| Revenues                                | \$ 6,975            | \$ 7,334             | \$ 7,339         | \$ 7,715          |
| Operating income                        | 579                 | 600                  | 552              | 740               |
| Net income                              | 330                 | 354                  | 317              | 448               |
| Basic earnings per common share(3)      | 1.10                | 1.18                 | 1.05             | 1.48              |
| Diluted earnings per common share(3)    | 1.08                | 1.15                 | 1.03             | 1.46              |

(1) Results for the first quarter of 2006 include a \$79 million (\$49 million, net of tax, or \$0.16 per basic and diluted share) one-time, noncash charge to adjust the accounting for certain facility leases as described in Note 8.

(2) Results for the second quarter of 2005 include \$48 million (\$31 million, net of tax, or \$0.10 per basic and diluted share) related to the Airline Stabilization Act charge described in Note 1, as well as an \$11 million (\$0.04 per basic and diluted share) benefit from an income tax adjustment described in Note 12.

(3) The sum of the quarterly earnings per share may not equal annual amounts due to differences in the weighted-average number of shares outstanding during the respective periods.

**EXHIBIT INDEX**

| <b>Exhibit Number</b> | <b>Description of Exhibit</b>   |
|-----------------------|---|
| 23                    | Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.  |
| 31.1                  | Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2                  | Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1                  | Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2                  | Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |

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