

November 3, 2006

Stock Rating  
**Overweight**

Industry View  
**In-Line**

## FedEx Corporation

### Express Rate Increase a Bullish Sign

**Quick Comment:** FedEx's 3.5% effective list rate increase at its flagship Express division is a good sign that domestic parcel pricing remains firm and rational. This is consistent with the results of our shipper survey that we published on October 13 and in-line with last year's effective rate increase.

**What's New:** The rate increase includes a 2.0 percentage point reduction in the fuel surcharge and 5.5% list rate increase, for an effective list rate increase of 3.5%. Also, FedEx Ground will implement dimensional weight pricing for all ground shipments larger than 3 cubic feet, effective Feb, '07. This follows a similar move by UPS earlier this year (also effective in 2007). Dimensional weight pricing should allow better price and cost alignment for oversized packages.

**Implications:** As identified in our Parcel Returns survey, shippers are anticipating healthy rate increases from FDX and UPS in '07, though we note that the companies seldom get the full announced rate increase, as significant amount of discounting takes place. Still, we believe that this is a positive signal that the pricing environment is stable and that FDX expects UPS to follow its lead in the air (UPS usually sets the upcoming year's price increase for the ground parcel market between late October and early December). FedEx indicated it will announce new Ground rates later this year.

**Reiterate Overweight on FedEx.** With pricing looking solid, we like FDX's operating and financial leverage. Secular growth trends are a positive for FedEx's efforts to expand international and ground packages, while investments in LTL freight have paid off very well. Overspending on capex and/or a large, dilutive acquisition are both risks.

#### Key Ratios and Statistics

Reuters: FDX.N Bloomberg: FDX US

Transportation / United States of America

<b>Price target</b>	<b>\$135.00</b>
Shr price, close (Nov 2, 2006)	\$112.09
Mkt cap, curr (mm)	\$35,202
52-Week Range	\$120.01-91.90

Fiscal Year (May)	2006	2007e	2008e	2009e
ModelWare EPS (\$)*	6.25	6.97	7.82	9.21
EPS adj for consensus (\$)	5.98	6.80	7.75	9.24
Consensus EPS (\$)	5.98	6.81	7.59	8.47
P/E pre op lease adj	18.3	16.5	14.5	12.1
Div yld (%)	0.3	0.3	0.4	0.4
EV, curr (\$mm)	45,619	45,619a	45,619a	45,619a
EBITDA pre pension, OPEB, lease (\$mm)	4,643	5,159	5,786	6,582

\* = Please see explanation of Morgan Stanley ModelWare later in this note.

a = Actual company reported data

e = Morgan Stanley Research estimates

#### Quarterly ModelWare EPS

Quarter	2006	2007e		2008e	
		Prior	Current	Prior	Current
Q1	1.25	-	1.53a	-	-
Q2	1.53	-	1.78	-	-
Q3	1.38	-	1.49	-	-
Q4	1.82	-	1.99	-	-

a = Actual company reported data

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## **Company Description**

FedEx Corp. provides a portfolio of transportation, e-commerce and business services through companies that operate independently and compete collectively under the FedEx brand. These companies are included in four business segments: FedEx Express, FedEx Ground, FedEx Freight and FedEx Kinko's.

## **Industry View: In-Line**

Our transportation view is In-Line. Falling fuel prices are generally a positive for transportation stocks, even those that impose fuel surcharges. That said, we believe lingering concerns about decelerating US GDP growth suggest that the stocks will perform in-line with the broader US market.

## **GICS Sector: Industrials**

Strategist's Recommended Weight: 11.3%  
S&P 500 Weight: 10.8%

Morgan Stanley

**ModelWare**<sup>SM</sup>

**ModelWare is Morgan Stanley's new system for helping investors and analysts to uncover value, free from the distortions and ambiguities created by accounting data.** Morgan Stanley has dissected and fundamentally redefined the components of corporate valuation, giving clients more consistent definitions, more comparable data, and more flexible analytic tools. ModelWare makes investment insights easier by making value more visible.

**Past inconsistencies in financial reporting made it difficult to compare performance among companies and across sectors and regions.** Even within US GAAP, flexibility complicates comparisons. And accounting standards were developed to analyze historical data, not to facilitate projections. In response, Morgan Stanley analysts spent two years reviewing our entire coverage universe of company metrics. They defined more than 2,000 general and industry-specific metrics that eliminated inconsistencies stemming from regional differences, historical precedents and accounting conventions. The team applied these metrics across also all 1900+ companies we cover, and created flexible tools and services that let analysts redefine and use the data with maximum creativity. Because ModelWare provides complete transparency, users see every component of every calculation, to choose elements or recombine them as they wish.

**ModelWare EPS illustrates the approach.** It represents ModelWare EPS as ModelWare net income divided by average fully diluted shares outstanding. ModelWare net income sums net operating profit after tax (NOPAT), net financial income or expense (NFE) and other income or expense. ModelWare adjusts reported net income to improve comparability across companies, sectors and regions. Among these adjustments: We exclude goodwill amortization and items deemed by analysts to be "one-time" events; we capitalize operating leases where their use is significant (e.g., in transportation and retail); and we convert inventory to FIFO accounting when LIFO costing is used. For more information on these adjustments and others, as well as additional background, please see *Morgan Stanley ModelWare (ver. 1.0): A Road Map for Investors*, by Trevor Harris and team, August 2, 2004.

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*(as of October 31, 2006)*

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
<b>Overweight/Buy</b>	<b>801</b>	<b>38%</b>	<b>309</b>	<b>44%</b>	<b>39%</b>
<b>Equal-weight/Hold</b>	<b>942</b>	<b>45%</b>	<b>308</b>	<b>44%</b>	<b>33%</b>
<b>Underweight/Sell</b>	<b>345</b>	<b>17%</b>	<b>78</b>	<b>11%</b>	<b>23%</b>
<b>Total</b>	<b>2,088</b>		<b>695</b>		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley or an affiliate received investment banking compensation in the last 12 months.

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**Overweight (O).** The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

**Equal-weight (E).** The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

**Underweight (U).** The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

**More volatile (V).** We estimate that this stock has more than a 25% chance of a price move (up or down) of more than 25% in a month, based on a quantitative assessment of historical data, or in the analyst's view, it is likely to become materially more volatile over the next 1-12 months compared with the past three years. Stocks with less than one year of trading history are automatically rated as more volatile (unless otherwise noted). We note that securities that we do not currently consider "more volatile" can still perform in that manner.

Unless otherwise specified, the time frame for price targets included in this report is 12 to 18 months.

## Analyst Industry Views

**Attractive (A):** The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

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**Cautious (C):** The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

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**The Americas**

1585 Broadway  
New York, NY 10036-8293  
**United States**  
Tel: +1 (1) 212 761 4000

**Europe**

25 Cabot Square, Canary Wharf  
London E14 4QA  
**United Kingdom**  
Tel: +44 (0) 20 7 425 8000

**Japan**

4-20-3 Ebisu, Shibuya-ku  
Tokyo 150-6008  
**Japan**  
Tel: +81 (0) 3 5424 5000

**Asia/Pacific**

Three Exchange Square  
Central  
**Hong Kong**  
Tel: +852 2848 5200

**Industry Coverage: Transportation**

Company (Ticker)	Rating (as of)	Price (11/02/2006)
<b>William J. Greene, CFA</b>		
AMR Corp. (AMR.N)	E-V (06/19/2006)	\$27.31
Continental Airlines (CAL.N)	E-V (06/19/2006)	\$34.80
Copa Holdings (CPA.N)	O-V (10/12/2006)	\$35.75
FedEx Corporation (FDX.N)	O (10/13/2006)	\$112.09
JetBlue Airways (JBLU.O)	O-V (06/19/2006)	\$11.95
Southwest Airlines (LUV.N)	U (06/19/2006)	\$14.75
United Parcel Service (UPS.N)	E (10/13/2006)	\$74.00

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