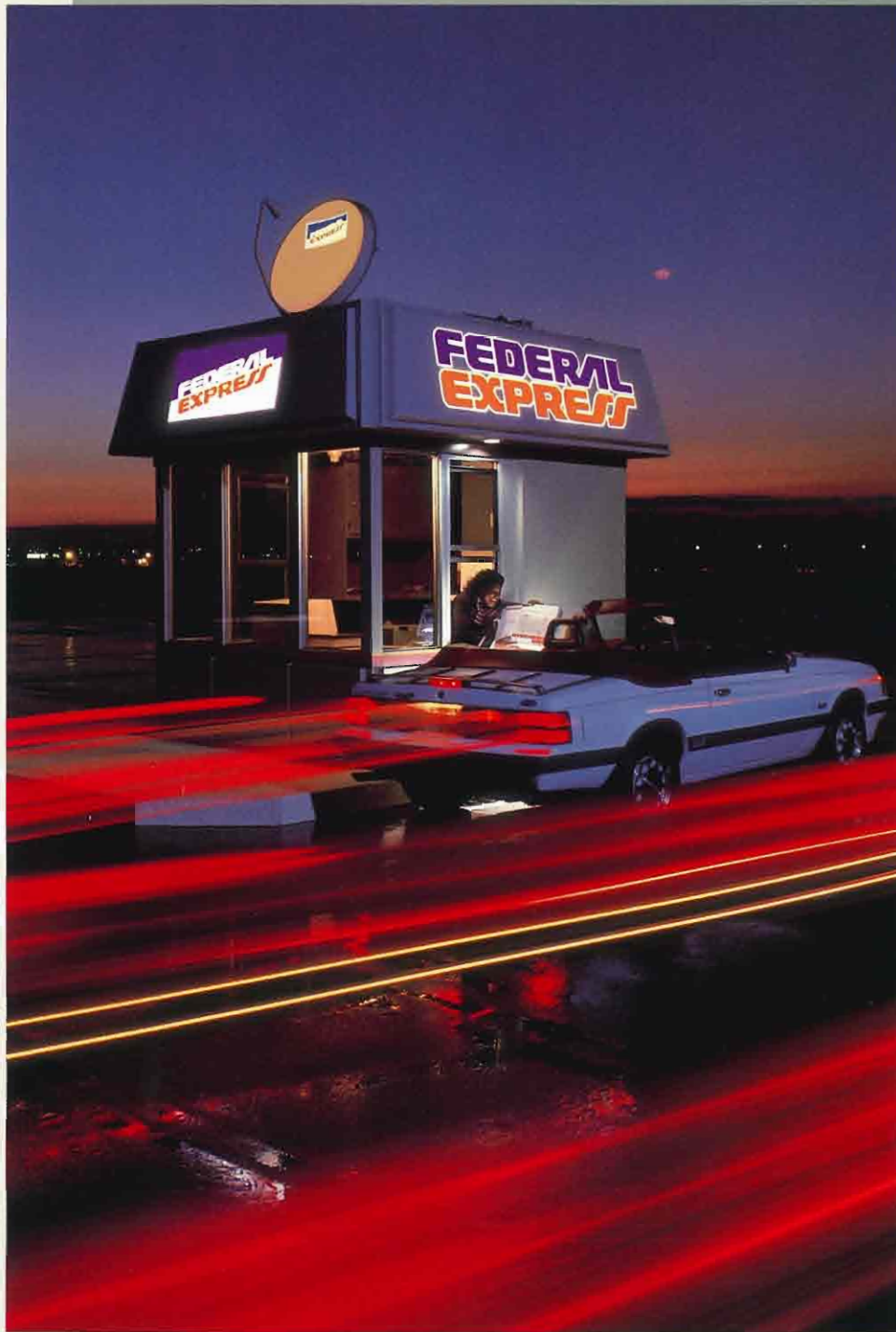


**B**uying a little extra time



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**Equal Employment Opportunity**

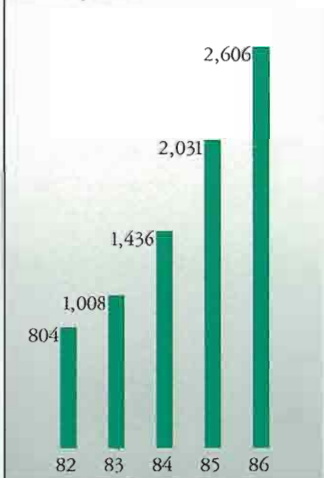
Federal Express Corporation is strongly bound to a policy of affording equal employment opportunity to all, regardless of race, color, religion, sex, national origin, handicap, disability, veteran status, or age (except where bona fide occupational qualifications exist). Because we believe that equal employment opportunity is the only acceptable principle, Federal Express is committed to ensuring that all personnel matters, such as compensation, benefits and opportunities for advancement, are administered fairly.

**Service Marks**

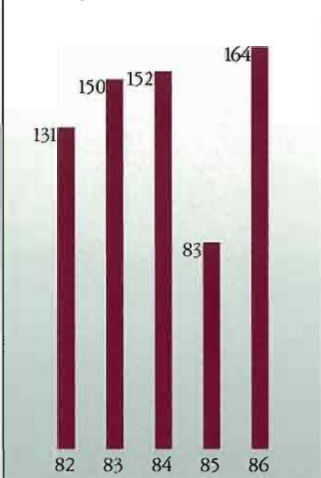
ZapMail, Priority One, Courier Pak, Standard Air and Overnight Letter are service marks of Federal Express Corporation.

Federal Express Corporation specializes in the door-to-door, express delivery of goods and information throughout the United States and abroad. The company delivers packages (150 pounds or less) and documents through its integrated, air-ground transportation system.

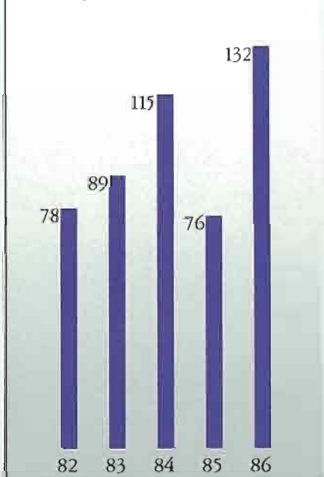
**Revenues**  
Millions of dollars



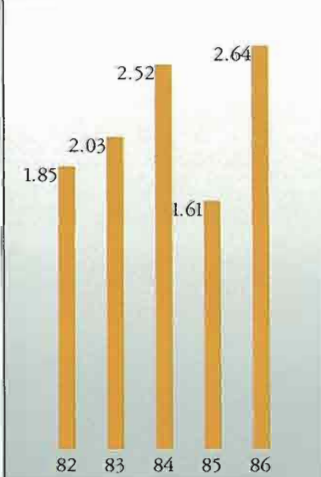
**Pretax Income**  
Millions of dollars



**Net Income**  
Millions of dollars



**Earnings per Share**  
Dollars



Combining this network with electronic equipment, the company offers a facsimile document transmission service. The company operates an air and ground fleet that serves a central sorting facility in Memphis, Tennessee. Approximately 450 city stations are maintained throughout the United States.

Customs-cleared, international service is available from the United States to approximately 85 countries, either directly or through contracted agents. A European sorting facility is located in Brussels, Belgium.

	<i>In thousands, except per share amounts and Other Operating Data</i>		
	1986	1985	1984
<i>Operating Results</i>			
Revenues	\$2,606,210	\$2,030,661	\$1,436,305
Operating income	212,141	136,723	165,208
Income before income taxes	164,205	83,378	152,260
Net income	131,839	76,077	115,430
Earnings per share	\$ 2.64	\$ 1.61	\$ 2.52
Average shares outstanding	49,840	46,970	45,448
 <i>Financial Position</i>			
Working capital	\$ 181,380	\$ 106,266	\$ 72,226
Property and equipment, net	1,551,845	1,346,023	1,112,639
Long-term debt	561,716	607,508	435,158
Common stockholders' investment	1,091,714	812,267	717,721
 <i>Other Operating Data</i>			
Average daily package volume	550,306	406,049	263,385
Average daily ZapMail volume	10,944	2,368	—
Average pounds per package	5.3	5.6	5.5
Average revenue per pound	\$ 3.40	\$ 3.45	\$ 3.80
Aircraft fleet at end of year:			
McDonnell Douglas DC-10-10s	6	6	6
McDonnell Douglas DC-10-30s	9	5	4
Boeing 727-100s	35	35	35
Boeing 727-200s	18	18	12
Cessna 208s	34	9	—
Vehicle fleet at end of year	14,500	12,300	9,000
Satellite earth stations at end of year	16	6	—
Average number of employees (based on a standard full-time workweek)	33,988	27,066	18,368

In terms of both volume and revenues, Federal Express enjoyed a successful year in 1986. We handled over 142 million package, document, and ZapMail transactions (including peak days exceeding 700,000 transactions just prior to Christmas). For the year, volume rose 37% over 1985, while revenues increased some 28%.

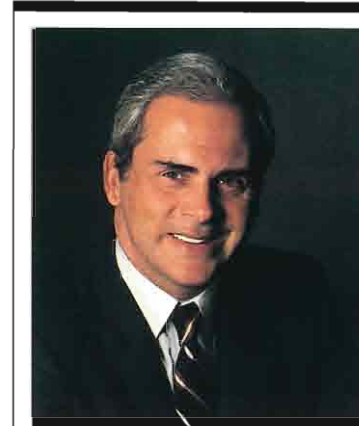
During the past year, Federal Express employees once again demonstrated they could manage growth efficiently and profitably. Our earnings per share performance improved from \$1.61 in 1985 to \$2.64 in 1986. While most of our competitors were experiencing serious financial difficulties, we improved service to our customers, lowered cost per unit, and raised our operating profit margin from 6.7% to 8.1%.

We entered 1986 with three major goals. First, we wanted to expand our express and ZapMail services overseas. Second, we wanted to improve service levels from their already high levels. And third, we wanted to further employ electronic technologies to enhance our package-tracking, tracing, sorting and billing systems.

There has been substantial progress in all three areas.

On the international level, Federal Express now has offices in nine countries in Europe and the Far East. Through independent contractors, packages are delivered in an additional 76 countries around the world. In January we purchased Lex Wilkinson Limited, Britain's premier express delivery company. Currently, Lex Wilkinson's operations are being integrated with our own, to develop a solid foundation for growth throughout the United Kingdom. Also, we initiated International ZapMail to the major cities of Europe in late 1985, and recently extended the service to Hong Kong and most of the United Kingdom.

In the U.S. over 98% of the American population now receives direct service from Federal Express. During the year, we continued to develop our Memphis Superhub, while expanding our regional sorting operations in Newark and Oakland. Our network of retail centers expanded into new cities, and drive-through centers were added in suburban locations.



**Frederick W. Smith**



**James L. Barksdale**

However, convenient, timely and reliable delivery of shipments is no longer all that is needed to meet the demands of the express industry. Real-time information about shipments is becoming increasingly important. Therefore, to dramatically illustrate the superiority of our tracking system, we began offering a full refund if a complete status report on any shipment is not provided within thirty minutes of inquiry. When coupled with our existing money-back guarantee in the event of a late delivery, this program offers Federal Express' customers the most comprehensive service commitment in the industry.

These service assurances would not be possible without the extensive data processing and electronic transmission systems operated by Federal Express. Other key enhancements to our express services are also dependent upon these networks. Customer automation devices will be linked to our central processing center to allow on-site tracing, billing and proof-of-delivery for larger customers. Billing operations for other customers will also be decentralized to improve the timeliness and accuracy of invoices.

In addition to transmitting ever greater portions of internal voice and data traffic, the satellite system we are constructing will, of course, serve as the backbone of an enhanced ZapMail facsimile document transmission network. Although ZapMail's operating losses remained high during 1986, our sales and marketing efforts progressed substantially. The base of installed ZapMailers climbed to 7,100, and transmission volumes increased fourfold over the prior year, averaging more than 16,700 per day during May 1986.

Our plans for 1987 are to stimulate ZapMail volumes through a major advertising campaign and to reduce the cost of operating ZapMail's communications network. We are hopeful that our entrepreneurial efforts to take a commanding position in the market for facsimile transmission will develop a winning formula for the future. Fortunately, the profitability of our express operations permits us to continue to develop a product in what will surely be a rapidly growing market for sending high priority documents.

In this same vein, the demonstrated popularity of our Overnight Letter offers ample proof that ours is an increasingly information-intensive society. We intend to remain the leader for urgent documents, whether transported on our DC-10s with other types of packages or transmitted through our high-powered Expressstar satellite scheduled for launch in 1989.

We believe our leading position in the profitable and expanding express delivery industry, combined with the potential of the rapidly emerging facsimile market, offers an exciting future for the customers, stockholders and employees of Federal Express.



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



James L. Barksdale  
*Executive Vice President and  
Chief Operating Officer*

**S**ince the dawn of history, people have constantly striven to make more efficient use of their work time. Time is, and always has been, the scarcest of resources. Nearly all of the great inventions of history—from the plow to the steam engine to the computer—have had as their ultimate objective the saving of time in the workplace. **M**any dramatic breakthroughs have involved improvements in transportation and communications. One hundred years ago, for example, novelist Jules Verne wrote *Around The World In Eighty Days*. Today, such a journey can be completed in a matter of hours. At the same time, the evolution of modern telecommunications—from Samuel Morse's telegraph and Guglielmo Marconi's radio to the sophisticated satellite transmission networks of the present—has brought man's age old dream of instantaneous communication with his neighbors around the world even closer to reality. **I**n recent times, in fact, our concern with moving people, goods and information from one place to another as quickly as possible has become ever more acute. Time is a highly valued resource in the fast-paced business world of the Eighties. Time is often the crucial factor in a contemporary corporate environment in which "survival of the fastest" has become as important a maxim as "survival of the fittest."

## *The Federal Express Network: Buying a Little Extra Time*

**G**iven the emphasis placed upon rapid communications in modern society, it comes as no surprise that many of the most successful business ventures of recent years have been those which have succeeded in “buying a little extra time” for their customers. Among the present generation of corporate time-savers, few companies have had as dramatic an impact upon American society as Federal Express. **P**rior to 1973, the speed and reliability of inter-city delivery of packages and documents were extremely limited. This was not due to lack of effort from the people and companies offering these services, but was the result of reliance upon a system constructed for an entirely different purpose—airlines designed to move people rather than packages. **F**ederal Express forever altered express delivery by introducing a new system—the now famous hub-and-spokes all-freight airline—and emerged as the leading force in the new industry it created. **J**ust five years

*The curious design of prehistoric Stonehenge, near the modern town of Salisbury, England, shows that even ancient man was aware of the important role which time played in everyday life. Built nearly two thousand years before the birth of Christ, Stonehenge consisted of dozens of enormous carved boulders, all arranged to form something of a seasonal clock; the alignment was deliberately designed to represent the exact path of sunlight at sunrise on the date of the summer solstice.*



ago, we handled a hundred thousand packages and documents on an average night; today, that figure is well over half a million. Within that same five-year period, company revenues quadrupled, from \$589 million in 1981 to \$2.6 billion in 1986. Federal Express employees now offer service to over 98% of the American population, with 100% coverage of 28 states. **T**hat Federal Express has been able to grow so rapidly and yet operate in a streamlined, customer-oriented fashion is a tribute to over 38,000 employees around the world whose reputation for quality, courtesy and efficiency is the most important ingredient in our success.

**Charlie McElwain, Senior Aircraft Mechanic**





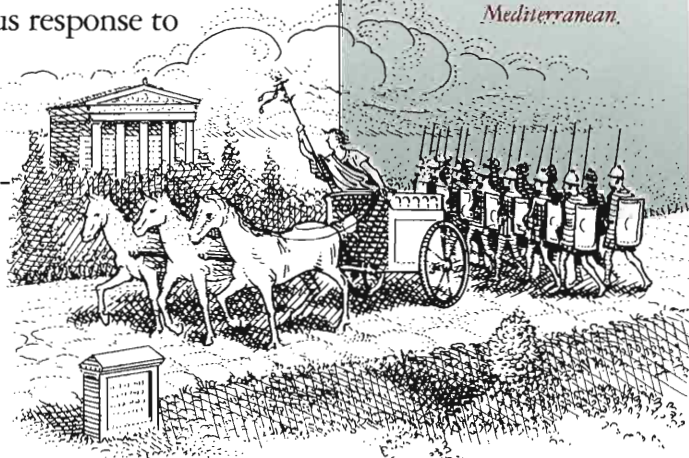
3 Fold in flap at each end of box, peel away strip to expose adhesive and press firmly to secure ends.

4

OVERNIGHT

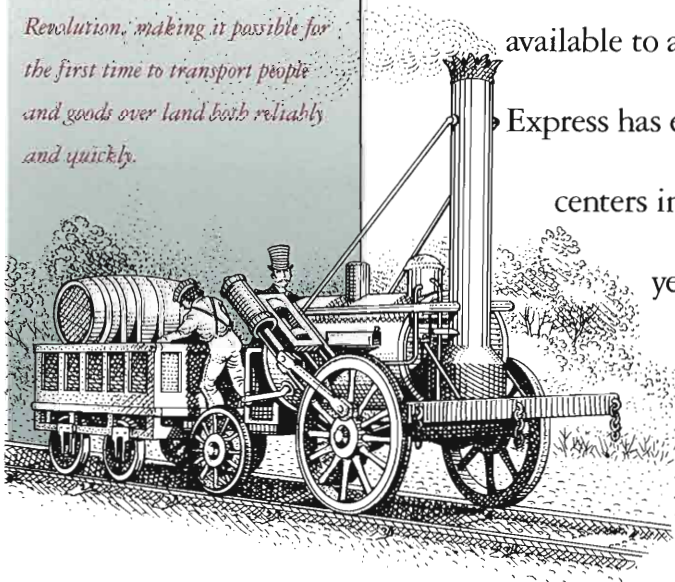
**R**ecognizing that their job satisfaction is reflected in *customer* satisfaction, we have always devoted much of our energy to meeting the needs of our employees. As a result, research shows that our employee attitude survey scores are 14% higher than the national average, and the gap is steadily widening. **I**n 1986, as our workforce grew more than 20%, we implemented over 10 new programs to maintain employee motivation. One of the most innovative of these, entitled DECADE, brings 10-year employees to our headquarters for facility tours and informal meetings with senior management. Employee concerns voiced during these meetings have already generated several policy changes, and our 1986 corporate-wide survey indicated that the attitude of many of our longer term people improved as a result. **J**ust as we continue monitoring employee programs, we never cease making refinements to our express delivery system, far and away the most sophisticated operation of its kind in the world today. Our widely acclaimed technological innovations are designed to ensure that our customers receive the industry's most comprehensive service at the lowest possible price. **F**or example, dramatic improvements are being made in the area of information retrieval. Our Cosmos IIB package-tracking system is in the final stages of testing, moving us closer to our ultimate goal of providing instantaneous response to every customer inquiry. In addition to sophisticated tracking and tracing capabilities, the portable "Super Trackers" will furnish vital routing information

*The leaders of ancient Rome, over two thousand years ago, recognized that a network of well-built roads was essential to the maintenance of their vast empire. The Appian Way, the most celebrated of these Roman roads, ran south from the imperial capital to the tip of the Italian Peninsula, and was the government's main communications link with Greece and the other Roman provinces in the eastern Mediterranean.*



to our couriers, an essential function in the Federal Express multi-hub distribution system. **I**n anticipation of the day that volume would exceed the maximum capabilities of the Memphis Superhub, we have recognized the necessity of “bleeding off” significant portions of traffic, specifically where packages are shipped within the same general region. Our mini-hubs in Newark and Oakland, for example, handle many of the shipments within the East and West regions. Some 22% of all express volume will be handled through such bleed-off operations by December 1986. **T**he same emphasis upon improved efficiency can be seen in our flight operations. In May 1986, we were operating a fleet of 15 DC-10s and 53 B727s. Our DC-10s and B727-200s have now been CAT IIIa certified so that they can operate when cloud ceilings are within 50 feet. In addition, we are continuing research of a system which is designed to enable pilots

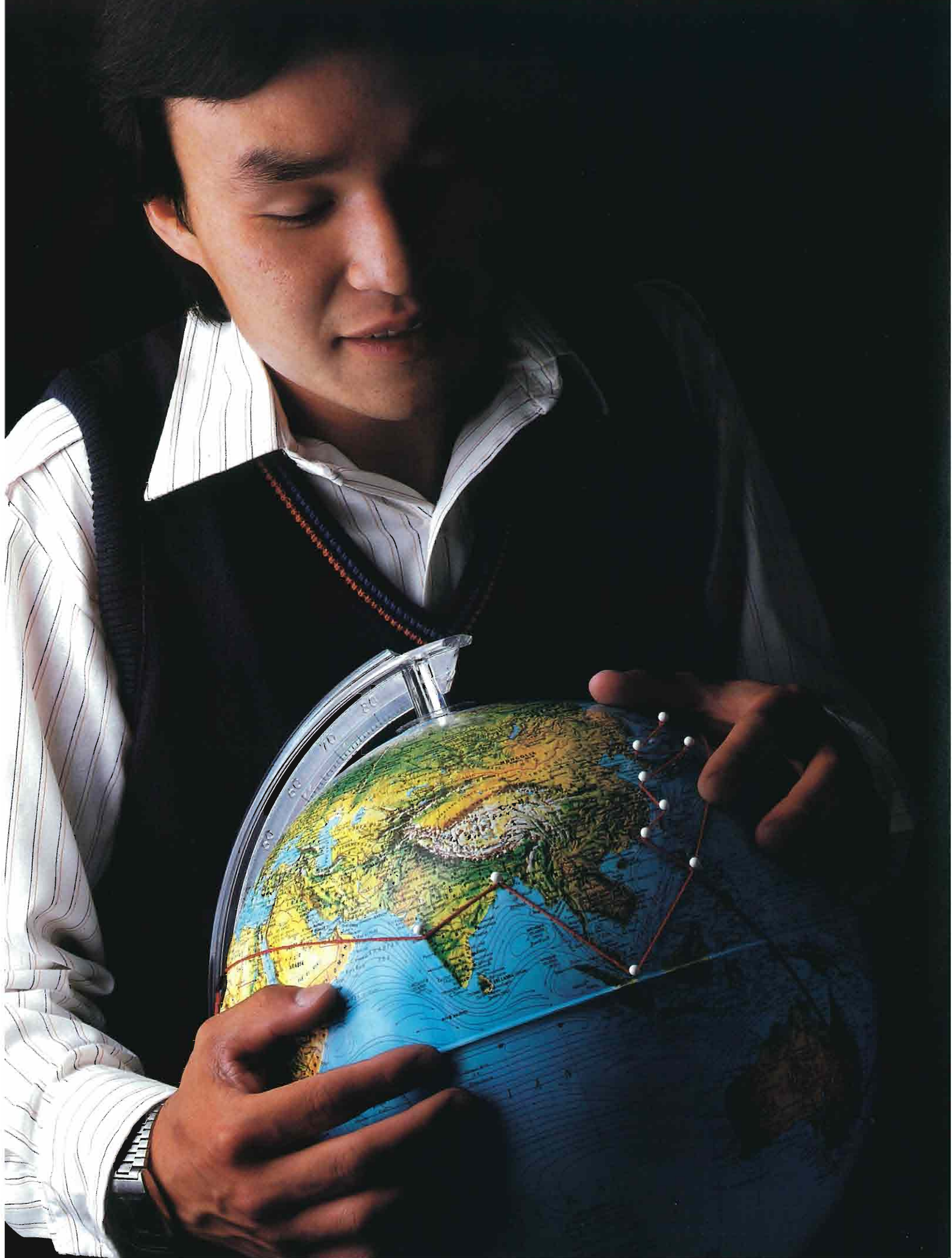
*The first railway engines were designed for hauling coal in English mines, but by 1830 the first passenger railway line was in operation between Liverpool and Manchester, and by 1850 there were thousands of miles of railway track laid in Europe and North America. Railways were a fundamental part of the Industrial Revolution, making it possible for the first time to transport people and goods over land both reliably and quickly.*



to “see” through fog and further improve landing capabilities. **W**e are also increasing the size of our small feeder aircraft fleet to provide even more comprehensive service to remote communities across the country. Twenty-six Cessna 208s were added during 1986, with an additional 75 expected through 1989. **T**o make the company’s services available to as many people as possible, Federal Express has established a network of over 300 retail centers in cities across America. During the past year, we began installing drive-through centers in suburban shopping centers and office parks. About 150 of these



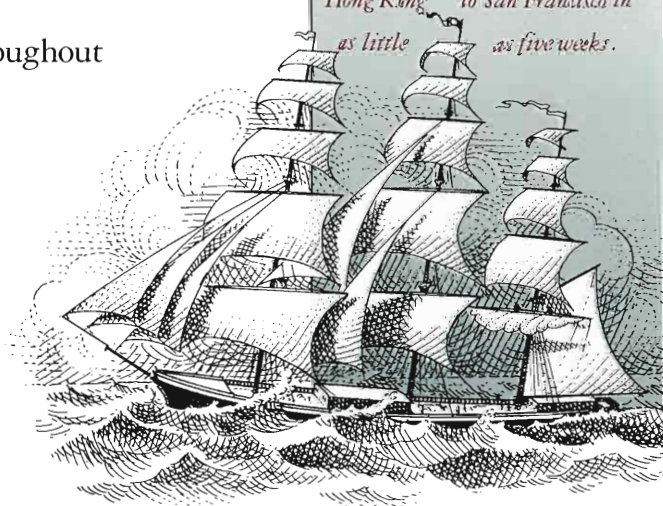
Crew Member



new centers should be in place by the summer of 1987. The convenient locations not only make it easier to serve existing customers, but also are encouraging trial by new customers. **I**n addition to convenience for these shippers, we are also making significant strides in customer automation. There are now more than 2,000 computerized meters on customer premises, enabling them to weigh and rate their own packages, print airbills and generate daily invoices. Recent enhancements have also made limited computer-to-computer billing feasible. **F**ederal Express made its strongest commitment ever to international development during 1986. Our worldwide service network covers a total of 10 countries, with Federal Express offices in 12 cities in Western Europe and three in the Far East. Contractors deliver Federal Express packages in more than 70 other countries. **D**aily flights to Brussels, inaugurated early in the year, dramatically improved European service. We are currently seeking rights to fly Federal Express aircraft to Japan. If successful, we will initiate daily flights by June 1987.

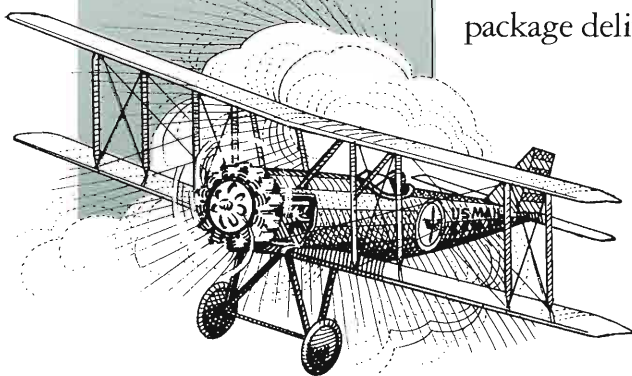
**T**his past winter Federal Express purchased Lex Wilkinson Limited, a major British package-and-document delivery concern. This acquisition provides yet another indication of the company's determination to be as successful internationally as well as domestically. **T**hroughout 1986 we continued to develop a unique satellite-based system which we believe will be the key to our ultimate success in the facsimile market.

*Growing European and American demand for exotic products from faraway places—products like silk, coffee, and tea—helped bring about the development of clipper ships during the middle decades of the nineteenth century. Sleek, beautiful clippers like The Flying Cloud and The Cutty Sark could travel up to four hundred miles in a single day, and make the journey from Hong Kong to San Francisco in as little as five weeks.*



**T**he advantages to be offered by this system are just as dramatic as those offered by our original hub-and-spokes concept for package movements. In fact, the design is somewhat analogous. Because telephone customers demand instantaneous transmission (no one wants noticeable delays in the middle of conversations), existing satellite networks must rely on a “single hop” system (transmissions from expensive origin earth stations are bounced by the satellite directly to the destination earth stations). **H**owever, a transmission delay of fractions of seconds is perfectly acceptable for documents. Thus, the Federal Express network is designed to use a much more economical “double hop” architecture. Transmissions originating from customer premise earth stations are relayed from the satellite to a central location—the Telehub—and then back to the satellite for final transmission to the destination earth station. **T**his design consolidates the

*The first American airmail routes were established between New York, Boston, and Washington, D.C., during 1918; three years later, regular transcontinental airmail service, between New York and San Francisco, was inaugurated. The use of airplanes to carry packages and documents between places thousands of miles apart in a matter of hours was a dramatic breakthrough that had enormous impact upon the operations of American business.*



computerized switching equipment at the Telehub, rather than at each of thousands of customer locations, and will allow us to achieve high-speed, error-free transmissions with much smaller, less costly earth stations. Also, the computer capacity can be expanded as needed and the equipment maintained more effectively due to the centralized location. We are confident the Telehub will revolutionize facsimile transmission the way our air express hub transformed package delivery. However, until the transition to this

network is completed, we intend to aggressively pursue the rapidly expanding



JON GRAY

FEDERAL EXPRESS

5099752





facsimile transmission market, and will introduce a full range of Group III facsimile products later in the year. **I**n addition to relying upon the existing telephone network, we have made several enhancements to our current hybrid satellite system. We added 36 new nodes, or switching centers, to the 12 already in operation, shifting much of the document traffic to satellite from terrestrial circuits. The operating software is being upgraded in both the network and the ZapMailer equipment. And, compatibility with Group III facsimile machines will be offered for ZapMailers. **I**n addition to significantly improving ZapMail service levels, these enhancements will become increasingly important to our express operations as we link customer automation devices, local billing operations and internal data traffic to our central data processing center through this electronic network. **W**hile we believe that the express delivery industry will continue to experience robust growth for many years, facsimile systems—such as our own—will capture ever larger portions of the document delivery market. Longer term, even routine business correspondence will be sent via facsimile. By building upon the highly successful foundation of our present operations and telecommunications skills, our expansion into facsimile transmission will provide Federal Express with the full range of products necessary to remain the leader in urgent document delivery.

*During the 1960s, dozens of unmanned satellites were put in orbit around the earth by American and Soviet space scientists. Many of these were designed for telecommunications purposes, to allow virtually instantaneous transmission of information around the world. Telstar I, for example, made possible the first live television broadcasts seen both in Europe and North America when it was launched in 1962.*



## Directors and Principal Officers

### Board of Directors

Robert H. Allen<sup>2</sup>  
*Chairman of the Board  
 and Chief Executive Officer  
 Realm Resources, Inc.  
 Oil and gas production and exploration*

James L. Barksdale  
*Executive Vice President  
 and Chief Operating Officer  
 Federal Express Corporation*

Anthony J. A. Bryan<sup>1</sup>  
*Chairman and Chief Executive Officer  
 Copperweld Corporation  
 Manufacturers of seamless and welded  
 steel tubing, bimetallic wire, rods  
 and strand and alloy and carbon steel bars*

Ralph D. DeNunzio<sup>2</sup>  
*President and Chief Executive Officer  
 Kidder, Peabody & Co. Incorporated  
 Investment bankers*

Philip Greer<sup>1\*</sup>  
*General Partner  
 Weiss, Peck & Greer Investments  
 Diversified investment management  
 and securities firm*

J. R. Hyde, III<sup>1</sup>  
*Chairman and President  
 Malone & Hyde, Inc.  
 Wholesale and retail foods, drugs,  
 sporting goods and auto parts*

Jackson W. Smart, Jr.<sup>2\*</sup>  
*Chairman, Executive Committee  
 Thomas Industries Inc.  
 Diversified manufacturer of high-quality  
 products for home and work, lighting,  
 decorative home accessories, tools and hardware*

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

John Burton Tigrett  
*Financial Consultant*

Peter S. Willmott<sup>1</sup>  
*Chairman and Chief Executive Officer  
 Carson Pirie Scott & Company  
 Department stores, floor covering distribution,  
 food services and lodging*

### Senior Corporate Officers

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

James L. Barksdale  
*Executive Vice President and  
 Chief Operating Officer*

David C. Anderson  
*Senior Vice President and  
 Chief Financial Officer*

Fred A. Manske, Jr.  
*Senior Vice President  
 Ground Operations*

Kenneth R. Masterson  
*Senior Vice President and  
 General Counsel*

T. Allan McArtor  
*Senior Vice President  
 Telecommunications*

Thomas R. Oliver  
*Senior Vice President  
 Sales and Customer Service*

James A. Perkins  
*Senior Vice President and  
 Chief Personnel Officer*

Carole A. Presley  
*Senior Vice President  
 Marketing*

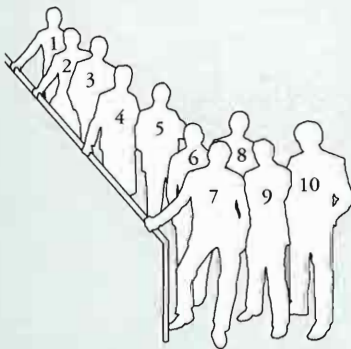
Ron J. Ponder  
*Senior Vice President  
 Information Systems*

James R. Riedmeyer  
*Senior Vice President  
 Linehaul Operations*

Theodore L. Weise  
*Senior Vice President  
 Central Support Services*

W. Jack Roberts  
*Vice President and Controller*

Robert L. Cox  
*Secretary*



1. Thomas R. Oliver
2. Ron J. Ponder
3. Fred A. Manske, Jr.
4. Carole A. Presley
5. Theodore L. Weise
6. James R. Riedmeyer
7. Kenneth R. Masterson
8. David C. Anderson
9. T. Allan McArtor
10. James A. Perkins

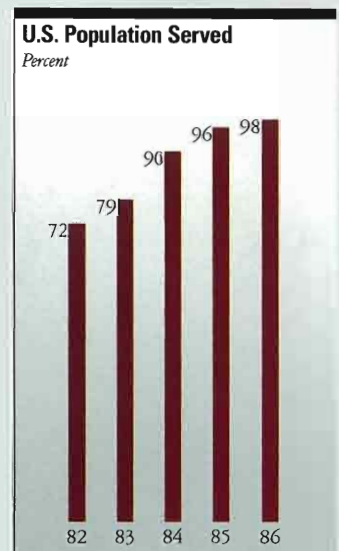
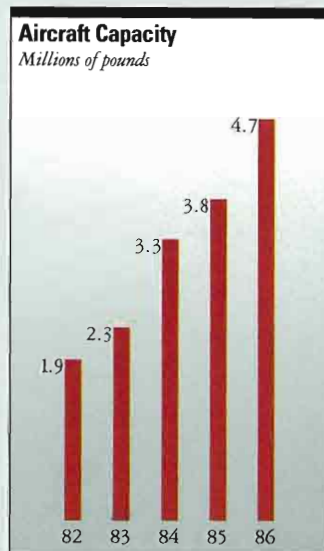
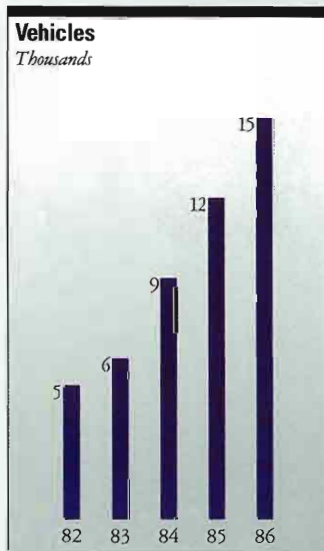
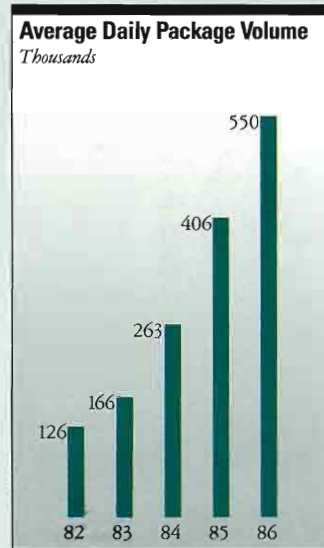
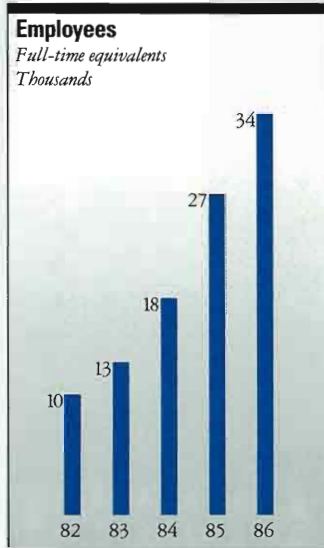
<sup>1</sup>Audit Committee

<sup>2</sup>Compensation Committee

\*Committee Chairman



# Operational Highlights



## *Financial Section*

<i>Management's Discussion and Analysis of Consolidated Results of Operations and Financial Condition</i>	22
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## Management's Discussion and Analysis of Results of Operations and Financial Condition

### Results of Operations

#### Operating Income

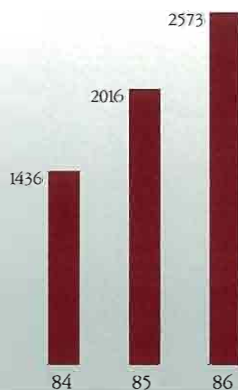
Millions of dollars

■ Excluding ZapMail  
■ As Reported



#### Express Delivery Revenues

Millions of dollars



Consolidated revenues of \$2.6 billion and net income of \$132 million in 1986 were the highest in the Company's history. These impressive results were achieved even though ZapMail losses were substantial and the Company continued to lower prices in the domestic express delivery business. Total revenues increased 28% in 1986, compared to increases of 41% in 1985 and 42% in 1984. These yearly increases have been primarily attributable to the significant growth in express delivery volumes. Lower consolidated operating margins subsequent to 1984 have been primarily due to the impact of ZapMail operations. However, continued cost control efforts and productivity improvements enabled the Company to improve its operating margin compared to 1985 and partially offset the decrease compared to 1984.

Federal Express specializes in the high priority delivery of goods and information through its express delivery and ZapMail services. While these two services are reported separately, their operations are integrated wherever possible in order to enhance productivity and to ensure the efficient use of resources. A detailed discussion of each business group follows.

#### Express Delivery Operations

Operating income in 1986 for express delivery operations was \$407 million, an increase of 32% for the year, compared with increases of 39% in 1985 and 25% in 1984. The operating margin improved in 1986 to 15.8% from 15.3% in 1985 and 13.2% in 1984.

Express delivery revenues were 28% higher in 1986 compared to increases of 40% in 1985 and 42% in 1984. This strong revenue performance has been due to increased package volumes during the corresponding periods of 35%, 54% and 58%, respectively. Revenue growth since 1983 has been restrained by declines in the composite package yield as a result of pricing actions and a continuing trend in package growth toward the lower-priced Overnight Letter and Standard Air services. These services comprised 55% of the total package volume for 1986 versus 50% in 1985 and 44% in 1984.

In response to the highly competitive express delivery environment, the Company reduced prices during the second quarter of 1986 for Priority One/Courier Pak and selected Standard Air services, initiated a money-back guarantee program in October 1985 related to the Company's delivery commitment and package tracking services, and continued to offer aggressive discounts to high volume shippers. The Company has been able to lower prices over the past three years as a result of vigorous cost control programs and productivity-enhancing measures which have lowered the costs of providing the services.

Operating expenses rose 27% in 1986, 37% in 1985 and 45% in 1984, primarily due to increased package volumes and expanded operations each year. Salaries and employee

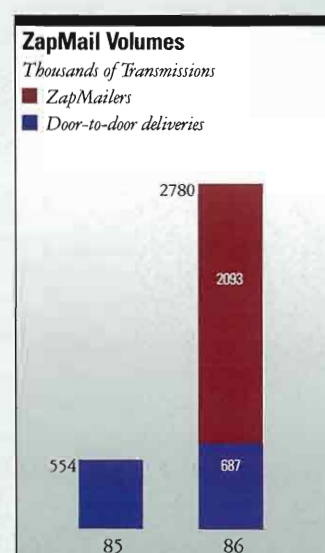
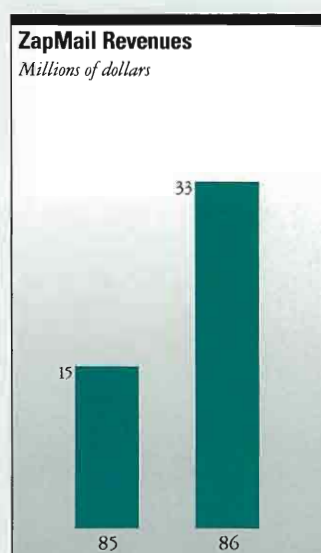
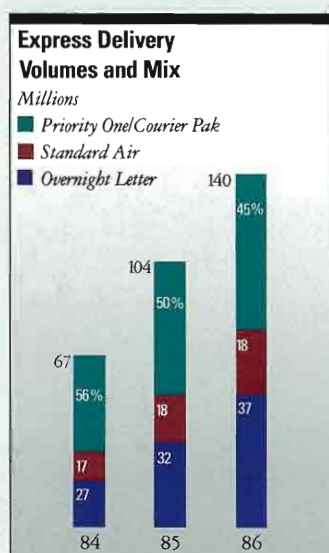
benefits expense increased as a result of additional employees needed to handle package volume growth. Significant growth in operations and a corresponding investment in additional aircraft, facilities and other equipment have led to higher equipment and facility rentals and depreciation expense over the past three years. Fuel costs, though tempered by declines in the average price per gallon, particularly in the second half of 1986, have increased due to the operation of an expanded aircraft and vehicle fleet. Maintenance and repairs expense has also increased since 1983 as a result of such fleet expansion. At May 31, 1986, there were approximately 14,500 vehicles and 102 aircraft compared to approximately 5,600 vehicles and 76 aircraft at May 31, 1983.

Communications expense has been adversely impacted by higher line charges since 1983, primarily the result of increased customer call volumes and network expansion. Partially offsetting these volume-related increases were cost savings realized from the ongoing transition to satellite-based communication networks.

#### *ZapMail Operations*

Operating losses for ZapMail in 1986 were \$132 million compared to 1985 losses of \$122 million. Revenues fell short of Company expectations, primarily due to volume shortfalls and lower rental income from customer-premise ZapMailers. Volumes reached 2.8 million transmissions in 1986 compared to 550,000 in 1985. During 1986, customer-premise ZapMailers accounted for 2.1 million transmissions.

In March 1986, the Company temporarily suspended placement of additional ZapMailers and waived monthly access charges for existing units until the speed and reliability of the service are upgraded to meet Company standards. In order to accomplish these objectives,



*Management's Discussion and Analysis of  
Results of Operations and Financial Condition  
(continued)*

the Company is revising the ZapMail service. The Company continues to believe ZapMail is responsive to the growing demand for facsimile document transmissions.

Communications costs comprised over 25% of total ZapMail operating expenses in 1986 compared to approximately 17% in 1985. The rise in communications costs is a result of network expansion and transition from a terrestrial network to a combination of terrestrial lines and satellite equipment. Substantial cost savings are expected to result in the future as the Company continues its transition to satellite-based communication systems.

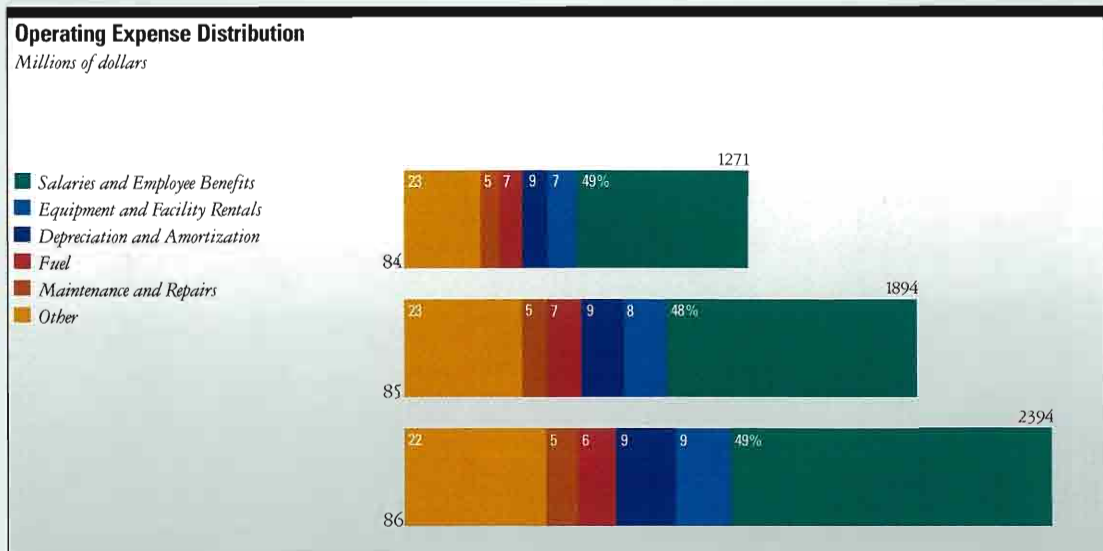
Salaries and employee benefits expense increased over the prior year as employees were hired to support and enhance the service. Depreciation expense and equipment rentals have risen due to the acquisition of ZapMailer equipment since 1984. Other expenses generally rose as a result of volume increases and product enhancements.

*Other Income and Expense Items*

Net other expense decreased slightly in 1986 compared to significant increases in 1985 and 1984, primarily reflecting changes in interest expense related to higher average debt levels in 1985 and fluctuations in the interest rates during these periods. Gains on the disposition of aircraft and related equipment during 1986 were primarily from the sale of the Company's purchase rights for three DC-10-30 aircraft and from the sale of three B727-200 aircraft prior to being placed into service.

*Income Taxes*

The effective tax rates were 19.7%, 8.8% and 24.2% in 1986, 1985 and 1984, respectively, and differ from the statutory rate primarily due to the effect of investment tax credits.



## Financial Condition

### Capital Expenditures

Capital expenditures during 1986 of \$530 million for the express delivery business provided for growth, productivity enhancements and product differentiation primarily through the acquisition of equipment and facilities, as well as investments in computer and telecommunications equipment. Major aircraft acquisitions consisted of four DC-10-30 and twenty-six Cessna 208 aircraft. Three of the DC-10-30 aircraft acquired in 1986 were later permanently financed through long-term operating leases, while long-term lease financing was secured for the other DC-10-30 prior to its delivery to the Company. Other significant expenditures consisted of sorting equipment and facilities, vehicles, and computer and telecommunications equipment. The Company also obtained property and equipment in connection with the purchase of Lex Wilkinson Limited.

In order to provide the resources necessary for further growth and expansion, the Company is committed to future acquisitions of property and equipment for the express delivery business. Current significant commitments include agreements to purchase five DC-10-30, seventy-five Cessna 208, two DC-10-10, six B727-200 and three B727-100 aircraft to be delivered through 1989.

Capital expenditures for ZapMail during 1986 totalled \$134 million and included ZapMailers and other network and telecommunications equipment used to expand and enhance the service. Of the approximately 16,000 ZapMailers acquired in 1986 and 1985, about 8,700 were financed through long-term operating leases. At May 31, 1986, the Company was committed to the purchase of additional ZapMailers to be delivered through 1989.

The Company is also developing a satellite-based telecommunications network which will further enhance the tracking and information-processing capabilities for express delivery and facsimile operations.

During 1987, the Company anticipates capital expenditures will exceed \$600 million. With the exception of committed capital expenditures, the amount and timing of expenditures will depend on various factors which cannot be predicted including future volumes, the introduction of new products and services, service area expansion and the availability of satisfactory financing. These factors, together with the Company's rapid growth and a highly competitive environment, require a certain degree of flexibility in the level of capital expenditures. Therefore, the Company continually reviews its long-range capital requirements to ensure adequate returns, superior services and the safety and well-being of its employees.

### Liquidity and Capital Resources

Working capital increased \$75 million during 1986 to \$181 million, compared to working capital of \$106 million at May 31, 1985 and \$72 million at May 31, 1984. During the past year, operations were the primary source of funds provided. Other significant additions to

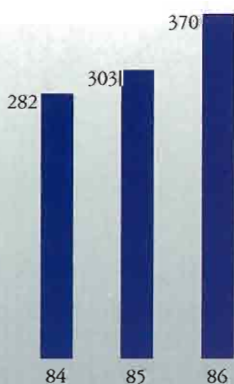
#### Capital Expenditures

Millions of dollars

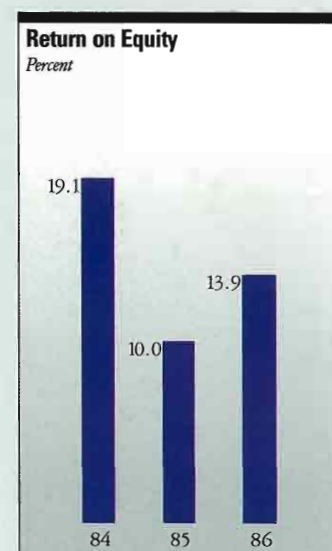
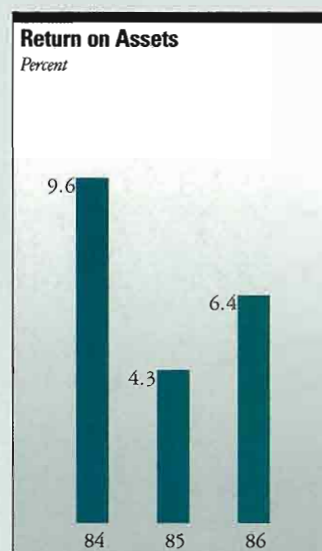
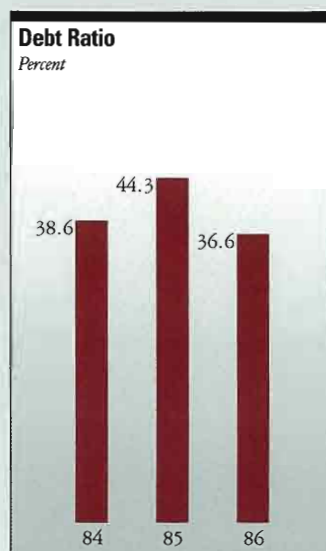


#### Working Capital from Operations

Millions of dollars



**Management's Discussion and Analysis of  
Results of Operations and Financial Condition**  
*(continued)*



working capital were provided from a public offering of two million shares of common stock and two public offerings of Senior Notes. The Company also utilized sale-leaseback financing for certain aircraft and ZapMail equipment purchased in 1986 and 1985. Sale-leaseback arrangements comprised the majority of asset dispositions during 1986. Funds provided were generally used to acquire capital assets and to reduce outstanding long-term debt.

Resources to meet future financing needs are expected to be provided from operations and the use of existing credit facilities. At May 31, 1986, \$37 million of escrowed bond funds were also available to fund the Company's facility expansion.

The Company's rates of return on assets and equity for 1986 improved from 1985 levels, but remained below the rates achieved for 1984. The significant investment in ZapMail combined with substantial operating losses during the first two years of the service have been the primary factors for the reductions in these performance measures since 1984. The Company intends to continue to improve its financial position through cost control efforts, productivity enhancements and product differentiation aimed at increasing its domestic and international market shares.

For additional information on the Company's long-term debt obligations and future commitments, see Notes 3 and 10 of Notes to Consolidated Financial Statements.

*Inflation and Changing Prices*

During 1986 as in the past several years, the inflation rate has continued its slow rate of increase. As a result, the impact of inflation on the Company's financial results has been minimal. Further information on inflation and changing prices is presented in Note 12 of Notes to Consolidated Financial Statements.

**Consolidated Statements of Income**  
Years ended May 31

<i>In thousands, except per share amounts</i>	1986	1985	1984
<i>Revenues</i>	\$2,606,210	\$2,030,661	\$1,436,305
<i>Operating Expenses:</i>			
Salaries and employee benefits (Note 8)	1,162,920	907,186	622,675
Equipment and facility rentals (Note 4)	214,372	146,389	87,572
Depreciation and amortization	212,404	172,333	111,956
Fuel	149,688	133,473	93,520
Maintenance and repairs	125,087	90,992	59,482
Other	529,598	443,565	295,892
	2,394,069	1,893,938	1,271,097
<i>Operating Income</i>	212,141	136,723	165,208
<i>Other Income (Expense):</i>			
Interest expense	(65,505)	(72,329)	(36,350)
Interest capitalized	6,808	9,736	11,851
Interest income	10,908	9,209	13,166
Gain on disposition of aircraft and related equipment	11,877	8,499	2,463
Other, net	(12,024)	(8,460)	(4,078)
	(47,936)	(53,345)	(12,948)
<i>Income before Income Taxes</i>	164,205	83,378	152,260
<i>Provision for Income Taxes (Note 7)</i>	32,366	7,301	36,830
<i>Net Income</i>	\$ 131,839	\$ 76,077	\$ 115,430
<i>Earnings Per Share (Note 6)</i>	\$ 2.64	\$ 1.61	\$ 2.52
<i>Average Shares Outstanding (Note 6)</i>	49,840	46,970	45,448

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

**C**onsolidated Balance Sheets  
May 31

	1986	1985
<i>In thousands</i>		
<i>Assets</i>		
<i>Current Assets:</i>		
Cash, including short-term investments of \$177,500,000 and \$11,300,000	\$ 185,036	\$ 12,189
Receivables, less allowance for doubtful accounts of \$19,788,000 and \$14,776,000	347,010	292,797
Spare parts, supplies and fuel	49,342	56,537
Refundable Federal income taxes (Note 7)	—	42,858
Prepaid expenses and other	31,902	18,763
Total current assets	613,290	423,144
<i>Property and Equipment, at cost (Notes 3, 4 and 10):</i>		
Flight equipment	841,410	774,114
Package handling and ground support equipment	418,053	341,108
Computer and electronic equipment	391,146	297,509
Other property and equipment	551,992	380,285
	2,202,601	1,793,016
Less accumulated depreciation and amortization	650,756	446,993
Property and equipment, net	1,551,845	1,346,023
<i>Other Assets</i>	111,227	130,339
	<b>\$2,276,362</b>	<b>\$1,899,506</b>

The accompanying Notes to Consolidated Financial Statements are an integral part of these balance sheets.

	<i>In thousands</i>	1986	1985
<i>Liabilities and Stockholders' Investment</i>	<i>Current Liabilities:</i>		
	Current portion of long-term debt and redeemable preferred stock (Notes 3 and 5)	\$ 72,979	\$ 44,730
	Accounts payable	184,534	127,721
	Accrued expenses (Note 2)	174,397	144,427
	Total current liabilities	431,910	316,878
	<i>Long-Term Debt, less current portion (Note 3)</i>	561,716	607,508
	<i>Deferred Income Taxes and Other (Note 7)</i>	189,513	159,810
	<i>Commitments and Contingencies (Notes 3, 4, 5, 8 and 10)</i>		
	\$9.50 Cumulative Preferred Stock, \$1.00 par value; stated at \$100 mandatory redemption value, less \$1,534,500 for shares currently redeemable; 30,439 and 45,772 shares authorized and issued (Note 5)	1,509	3,043
	<i>Common Stockholders' Investment (Notes 3 and 6):</i>		
	Common stock, \$.10 par value; 100,000,000 shares authorized, 50,808,280 and 47,030,565 shares issued	5,081	4,703
	Additional paid-in capital	530,618	340,753
	Retained earnings	598,215	466,811
		1,133,914	812,267
	Less deferred compensation related to stock plan	42,200	—
Total common stockholders' investment	1,091,714	812,267	
	\$2,276,362	\$1,899,506	

**Consolidated Statements of Changes in Financial Position**  
Years ended May 31

	<i>In thousands</i>	1986	1985	1984
<i>Funds Provided By</i>	Net income	\$ 131,839	\$ 76,077	\$115,430
	Charges to income not requiring working capital:			
	Depreciation and amortization	212,404	172,333	111,956
	Deferred income taxes and other	25,530	54,393	54,206
	Working capital provided from operations	369,773	302,803	281,592
	Increase in long-term debt	284,387	610,807	258,791
	Disposition of property and equipment:			
	Sale-leaseback transactions	251,533	149,503	—
	Other	5,012	15,834	20,536
	Proceeds from issuance of common stock	190,243	19,049	99,224
	Decrease in other assets	17,256	—	44,260
	<b>Total funds provided</b>	<b>1,118,204</b>	<b>1,097,996</b>	<b>704,403</b>
<i>Funds Used For</i>	Acquisition of property and equipment	674,771	571,054	648,736
	Reduction of long-term debt	323,137	438,457	71,057
	Increase in other assets	—	46,638	—
	Increase in deferred compensation related to stock plan	42,200	—	—
	Other	2,982	7,807	2,262
	<b>Total funds used</b>	<b>1,043,090</b>	<b>1,063,956</b>	<b>722,055</b>
	<i>Increase (Decrease) in Working Capital</i>	<b>\$ 75,114</b>	<b>\$ 34,040</b>	<b>\$(17,652)</b>
<i>Increase (Decrease) in Working Capital by Component</i>	Cash	\$ 172,847	\$ (25,501)	\$(67,747)
	Receivables	54,213	85,541	82,415
	Spare parts, supplies and fuel	(7,195)	16,812	23,522
	Refundable Federal income taxes	(42,858)	15,576	22,224
	Prepaid expenses and other	13,139	2,580	2,551
	Current portion of long-term debt and redeemable preferred stock	(28,249)	(22,729)	(9,830)
	Note payable	—	—	15,912
	Accounts payable	(56,813)	2,239	(70,913)
	Accrued expenses	(29,970)	(40,478)	(15,786)
	<b>Increase (Decrease) in Working Capital</b>	<b>\$ 75,114</b>	<b>\$ 34,040</b>	<b>\$(17,652)</b>

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

**Consolidated Statements of Changes in Common Stockholders' Investment**

<i>In thousands</i>	Common Stock	Additional Paid-in Capital	Retained Earnings	Deferred Compensation
<i>Balance at May 31, 1983</i>	\$2,197	\$222,782	\$278,815	\$ —
Dividends paid on preferred stock	—	—	(727)	—
Sale of common stock (2,000,000 shares)	200	86,600	—	—
Two-for-one stock split effected in the form of a stock divi- dend (22,040,715 shares)	2,204	—	(2,204)	—
Issuance of common stock under employee incentive plans (375,523 shares)	38	12,386	—	—
Net income	—	—	115,430	—
<i>Balance at May 31, 1984</i>	4,639	321,768	391,314	—
Dividends paid on preferred stock	—	—	(580)	—
Issuance of common stock under employee incentive plans (644,278 shares)	64	18,985	—	—
Net income	—	—	76,077	—
<i>Balance at May 31, 1985</i>	4,703	340,753	466,811	—
Dividends paid on preferred stock	—	—	(435)	—
Sale of common stock (2,000,000 shares)	200	108,980	—	—
Issuance of common stock under employee incentive plans (1,777,710 shares)	178	80,885	—	(50,000)
Amortization of deferred compensation	—	—	—	7,800
Net income	—	—	131,839	—
<i>Balance at May 31, 1986</i>	\$5,081	\$530,618	\$598,215	\$(42,200)

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

Note 1  
Summary of Significant  
Accounting Policies

*Principles of consolidation.* The consolidated financial statements include the accounts of Federal Express Corporation and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

*Property and equipment.* Expenditures for major additions, improvements, flight equipment modifications and certain overhaul costs are capitalized. Maintenance and repairs are charged to expense as incurred. The cost and accumulated depreciation of property and equipment disposed of are removed from the related accounts and any gain or loss reflected in income.

For financial reporting purposes, depreciation and amortization of property and equipment is provided on a straight-line basis over the asset's service life or related lease term as follows:

Flight equipment	7 to 20 years
Package handling and ground support equipment	5 to 30 years
Computer and electronic equipment	3 to 10 years
Other property and equipment	3 to 30 years

For income tax purposes, depreciation is generally computed utilizing accelerated methods.

*Capitalized interest.* Interest on funds used to finance the acquisition of aircraft and construction of certain facilities is capitalized as an additional cost of the asset until the date the asset is placed in service. For income tax purposes, capitalized interest is deducted currently for personal property (primarily aircraft and sort equipment) and amortized over a ten-year period for real property (primarily facilities).

*Short-term investments.* Short-term investments are carried at cost, which approximates market, and consist of commercial paper, collateralized repurchase agreements, certificates of deposit and other money-market instruments.

*Spare parts, supplies and fuel.* Spare parts, supplies and fuel are stated principally at standard cost (approximates actual cost on a first-in, first-out basis) which is not in excess of current replacement cost.

Note 1  
Continued

*Income taxes.* Deferred income taxes are provided for the tax effect of timing differences which occur in the recognition of certain expenses (principally depreciation of property and equipment) for tax and financial reporting purposes. Investment tax credit is accounted for using the flow-through method as a reduction of Federal income taxes in the year in which the related assets are placed in service.

*Earnings per share.* Earnings per share is computed based on net income after adjustment for dividend requirements on the \$9.50 Cumulative Preferred Stock and on the weighted average number of common and common equivalent shares outstanding during the year. Common equivalent shares are the number of shares of common stock that would be issued upon the exercise of all outstanding stock options.

Earnings per share assuming full dilution is substantially the same as earnings per share as stated and, accordingly, is not shown separately.

*Reclassifications.* Certain amounts for 1985 and 1984 have been reclassified to conform to the 1986 presentation.

Note 2  
Accrued Expenses

<i>In thousands</i>	May 31	
	1986	1985
Employee benefits	\$ 83,768	\$ 75,561
Insurance	25,422	18,089
Interest	16,711	8,211
Salaries	16,330	14,381
Taxes other than income taxes	12,971	15,722
Other	19,195	12,463
	<b>\$174,397</b>	<b>\$144,427</b>

**Notes to Consolidated Financial Statements**  
(continued)

**Note 3**  
**Long-Term Debt**

<i>In thousands</i>	May 31	
	1986	1985
Unsecured notes payable:		
9% Senior Notes, due 1991	\$ 99,650	\$ —
10 <sup>5</sup> / <sub>8</sub> % Senior Notes, due 1996	99,540	—
10 <sup>1</sup> / <sub>4</sub> % and 12 <sup>7</sup> / <sub>8</sub> % notes, due through 1996	69,500	75,000
8 <sup>3</sup> / <sub>4</sub> % note, due through 1991	50,000	—
	318,690	75,000
Revolving credit agreement	—	150,000
Commercial paper	—	99,796
Memphis-Shelby County Airport Authority Special Facilities Revenue Bonds:		
7 <sup>1</sup> / <sub>2</sub> % and 7 <sup>5</sup> / <sub>8</sub> % Series 1979, due 1995 through 2010	34,970	34,970
13% and 13 <sup>1</sup> / <sub>4</sub> % Series 1982A, due 2003 through 2013	48,000	48,000
11% Series 1982B, due 2013	22,000	22,000
10 <sup>7</sup> / <sub>8</sub> % Series 1982C, due 2004 through 2013	47,770	47,770
5 <sup>3</sup> / <sub>4</sub> % Series 1984, due 2010	94,550	94,550
	247,290	247,290
Less bond reserve funds and unamortized discount	28,866	29,085
	218,424	218,205
Capital lease obligations and other debt, effective rates of 6 <sup>1</sup> / <sub>4</sub> % to 16 <sup>5</sup> / <sub>8</sub> %	96,047	107,702
	633,161	650,703
Less current portion	71,445	43,195
	\$561,716	\$607,508

The Company has a \$400,000,000 revolving credit agreement with a group of banks. Borrowings under the agreement bear interest at essentially the prime rate. At May 31, 1986, the \$400,000,000 commitment consisted of a \$200,000,000 available commitment for general corporate purposes and a \$200,000,000 standby commitment, primarily to support

Note 3  
Continued

the issuance of any commercial paper by the Company. A commitment fee is payable annually at the rate of  $\frac{1}{2}\%$  on the unused portion of the available commitment and  $\frac{1}{4}\%$  on the standby commitment. The Company has an additional \$100,000,000 credit line with a group of banks available through November 1987 with terms similar to those of the primary credit agreement. No borrowings are outstanding under these agreements.

The credit agreements contain, among other things, provisions regarding the maintenance of minimum working capital and certain financial ratios, the incurrence of additional indebtedness and long-term lease commitments, the sale of assets, the creation of liens on assets and the payment of cash dividends, all as defined. At May 31, 1986, the amount the Company may expend for cash dividends and the repurchase or redemption of the Company's stock was limited under these agreements to approximately \$500,000,000.

The Memphis-Shelby County Airport Authority has issued Special Facilities Revenue Bonds to finance the acquisition and construction of various facilities and equipment for the Company at the Memphis International Airport. Proceeds from the bonds are held in escrow by a trustee until used by the Company. Lease agreements with the Authority covering the facilities and equipment financed with the bond proceeds obligate the Company for rentals equal to principal and interest due on the bonds. Annual principal payments due on the bonds outstanding at May 31, 1986 are \$1,860,000 in 1995 through 2002; \$13,860,000 in 2003; \$3,810,000 in 2004; \$8,320,000 in 2005; \$3,450,000 in 2006 through 2009; \$100,500,000 in 2010; \$1,950,000 in 2011 and 2012; and \$88,220,000 in 2013.

In accordance with the provisions of the Series 1984 Special Facilities Revenue Bonds, the interest rate was adjusted to  $5\frac{3}{4}\%$  from  $7\frac{1}{4}\%$  for the annual interest period beginning September 1, 1985. In July 1986, the Company elected to exercise the one-time option under the indenture agreement to convert the bonds to a fixed interest rate as of September 1, 1986. Prior to September 1, 1986, bondholders may tender their bonds to the Company for repurchase at par.

In July 1985, the Company established an Employee Stock Ownership Plan (ESOP) and in connection therewith borrowed \$50,000,000 from a bank. The proceeds were loaned to the ESOP to purchase shares of the Company's unissued common stock.

Scheduled annual principal maturities of long-term debt for the five years subsequent to May 31, 1986 are as follows: \$71,400,000 in 1987; \$35,000,000 in 1988; \$34,800,000 in 1989; \$26,800,000 in 1990 and \$121,400,000 in 1991.

**Notes to Consolidated Financial Statements**  
(continued)

**Note 4**  
**Lease Commitments**

The Company utilizes certain aircraft, land, facilities and equipment under capital and operating leases which expire at various dates through 2022. In addition, supplemental aircraft are leased under agreements which generally provide for cancellation upon sixty days notice.

Property and equipment recorded under capital leases at May 31 was as follows:

<i>In thousands</i>	1986	1985
Package handling and ground support equipment	\$236,743	\$193,994
Computer and electronic equipment	58,856	57,635
Other property and equipment	90,521	84,351
	386,120	335,980
Less accumulated amortization	111,598	72,389
	\$274,522	\$263,591

Rent expense under operating leases for the years ended May 31 was as follows:

<i>In thousands</i>	1986	1985	1984
Minimum rentals	\$182,941	\$120,555	\$74,689
Contingent rentals	31,431	25,834	12,883
	\$214,372	\$146,389	\$87,572

Contingent rentals are based on mileage under supplemental aircraft leases.

A summary of future minimum lease payments under capital leases and noncancellable operating leases (principally aircraft and facilities) with an initial or remaining term in excess of one year at May 31, 1986 follows:

<i>In thousands</i>	Capital Leases	Operating Leases
1987	\$ 57,253	\$ 165,702
1988	47,224	162,778
1989	43,112	132,576
1990	32,373	111,844
1991	26,061	80,103
Thereafter	627,396	853,825
	\$833,419	\$1,506,828

At May 31, 1986, the present value of future minimum lease payments for capital lease obligations, including the Special Facilities Revenue Bonds, was \$299,228,000.

*Note 5*  
*Preferred Stock*

The \$9.50 Cumulative Preferred Stock is redeemable at a price of \$100 per share. The Company is required to redeem approximately 15,400 shares on each January 1 through 1988. In addition, the Company has the option to redeem the stock, in whole or in part, at any time. The holders of such stock are not entitled to vote except as provided by law.

The Certificate of Incorporation authorizes the Board of Directors to issue, at their discretion, up to 4,000,000 shares of Series Preferred Stock. The stock is issuable in series which may vary as to certain rights and preferences and has no par value. As of May 31, 1986, none of these shares had been issued.

*Note 6*  
*Common Stockholders'*  
*Investment*

Under the provisions of the Company's stock incentive plans, options may be granted to certain key management personnel to purchase common stock of the Company at a price not less than its fair market value at the date of grant. The following summarizes information with respect to the Company's stock incentive plans:

	Number of Shares Under Option	Option Price Per Share
Outstanding at May 31, 1985	2,231,480	\$ 8.00-\$44.69
Granted	174,550	\$40.81-\$62.00
Exercised	(275,960)	\$ 8.00-\$45.00
Cancelled	(87,056)	\$23.59-\$45.00
Outstanding at May 31, 1986	2,043,014	\$ 8.00-\$62.00
Exercisable at May 31, 1986	901,817	\$ 8.00-\$45.00

At May 31, 1986, 401,473 shares were available for future grants.

The Company has an employee stock purchase plan which provides for the purchase of common stock by non-officer employees at a price equal to 85% of market. During 1986, 409,059 shares were issued under this plan at prices ranging from \$36.75 to \$53.65 per share.

At May 31, 1986, there were 3,728,283 shares of common stock reserved for issuance under the above mentioned plans.

In July 1985, the Company established an Employee Stock Ownership Plan (ESOP) which borrowed \$50,000,000 from the Company and used the proceeds to purchase 992,556 shares of the Company's unissued common stock for the benefit of eligible employees. Contributions are being made annually by the Company to the ESOP sufficient to pay principal and interest on the loan. Deferred compensation related to this plan was recorded as a reduction of common stockholders' investment and is being amortized over the term of the loan.

**Notes to Consolidated Financial Statements**  
(continued)

Note 7  
Income Taxes

<i>In thousands</i>	Year Ended May 31		
	1986	1985	1984
Current Provision (Benefit):			
Federal	\$ 5,948	\$(45,702)	\$(19,515)
State	3,592	(320)	3,551
Total current provision (benefit)	9,540	(46,022)	(15,964)
Deferred Provision:			
Federal	19,306	49,648	51,025
State	3,520	3,675	1,769
Total deferred provision	22,826	53,323	52,794
	\$32,366	\$ 7,301	\$ 36,830

The effective tax rates of 19.7% in 1986, 8.8% in 1985 and 24.2% in 1984 differ from the statutory Federal income tax rate, primarily due to the utilization of investment tax credits of \$49,000,000, \$37,000,000 and \$42,000,000 in such years, respectively. At May 31, 1986, the Company had investment tax credit carryforwards for income tax reporting purposes of approximately \$37,000,000 expiring in the year 2001.

Also impacting the effective tax rates were foreign operating losses of approximately \$9,000,000 in 1986 and \$9,300,000 in 1985 which could not be deducted for Federal income tax purposes and tax credits of \$3,000,000 in 1986 and \$2,200,000 in 1985 related to an employee stock ownership plan.

The tax effect of items included in the Federal deferred tax provision consisted of:

<i>In thousands</i>	Year Ended May 31		
	1986	1985	1984
Depreciation	\$57,120	\$46,230	\$35,124
Allowance for doubtful accounts	(5,791)	(2,939)	324
Tax operating leases	6,723	7,317	4,712
Interest and taxes capitalized for books	4,060	5,774	2,782
Gains on sales of fixed assets	(2,967)	(6,442)	—
Investment in tax lease	(7,487)	6,758	8,452
ITC carryover	(25,974)	(10,826)	—
Other	(6,378)	3,776	(369)
	\$19,306	\$49,648	\$51,025

Note 8  
 Postretirement  
 Benefit Plans

The Company has a defined benefit pension plan covering substantially all full-time employees age 21 and over with at least one year of service. Annual funding is based on an actuarially determined amount using the aggregate cost method. Effective June 1, 1985, the Company adopted Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," issued by the Financial Accounting Standards Board in December 1985. Pension expense for the year was reduced by \$21,000,000 due to the adoption of this Statement but was substantially offset by additional employee benefits provided based on income levels. The combined impact of these actions did not have a significant effect on net income or earnings per share for 1986 or for any of the previously reported quarters therein.

The following table sets forth the plan's funded status as of May 31, 1986:

*In thousands*

Actuarial present value of the projected benefit obligation for service rendered to date (1)	\$187,914
Plan assets at fair value	149,004
Projected benefit obligation in excess of plan assets	38,910
Unrecognized net losses from past experience different from that assumed and effects of changes in assumptions	(12,426)
Unrecognized net obligation at June 1, 1985, being recognized over 15.5 years	(333)
Accrued pension cost	\$ 26,151

Net pension cost for 1986 included the following components:

*In thousands*

Service cost—benefits earned during the period	\$ 22,792
Interest cost on projected benefit obligation	10,339
Actual return on plan assets	(27,822)
Net amortization and deferral	20,842
Net periodic pension cost	\$ 26,151

(1) The actuarial present value of the accumulated benefit obligation is \$90,765,000, of which vested benefits are \$40,629,000.

The weighted-average discount rate and rate of increase in future compensation levels used in determining the actuarial present value of the projected benefit obligation were 7.9% and 7.5%, respectively. The expected long-term rate of return on assets was 7%.

**Notes to Consolidated Financial Statements**  
(continued)

*Note 8*  
*Continued*

The Company also has a deferred profit sharing plan which covers substantially all full-time employees age 21 and over with at least one year of service. The plan provides for discretionary contributions by the Company, which are determined annually by the Board of Directors, and voluntary contributions by employees. Deferred profit sharing expense was \$10,800,000 in 1986, \$4,500,000 in 1985 and \$2,600,000 in 1984.

In addition to the above benefits, the Company provides certain health care benefits for retired employees. Substantially all of the Company's employees may become eligible for those benefits at age sixty and older if they have at least ten years of permanent, continuous service to the Company. These and similar benefits for approximately 31,300 active employees are expensed at the time claims are incurred. For 1986, total health care benefit costs were \$39,900,000. Due to the insignificant number of retirees, the cost of providing benefits for retired employees is immaterial and has not been separately reported.

*Note 9*  
*Segment Information*

The Company's business is primarily comprised of two segments: Express Delivery and ZapMail. These services are described elsewhere in this Annual Report. The following table shows financial information by business segment for the years ended May 31, 1986 and 1985.

<i>In thousands</i>	Express Delivery	ZapMail	Corporate	Total
<b>1986</b>				
Revenues	\$2,573,229	\$ 32,981	\$ —	\$2,606,210
Operating Income (Loss)	406,800	(131,880)	(62,779)	212,141
Identifiable Assets	1,887,107	170,351	218,904	2,276,362
Depreciation	191,574	18,860	1,970	212,404
Capital Expenditures	529,867	134,345	10,559	674,771
<b>1985</b>				
Revenues	\$2,015,920	\$ 14,741	\$ —	\$2,030,661
Operating Income (Loss)	308,183	(121,894)	(49,566)	136,723
Identifiable Assets (1)	1,668,029	185,945	45,532	1,899,506
Depreciation	158,203	12,281	1,849	172,333
Capital Expenditures	496,223	70,410	4,421	571,054

(1) ZapMail identifiable assets in 1985 include refundable Federal income taxes and equipment subsequently sold and leased back.

*Note 9*  
*Continued*

Operating income for each segment is revenue less operating expenses related to that segment's operations. Corporate expenses include general and administrative costs such as legal, finance, treasury, executive and personnel administration. Corporate assets include cash, corporate aircraft, other assets and certain land, buildings and furniture and fixtures used for administrative purposes. Identifiable assets used jointly by both the express delivery and ZapMail segments have been allocated based on estimated usage by each segment.

In 1984, expenses incurred relating to the development of ZapMail were \$23,500,000. Information by geographic area has not been provided as the financial results of the Company's international operations are not significant.

*Note 10*  
*Commitments*

Under various contracts, the Company is committed to purchase five DC-10-30, seventy-five Cessna 208, two DC-10-10, six B727-200, and three B727-100 aircraft to be delivered through 1989. At May 31, 1986, deposits of \$36,400,000 had been made toward these purchases. The Company is also reconditioning its fleet of thirty-five B727-100 aircraft through 1987, of which nine remain to be completed at May 31, 1986. Additional deposits and payments for aircraft acquisitions and modifications are expected to approximate \$262,600,000, \$170,000,000 and \$6,500,000 in 1987, 1988 and 1989, respectively.

The Company has contracts for the purchase of certain electronic equipment for its ZapMail service. Payments under these contracts are expected to be approximately \$43,700,000 in 1987 and \$22,900,000 in 1988.

During 1987, the Company anticipates capital expenditures will exceed \$600,000,000. In connection therewith, in addition to the commitments discussed above, other substantial commitments have been made as of May 31, 1986. With the exception of committed capital expenditures, the amount and timing of expenditures will depend on various factors which cannot be predicted including future volumes, the introduction of new products and services, service area expansion and the availability of satisfactory financing.

**Notes to Consolidated Financial Statements**  
(continued)

*Note 11*  
*Summary of Quarterly*  
*Operating Results*  
*(Unaudited)*

<i>In thousands, except per share amounts</i>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>1986</b>				
Revenues	\$589,318	\$625,540	\$668,155	\$723,197
Operating income	53,736	56,176	39,824	62,405
Income before income taxes	40,007	45,649	32,664	45,885
Net income	31,611	34,945	26,325	38,958
Earnings per share	\$ .66	\$ .71	\$ .51	\$ .76
Average shares outstanding	48,044	48,854	50,936	51,526
<b>1985</b>				
Revenues	\$439,106	\$485,200	\$513,695	\$592,660
Operating income	23,378	26,890	21,860	64,595
Income before income taxes	11,914	10,898	9,142	51,424
Net income	8,340	10,192	15,649	41,896
Earnings per share	\$ .18	\$ .21	\$ .33	\$ .89
Average shares outstanding	46,716	46,954	47,004	47,203

*Note 12*  
*Supplemental Information*  
*on the Effects of*  
*Changing Prices*  
*(Unaudited)*

The Financial Accounting Standards Board (FASB) requires that certain companies present supplemental information describing the effects of inflation on selected financial data adjusted for current costs which adjusts operating results for changes in specific prices. As current costs are determined by competitive market forces, they are more representative of net present value than historical costs. As applied to the Company, aircraft and engines have been restated using estimated current market prices. Other classes of assets were restated to estimated current prices through the use of externally developed indices.

Operating results adjusted for changes in specific prices reflect a remeasured depreciation and amortization amount based on the assumed purchase of property and equipment having the same service potential (i.e., service life, service capability, and operating cost) at current prices in effect during 1986. At May 31, 1986, the current cost of property and equipment, net of accumulated depreciation was \$1.7 billion. The current cost of property and equipment does not necessarily represent the market value of the Company's assets, nor is it an indication of their future replacement cost.

The increase in specific prices over the general inflation rate resulted from the higher replacement cost of aircraft and related equipment over the rate of inflation. Revenues and other expenses are assumed to have occurred proportionately throughout the year and, therefore, are considered to be stated in the average price level for the year. Disclosure of financial statement components, such as revenues, depreciation and amortization, and net income at current costs, is intended to reflect operating results of the period with the current costs of resources required to produce those results.

In accordance with FASB guidelines, no adjustments have been made to reflect any effects of inflation on the provision for income taxes as current laws do not allow deductions for inflation adjusted expenses.

The gain from decline in purchasing power of net amounts owed of \$9,398,000, represents an unrealized gain to the Company from maintaining a net monetary liability position (excess of amounts owed, which are fixed in terms of dollars, over cash and claims to cash) during a period of rising prices.

Although the Company recognizes the importance for readers of financial statements to understand the impact of inflation, management believes that the user should continue to focus on the historical financial statements in assessing the Company's results of operations and financial condition. The supplemental data contained in this section may not be a complete or fair presentation of the effects of inflation and the Company cautions the reader against accepting it as such.

**Notes to Consolidated Financial Statements**  
(continued)

Note 12

Continued

Statement of Income Adjusted  
for the Effects of  
Changing Prices

	Year Ended May 31, 1986	
	As Reported in the Consolidated Income Statements	Adjusted for Changes in Specific Prices (Current Cost)
<i>In thousands, except per share amounts</i>		
Revenues	\$2,606,210	\$2,606,210
Depreciation and amortization	212,404	232,859
Other operating expenses	2,181,665	2,181,665
Other expense, net	47,936	47,936
Total expenses	2,442,005	2,462,460
Income before income taxes	164,205	143,750
Provision for income taxes	32,366	32,366
Net income	\$ 131,839	\$ 111,384
Earnings per share	\$ 2.64	\$ 2.23
Increase in specific prices (current cost) of property and equipment held during the year		\$ 85,219
Effect of increase in general price level		22,773
Excess of increase in specific prices over increase in general price level		\$ 62,446

Note 12

Continued

Five-Year Comparison of  
Selected Financial Informa-  
tion Adjusted for the Effects of  
Changing Prices, Stated in  
Average Fiscal 1986 Dollars

	Year Ended May 31				
	1986	1985	1984	1983	1982
<i>In thousands, except per share data and index</i>					
Revenues, as reported	\$2,606,210	\$2,030,661	\$1,436,305	\$1,008,087	\$803,915
Net income:					
As reported	\$ 131,839	\$ 76,077	\$ 115,430	\$ 88,933	\$ 78,385
At current cost	111,384	68,620	122,682	98,665	83,160
Earnings per share:					
As reported	\$ 2.64	\$ 1.61	\$ 2.52	\$ 2.03	\$ 1.85
At current cost	2.23	1.45	2.68	2.25	1.96
Net assets at year end:					
As reported	\$1,091,714	\$ 812,267	\$ 717,721	\$ 503,794	\$350,319
At current cost	1,239,407	904,587	761,635	528,061	396,127
Increase in general price level in excess of (less than) change in specific prices	\$ (62,446)	\$ (54,135)	\$ (3,927)	\$ 43,220	\$ 27,830
Gain from decline in purchasing power of net amounts owed	\$ 9,398	\$ 21,518	\$ 10,938	\$ 5,190	\$ 10,328
Market price per common share at year end as quoted	\$ 62.50	\$ 43.50	\$ 32.75	\$ 38.88	\$ 21.63
Average consumer price index	325.5	315.8	303.9	293.5	281.9

## *Auditors' Report*

*To the Stockholders of Federal Express Corporation:*

We have examined the consolidated balance sheets of Federal Express Corporation (a Delaware corporation) and subsidiaries as of May 31, 1986 and 1985, and the related consolidated statements of income, changes in common stockholders' investment and changes in financial position for each of the three years in the period ended May 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Federal Express Corporation and subsidiaries as of May 31, 1986 and 1985 and the results of their operations and the changes in their financial position for each of the three years in the period ended May 31, 1986, in conformity with generally accepted accounting principles which, except for the change, with which we concur, in the method of determining pension expense as described in Note 8, were applied on a consistent basis.

*Arthur Andersen & Co.*

Memphis, Tennessee,  
July 15, 1986.

**Selected Consolidated Financial Data**

	<i>In thousands, except per share amounts</i>				
	1986	1985	1984	1983	1982
<i>Operating Results</i>					
Revenues	\$2,606,210	\$2,030,661	\$1,436,305	\$1,008,087	\$803,915
Operating expenses	2,394,069	1,893,938	1,271,097	857,350	684,449
Operating income	212,141	136,723	165,208	150,737	119,466
Other income (expense)	(47,936)	(53,345)	(12,948)	(521)	11,614
Income before income taxes	164,205	83,378	152,260	150,216	131,080
Income taxes	32,366	7,301	36,830	61,283	52,695
Net income	\$ 131,839	\$ 76,077	\$ 115,430	\$ 88,933	\$ 78,385
<i>Earnings Per Share</i>					
Earnings per share	\$ 2.64	\$ 1.61	\$ 2.52	\$ 2.03	\$ 1.85
Average shares outstanding	49,840	46,970	45,448	43,316	41,788
<i>Financial Position</i>					
Current assets	\$ 613,290	\$ 423,144	\$ 328,136	\$ 265,171	\$194,265
Property and equipment, net	1,551,845	1,346,023	1,112,639	596,392	457,572
Total assets	2,276,362	1,899,506	1,525,805	991,717	730,291
Current liabilities	431,910	316,878	255,910	175,293	114,596
Long-term debt	561,716	607,508	435,158	247,424	223,856
Common stockholders' investment	1,091,714	812,267	717,721	503,794	350,319

## Corporate Information

*Form 10-K* A copy of Federal Express' Form 10-K annual report, filed with the Securities and Exchange Commission, is available free. You will be mailed a copy upon request to Investor Relations Department, Federal Express Corporation, Box 727, Memphis, Tennessee 38194-1719, (901) 922-4553.

*Stock Listing* The Company's common stock is listed on The New York Stock Exchange under the ticker symbol FDX.

*Stockholders* At June 30, 1986, there were 7,360 stockholders of record.

*Market Information* Following are high and low closing prices, by quarters, for Federal Express stock in fiscal 1985 and 1986. No cash dividends have been declared.

<i>Closing Prices of Common Stock</i>		<i>First Quarter</i>	<i>Second Quarter</i>	<i>Third Quarter</i>	<i>Fourth Quarter</i>
FY 1985	High	\$45.00	\$45.38	\$38.88	\$44.13
	Low	32.13	31.25	31.38	33.38
FY 1986	High	\$51.38	\$54.88	\$72.38	\$73.38
	Low	41.50	41.00	53.75	59.00

*Annual Meeting* The annual meeting of stockholders will be held at the Memphis Airport Hilton Inn, 2240 Democrat Road, Memphis, Tennessee, on Monday, September 29, 1986, at 10:00 AM, CDT.

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Design: The Graphic Expression, Inc., New York

Cover and Executive Photography: Dana Duke

Employee Portrait Photography: Terry Heffernan

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