FUEL TECH, INC.
Form 10-K
March 24, 2016
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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K
(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended: December 31, 2015
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 001-33059

Fuel Tech, Inc.
(Exact name of registrant as specified in its charter)

Delaware	20-5657551
(State of Incorporation)	(I.R.S. ID)

Fuel Tech, Inc.
27601 Bella Vista Parkway
Warrenville, IL 60555-1617
(630) 845-4500
www.ftek.com
Securities registered pursuant to Section 12(b) of the Act:

COMMON STOCK, $0.01 par value per share	NASDAQ

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 ý
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No ý
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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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 amendment to this Form 10-K.
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large" accelerated filer, "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

As of June 30, 2015, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately $45,681,000 based on the closing sale price as reported on the NASDAQ National Market System.

As of February 29, 2016, there were 23,167,216 shares of common stock outstanding.

Documents incorporated by reference:

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on May 19, 2016 are incorporated by reference into Part III.

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TABLE OF DEFINED TERMS

Term	Definition
AIG	Ammonia Injection Grid
ASCR™	A trademark used to describe our Advanced Selective Catalytic Reduction process
CAIR	Clean Air Interstate Rule
CAVR	Clean Air Visibility Rule
CSAPR	Cross-State Air Pollution Rule
CFD	Computational Fluid Dynamics
EPA	The U.S. Environmental Protection Agency
ESP	Electrostatic Precipitator
FGC	Flue Gas Conditioning
FUEL CHEM®	A trademark used to describe our fuel and flue gas treatment processes, including its TIFI® Targeted In-Furnace Injection™ technology to control slagging, fouling, corrosion and a variety of sulfur trioxide-related issues
GSG™	Graduated Straightening Grid
HERT™ High Energy Reagent Technology™	A trademark used to describe one of our SNCR processes for the reduction of NOx
NO_x	Oxides of nitrogen
NO_xOUT®	A trademark used to describe one of our SNCR processes for the reduction of NOx
NO_xOUT-SCR®	A trademark used to describe our direct injection of urea as a catalyst reagent
NO_xOUT CASCADE®	A trademark used to describe our process for the combination of SNCR and SCR technologies
SCR	Selective Catalytic Reduction
SNCR	Selective Non-Catalytic Reduction
TIFI® Targeted In-Furnace Injection™	A trademark used to describe our proprietary technology that enables the precise injection of a chemical reagent into a boiler or furnace as part of a

	FUEL CHEM program
ULTRA™	A trademark used to describe our process for generating ammonia for use as a Selective Catalytic Reduction reagent

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PART I

Forward-Looking Statements

This Annual Report on Form 10-K contains “forward-looking statements,” as defined in Section 21E of the Securities Exchange Act of 1934, as amended, that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and reflect our current expectations regarding our future growth, results of operations, cash flows, performance and business prospects, and opportunities, as well as assumptions made by, and information currently available to, our management. We have tried to identify forward-looking statements by using words such as “anticipate,” “believe,” “plan,” “expect,” “intend,” “will,” and similar expressions, but these words are not the exclusive means identifying forward-looking statements. These statements are based on information currently available to us and are subject to various risks, uncertainties, and other factors, including, but not limited to, those discussed herein under the caption “Risk Factors” that could cause our actual growth, results of operations, financial condition, cash flows, performance and business prospects and opportunities to differ materially from those expressed in, or implied by, these statements. Except as expressly required by the federal securities laws, we undertake no obligation to update such factors or to publicly announce the results of any of the forward-looking statements contained herein to reflect future events, developments, or changed circumstances or for any other reason. Investors are cautioned that all forward-looking statements involve risks and uncertainties, including those detailed in our filings with the Securities and Exchange Commission. See “Risk Factors” in Item 1A.

ITEM 1 - BUSINESS

As used in this Annual Report on Form 10-K, the terms “we,” “us,” or “our,” refer to Fuel Tech, Inc. and our wholly-owned subsidiaries.

GENERAL

We are a leading technology company engaged in the worldwide development, commercialization and application of state-of-the-art proprietary technologies for air pollution control, process optimization, combustion efficiency and advanced engineering services. These technologies enable our customers to operate efficiently in a cost-effective and environmentally sustainable manner. We operate as a fully integrated company to apply our extensive knowledge of carbonaceous fuel and combustion engineering to serve a variety of end markets. Our Air Pollution Control (APC) and FUEL CHEM® business processes rely heavily on our unique ability to inject chemical slurries into combustion units, in precise concentrations and locations, to achieve a desired outcome. Our Fuel Conversion business is a development stage opportunity focused on creating and manufacturing value-added engineered carbon feedstock products for carbon feedstock customer markets.

- Our APC technologies include advanced combustion modification techniques including low NO_x burners and over fire air systems, along with post-combustion nitrogen oxide (NO_x) control approaches, including NO_xOUT® and HERT™ Selective Non-Catalytic Reduction (SNCR) and Rich Reagent Injection (RRI) systems. Our Advanced Selective Catalytic Reduction (ASCR) system utilizes the combination of combustion systems and SNCR to provide a cost effective alternative to high capital cost, standalone conventional SCR systems while providing similar NO_x reduction levels. The ULTRA™ system generates ammonia on-site for SCR systems using safe urea reagent. Our SCR group provides process design optimization, performance testing and improvement, and catalyst selection services for SCR systems on coal-fired boilers. These technologies have established us as a leader in NO_x reduction, with installations on over 1,000 units worldwide, where coal, fuel oil, natural gas, municipal waste, biomass, and other fuels are utilized.

- Our FUEL CHEM technologies revolve around the unique application of chemical injection programs which improve the efficiency, reliability, fuel flexibility and environmental status of combustion units by controlling slagging, fouling, corrosion, opacity and acid plume, as well as the formation of sulfur trioxide, ammonium bisulfate, particulate matter ($PM_{2.5}$), sulfur dioxide (SO_2), and carbon dioxide (CO_2). We use our patented TIFI® Targeted In-Furnace Injection™ processes to apply specialty chemical programs to units burning a wide variety of fuels including coal, heavy oil, biomass, and municipal waste. These TIFI programs incorporate design, modeling, equipment, reagent, and service to provide complete customized on-site programs designed to improve plant operations and provide a return on investment in addition to helping meet emission regulatory requirements.

- The Fuel Conversion business represents the continuing evolution of a new research and business development initiative we first commenced in 2014 following our acquisition of intellectual property rights and know-how related to the CARBONITE® fuel conversion process and technology. The goal of our Fuel Conversion technology is to convert coals of various grades into value-added engineered carbon feedstock products that are designed to be high in energy content and manufactured to contain other customizable carbon feedstock characteristics desirable in a variety of carbon feedstock use applications. Our Fuel Conversion technology has a number of potential applications including certain coal replacement, electric arc furnace reductant, ferro-alloy feedstock, and mercury reduced carbon feedstock. During 2015,

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we have been testing and developing certain engineered carbon feedstock products for specific market applications. We are in the process of evaluating the commercialization of these product offerings with prospective customers.

Many of our products and services rely heavily on our computational fluid dynamics and chemical kinetics modeling capabilities, which are enhanced by internally developed, high-end visualization software. These capabilities, coupled with our innovative technologies and multi-disciplined team approach, enable us to provide practical solutions to some of our customers' most challenging issues.

AIR POLLUTION CONTROL

Regulations and Markets: Domestic

The continued growth of our APC technology segment is dependent upon the adoption and enforcement of increasingly stringent environmental regulations in the U.S. and globally. In the U.S., federal and state laws regulating the emission of NO_x are the primary driver in our APC technology segment. The principal regulatory drivers currently in effect are as follows:

Clean Air Act: The Clean Air Act (CAA) requires the U.S. Environmental Protection Agency (EPA) to establish national ambient air quality standards (NAAQS) at levels that are protective of public health with an adequate margin of safety. The six pollutants specified include: Ozone (O_3), Particulate Matter (PM), Nitrogen Dioxide (NO_2), Sulfur Dioxide (SO_2), Lead, and Carbon Monoxide (CO). The NAAQS provisions require that states comply with ozone and particulate emissions standards. NO_x emissions are a precursor to ozone formation and also contribute to fine particulate emissions ($PM_{2.5}$), which has been the recent regulatory driver through the Cross-State Air Pollution Rule (CSAPR). NO_x emissions were targeted as contributors to fine particulate emissions and ozone emissions. Since 1990, programs have been established by the EPA at the regional and federal level to help states in their mission to define and meet their State Implementation Plans (SIPs) for attainment. NAAQS PM standards were issued in 1997, with more stringent standards issued in 2006 and 2012. The NAAQS ozone standards issued in 1997 were made more stringent in 2008. On October 1, 2015, the EPA strengthened the NAAQS for ground-level ozone by reducing the minimum acceptable level from 75 to 70 parts per billion (ppb).

Cross-State Air Pollution Rule (CSAPR): On July 7, 2011, the Environmental Protection Agency passed the Cross-State Air Pollution Rule (CSAPR) under the “good neighbor” provision of the Clean Air Act to reduce emissions of SO_2 and NO_x from power plants in the eastern half of the United States. This rule replaces the Clean Air Transport Rule (CATR) and focuses on reducing air emissions contributing to fine particle ($PM_{2.5}$) and ozone nonattainment that often travel across state lines; including SO_2 and NO_x which contribute to $PM_{2.5}$ transport. CSAPR affected 27 states, with compliance for the first phase in 2012, with additional reductions required in the second phase by 2014. Under CSAPR, state emission caps were designated to mitigate the emission impact on downwind states by controlling emissions from upwind states. If sources within a state caused the state to exceed its assurance limit, severe penalties including a two-for-one reduction based on each source’s contribution percentage of the state overage would be applied. The timing of CSAPR's implementation has been affected by a number of court actions. In December 2011, CSAPR was stayed prior to implementation due to lawsuits filed by various states and combustion sources, and in August 2012 the U.S. Circuit Court of Appeals, D.C. Circuit, vacated CSAPR and remanded it to the EPA. The U.S. Supreme Court reversed that decision in April, 2014. Following the remand of the case to the D.C. Circuit, the EPA requested that the court lift the CSAPR stay and toll the CSAPR compliance deadlines by three years. In October, 2014, the D.C. Circuit granted the EPA's request and, accordingly, CSAPR Phase 1 implementation commenced in 2015, with Phase 2 beginning in 2017.

Most recently, in November 2015, the EPA proposed an update to CSAPR for the 2008 ozone NAAQS. The rule is expected to be finalized in 2016.

Industrial Boiler MACT: In December 2011, the EPA re-proposed its new emissions rule for industrial, commercial and institutional boilers and process heaters, known as the Industrial Boiler Maximum Achievable Control Technology (MACT) standard. The EPA proposed the final rule on January 31, 2013, with compliance scheduled for January 2016. Emissions regulated include acid gas emissions including hydrochloric acid (HCl), carbon monoxide (CO), mercury, PM, and dioxins.

Clean Air Visibility Rule (CAVR: The Clean Air Visibility Rule (CAVR), also known as the Regional Haze rule, is part of the Clean Air Act and was finalized in 2005. Under CAVR, certain States are required to submit implementation plans to the EPA to comply with the Regional Haze requirements, and updates are required every five years. The overall obligation of CAVR is to return the US scenic areas to “active” visibility by 2064.
Consent Decrees: Consent decree activity through the US Department of Justice or EPA may require emission sources to meet individual requirements. Sources may also agree to specific air pollution requirements with states or environmental groups.

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Regulations and Markets: International

We also sell NO_x control systems outside the United States, specifically in Europe, Latin America, and in the Pacific Rim, including the People's Republic of China (China). Under European Union Directives, existing coal fired power plants will need to meet tighter emission regulations, and come into compliance by 2019 or 2020 (country specific). The Latin American countries will also present some opportunities for SNCR systems with plants that have inter-company directives for curbing emissions, in the absence of national regulations. However, these opportunities will not be time sensitive, and will greatly depend on allocation of capital budgets from the parent companies.

China continues to represent an attractive opportunity for us as the government sets pollution control, energy conservation and efficiency improvements as top priorities, as part of tightened standards addressed by the super clean emission regulation officially released in December, 2015. We have viable technologies to help achieve these objectives. China's dominant reliance on coal as an energy resource is not expected to change in the foreseeable future. China alone is forecasted to account for 76% of the projected increase in world coal use through 2035. Clean air will continue to be a pressing issue and has become a political issue, especially given China's growing awareness of air pollution and increasingly expanded role in international events and organizations.

China's Ministry of Environmental Protection issued super clean emission regulations to be fully implemented by 2020, in support of reducing harmful pollutants and further defining the technologies recommended to achieve the reductions. Super clean emission requires NOx emission under 50 mg/Nm3, SO2 emission under 35 mg/Nm3 and particulate emission under 10 mg/Nm3. The regulations apply to all public utility units of 300MW or larger and private power generation units of 100MW or larger, and will be progressively implemented in the eastern region by 2017, the central region by 2018, and the western region by 2020. Newly constructed units and existing units must meet the same stringent emission standard. The existing units which cannot be retrofitted will be closed, particularly for units under 300MW as part of Thirteenth Five Year Plan-improving overall energy efficiency and clean emission from 2015-2020. In addition, Chinese government promotes the use of waste incineration plants to replace landfills with focus on major cities. New construction of MSW's units which are equipped with SNCR or SCR has been growing.

The European Industrial Emissions Directive (IED) sets the target for NOx emissions to be at or below 200 mg/Nm3 from 1st January 2016. 15 member states have applied for temporary derogation primarily due to aging coal-fired fleets and compliance time frames vary between 2016 and 2020. The implementation is country specific and each member country sets its own limits based on this guideline. Turkey, while not a member state, is also looking to meet this guideline as part of their bid to join the European Union. Presently, Fuel Tech is best positioned to compete in the UK market based on the relationships and partnerships built there over last several years. A number of coal-fired units in the UK are converting to biomass firing due to the subsidies available from the government. Other European countries that rely heavily on coal generation, and are impacted by the IED include Spain, Poland and Czech Republic. Turkey will also see modernization of its fleet of coal-based power generation.

The Latin American governments in general have not enacted NOx specific emission regulations (with the exception of Chile). However, certain companies have set internal targets for pollution control and these will present a few opportunities for Fuel Tech in the next 2 - 3 years. Current Chilean NOx emission limits for existing units are being met with retrofitting of Low NOx burners and OFA systems, while the new units are being fitted with SCRs. Further tightening of NOx limits may require the addition of SCRs to existing plants for compliance.

Products

Our NO_x reduction and particulate control technologies are installed worldwide on over 1000 combustion units, including utility, industrial and municipal solid waste applications. Our products include customized NO_x control systems and our patented ULTRA™ technology, which converts urea-to-ammonia on site and provides safe reagent for use in Selective Catalytic Reduction (SCR) systems.

- SNCR Systems: Our NO_xOUT® and HERT™ SNCR processes use non-hazardous urea as the reagent rather than ammonia. Both the NO_xOUT® and HERT™ processes on their own are capable of reducing NO_x by up to 25% - 50% for utilities and by potentially significantly greater amounts for industrial units in many types of plants with capital costs ranging from \$5 - \$20/kW for utility boilers and with total annualized operating costs ranging from \$1,000 - \$2,000/ton of NO_x removed.

• Combined Systems: Our Advanced Selective Catalytic Reduction (ASCR™) systems include LNB, OFA, and SNCR components, along with a downsized SCR catalyst, Ammonia Injection Grid (AIG), and Graduated Straightening Grid (GSG™) system. Together, these systems provide up to 90% NO_x reduction at significantly lower capital and operating costs than conventional SCR systems while providing greater operational flexibility to plant operators. The capital costs for ASCR systems can range from $30 - $150/kW depending on boiler size and configuration, which is significantly less than that of conventional SCRs, which can cost $300/kW or more, while operating costs are competitive with those experienced by SCR systems. The NO_xOUT CASCADE® and NO_xOUT-SCR® processes are basic types of ASCR systems which use just SNCR and SCR catalyst components. The NO_xOUT CASCADE® systems can achieve 60% - 70% NO_x

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reduction, with capital costs being a portion of the ASCR values defined above. Our NO_xOUT-SCR® process utilizes urea as the SCR catalyst reagent to achieve NO_x reductions of up to 85% from smaller stationary combustion sources with capital and operating costs competitive with equivalently sized, standard SCR systems.

- ULTRA Technology: Our ULTRA™ process is designed to convert urea to ammonia safely and economically for use as a reagent in the SCR process for NO_x reduction. Recent local objections in the ammonia permitting process have raised concerns regarding the safety of ammonia shipment and storage in quantities sufficient to supply SCR. In addition, the Department of Homeland Security has characterized anhydrous ammonia as a Toxic Inhalation Hazard commodity. Overseas, new coal-fired power plants incorporating SCR systems are expected to be constructed at a rapid rate in China, and our ULTRA™ process is believed to be a market leader for the safe conversion of urea to ammonia just prior to injection into the flue gas duct, which is particularly important near densely populated cities, major waterways, harbors or islands, or where the transport of anhydrous or aqueous ammonia is a safety concern.
- SCR Processes and Services: Our SCR group provides process design optimization, performance testing and improvement, and catalyst selection services for SCR systems on coal-fired boilers. In addition, other related services, including start-ups, maintenance support and general consulting services for SCR systems, Ammonia Injection Grid design and tuning to help optimize catalyst performance, and catalyst management services to help optimize catalyst life, are now offered to customers around the world. We also specialize in both physical experimental models, which involve construction of scale models through which fluids are tested, and computational fluid dynamics models, which simulate fluid flow by generating a virtual replication of real-world geometry and operating inputs. We design flow corrective devices, such as turning vanes, ash screens, static mixers and our patent pending Graduated Straightening Grid (GSG™). Our models help clients optimize performance in flow critical equipment, such as selective catalytic reactors in SCR systems, where the effectiveness and longevity of catalysts are of utmost concern. The Company's modeling capabilities are also applied to other power plant systems where proper flow distribution and mixing are important for performance, such as flue gas desulphurization scrubbers, electrostatic precipitators, air heaters, exhaust stacks and carbon injection systems for mercury removal.
- ESP Processes and Services: ESP technologies for particulate control include Electrostatic Precipitator (ESP) products and services including ESP Inspection Services, Performance Modeling, and Performance and Efficiency Upgrades, along with complete turnkey capability for ESP retrofits. Flue gas conditioning (FGC) systems include treatment using sulfur trioxide (SO_3) and ammonia (NH_3) based conditioning to improve the performance of ESPs by modifying the properties of the fly ash particle. Our ULTRA technology can provide the ammonia system feed requirements for FGC applications as a safe alternative to ammonia reagent based systems. FGC systems offer a lower capital cost approach to improving ash particulate capture versus the alternative of installing larger ESPs or utilizing fabric filter technology to meet targeted emissions and opacity limits. Fuel Tech's particulate control technologies have been installed on more than 125 units worldwide.
- Burner Systems: Low NO_x Burners and Ultra Low NO_x Burners (LNB and ULNB) are available for coal-, oil-, and gas-fired industrial and utility units. Each system application is specifically designed to maximize NO_x reduction. Computational fluid dynamics combustion modeling is used to validate the design prior to fabrication of equipment. NO_x reductions can range from 40%-60% depending on the fuel type. Over-Fire Air (OFA) systems stage combustion for enhanced NO_x reduction. Additional NO_x reductions, beyond Low NO_x Burners, of 35% - 50% are possible on different boiler configurations on a range of fuel types. Combined overall reductions range from 50% - 70%, with overall capital costs ranging from $10 - $20/kW and total costs ranging from $300 - $1,500/ton of NO_x removed, depending on the scope.

The key market dynamic for the APC product line is the continued use of coal as the principal fuel source for global electricity production. Coal currently accounts for approximately 39% of all U.S. electricity generation and roughly 67% of Chinese electricity generation. Major coal consumers include China, the United States and India.

Sales of APC products were $43.5 million, $42.0 million, and $72.6 million for the years ended December 31, 2015, 2014 and 2013, respectively.

NO_x Reduction Competition

Competition with our NO_x reduction suite of products may be expected from companies supplying urea SNCR systems, combustion modification products, SCR systems and ammonia SNCR systems. In addition, we experience competition in the urea-to-ammonia conversion market.

Combustion modifications, including Low NO_x Burners and Over-Fire Air systems, can be fitted to most types of boilers with cost and effectiveness varying with specific boilers. Combustion modifications may yield up to 20% - 60% NO_x reduction economically with capital costs ranging from $10 - $20/kW and total costs ranging from $300 - $1,500/ton of NO_x removed. The modifications are designed to reduce the formation of NO_x and are typically the first NO_x reduction efforts employed. Companies

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1,761
FedEx Freight segment
982 1,353
FedEx Services segment
451 513
Other and eliminations
(78) (76)

-

-
$8,009 $9,970

-

-

Operating Income [1]

FedEx Express segment
$104 $345
FedEx Ground segment
209 196
FedEx Freight segment
2 89

-

-
$315 $630

-

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

(8) Commitments

As of August 31, 2009, our purchase commitments under various contracts for the remainder of 2010 and annually thereafter were as follows (in millions):

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

2014	466	12	478
Thereafter	1,924	125	2,049

(1) Our obligation to purchase 15 of these aircraft (Boeing 777 Freighters, or B777Fs) is conditioned upon there being no event that causes FedEx Express or its employees not to be covered by the Railway Labor Act of 1926, as amended.

(2) Primarily aircraft modifications.

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

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

We had $762 million in deposits and progress payments as of August 31, 2009 (an increase of $218 million from May 31, 2009) on aircraft purchases and other planned aircraft-related transactions. These deposits are classified in the Other assets caption of our condensed consolidated balance sheets. Our primary aircraft purchase commitments include the Boeing 757 (B757) in passenger configuration, which will require additional costs to modify for cargo transport, and the new B777F aircraft. In addition, we have committed to modify our DC10 aircraft for two-man cockpit configurations. Future payments related to these activities are included in the table above. Aircraft and aircraft-related contracts are subject to price escalations. The following table is a summary of the number and type of aircraft we are committed to purchase as of August 31, 2009, with the year of expected delivery:

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

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

A summary of future minimum lease payments under capital leases and noncancelable operating leases with an initial or remaining term in excess of one year at August 31, 2009 is as follows (in millions):

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

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

While certain of our lease agreements contain covenants governing the use of the leased assets or require us to maintain certain levels of insurance, none of our lease agreements include material financial covenants or limitations.

(9) Contingencies

Wage-and-Hour. We are a defendant in a number of lawsuits containing various class-action allegations of wage-and-hour violations. The plaintiffs in these lawsuits allege, among other things, that they were forced to work off the clock, were not paid overtime or were not provided work breaks or other benefits. The complaints generally seek unspecified monetary damages, injunctive relief, or both.

In February 2008, one of these wage-and-hour cases, *Wiegele v. FedEx Ground*, was certified as a class action by a California federal court, and in April 2008, the U.S. Court of Appeals for the Ninth Circuit denied our petition to review the class certification ruling. The certified class initially included FedEx Ground sort managers and dock service managers in California from May 10, 2002 to the present, but the court subsequently approved the dismissal of the sort managers, leaving only the dock service managers in the class. The plaintiffs allege that FedEx Ground has misclassified the managers as exempt from the overtime requirements of California wage-and-hour laws and is correspondingly liable for failing to pay them overtime compensation and provide them with rest and meal breaks.

In September 2008, in another one of these wage-and-hour cases, *Tidd v. Adecco USA, Kelly Services and FedEx Ground*, a Massachusetts federal court conditionally certified a class limited to individuals who were employed by two temporary employment agencies and who worked as temporary pick-up-and-delivery drivers for FedEx Ground in the New England region within the past three years. Potential claimants must voluntarily opt in to the lawsuit in order to be considered part of the class. In addition, in the same opinion, the court granted summary judgment in favor of FedEx Ground with respect to the plaintiffs claims for unpaid overtime wages. Accordingly, as to FedEx Ground, the conditionally certified class of plaintiffs is now limited to a claim of failure to pay regular wages due under the federal Fair Labor Standards Act.

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

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

These class certification rulings do not address whether we will ultimately be held liable. We have denied any liability and intend to vigorously defend ourselves in these wage-and-hour lawsuits. We do not believe that any loss is probable in these lawsuits.

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

Most of the class-action lawsuits have been consolidated for administration of the pre-trial proceedings by a single federal court, the U.S. District Court for the Northern District of Indiana. With the exception of recently filed cases that have been or will be transferred to the multidistrict litigation, discovery on class certification and classification issues and class certification briefing are now complete. In October 2007, we received a decision from the court granting class certification in a Kansas action alleging state law claims on behalf of a statewide class and federal law claims under the Employee Retirement Income Security Act of 1974 on behalf of a nationwide class. In January 2008, the U.S. Court of Appeals for the Seventh Circuit declined our request for appellate review of the class certification decision. In March 2008, the court granted class certification in 19 additional cases and denied it in nine cases. In July 2009, the court granted class certification in eight additional cases and denied it in five cases. The court has not yet ruled on class certification in the other cases that are pending in the multidistrict litigation. Motions for summary judgment on the classification issue (*i.e.,* independent contractor vs. employee) are (or are expected soon to be) pending in all 28 of the multidistrict litigation cases that have been certified as class actions.

In January 2008, one of the contractor-model lawsuits that is not part of the multidistrict litigation, *Anfinson v. FedEx Ground*, was certified as a class action by a Washington state court. The plaintiffs in *Anfinson* represent a class of FedEx Ground single-route, pickup-and-delivery owner-operators in Washington from December 21, 2001 through December 31, 2005 and allege that the class members should be reimbursed as employees for their uniform expenses and should receive overtime pay. In March 2009, a jury trial in the *Anfinson* case was held, and the jury returned a verdict in favor of FedEx Ground, finding that all 320 class members were independent contractors, not employees. The plaintiffs have appealed the verdict. The other contractor-model lawsuits that are not part of the multidistrict litigation are not as far along procedurally as *Anfinson* and all but one of the lawsuits are currently stayed pending further developments in the multidistrict litigation.

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

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

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

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

Independent Contractor Shareholder Derivative Lawsuits. The Plumbers and Pipefitters Local 51 Pension Fund and the Western Pennsylvania Bricklayers Pension Fund each filed shareholder derivative lawsuits (which have now been consolidated) in Tennessee federal court naming FedEx Corporation as a nominal defendant and the members of the Board of Directors of FedEx Corporation as defendants (the Plumbers and Pipefitters suit was filed in May 2008 and the Bricklayers suit was filed in June 2008). The derivative lawsuits, which were purportedly brought to assert the rights of FedEx Corporation, asserted claims against the Board members for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment in connection with the management of FedEx Ground in particular, the classification of FedEx Ground s owner-operators as independent contractors. In July 2009, the court dismissed the consolidated shareholder derivative lawsuits, and the time period for appeal has expired.

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

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

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(10) Supplemental Cash Flow Information

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

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

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

(11) Condensed Consolidating Financial Statements

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

The guarantor subsidiaries, which are wholly owned by FedEx, guarantee $1.2 billion of our debt. The guarantees are full and unconditional and joint and several. Our guarantor subsidiaries were not determined using geographic, service line or other similar criteria, and as a result, the Guarantor and Non-Guarantor columns each include portions of our domestic and international operations. Accordingly, this basis of presentation is not intended to present our financial condition, results of operations or cash flows for any purpose other than to comply with the specific requirements for subsidiary guarantor reporting. The internal reorganization discussed in Note 7 had no significant impact on the assets or operations of the guarantor entities. Condensed consolidating financial statements for our guarantor subsidiaries and non-guarantor subsidiaries are presented in the following tables (in millions):

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CONDENSED CONSOLIDATING BALANCE SHEETS
(UNAUDITED)
August 31, 2009

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

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

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CONDENSED CONSOLIDATING BALANCE SHEETS
May 31, 2009

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

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

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

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

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

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated
REVENUES	$	$ 8,246	$ 1,795	$ (71)	$ 9,970
OPERATING EXPENSES:					
Salaries and employee benefits	24	2,931	630		3,585

Purchased transportation		910	378	(10)	1,278
Rentals and landing fees	1	535	82	(1)	617
Depreciation and amortization		421	71		492
Fuel		1,422	106		1,528
Maintenance and repairs		497	40		537
Intercompany charges, net	(56)	(26)	82		
Other	31	1,073	259	(60)	1,303
		7,763	1,648	(71)	9,340
OPERATING INCOME		483	147		630
OTHER INCOME (EXPENSE):					
Equity in earnings of subsidiaries	384	77		(461)	
Interest, net	(10)	5	(4)		(9)
Intercompany charges, net	14	(24)	10		
Other, net	(4)		1		(3)
INCOME BEFORE INCOME TAXES	384	541	154	(461)	618
Provision for income taxes		176	58		234
NET INCOME	$ 384	$ 365	$ 96	$ (461)	$ 384

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

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

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

	Parent	Guarantor Subsidiaries	Non-guarantor Subsidiaries	Eliminations	Consolidated

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

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
FedEx Corporation

We have reviewed the condensed consolidated balance sheet of FedEx Corporation as of August 31, 2009, and the related condensed consolidated statements of income and cash flows for the three-month periods ended August 31, 2009 and 2008. These financial statements are the responsibility of the Company s management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of FedEx Corporation as of May 31, 2009, and the related consolidated statements of income, changes in stockholders investment and comprehensive income, and cash flows for the year then ended not presented herein, and in our report dated July 10, 2009, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of May 31, 2009, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Memphis, Tennessee
September 18, 2009

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

GENERAL

The following Management s Discussion and Analysis of Results of Operations and Financial Condition describes the principal factors affecting the results of operations, liquidity, capital resources, contractual cash obligations and critical accounting estimates of FedEx Corporation (FedEx). This discussion should be read in conjunction with the accompanying quarterly unaudited condensed consolidated financial statements and our Annual Report on Form 10-K for the year ended May 31, 2009 (Annual Report). Our Annual Report includes additional information about our significant accounting policies, practices and the transactions that underlie our financial results, as well as a detailed discussion of the most significant risks and uncertainties associated with our financial condition and operating results.

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

The key indicators necessary to understand our operating results include:

- the overall customer demand for our various services;
- the volumes of transportation services provided through our networks, primarily measured by our average daily volume and shipment weight;
- the mix of services purchased by our customers;
- the prices we obtain for our services, primarily measured by yield (revenue per package or pound or revenue per hundredweight for LTL freight shipments);
- our ability to manage our cost structure (capital expenditures and operating expenses) to match shifting volume levels; and
- the timing and amount of fluctuations in fuel prices and our ability to recover incremental fuel costs through our fuel surcharges.

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

Except as otherwise specified, references to years indicate our fiscal year ending May 31, 2010 or ended May 31 of the year referenced and comparisons are to the corresponding period of the prior year. References to our transportation segments include, collectively, our FedEx Express, FedEx Ground and FedEx Freight segments.

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RESULTS OF OPERATIONS

CONSOLIDATED RESULTS

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

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

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

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

Overview

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

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

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

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

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Revenue

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

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

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Operating Income

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

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

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

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

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

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

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

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

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

Our analysis considers the estimated benefits of the reduction in fuel surcharges included in the base rates charged for FedEx Express services. However, this analysis does not consider the negative effects that fuel surcharge levels may have on our business, including reduced demand and shifts by our customers to lower-yielding services. While fluctuations in fuel surcharge rates can be significant from period to period, fuel surcharges represent one of the many individual components of our pricing structure that impact our overall revenue and yield. Additional components include the mix of services purchased, the base price and extra service charges we obtain for these services and the level of pricing discounts offered. In order to provide information about the impact of fuel surcharges on the trend in revenue and yield growth, we have included the comparative fuel surcharge rates in effect for the first quarter of 2010 and 2009 in the accompanying discussions of each of our transportation segments.

Income Taxes

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

As of August 31, 2009, there had been no material changes to our liabilities recorded under Financial Accounting Standards Board (FASB) Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes, from May 31, 2009. During the first quarter of 2010, the Internal Revenue Service commenced an audit of our 2007 and 2008 consolidated U.S. income tax returns.

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

Outlook

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

We believe our year-over-year comparisons will be somewhat better by the second half of 2010; however, our expectations assume a modest recovery in global economic conditions, the timing and pace of which is difficult to predict, and fuel prices that remain at current forecasted levels. Further, our current results reflect the suspension of many employee compensation programs (as indicated above) that may be reinstated if our financial results begin to improve, somewhat dampening the near-term earnings potential of an economic recovery. If economic conditions deteriorate further, additional actions will be necessary to reduce the size of our networks. However, we will not compromise our outstanding service levels or take actions that negatively impact the customer experience in exchange for short-term cost reductions.

For the remainder of 2010, we will continue to balance the need to control spending with the opportunity to make investments with high returns, such as in substantially more fuel-efficient Boeing 757 (B757) and Boeing 777 Freighter (B777F) aircraft. Moreover, we will continue to invest in critical long-term strategic projects focused on enhancing and broadening our service offerings to position us for stronger growth under improved economic conditions. For additional details on key 2010 capital projects, refer to the Liquidity Outlook section of this MD&A.

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

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

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

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NEW ACCOUNTING PRONOUNCEMENTS

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

On June 1, 2008, we adopted Statement of Financial Accounting Standards (SFAS) 157, Fair Value Measurements, which provides a common definition of fair value, establishes a uniform framework for measuring fair value and requires expanded disclosures about fair value measurements. On June 1, 2009, we implemented the previously deferred provisions of SFAS 157 for nonfinancial assets and liabilities recorded at fair value, as required. The adoption of SFAS 157 had no impact on our financial statements.

In December 2007, the FASB issued SFAS 141R, Business Combinations, and SFAS 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin (ARB) No. 51. These new standards significantly change the accounting for and reporting of business combination transactions, including noncontrolling interests (previously referred to as minority interests). For example, these standards require the acquiring entity to recognize the full fair value of assets acquired and liabilities assumed in the transaction and require the expensing of most transaction and restructuring costs. Both standards became effective for us beginning June 1, 2009 and had no impact on our financial statements.

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

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

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

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

REPORTABLE SEGMENTS

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

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

FEDEX SERVICES SEGMENT

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

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

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

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

FedEx Services segment revenues, which reflected the operations of FedEx Office and FedEx Supply Chain Services, decreased 12% during the first quarter of 2010. Revenue at FedEx Office declined during the first quarter of 2010; however, the allocated net operating costs of FedEx Office decreased, as we began to see benefits from initiatives begun in 2009 to reduce our cost structure.

OTHER INTERSEGMENT TRANSACTIONS

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

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FEDEX EXPRESS SEGMENT

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

	2009	2008	Percent Change	Percent of Revenue [3] 2009	Percent of Revenue [3] 2008
Revenues:					
Package:					
U.S. overnight box	$ 1,331	$ 1,711	(22)		
U.S. overnight envelope	408	525	(22)		
U.S. deferred	601	762	(21)		
Total U.S. domestic package revenue	2,340	2,998	(22)		
International Priority (IP)	1,594	2,044	(22)		
International domestic [1]	134	170	(21)		
Total package revenue	4,068	5,212	(22)		
Freight:					
U.S.	449	598	(25)		
International priority freight	260	340	(24)		
International airfreight	61	131	(53)		
Total freight revenue	770	1,069	(28)		
Other [2]	86	138	(38)		
Total revenues	4,924	6,419	(23)	100.0%	100.0%
Operating expenses:					
Salaries and employee benefits	2,043	2,129	(4)	41.5	33.2
Purchased transportation	255	336	(24)	5.2	5.2
Rentals and landing fees	385	417	(8)	7.8	6.5
Depreciation and amortization	252	239	5	5.1	3.7
Fuel	571	1,319	(57)	11.6	20.6
Maintenance and repairs	261	394	(34)	5.3	6.1
Intercompany charges	469	533	(12)	9.5	8.3
Other	584	707	(17)	11.9	11.0
Total operating expenses	4,820	6,074	(21)	97.9	94.6
Operating income	$ 104	$ 345	(70)		
Operating margin	2.1%	5.4%	(330) bp		

(1) International domestic revenues include our international domestic express

operations, primarily in the United Kingdom, Canada, China, India and Mexico.

(2) Other revenues includes FedEx Trade Networks.

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

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

	2009	2008	Percent Change
Package Statistics [1]			
Average daily package volume (ADV):			
U.S. overnight box	1,128	1,103	2
U.S. overnight envelope	617	629	(2)
U.S. deferred	823	828	(1)
Total U.S. domestic ADV	2,568	2,560	
IP	475	495	(4)
International domestic [2]	293	307	(5)
Total ADV	3,336	3,362	(1)
Revenue per package (yield):			
U.S. overnight box	$ 18.16	$ 24.24	(25)
U.S. overnight envelope	10.17	13.04	(22)
U.S. deferred	11.23	14.38	(22)
U.S. domestic composite	14.02	18.30	(23)
IP	51.61	64.54	(20)
International domestic [2]	7.05	8.63	(18)
Composite package yield	18.76	24.23	(23)
Freight Statistics [1]			
Average daily freight pounds:			
U.S.	6,584	7,296	(10)
International priority freight	2,142	2,312	(7)
International airfreight	1,297	1,866	(30)
Total average daily freight pounds	10,023	11,474	(13)
Revenue per pound (yield):			
U.S.	$ 1.05	$ 1.28	(18)
International priority freight	1.87	2.30	(19)
International airfreight	0.72	1.10	(35)
Composite freight yield	1.18	1.46	(19)

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

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

FedEx Express Segment Revenues

FedEx Express segment revenues decreased 23% in the first quarter of 2010 primarily due to lower yields driven by a decrease in fuel surcharges and a decrease in volumes in virtually all services as a result of the ongoing weak global economic conditions. During the first quarter of 2010, volume gains resulting from DHL s exit from the U.S. domestic market were not enough to offset the negative impact of weak global economic conditions. While we acquired significant volumes from this competitor, these shipments were generally at lower weights and yields than our other volumes. The impact of one additional operating day partially offset the decline in revenue in the first quarter of 2010. Lower fuel surcharges were the primary driver of decreased composite package and freight yield in the first quarter of 2010. Our weighted-average U.S. domestic and outbound fuel surcharge was 31.7% in the first quarter of 2009 and 3.3% in the first quarter of 2010. U.S. domestic package yield also declined during the first quarter of 2010 due to a lower rate per pound and lower package weights. In addition to lower fuel surcharges, IP and international domestic yield decreased during the first quarter of 2010 due to unfavorable exchange rates and lower weights and rates.

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

	2009	2008
U.S. Domestic and Outbound Fuel Surcharge:		
Low	1.00%	28.00%
High	6.50	34.50
Weighted-average	3.29	31.67
International Fuel Surcharges:		
Low	1.00	18.00
High	12.00	34.50
Weighted-average	7.30	25.26

On September 17, 2009, we announced a 5.9% average list price increase effective January 4, 2010 on FedEx Express U.S. domestic and U.S. outbound express package and freight shipments and made various changes to other surcharges, while we lowered our fuel surcharge index by 2%.

FedEx Express Segment Operating Income

FedEx Express segment operating income and operating margin declined during the first quarter of 2010 as a result of significantly lower fuel surcharges (described below), a more competitive pricing environment and lower shipping volumes due to the continued weak global economy. During 2009, we implemented several actions (in addition to those described above in the Consolidated Results section) to lower our cost structure. These actions included significant volume-related reductions in flight hours, resulting in lower fuel consumption and maintenance costs, as we permanently and temporarily grounded a limited number of aircraft due to excess capacity in the current economic environment. Our cost-containment activities also included deferral of merit-based pay increases and stringent control over discretionary spending, such as travel, entertainment and professional fees. All of these actions partially mitigated the negative impact of lower fuel surcharge revenue and lower volumes on our results.

Fuel costs decreased 57% in the first quarter of 2010 due to decreases in the average price per gallon of fuel and fuel consumption. Based on a static analysis of the net impact of year-over-year changes in fuel prices compared to year-over-year changes in fuel surcharges, fuel had a negative impact to operating income in the first quarter of 2010. This analysis considers the estimated benefits of the reduction in fuel surcharges included in the base rates charged for FedEx Express services. Purchased transportation costs decreased 24% in the first quarter of 2010 due to lower IP and international priority freight average daily volumes, which reduced the utilization of contract pickup-and-delivery services, and the strengthening of the U.S. dollar. Maintenance and repairs expense decreased 34% in the first quarter of 2010 primarily due to volume-related reductions in flight hours and the grounding of certain aircraft due to excess capacity in the current economic environment. Depreciation expense increased 5% primarily due to the addition of 16 aircraft into service since the first quarter of 2009.

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FEDEX GROUND SEGMENT

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

	2009	2008	Percent Change	Percent of Revenue 2009	Percent of Revenue 2008
Revenues	$ 1,730	$ 1,761	(2)	100.0%	100.0%
Operating expenses:					
Salaries and employee benefits	282	267	6	16.3	15.2
Purchased transportation [(1)]	693	771	(10)	40.1	43.8
Rentals	58	51	14	3.3	2.9
Depreciation and amortization	85	80	6	4.9	4.5
Fuel [(1)]	1	2	NM	0.1	0.1
Maintenance and repairs	38	37	3	2.2	2.1
Intercompany charges	184	178	3	10.6	10.1
Other	180	179	1	10.4	10.2
Total operating expenses	1,521	1,565	(3)	87.9%	88.9%
Operating income	$ 209	$ 196	7		
Operating margin	12.1%	11.1%	100 bp		
Average daily package volume					
FedEx Ground	3,311	3,339	(1)		
FedEx SmartPost	1,009	584	73		
Revenue per package (yield)					
FedEx Ground	$ 7.60	$ 7.86	(3)		
FedEx SmartPost	$ 1.41	$ 2.14	(34)		

(1) We reclassified certain fuel supplement costs related to our independent contractors from fuel expense to purchased transportation expense to conform to the current period presentation.

FedEx Ground Segment Revenues

FedEx Ground segment revenues decreased 2% during the first quarter of 2010 due to lower yields at both FedEx Ground and FedEx SmartPost and slightly lower average daily volumes at FedEx Ground. The decline in yield at FedEx Ground during the first quarter of 2010 was primarily due to lower fuel surcharges, partially offset by increased extra service revenue and higher base rates. FedEx Ground average daily volume declined during the first quarter of 2010, as continued growth in the FedEx Home Delivery service was more than offset by a decline in commercial volume. The impact of one additional operating day partially offset the revenue decrease in the first quarter of 2010. Yields at FedEx SmartPost decreased 34% during the first quarter of 2010 due to changes in customer and service mix. For example, some customers elected to utilize lower-yielding service offerings that did not require standard pickup and linehaul services. FedEx SmartPost volumes grew 73% during the first quarter of 2010 as a result of market share gains, including volumes gained from DHL s exit from the U.S. market.

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

	2009	2008
Low	2.75%	8.50%
High	3.50	10.25
Weighted-average	3.00	9.43

FedEx Ground Segment Operating Income

FedEx Ground segment operating income increased during the first quarter of 2010, as the revenue decline was offset by decreased purchased transportation costs and the impact of one additional operating day. Purchased transportation costs decreased 10% during the first quarter of 2010 due to a lower average price per gallon of fuel, which is reflected in lower fuel surcharges paid to our contractors. Rent expense increased 14% and depreciation expense increased 6% during the first quarter of 2010 primarily due to higher spending on material handling equipment and facilities associated with our multi-year network expansion plan. The increase in salaries and employee benefits expense during the first quarter of 2010 was primarily due to increased health insurance costs and increased staffing at FedEx SmartPost to support volume growth, partially offset by the base salary reductions and suspension of 401(k) company-matching contributions. Intercompany charges increased 3% in the first quarter of 2010 primarily due to allocated telecommunication expenses (formerly a direct charge and thus had no net impact on our operating results).

Independent Contractor Matters

FedEx Ground faces increased regulatory and legal uncertainty with respect to its independent contractors. As part of its operations, FedEx Ground has made changes to its relationships with contractors that, among other things, provide incentives for improved service and enhanced regulatory and other compliance by our contractors. Under an on-going nationwide program, FedEx Ground provides greater incentives to certain of its contractors who choose to grow their businesses by adding routes.

In addition, during 2009, because of state-specific legal and regulatory issues, FedEx Ground offered special incentives to encourage each New Hampshire-based and Maryland-based single-route pickup-and-delivery contractor to assume responsibility for the pickup-and-delivery operations of an entire geographic service area that includes multiple routes.

As of August 31, 2009, over 60% of all service areas nationwide are supported by multiple-route contractors, which comprise approximately 35% of all FedEx Ground pickup-and-delivery contractors.

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

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FEDEX FREIGHT SEGMENT

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

	2009	2008 [2]	Percent Change	Percent of Revenue [3] 2009	2008
Revenues	$ 982	$ 1,353	(27)	100.0%	100.0%
Operating expenses:					
Salaries and employee benefits	507	614	(17)	51.6	45.4
Purchased transportation	118	180	(34)	12.0	13.3
Rentals	29	33	(12)	2.9	2.4
Depreciation and amortization	55	54	2	5.6	4.0
Fuel	94	206	(54)	9.6	15.2
Maintenance and repairs	34	43	(21)	3.5	3.2
Intercompany charges [1]	52	22	136	5.3	1.6
Other	91	112	(19)	9.3	8.3
Total operating expenses	980	1,264	(22)	99.8%	93.4%
Operating income	$ 2	$ 89	(98)		
Operating margin	0.2%	6.6%	(640) bp		
Average daily LTL shipments (in thousands)	71.4	82.7	(14)		
Weight per LTL shipment (lbs)	1,109	1,140	(3)		
LTL yield (revenue per hundredweight)	$ 17.87	$ 20.44	(13)		

(1) Certain functions were transferred from the FedEx Freight segment to FedEx Services and FCIS effective August 1, 2009 (as described below). For 2010, the costs associated with these functions, previously a direct charge, are being allocated to the FedEx Freight segment through

intercompany allocations.

(2) Includes Caribbean Transportation Services, which was merged into FedEx Express effective June 1, 2009.

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

FedEx Freight Segment Revenues

FedEx Freight segment revenues decreased 27% during the first quarter of 2010 due to a decrease in average daily LTL shipments and lower LTL yield, partially offset by one additional operating day. Average daily LTL shipments decreased 14% for the first quarter of 2010, reflecting the continued weak economy. LTL yield decreased 13% for the first quarter of 2010 due to lower fuel surcharges and an increasingly competitive pricing environment resulting from excess industry capacity. Although LTL average daily shipments decreased year over year, we have experienced sequential month-over-month improvement in average daily shipments throughout the quarter, indicating a possible stabilization of economic conditions in the U.S.

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

	2009	2008
Low	10.80%	20.80%
High	13.10	23.90
Weighted-average	12.40	22.90

FedEx Freight Segment Operating Income

The decrease in average daily LTL shipments and the competitive pricing environment had a significant impact on operating income and operating margin in the first quarter of 2010. The actions implemented in 2009 to lower our cost structure were more than offset by the negative impacts of lower shipments and yields during the first quarter of 2010. Intercompany charges increased in the first quarter of 2010 due to expenses associated with the functions of approximately 2,700 FedEx Freight segment employees that were transferred to FedEx Services and FCIS. The costs of these functions were previously a direct charge. As described above in the Reportable Segments section, these employees represented the sales, information technology, marketing, pricing, customer service, claims and credit and collection functions of the FedEx Freight segment and were transferred to allow further centralization of these functions into the FedEx Services segment shared service organization. For 2010, the costs of the functions will be allocated to the FedEx Freight segment through intercompany charges. These transfers had no net impact to operating income, although they significantly increased our intercompany allocations.

Fuel costs decreased 54% during the first quarter of 2010 due to a lower average price per gallon of diesel fuel and decreased fuel consumption as a result of lower shipment volume levels. Based on a static analysis of the net impact of year-over-year changes in fuel prices compared to year-over-year changes in fuel surcharges, fuel had a negative impact to operating income in the first quarter of 2010. Salaries and employee benefits decreased in the first quarter of 2010 primarily due to staffing reductions made in the second half of 2009 and the consolidation of FedEx Freight regional offices in 2009. Purchased transportation costs decreased 34% in the first quarter of 2010 due to lower shipment volumes, lower rates and decreased utilization of third-party providers. Rent expense decreased 12% in the first quarter of 2010, as the impact of strategic LTL service center expansion in key markets was more than offset by the merger of Caribbean Transportation Services into FedEx Express effective June 1, 2009.

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FINANCIAL CONDITION

LIQUIDITY

Cash and cash equivalents totaled $1.789 billion at August 31, 2009, compared to $2.292 billion at May 31, 2009. The following table provides a summary of our cash flows for the three-month periods ended August 31 (in millions):

	2009	2008
Operating activities:		
Net income	$ 181	$ 384
Noncash charges and credits	617	595
Changes in assets and liabilities	100	(281)
Cash provided by operating activities	898	698
Investing activities:		
Capital expenditures and other	(854)	(621)
Cash used in investing activities	(854)	(621)
Financing activities:		
Principal payments on debt	(508)	(1)
Dividends paid	(34)	(34)
Proceeds from stock issuances	7	5
Other	(15)	
Cash used in financing activities	(550)	(30)
Effect of exchange rate changes on cash	3	(13)
Net (decrease) increase in cash and cash equivalents	$ (503)	$ 34

Cash Provided by Operating Activities. Cash flows from operating activities increased $200 million in the first quarter of 2010 primarily due to the receipt of income tax refunds of $263 million. We made no contributions to our tax-qualified U.S. domestic pension plans (U.S. Retirement Plans) during the first quarter of 2010 or 2009. However, in September 2009, we made contributions of $613 million to our U.S. Retirement Plans, including $495 million in tax-deductible voluntary contributions and $118 million in minimum required contributions.

Cash Used in Investing Activities. Capital expenditures during first quarter of 2010 were 38% higher largely due to increased spending at FedEx Express. See Capital Resources for a discussion of capital expenditures during 2010 and 2009.

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

A new three-year $1 billion revolving credit facility was executed in July 2009, which replaced our prior $1 billion revolving credit facility. The new revolving credit agreement is available to finance our operations and other cash flow needs and to provide support for the issuance of commercial paper. This revolving credit agreement expires in

July 2012. Our revolving credit agreement contains a financial covenant, which requires us to maintain a leverage ratio of adjusted debt (long-term debt, including the current portion of such debt, plus six times rentals and landing fees) to capital (adjusted debt plus total common stockholders investment) that does not exceed 0.7 to 1.0. This covenant was unchanged from our prior revolving credit facility. Our leverage ratio of adjusted debt to capital was 0.5 at August 31, 2009. We are in compliance with this and all other restrictive covenants of our revolving credit agreement and do not expect the covenants to affect our operations. As of August 31, 2009, no commercial paper was outstanding and the entire $1 billion under the revolving credit facility was available for future borrowings.

Dividends. We paid cash dividends of $34 million in the first quarter of 2010 and $34 million in the first quarter of 2009. On June 8, 2009, our Board of Directors declared a dividend of $0.11 per share of common stock. The dividend was paid on July 1, 2009 to stockholders of record as of the close of business on June 18, 2009. On August 14, 2009, our Board of Directors declared a dividend of $0.11 per share of common stock. The dividend is payable on October 1, 2009, to stockholders of record as of the close of business on September 10, 2009. Each quarterly dividend payment is subject to review and approval by our Board of Directors, and we evaluate our dividend payment amount on an annual basis at the end of each fiscal year.

CAPITAL RESOURCES

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

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

	2009	2008	Dollar Change	Percent Change
Aircraft and related equipment	$ 555	$ 240	$ 315	131
Facilities and sort equipment	186	153	33	22
Information and technology investments	56	67	(11)	(16)
Vehicles	56	133	(77)	(58)
Other equipment	27	43	(16)	(37)
Total capital expenditures	$ 880	$ 636	$ 244	38
FedEx Express segment	$ 641	$ 333	$ 308	92
FedEx Ground segment	111	134	(23)	(17)
FedEx Freight segment	67	100	(33)	(33)
FedEx Services segment	61	69	(8)	(12)
Total capital expenditures	$ 880	$ 636	$ 244	38

Capital expenditures during the first quarter of 2010 were higher than the prior-year period primarily due to increased spending for aircraft and related equipment at FedEx Express (described below).

LIQUIDITY OUTLOOK

We believe that our existing cash and cash equivalents, cash flow from operations, and available financing sources are adequate to meet our liquidity needs, including working capital, capital expenditure requirements and debt payment obligations. Although we expect higher capital expenditures in 2010, we anticipate that our cash flow from operations will exceed our capital expenditures. We are closely managing our capital spending based on current and anticipated volume levels and will defer or limit capital additions where economically feasible, while continuing to invest strategically for future growth.

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Secured financing may be used to obtain capital assets if we determine that it best suits our needs. Historically, we have been successful in obtaining unsecured financing, from both domestic and international sources, although the marketplace for such investment capital can become restricted depending on a variety of economic factors, as we experienced in 2009. During 2009, global credit markets experienced significant liquidity disruptions, and continued uncertainty in the credit markets has made financing terms for borrowers less attractive and in certain cases resulted in the unavailability of certain types of debt financing, such as commercial paper. Although these factors may make it more difficult or expensive for us to access credit markets, we still have access to credit, as evidenced by our debt issuance in 2009 and the renewal of our revolving credit facility.

Our capital expenditures are expected to be approximately $2.6 billion in 2010 and include spending for aircraft and related equipment at FedEx Express, network expansion at FedEx Ground and revenue equipment at FedEx Freight. We also continue to invest in productivity-enhancing technologies. We invested $555 million in aircraft and aircraft-related equipment in the first quarter of 2010 and expect to invest an additional $609 million for aircraft and aircraft-related equipment for the remainder of 2010 at FedEx Express. Aircraft-related capital outlays include the B757s, the first of which entered revenue service in 2009 and which are substantially more fuel-efficient per unit than the aircraft type they are replacing, and the new B777Fs, the first of which is expected to enter revenue service in 2010. These aircraft-related capital expenditures are necessary to achieve significant long-term operating savings and to support projected long-term international volume growth. Our ability to delay the timing of these aircraft-related expenditures is limited without incurring significant costs to modify existing purchase agreements.

As noted above, in September 2009, we made $495 million in tax-deductible voluntary contributions and $118 million in minimum required contributions to our U.S. Retirement Plans. Our U.S. Retirement Plans have ample funds to meet benefit payments. For 2010, we have $235 million in remaining minimum required contributions to our U.S. Retirement Plans.

In June 2009, Standard & Poor s reaffirmed our senior unsecured debt credit rating of BBB and commercial paper rating of A-2 and our rating outlook as stable. Moody s Investors Service has assigned us a senior unsecured debt credit rating of Baa2 and commercial paper rating of P-2 and a ratings outlook as negative. If our credit ratings drop, our interest expense may increase. If our commercial paper ratings drop below current levels, we may have difficulty utilizing the commercial paper market. If our senior unsecured debt ratings drop below investment grade, our access to financing may become limited.

CONTRACTUAL CASH OBLIGATIONS

The following table sets forth a summary of our contractual cash obligations as of August 31, 2009. Certain of these contractual obligations are reflected in our balance sheet, while others are disclosed as future obligations under accounting principles generally accepted in the United States. Except for the current portion of long-term debt and capital lease obligations, this table does not include amounts already recorded in our balance sheet as current liabilities at August 31, 2009. Accordingly, this table is not meant to represent a forecast of our total cash expenditures for any of the periods presented.

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	Payments Due by Fiscal Year (Undiscounted) (in millions)						
	2010 (1)	2011	2012	2013	2014	There-after	Total
Operating activities:							
Operating leases	$ 1,366	$ 1,685	$ 1,493	$ 1,351	$ 1,196	$ 7,515	$ 14,606
Non-capital purchase obligations and other	206	145	118	63	12	125	669
Interest on long-term debt	84	144	125	98	97	1,815	2,363
Required quarterly contributions to our U.S. Retirement Plans	353						353
Investing activities:							
Aircraft and aircraft-related capital commitments	497	791	527	425	466	1,924	4,630
Other capital purchase obligations	136						136
Financing activities:							
Debt		250		300	250	990	1,790
Capital lease obligations	153	20	8	119	2	15	317
Total	$ 2,795	$ 3,035	$ 2,271	$ 2,356	$ 2,023	$ 12,384	$ 24,864

(1) Cash obligations for the remainder of 2010.

We have certain contingent liabilities that are not accrued in our balance sheet in accordance with accounting principles generally accepted in the United States. These contingent liabilities are not included in the table above. In addition, we have historically made voluntary tax-deductible contributions to our U.S. Retirement Plans. These amounts have not been legally required and therefore are not reflected in the table above. However, included in the table above are anticipated minimum required quarterly contributions totaling $353 million for the remainder of 2010 ($118 million of which was paid in September 2009).

We have other long-term liabilities reflected in our balance sheet, including deferred income taxes, qualified and nonqualified pension and postretirement healthcare plan liabilities and other self-insurance accruals. The payment obligations associated with these liabilities are not reflected in the table above due to the absence of scheduled maturities. Therefore, the timing of these payments cannot be determined, except for amounts estimated to be payable within 12 months, which are included in current liabilities.

Operating Activities

The amounts reflected in the table above for operating leases represent future minimum lease payments under noncancelable operating leases (principally aircraft and facilities) with an initial or remaining term in excess of one year at August 31, 2009.

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

Included in the preceding table within the caption entitled Non-capital purchase obligations and other is our estimate of the current portion of the liability for uncertain tax positions under FIN 48 of $5 million. We cannot reasonably estimate the timing of the long-term payments or the amount by which the liability will increase or decrease over time; therefore, the long-term portion of the liability ($66 million) is excluded from the preceding table.

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

Investing Activities

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

Financing Activities

The amounts reflected in the table above for long-term debt represent future scheduled payments on our long-term debt. In 2010, we have scheduled debt payments of $153 million, which includes principal and interest payments on capital leases. During the first quarter of 2010, we repaid upon maturity our $500 million aggregate principal amount of 5.50% notes that matured on August 15, 2009.

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

CRITICAL ACCOUNTING ESTIMATES

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

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

FORWARD-LOOKING STATEMENTS

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

- economic conditions in the global markets in which we operate;
- the impact of any international conflicts or terrorist activities on the United States and global economies in general, the transportation industry or us in particular, and what effects these events will have on our costs or the demand for our services;

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damage to our reputation or loss of brand equity;
disruptions to the Internet or our technology infrastructure, including those impacting our computer systems and Web site, which can adversely affect shipment levels;
the price and availability of jet and vehicle fuel;
the impact of intense competition on our ability to maintain or increase our prices (including our fuel surcharges in response to rising fuel costs) or to maintain or grow our market share;
our ability to manage our cost structure for capital expenditures and operating expenses, and match it to shifting and future customer volume levels;
our ability to effectively operate, integrate, leverage and grow acquired businesses, and to continue to support the value we allocate to these acquired businesses, including their goodwill;
any impacts on our businesses resulting from new domestic or international government laws and regulation, including regulatory actions affecting global aviation rights, increased air cargo and other security requirements, and tax, accounting, trade (such as protectionist measures enacted in response to the current weak economic conditions), labor (such as card-check legislation or changes to the Railway Labor Act affecting FedEx Express employees), environmental (such as climate change legislation) or postal rules;
changes in foreign currency exchange rates, especially in the euro, Chinese yuan, Canadian dollar, British pound and Japanese yen, which can affect our sales levels and foreign currency sales prices;
the impact of costs related to (i) challenges to the status of FedEx Ground s owner-operators as independent contractors, rather than employees, and (ii) any related changes to our relationship with these owner-operators;
any liability resulting from and the costs of defending against class-action litigation, such as wage-and-hour and discrimination and retaliation claims, patent litigation, and any other legal proceedings;
our ability to maintain good relationships with our employees and prevent attempts by labor organizations to organize groups of our employees, which could significantly increase our operating costs and reduce our operational flexibility;
increasing costs, the volatility of costs and legal mandates for employee benefits, especially pension and healthcare benefits;
significant changes in the volumes of shipments transported through our networks, customer demand for our various services or the prices we obtain for our services;
market acceptance of our new service and growth initiatives;
the impact of technology developments on our operations and on demand for our services;
adverse weather conditions or natural disasters, such as earthquakes and hurricanes, which can disrupt electrical service, damage our property, disrupt our operations, increase fuel costs and adversely affect shipment levels;

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- widespread outbreak of an illness or any other communicable disease, or any other public health crisis;
- availability of financing on terms acceptable to us and our ability to maintain our current credit ratings, especially given the capital intensity of our operations and the current volatility of credit markets;
- credit losses from our customers inability or unwillingness to pay for previously provided services as a result of, among other things, weak economic conditions and tight credit markets; and
- other risks and uncertainties you can find in our press releases and SEC filings, including the risk factors identified under the heading Risk Factors in Management s Discussion and Analysis of Results of Operations and Financial Condition in our Annual Report, as updated by our quarterly reports on Form 10-Q.

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

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of August 31, 2009, there had been no material changes in our market risk sensitive instruments and positions since our disclosures in our Annual Report. While we are a global provider of transportation, e-commerce and business services, the substantial majority of our transactions are denominated in U.S. dollars. The distribution of our foreign currency denominated transactions is such that foreign currency declines in some areas of the world are often offset by foreign currency gains in other areas of the world. The principal foreign currency exchange rate risks to which we are exposed are in the euro, Chinese yuan, Canadian dollar, British pound and Japanese yen. Historically, our exposure to foreign currency fluctuations has been more significant with respect to our revenues rather than our expenses, as a significant portion of our expenses are denominated in U.S. dollars, such as aircraft and fuel expenses. During the first quarter of 2010, the U.S. dollar has weakened relative to the currencies of the foreign countries in which we operate as compared to the fourth quarter of 2009; however, this weakening did not have a material effect on our results of operations.

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

Item 4. Controls and Procedures

The management of FedEx, with the participation of our principal executive and financial officers, has evaluated the effectiveness of our disclosure controls and procedures in ensuring that the information required to be disclosed in our filings under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, including ensuring that such information is accumulated and communicated to FedEx management as appropriate to allow timely decisions regarding required disclosure. Based on such evaluation, our principal executive and financial officers have concluded that such disclosure controls and procedures were effective as of August 31, 2009 (the end of the period covered by this Quarterly Report on Form 10-Q).

During our fiscal quarter ended August 31, 2009, no change occurred in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

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

Item 1A. *Risk Factors*

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

Item 6. *Exhibits*

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

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SIGNATURE

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

	FEDEX CORPORATION
Date: September 18, 2009	/s/ JOHN L. MERINO JOHN L. MERINO CORPORATE VICE PRESIDENT PRINCIPAL ACCOUNTING OFFICER

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