FedEx Corp FDX (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
166.67 USD	171.00 USD	119.70 USD	230.85 USD	Medium	Narrow	Positive	Standard	Transportation & Logistics

FedEx Handles Peak Season Rush Adroitly, Expanding Volume and Revenue per Unit in All Segments

See Page 2 for the full Analyst Note from 19 Mar 2015

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The primary analyst covering this company does not own its stock.

Research as of 19 Mar 2015
Estimates as of 18 Mar 2015
Pricing data through 06 Apr 2015
Rating updated as of 06 Apr 2015

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

Contents

Investment Thesis 30 Nov 2014

Express pioneer FedEx continues to refine its portfolio to increase margins and capture more of its clients' shipping spending. Well known for overnight parcel deliveries, FedEx has improved its competitive advantage by building the capacity to handle additional modes of shipping. After purchasing assets in ground delivery and less-than-truckload freight (both domestic U.S. operations) and building out its asset-light air and ocean forwarding network, FedEx can now handle most shipping modes. Fulfilling more of its customers' needs makes FedEx more difficult to displace and a bigger, stickier part of clients' operations.

FedEx's massive international shipping network would be difficult and costly to duplicate, giving the company a narrow economic moat. The strength of FedEx's barriers to entry was on full display when worthy competitor DHL exited the domestic U.S. parcel delivery market in 2009, having determined the incumbent duopoly was too powerful to challenge without extended losses. We expect FedEx to exploit its competitive advantages for years to come, despite the challenges of fuel price shocks and global economic cycles.

Furthermore, we expect mix shifts to boost returns on invested capital, as the firm expands high-margin ground operations and realigns international express operations to produce greater profitability. In response to weak international priority volume and growth of lower-yield international economy shipments, the firm is realigning its express fleet capacity to better match demand. In fiscal 2014, the legacy express segment produced about 60% of total firm sales, but the higher-margin ground operation generated about 57% of total operating profit (on just 26% of total sales--double the percentage contributed in 1999). The firm's less-than-truckload operation constitutes 13% of sales, and during the recession, market overcapacity drove down LTL rates; FedEx freight margins dropped from 10%-13% in 2005-07 to multiple quarters of loss-making, but recently recovered to mid-single-digit range. Growth in ground and international express are key to improving returns, and margin recovery in the LTL market will aid this somewhat.

Vital Statistics

Market Cap (USD Mil)	47,294
52-Week High (USD)	183.51
52-Week Low (USD)	130.64
52-Week Total Return %	24.7
YTD Total Return %	-3.9
Last Fiscal Year End	31 May 2014
5-Yr Forward Revenue CAGR %	4.6
5-Yr Forward EPS CAGR %	18.4
Price/Fair Value	0.97

Valuation Summary and Forecasts

Fiscal Year:	2013	2014	*2015(E)*	*2016(E)*
Price/Earnings	15.4	21.3	*18.6*	*15.4*
EV/EBITDA	5.1	7.9	*7.2*	*6.5*
EV/EBIT	8.9	13.8	*11.7*	*10.2*
Free Cash Flow Yield %	4.3	1.6	*2.5*	*3.4*
Dividend Yield %	0.6	0.4	*0.5*	*0.6*

Financial Summary and Forecasts (USD Mil)

Fiscal Year:	2013	2014	*2015(E)*	*2016(E)*
Revenue	44,287	45,567	*48,014*	*50,488*
Revenue YoY %	3.8	2.9	*5.4*	*5.2*
EBIT	3,211	3,446	*4,370*	*5,014*
EBIT YoY %	-1.3	7.3	*26.8*	*14.7*
Net Income, Adjusted	1,981	2,097	*2,594*	*3,022*
Net Income YoY %	-4.6	5.9	*23.7*	*16.5*
Diluted EPS	6.25	6.76	*8.98*	*10.79*
Diluted EPS YoY %	-4.6	8.3	*32.7*	*20.2*
Free Cash Flow	961	728	*1,307*	*1,724*
Free Cash Flow YoY %	21.1	-24.2	*79.5*	*31.9*

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

FedEx, which pioneered overnight delivery in 1973 and remains the world's largest express delivery firm, derives about 60% of its $45 billion top line from its express division. The company's ground segment delivers small parcels at a lower cost than express to the entire United States, and the freight segment provides less-than-truckload freight services. FedEx Office provides document production and shipping services, and Trade Networks offers freight forwarding services.

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Morningstar Analysis

FedEx Handles Peak Season Rush Adroitly, Expanding Volume and Revenue per Unit in All Segments 19 Mar 2015

FedEx increased volume and improved pricing in all segments and expanded consolidated margins during the same holiday peak season that threw UPS for a loop. Still, while FedEx improved its consolidated operating margin to 8.2% from 5.7%, a challenged UPS put up 11.7% excluding pension mark-to-market charges. Execution was right on point, but not much deviated from our projections, so we are maintaining our operating assumptions.

However, we increased our fair value estimates for FedEx and UPS due to a change in Morningstar's methodology. We decreased the cost of equity to 9% from 10% to better reflect returns we believe investors demand for firms of average systematic risk; these lower costs of capital increase the sum of our discounted cash flows. Accordingly, we raised our fair value estimates for FedEx to $171 from $162 and for UPS to $101 from $95; we consider the shares of both firms fairly valued.

Main takeaways from the FedEx report are three. First, demand continues to grow, as evidenced in year-over-year average daily volume growth of 4% in Express, 7% in Ground, 14% in Smart Post excluding a large customer loss, and 3% in Freight.

Second, the firm executed well during a challenging quarter. We credit FedEx Ground's independent contractor-based high-variable-cost model (drivers paid per piece) for the relative success compared with its main rival. UPS overinsured during the 2014 peak season against a brand-tarnishing recurrence of 2013 missed deliveries. This translated to excess personnel and commensurate costs.

Third, the Express margin initiative continues even as the firm negotiates changing conditions. Cheaper fuel dulls some of the luster on new 767s and 777s, but lower maintenance and accelerated depreciation benefits remain. Mix has changed since Express margins peaked in fiscal 2006-07, but via cost-saving and capacity-matching efforts during the past three years, we believe the segment can return to 8.5% levels within a couple of years.

FedEx handled the calendar 2014 peak well, but it's clear that both firms need to get paid for accomplishing the incredible: time-guaranteed next-day delivery with a money-back guarantee, or day-specific delivery with the same guarantee for a fraction of the price.

FedEx implemented dimensional pricing on the remaining (sub-3 cubic feet) Ground packages for two of the reported months, but declined to disclose the impact. Due to FedEx's telegraphing this pricing shift months in advance, customers were price motivated to modify packaging, some with the assistance of FedEx's packaging lab, to reduce the amount of empty box space for which they pay to ship. UPS has dimensional pricing in place for all ground products too. This is certainly a positive, but we opine that offsetting the cost of residential deliveries will demand price increases at a rate greater than the normal 2% or so annual increase.

We expect UPS in particular will step up in pushing price in 2015, having refrained in 2014 following widespread Christmas disappointments in 2013. Rate raises and full dimensional pricing will be countered in part by declining fuel surcharges and smaller (cheaper) packages entering the mix at both firms, such that the average revenue per piece may not quickly increase. Mix is ever richer in business to consumer, so both companies must take price at every opportunity. We think peak-season surcharges make good sense, but some large customers have contractual rates that need a couple of years to cycle. Still, we expect UPS and FedEx to test the benefit of operating in an oligopoly in the U.S. domestic market during the 2015 peak and beyond.

Valuation, Growth and Profitability 18 Mar 2015

Following FedEx's fiscal third quarter report, we maintain

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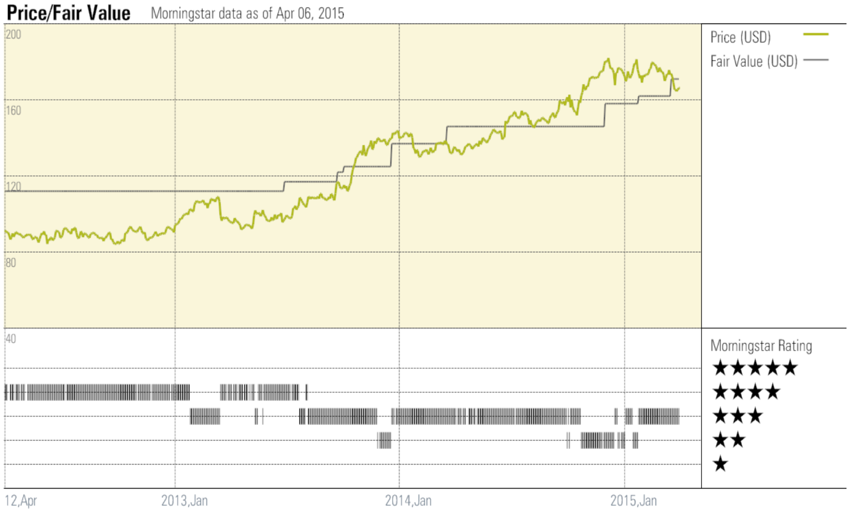
Price/Fair Value Morningstar data as of Apr 06, 2015



most of our valuation assumptions, but we increased our fair value estimate to $171 per share from $162 to reflect two factors. First, we accrue the time value of money since our last update, which adds about 2% to our valuation, and second, we adjusted our cost of equity downward to 9% from 10%, consistent with Morningstar's global equity research methodology. Based on our research, we believe 9% is the annual return investors demand for firms of average systematic risk, like FedEx.

We expect stronger near- and medium-term revenue and margin results from the freight segment because of ongoing tight supply in the trucking market (in part due to persistent driver shortage, also because of sustained strong demand in truckload and LTL shipments). We project freight revenue will grow 10% and 7% in fiscal 2015 and 2016. In the first half of fiscal 2015, freight increased its top line more than 10%. We model freight operating margins this year and next at 7.5% (more conservative than the first quarter's impressive 10.4%). Our assumption for midterm capital expenditure as a percentage of revenue is 6%, assuming the firm will invest a bit less once the current fleet refresh has slowed. In the past 10 years, FedEx has spent an average of 8.0% of revenue on capital investments annually, but UPS has spent only about half this portion of (greater) revenue in recent years, given its newer air fleet.

We expect FedEx to increase revenue 4.5% per year on average through fiscal 2019 (ending May 31, 2019). Our revenue projections assume ground sales grow at nearly 10% annually, based on organic growth (including from e-commerce shipments) plus clients downshifting from express and continued expansion of SmartPost, a low-priced product that uses a partnership with the U.S. Postal Service for final-mile delivery. Ground margins are likely to remain the highest of any sector; we model improvement from the past couple of years' 17%-18% to 18% by fiscal 2018 (it reached 20% in the final quarters of fiscal 2012 and 2013). We project long-run EBIT margins at the express and freight segments to average 8.5% and 7.5%, respectively. These estimates produce consolidated operating margins of about 11.5%--greater than the 9.3% peaks in fiscal 2006 and 2007 due largely to our projection that FedEx will expand the portion of its revenue earned from higher-margin ground operations.

Scenario Analysis

Our valuation scenarios vary growth and operating margin by segment. We project no major acquisitions. In our base case we model 4.5% average long-run growth coupled with long-run 11.5% consolidated operating margins. We derive our consolidated revenue growth expectation by projecting long-run growth rates in its express, ground, and freight businesses around 2%, 10%, and 3%, respectively. In our base case, we estimate normalized margins for express, ground, and freight of 8.5%, 19%, and 7.5%, assuming no margin-diluting legal consequences from broad unionization or destruction of ground's independent contractor model, nor unionization of freight that could compromise worker flexibility.

Express segment operating margin projections are a

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tremendous lever on the valuation of FedEx shares. Slower growth (2% overall) and significantly deteriorated margins in express, ground, and freight (6%, 17%, and 4%, respectively) knock 35% off our base-case valuation. Our bull case assumes slightly higher (than base case) 4.5% long-run express segment growth, based on faster international priority and economy package expansion. Despite FedEx's status as the now-largest LTL firm, freight's growth rate does not exert a strong pull on valuation. In both segments, we also project a few percentage points of margin expansion resulting from greater density through relatively fixed-dimension networks (about 10% EBIT margin for express and 8% for freight). Our bull case also grants 12% growth to ground and 22% ground margins; this combination would add about 30% to our base-case fair value estimate.

We model fuel as a flat percentage of revenue around 2010 levels, since we believe FedEx will successfully hedge fuel prices via effective fuel surcharges in all sectors. This is possible in part because of the duopoly structure in the market, which facilitates rational pricing. When fuel prices increase, fuel expenses and fuel surcharges both increase, albeit with a few weeks' delay between the rise in prices and surcharge implementation. However, when prices drop, the surcharge remains higher than prices for the same lag time, leading to a net neutral position. Surcharges may not be perfectly margin- and revenue-neutral, but we consider this to be our best modeling assumption. Our treatment of fuel is identical in all three scenarios.

Economic Moat

We identify three sources of economic moat for FedEx: cost advantage, efficient scale, and network effect. Global parcel shipping is dominated by FedEx, UPS, and DHL, and the networks these firms have erected constitute formidable barriers to entry. In fact, we believe no firm will try to replicate a global shipping network anytime soon, given the massive financial losses one would incur while trying to develop sufficient volume to cover the high fixed costs of such a system. In U.S. domestic parcel shipping, FedEx is one of only two titans, and rational pricing has been the result. We don't anticipate this will change, even if the U.S. Postal Service wins some of the rapidly growing e-commerce shipping business. In replicating a network of planes, trucks, sorting sites, rights to fly, and skilled employees, a new entrant would burn through tremendous resources before it could win away a critical volume of customers from the entrenched strong brands. In fact, even after tremendous investment, able competitor DHL lost nearly $1 billion on U.S. operations in 2007. Facing larger losses because of soft volume during 2008 and beyond, DHL finally threw in the towel after a decade of trying to establish its U.S. domestic express delivery business. We consider this to be a textbook example of the power of an efficient-scale economic moat: a worthy competitor foiled by steep barriers to entry erected by the incumbent domestic U.S. integrated shippers. In this high-fixed-cost business, the substantial parcel volume handled by the incumbents provides a cost advantage that makes competing at market prices difficult for low-volume entrants. The firm's foray into freight forwarding opens a network-effect moat source because each additional office in this business makes the rest of the system more valuable to shippers. We also like this business for diversifying away from such asset intensity present in the rest of the company.

Despite the industry's barriers to entry, we constrain FedEx's economic moat rating to narrow rather than wide because we expect the firm to outearn its cost of capital by a slim margin--this tempers our confidence that the firm reliably will exceed its cost of capital two decades from now. We consider two of FedEx's reporting segments to have economic moats: air express and ground shipping operations, but its less-than-truckload freight shipping business (the largest LTL operation in the U.S.) earns low margins subject to economic cycles in part because customers have many alternatives, which drives down pricing. In freight, customer switching costs are low and many truckers can provide adequate service, leaving little opportunity to differentiate the firm's offerings.

Moat Trend

FedEx's positive moat trend reflects improvement of its competitive position in domestic U.S. parcel delivery. In particular, the firm has improved ground operations such that its speed is greater than its competitors' in many lanes, helping attract volume to the firm. In short, FedEx's network effect is strengthening. We believe ground's growth, improved margins, and market share gains reflect the improvement of the competitive position of the underlying businesses. Further, we believe this expansion will require relatively low incremental capital expenditures because much of the sorting network is quite new, and we note that delivery costs are variable due to the independent contractor model. We believe continued online fulfillment expansion and annual price improvement constitute a long runway for continued U.S. ground growth. We also think the express business will source improvement from eventual recovery in international priority freight and parcel growth.

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Bulls Say/Bears Say

Bulls Say

- FedEx's huge air fleet, 50,000 drop boxes, and global operations knit together a massive presence unlikely to be replicated except by its few current competitors.
- In addition to ground growth, resumption of higher margins in the LTL freight and international express businesses should boost revenue growth and consolidated operating margins, assuming some boost in international volume over current levels.
- During its four-decade history, FedEx has weathered multiple economic cycles and oil supply crises. While short-term results may suffer, the firm's powerful network is here to stay.

Bears Say

- Although critical to growth, a high level of international exposure makes the firm vulnerable to downturns in global trade and political interference.
- Operating one of the world's largest airlines is a highly capital-intensive endeavor, and air freighter replenishment will demand substantial capital expenditures during the next several years.
- While fuel surcharges buffer much of the impact of rapid jet fuel and diesel price shocks, FedEx remains highly exposed to the price of crude oil.

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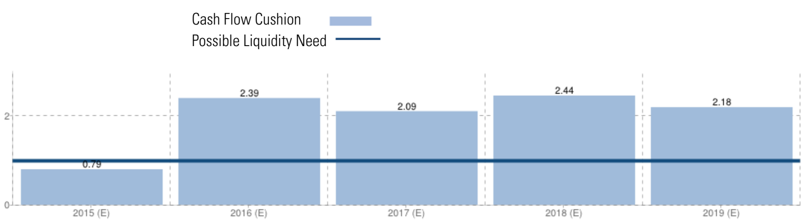
Five Year Adjusted Cash Flow Forecast (USD Mil)

	2015(E)	2016(E)	2017(E)	2018(E)	2019(E)
Cash and Equivalents (beginning of period)	2,908	2,923	1,741	1,490	2,292
Adjusted Available Cash Flow	-331	3,426	3,883	5,141	5,332
Total Cash Available before Debt Service	2,577	6,349	5,625	6,631	7,624
Principal Payments	—	—	—	—	-750
Interest Payments	-289	-259	-263	-267	-271
Other Cash Obligations and Commitments	-2,955	-2,398	-2,422	-2,446	-2,471
Total Cash Obligations and Commitments	-3,244	-2,657	-2,685	-2,714	-3,492

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	USD Millions	% of Commitments
Beginning Cash Balance	2,908	19.7
Sum of 5-Year Adjusted Free Cash Flow	17,451	118.0
Sum of Cash and 5-Year Cash Generation	20,359	137.6
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	20,359	137.6
Sum of 5-Year Cash Commitments	-14,792	—

Financial Health

At the end of February, FedEx held $3.5 billion of cash and equivalents and owed $7.2 billion in interest-bearing debt. The firm deployed a portion of its excess cash in fiscal 2013 and 2014 to repurchase shares, and we believe this will continue during the next several years. In January, the firm issued $2 billion of debt in 10-, 20-, and 30-year maturities to fund an accelerated share repurchase agreement. Total debt/EBITDA is 1.1 times, which remains reasonably low. However, FedEx uses operating leases to finance a portion of its wide-body aircraft fleet and pays even greater rent to lease facilities and equipment. The firm paid total rent of $2.4 billion in its most recent fiscal year. As such, on a rent-adjusted basis, leverage was meaningfully higher at around 3 times. While we consider the firm's trailing 12-month adjusted EBITDAR/interest and rent ratio of about 4 to be adequate, this coverage including rent is certainly not as glowing as the firm's 30 times EBITDA/interest expense ratio. These sizable lease commitments contribute to the company's poor Cash Flow Cushion score. However, our projected single-digit top-line growth over the remaining four years of our discrete forecast period should lead to healthy free cash flow generation and gradual deleveraging, supporting Morningstar's BBB+ credit issuer rating.

FedEx's capital structure is comprised primarily of a series of senior unsecured notes. In addition to the $2 billion of debt noted above, FedEx issued 10- and 30-year notes in both 2012 and 2013. The firm's next maturity is a $750 million bond due in 2019. FedEx also has a $1 billion credit facility that matures in March 2018.

Enterprise Risk

FedEx is chiefly exposed to the health of the U.S. and global economies. As FedEx expands into developing nations such as China, continuing success depends not only on busy, healthy domestic and global economies, but also on continued stable conditions in these regions. Domestically, ground drivers who are currently contractors may seek to become classified as employees, but we think the firm's moving ground drivers to a multiple-route-owning independent contractor model neutralizes this risk (and the risk of subsequent organization). We think freight operations could organize more easily, though only a couple of terminals have voted to join the Teamsters to date and multiple terminals in 2014 voted against joining the union. Currently within FedEx, only express pilots are unionized; widespread unionization, such as among express drivers, could reduce FedEx's ability to flex shipping capacity to match demand. But the systemwide vote required by the Railway Labor Act presents a threshold for unionization greater than if express could organize into locals.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
MR. FREDERICK W. SMITH	CEO/Chairman of the Board/ Chairman of the Board, Subsidiary/ Director/Founder/President, Director	15,388,652	09 Jan 2015	180,200
MR. ALAN B. GRAF, JR.	Executive VP/CFO	150,980	18 Dec 2014	—
MR. T. MICHAEL GLENN	Executive VP, Divisional	120,325	02 Oct 2014	—
MS. CHRISTINE P. RICHARDS	Executive VP/Secretary/General Counsel	90,410	22 Dec 2014	—
MR. DAVID J. BRONCZEK	CEO, Subsidiary/President, Subsidiary	63,718	29 Dec 2014	—
MR. JAMES L. BARKSDALE	Director	59,800	25 Sep 2014	—

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Vanguard PrimeCap Fund	3.46	3.66	-1,561	31 Dec 2014
Dodge & Cox Stock Fund	3.11	2.54	—	31 Dec 2014
Vanguard Total Stock Mkt Idx	1.47	0.20	54	28 Feb 2015
Fidelity® Contrafund® Fund	1.20	0.60	67	28 Feb 2015
Vanguard Wellington™	1.33	0.73	23	31 Dec 2014
Concentrated Holders				
iShares Transportation Average	0.36	11.96	-22	02 Apr 2015
Fidelity® Select Transportation	0.16	8.10	-47	28 Feb 2015
Fidelity® Select Air Transportation Port	0.10	7.58	-13	28 Feb 2015
Mackenzie Cundill US Class	0.01	5.64	—	31 Dec 2014
WF Valeurs Internationales	—	5.56	—	28 Feb 2015

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
Fidelity Management and Research Company	5.05	0.35	3,097	31 Dec 2014
T. Rowe Price Associates, Inc.	3.00	0.31	971	31 Dec 2014
New Jersey Division of Pensions and Benefits	0.25	0.09	770	30 Jun 2010
UBS Securities LLC	0.26	0.09	661	31 Dec 2014
Wellington Management Company LLP	2.73	0.35	581	31 Dec 2014
Top 5 Sellers				
Southeastern Asset Management Inc.	2.07	5.86	-3,519	31 Dec 2014
Harris Associates L.P.	2.46	1.88	-3,029	31 Dec 2014
PRIMECAP Management Company	5.48	2.73	-2,421	31 Dec 2014
Citadel Advisors Llc	0.41	0.24	-353	31 Dec 2014
STRS OHIO	0.09	0.19	-264	31 Dec 2014

Management 01 Oct 2013

Fred Smith, FedEx's founder and the inventor of overnight national delivery, remains at the helm of a largely independent board that has guided the firm through years of growth and profitability. As chairman, president, and CEO, Smith received $12.6 million in total compensation in fiscal 2013, including $1.3 million in salary, $5.6 million in option awards, and $5.3 million in unusually high long-term incentive compensation. Smith's compensation in fiscal 2011 and 2012 was around $7 million and $14 million, respectively. FedEx cut costs in 2009, including reducing Smith's base salary 20%, lowering named executive base pay 10%, and freezing merit increases companywide. FedEx paid three additional named executive officers $4.8 million-$6.4 million in total compensation (including increased actuarial value of pension plans) during fiscal 2013.

We think Smith's option awards and material equity position--6.7% of total outstanding FedEx shares as of Aug. 12--align his interests with other shareholders'. Smith has pledged more than 22% of his shares to collateralize loans to fund prior share purchases and outside business ventures, but he is the only insider making such pledges and we don't doubt the proxy statement that claims Smith established his financial capacity to repay the loan without resorting to pledged shares.

Substantial cash holdings may tempt management to pursue acquisitions that fail to generate adequate returns on invested capital, but we applaud FedEx's development of a non-asset-based freight forwarding operation in the past three to four years, as we believe this will help to insulate the firm from the full brunt of fuel shocks and help to retain share of customers' shipping spend even as some downshift from air to ocean shipping. Partnerships with retailers seem in hindsight perhaps more prudent than spending $2.4 billion to acquire Kinko's (now FedEx Office), but predicting plummeting copy demand would have

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required a crystal ball, and while retail store margins are undisclosed, FedEx indicates that Office still attracts undiscounted retail parcels into its express and ground networks. Moreover, this acquisition was a decade ago, so we may be approaching a reasonable statute of limitations for our criticism.

Overall, we believe FedEx acts in the best interests of shareholders, and we consider its governance to be solid, in line with that of other large-cap transport and industrial companies.

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Analyst Notes

FedEx Reports Solid Fiscal 2Q Earnings 17 Dec 2014

FedEx's Express profit-improvement initiatives continue to pay off, as this largest of FedEx's segments improved operating margin 170 basis points from the prior-year period to 6.9%, and Express volume gains (7% U.S. and 2% international) easily outpaced expense growth (1% year over year). Companywide, FedEx reported 36% growth in second-quarter earnings, boosted by volume improvements in all modes. Yields declined slightly in Express because of lower weights, but in Ground, excluding Smart Post and fuel surcharges, yield improved 3.3% and Freight yield per shipment excluding fuel increased 2.3%. Lower pension expense, lower fuel cost, and share repurchases boosted EPS as well, and consolidated margins improved 120 basis points to 8.5%--we model 9.0% for the full year. The firm reiterated its EPS guidance for fiscal 2015 of $8.50-$9.00. We maintain our narrow moat rating and expect to maintain our fair value estimate.

While earnings growth is lower than the 40% consensus expected, we think a sell-off is probably just due to the miss, and believe FedEx demand, pricing, and operating improvements are intact. Two expenses deserve some explanation. First, cheaper jet fuel had little impact because the company buys under contracts tied to indexes that update on a lag. Spot jet fuel declined 30% from August to November, but given its purchasing practices, FedEx's average price declined only 8% sequentially. Greater savings is likely in the coming quarter. We assume fuel prices are covered by surcharges such that there is little long-run impact on margins, but lower fuel prices may stimulate consumer demand and lower surcharges may push mix to higher-priced international priority parcels, particularly given the current continued congestion in West Coast U.S. ports. The second noteworthy expense was MD10 aircraft engine maintenance, which increased the maintenance and repair expense line by 16%--much faster than the 5% revenue growth in the period.

Earlier this week the firm announced two acquisitions to grow its supply chain services. Bongo International, which through its technologies and services facilitates international e-commerce via duty and tax calculations, currency conversion, fraud protection, payment options, and export compliance management, will operate as a FedEx Trade Networks subsidiary. Bongo makes sense to us as an enhancement of FedEx's offerings to serve fast-growing e-commerce on a global scale. FedEx also announced its acquisition of 3PL GENCO this week. GENCO's 130 operations process more than 600 million returned items annually; the firm serves a variety of industries by providing warehousing, contract packaging, test/repair/refurbishment, product liquidation, recycling, and other transportation management services. Adding this $1.6 billion in annual revenue 3PL to its portfolio substantially boosts FedEx's asset-light supply chain operations, a segment the company has been building up for the past five years or so by expanding its Trade Networks international freight forwarding business from a couple of dozen offices to more than 130 offices around the world. UPS' supply chain business produces over $5 billion of sales annually.

FedEx Acquires 3PL GENCO, Bolstering Its Asset-Light Supply Chain Capabilities 16 Dec 2014

FedEx announced the acquisition of Pittsburgh-based third-party logistics firm GENCO, which produces $1.6 billion of annual revenue (FedEx generated $46 billion in the trailing 12 months). GENCO's 11,000 employees in 130 operations process more than 600 million returned items annually; the firm serves a variety of industries by providing warehousing, contract packaging, test/repair/refurbishment, product liquidation, recycling, and other transportation management services. Adding this 3PL to its portfolio substantially boosts FedEx's asset-light supply chain operations, a segment the company has been building up for the past five years or so by expanding its Trade Networks international freight forwarding business from a couple of dozen offices to more

FedEx Corp FDX (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
166.67 USD	171.00 USD	119.70 USD	230.85 USD	Medium	Narrow	Positive	Standard	Transportation & Logistics

Analyst Notes

than 130 offices around the world. Trade Networks' revenue is not reported separately from other Express operations. The deal is scheduled to close in 2015; terms were undisclosed. Absent information, we assume the firm paid fairly and we maintain our fair value estimate. Still, we think extending its reach into forwarding and supply chain functions can serve to funnel additional parcels into FedEx's air, ground, and freight networks.

FedEx will report earnings Wednesday.

FedEx Corp FDX (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in May

Growth (% YoY)	3-Year Hist. CAGR	2012	2013	2014	*2015* (Forecast)	*2016* (Forecast)	*5-Year Proj. CAGR*
Revenue	*5.1*	8.6	3.8	2.9	*5.4*	*5.2*	*4.6*
EBIT	*10.8*	28.5	-1.3	7.3	*26.8*	*14.7*	*13.4*
EBITDA	*10.2*	19.1	4.3	7.8	*17.3*	*10.9*	*9.9*
Net Income	*10.6*	33.8	-4.6	5.9	*23.7*	*16.5*	*13.4*
Diluted EPS	*11.4*	33.8	-4.6	8.3	*32.7*	*20.2*	*18.4*
Earnings Before Interest, after Tax	*6.1*	46.3	-20.1	2.2	*3.5*	*14.7*	*8.9*
Free Cash Flow	*0.1*	9.1	21.1	-24.2	*79.5*	*31.9*	*38.0*

Profitability	3-Year Hist. Avg	2012	2013	2014	*2015*	*2016*	*5-Year Proj. Avg*
Operating Margin %	*7.5*	7.6	7.3	7.6	*9.1*	*9.9*	*10.4*
EBITDA Margin %	*12.8*	12.6	12.6	13.2	*14.7*	*15.5*	*16.0*
Net Margin %	*4.7*	4.9	4.5	4.6	*5.4*	*6.0*	*6.3*
Free Cash Flow Margin %	*1.9*	1.9	2.2	1.6	*2.7*	*3.4*	*4.6*
ROIC %	—	—	—	—	—	—	—
Adjusted ROIC %	*8.3*	9.6	7.7	7.6	*7.5*	*8.2*	*8.6*
Return on Assets %	*6.1*	7.1	4.9	6.3	*7.7*	*8.7*	*9.2*
Return on Equity %	*12.0*	13.6	9.7	12.8	*17.6*	*20.4*	*20.6*

Leverage	3-Year Hist. Avg	2012	2013	2014	*2015*	*2016*	*5-Year Proj. Avg*
Debt/Capital	*0.16*	0.10	0.15	0.24	*0.34*	*0.30*	*0.29*
Total Debt/EBITDA	*0.54*	0.31	0.53	0.79	*1.02*	*0.83*	*0.81*
EBITDA/Interest Expense	*69.72*	103.21	68.26	37.71	*24.47*	*30.27*	*31.39*

Valuation Summary and Forecasts

	2013	2014	*2015(E)*	*2016(E)*
Price/Fair Value	0.86	0.99	—	—
Price/Earnings	15.4	21.3	*18.6*	*15.4*
EV/EBITDA	5.1	7.9	*7.2*	*6.5*
EV/EBIT	8.9	13.8	*11.7*	*10.2*
Free Cash Flow Yield %	4.3	1.6	*2.5*	*3.4*
Dividend Yield %	0.6	0.4	*0.5*	*0.6*

Key Valuation Drivers

Cost of Equity %	9.0
Pre-Tax Cost of Debt %	6.5
Weighted Average Cost of Capital %	8.6
Long-Run Tax Rate %	36.5
Stage II EBI Growth Rate %	5.0
Stage II Investment Rate %	25.0
Perpetuity Year	15

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	9,280	18.4	34.63
Present Value Stage II	17,135	34.0	63.94
Present Value Stage III	24,043	47.7	89.71
Total Firm Value	**50,459**	**100.0**	**188.28**
Cash and Equivalents	2,908	—	10.85
Debt	-4,737	—	-17.68
Preferred Stock	—	—	—
Other Adjustments	-5,585	—	-20.84
Equity Value	**43,045**	**—**	**160.61**
Projected Diluted Shares	268		
Fair Value per Share (USD)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

FedEx Corp FDX (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
166.67 USD	171.00 USD	119.70 USD	230.85 USD	Medium	Narrow	Positive	Standard	Transportation & Logistics

Morningstar Analyst Forecasts

Income Statement (USD Mil)

Fiscal Year Ends in May

	2012	2013	2014	*Forecast* 2015	*Forecast* 2016
Revenue	**42,680**	**44,287**	**45,567**	***48,014***	***50,488***
Cost of Goods Sold	39,426	41,076	42,121	*43,644*	*45,474*
Gross Profit	**3,254**	**3,211**	**3,446**	***4,370***	***5,014***
Selling, General & Administrative Expenses	—	—	—	—	—
Other Operating Expense (Income)	—	—	—	—	—
Other Operating Expense (Income)	—	—	—	—	—
Depreciation & Amortization (if reported separately)	—	—	—	—	—
Operating Income (ex charges)	**3,254**	**3,211**	**3,446**	***4,370***	***5,014***
Restructuring & Other Cash Charges	—	560	—	—	—
Impairment Charges (if reported separately)	134	100	—	—	—
Other Non-Cash (Income)/Charges	-66	—	—	—	—
Operating Income (incl charges)	**3,186**	**2,551**	**3,446**	***4,370***	***5,014***
Interest Expense	52	82	160	*289*	*259*
Interest Income	7	-14	3	*5*	*5*
Pre-Tax Income	**3,141**	**2,455**	**3,289**	***4,086***	***4,760***
Income Tax Expense	1,109	894	1,192	*1,491*	*1,737*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	—	—
(Minority Interest)	—	—	—	—	—
(Preferred Dividends)	—	—	—	—	—
Net Income	**2,032**	**1,561**	**2,097**	***2,594***	***3,022***
Weighted Average Diluted Shares Outstanding	317	317	310	*289*	*280*
Diluted Earnings Per Share	**6.41**	**4.92**	**6.76**	***8.98***	***10.79***
Adjusted Net Income	2,076	1,981	2,097	*2,594*	*3,022*
Diluted Earnings Per Share (Adjusted)	**6.55**	**6.25**	**6.76**	***8.98***	***10.79***
Dividends Per Common Share	0.52	0.56	0.60	*0.80*	*1.00*
EBITDA	**5,299**	**4,937**	**6,033**	***7,074***	***7,843***
Adjusted EBITDA	**5,367**	**5,597**	**6,033**	***7,074***	***7,843***

FedEx Corp FDX (NYSE) | ★★★

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166.67 USD	171.00 USD	119.70 USD	230.85 USD	Medium	Narrow	Positive	Standard	Transportation & Logistics

Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

Fiscal Year Ends in May

	2012	2013	2014	*Forecast 2015*	*2016*
Cash and Equivalents	2,843	4,917	2,908	*2,923*	*1,741*
Investments	—	—	—	—	—
Accounts Receivable	4,704	5,044	5,460	*5,393*	*5,671*
Inventory	440	457	463	*478*	*498*
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	1,069	856	852	*900*	*900*
Current Assets	**9,056**	**11,274**	**9,683**	***9,694***	***8,811***
Net Property Plant, and Equipment	17,248	18,484	19,550	*21,071*	*22,305*
Goodwill	2,387	2,755	2,790	*2,800*	*2,810*
Other Intangibles	1,212	1,054	1,047	*1,062*	*1,077*
Deferred Tax Assets (Long-Term)	—	—	—	—	—
Other Long-Term Operating Assets	—	—	—	—	—
Long-Term Non-Operating Assets	—	—	—	—	—
Total Assets	**29,903**	**33,567**	**33,070**	***34,627***	***35,003***
Accounts Payable	1,613	1,879	1,971	*2,033*	*2,118*
Short-Term Debt	417	251	1	*1*	*250*
Deferred Tax Liabilities (Current)	—	—	—	—	—
Other Short-Term Liabilities	3,344	3,620	3,340	*3,340*	*3,340*
Current Liabilities	**5,374**	**5,750**	**5,312**	***5,374***	***5,708***
Long-Term Debt	1,250	2,739	4,736	*7,228*	*6,228*
Deferred Tax Liabilities (Long-Term)	836	1,652	2,114	*2,114*	*2,114*
Other Long-Term Operating Liabilities	2,134	2,112	2,147	*2,147*	*2,147*
Long-Term Non-Operating Liabilities	5,582	3,916	3,484	*3,484*	*3,484*
Total Liabilities	**15,176**	**16,169**	**17,793**	***20,347***	***19,681***
Preferred Stock	—	—	—	—	—
Common Stock	32	32	32	*32*	*32*
Additional Paid-in Capital	2,595	2,668	2,643	*2,643*	*2,643*
Retained Earnings (Deficit)	17,134	18,519	20,429	*22,792*	*25,535*
(Treasury Stock)	-81	-1	-4,133	*-7,493*	*-9,194*
Other Equity	-4,953	-3,820	-3,694	*-3,694*	*-3,694*
Shareholder's Equity	**14,727**	**17,398**	**15,277**	***14,280***	***15,322***
Minority Interest	—	—	—	—	—
Total Equity	**14,727**	**17,398**	**15,277**	***14,280***	***15,322***

FedEx Corp FDX (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
166.67 USD	171.00 USD	119.70 USD	230.85 USD	Medium	Narrow	Positive	Standard	Transportation & Logistics

Morningstar Analyst Forecasts

Cash Flow (USD Mil)
Fiscal Year Ends in May

				Forecast	
	2012	2013	2014	*2015*	*2016*
Net Income	2,032	1,561	2,097	*2,594*	*3,022*
Depreciation	2,113	2,386	2,587	*2,704*	*2,830*
Amortization	—	—	—	—	—
Stock-Based Compensation	—	—	—	—	—
Impairment of Goodwill	134	479	—	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	1,126	521	581	—	—
Other Non-Cash Adjustments	—	—	—	—	—
(Increase) Decrease in Accounts Receivable	-254	-451	-516	*67*	*-278*
(Increase) Decrease in Inventory	—	—	—	*-15*	*-20*
Change in Other Short-Term Assets	-231	257	-22	*-48*	—
Increase (Decrease) in Accounts Payable	144	10	-235	*62*	*85*
Change in Other Short-Term Liabilities	-229	-75	-228	—	—
Cash From Operations	**4,835**	**4,688**	**4,264**	***5,364***	***5,639***
(Capital Expenditures)	-4,007	-3,375	-3,533	*-4,200*	*-4,039*
Net (Acquisitions), Asset Sales, and Disposals	-42	-428	-18	*-50*	*-50*
Net Sales (Purchases) of Investments	—	—	—	—	—
Other Investing Cash Flows	—	—	—	—	—
Cash From Investing	**-4,049**	**-3,803**	**-3,551**	***-4,250***	***-4,089***
Common Stock Issuance (or Repurchase)	-69	34	-4,300	*-3,360*	*-1,701*
Common Stock (Dividends)	-164	-177	-187	*-231*	*-280*
Short-Term Debt Issuance (or Retirement)	—	—	—	—	*249*
Long-Term Debt Issuance (or Retirement)	-29	1,322	1,743	*2,492*	*-1,000*
Other Financing Cash Flows	18	5	25	—	—
Cash From Financing	**-244**	**1,184**	**-2,719**	***-1,099***	***-2,732***
Exchange Rates, Discontinued Ops, etc. (net)	-27	5	-3	—	—
Net Change in Cash	**515**	**2,074**	**-2,009**	***15***	***-1,181***

FedEx Corp FDX (NYSE) | ★★★

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Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

Company/Ticker	Price/Fair Value	Price/Earnings 2014	2015(E)	2016(E)	EV/EBITDA 2014	2015(E)	2016(E)	Price/Free Cash Flow 2014	2015(E)	2016(E)	Price/Book 2014	2015(E)	2016(E)	Price/Sales 2014	2015(E)	2016(E)
United Parcel Service Inc (UPS) UPS	0.96	33.9	19.1	17.0	15.7	10.0	9.2	29.6	27.5	23.1	46.6	34.6	23.0	1.7	1.4	1.4
TNT Express NV TNTE NLD	1.09	—	19.4	15.8	—	7.6	7.1	—	114.8	101.6	—	1.4	1.4	—	0.5	0.5
Average		33.9	19.3	16.4	15.7	8.8	8.2	29.6	71.2	62.4	46.6	18.0	12.2	1.7	1.0	1.0
FedEx Corp FDX US	**0.97**	**21.3**	**18.6**	**15.4**	**7.9**	**7.2**	**6.5**	**62.7**	**40.6**	**29.6**	**3.0**	**3.3**	**3.1**	**1.0**	**1.0**	**0.9**

Returns Analysis

Company/Ticker	Last Historical Year Total Assets (Mil)	ROIC % 2014	2015(E)	2016(E)	Adjusted ROIC % 2014	2015(E)	2016(E)	Return on Equity % 2014	2015(E)	2016(E)	Return on Assets % 2014	2015(E)	2016(E)	Dividend Yield % 2014	2015(E)	2016(E)
United Parcel Service Inc (UPS) UPS	35,471 USD	—	—	—	19.0	20.0	20.5	70.1	196.7	161.1	8.5	12.9	13.8	2.4	2.9	3.1
TNT Express NV TNTE NLD	— EUR	—	—	—	1.6	5.3	5.5	-8.5	4.6	5.0	-4.6	2.5	2.7	—	0.8	1.3
Average		—	—	—	10.3	12.7	13.0	30.8	100.7	83.1	2.0	7.7	8.3	2.4	1.9	2.2
FedEx Corp FDX US	— USD	**—**	**—**	**—**	**7.6**	**7.5**	**8.2**	**12.8**	**17.6**	**20.4**	**6.3**	**7.7**	**8.7**	**0.4**	**0.5**	**0.6**

Growth Analysis

Company/Ticker	Last Historical Year Revenue (Mil)	Revenue Growth % 2014	2015(E)	2016(E)	EBIT Growth % 2014	2015(E)	2016(E)	EPS Growth % 2014	2015(E)	2016(E)	Free Cash Flow Growth % 2014	2015(E)	2016(E)	Dividend/Share Growth % 2014	2015(E)	2016(E)
United Parcel Service Inc (UPS) UPS	58,232 USD	5.0	3.6	5.0	-28.8	48.9	10.7	-28.2	54.8	11.8	-4.3	-22.2	25.1	8.1	4.5	7.1
TNT Express NV TNTE NLD	6,680 EUR	-0.2	1.6	3.0	-200.0	-459.7	9.8	59.2	-186.8	22.8	-152.2	-149.4	7.6	39.1	—	73.9
Average		2.4	2.6	4.0	-114.4	-205.4	10.3	15.5	-66.0	17.3	-78.3	-85.8	16.4	23.6	4.5	40.5
FedEx Corp FDX US	**45,567** USD	**2.9**	**5.4**	**5.2**	**7.3**	**26.8**	**14.7**	**8.3**	**32.7**	**20.2**	**-24.2**	**79.5**	**31.9**	**7.1**	**33.3**	**25.0**

FedEx Corp FDX (NYSE) | ★★★

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Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin % 2014	2015(E)	2016(E)	EBITDA Margin % 2014	2015(E)	2016(E)	Operating Margin % 2014	2015(E)	2016(E)	Net Margin % 2014	2015(E)	2016(E)	Free Cash Flow Margin % 2014	2015(E)	2016(E)
United Parcel Service Inc (UPS) UPS	3,032 USD	8.5	12.3	12.9	11.8	15.7	16.3	8.5	12.3	12.9	5.2	7.6	8.0	5.8	5.3	6.0
TNT Express NV TNTE NLD	-195 EUR	1.9	5.4	5.6	1.9	5.4	5.6	-0.7	2.5	2.7	-2.9	2.5	3.0	-1.8	0.4	0.5
Average		5.2	8.9	9.3	6.9	10.6	11.0	3.9	7.4	7.8	1.2	5.1	5.5	2.0	2.9	3.3
FedEx Corp FDX US	**2,097** USD	**7.6**	**9.1**	**9.9**	**13.2**	**14.7**	**15.5**	**7.6**	**9.1**	**9.9**	**4.6**	**5.4**	**6.0**	**1.6**	**2.4**	**3.2**

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity % 2014	2015(E)	2016(E)	Debt/Total Cap % 2014	2015(E)	2016(E)	EBITDA/Interest Exp. 2014	2015(E)	2016(E)	Total Debt/EBITDA 2014	2015(E)	2016(E)	Assets/Equity 2014	2015(E)	2016(E)
United Parcel Service Inc (UPS) UPS	10,787 USD	499.9	437.7	303.9	83.3	81.4	75.2	19.5	28.5	28.0	1.6	1.2	1.1	16.4	14.2	9.9
TNT Express NV TNTE NLD	211 EUR	9.6	9.3	9.0	8.7	8.5	8.2	3.4	10.0	10.6	1.7	0.6	0.5	1.9	1.9	1.8
Average		254.8	223.5	156.5	46.0	45.0	41.7	11.5	19.3	19.3	1.7	0.9	0.8	9.2	8.1	5.9
FedEx Corp FDX US	**4,737** USD	**31.0**	**50.6**	**42.3**	**23.7**	**33.6**	**29.7**	**37.7**	**24.5**	**30.3**	**0.8**	**1.0**	**0.8**	**2.2**	**2.4**	**2.3**

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share 2014	2015(E)	2016(E)	Current Ratio 2014	2015(E)	2016(E)	Quick Ratio 2014	2015(E)	2016(E)	Cash/Short-Term Debt 2014	2015(E)	2016(E)	Payout Ratio % 2014	2015(E)	2016(E)
United Parcel Service Inc (UPS) UPS	87,402 USD	2.48	1.32	1.86	1.37	1.45	1.55	1.37	1.45	1.55	2.48	23.87	33.32	81.7	55.1	52.8
TNT Express NV TNTE NLD	3,291 EUR	1.01	1.01	0.99	1.18	1.18	1.18	1.17	1.17	1.18	12.21	12.29	12.04	-12.9	24.2	37.8
Average		1.75	1.17	1.43	1.28	1.32	1.37	1.27	1.31	1.37	7.35	18.08	22.68	34.4	39.7	45.3
FedEx Corp FDX US	**47,294** USD	**9.38**	**10.11**	**6.22**	**1.82**	**1.80**	**1.54**	**1.74**	**1.72**	**1.46**	**2,908.00**	**2,922.75**	**6.97**	**8.9**	**8.9**	**9.3**

Research Methodology for Valuing Companies

Components of Our Methodology

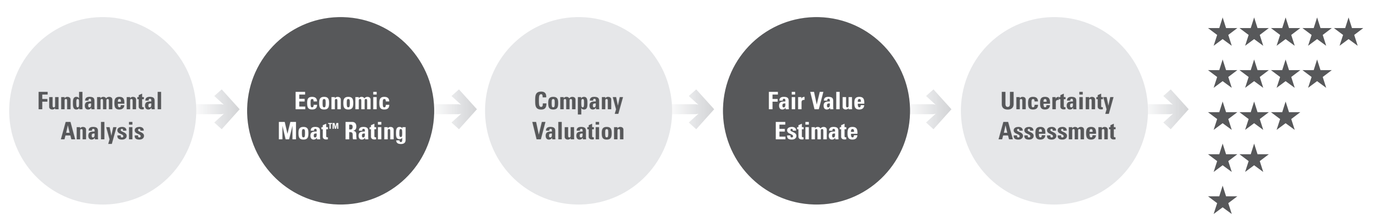
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts' assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm's moat determine the length of "economic outperformance" that we assume in the latter stages of our valuation model. We also quantify the value of each firm's moat, which represents the difference between a firm's enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm's competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

Morningstar Research Methodology for Valuing Companies



Analyst conducts company and industry research:

- Financial statement analysis
- Channel checks
- Trade-show visits
- Industry and company reports and journals
- Conference calls
- Management and site visits

Strength of competitive advantage is rated: None, Narrow, or Wide

Advantages that confer an economic moat:

High Switching Costs (Microsoft)

Cost advantage (Wal-Mart)

Intangible assets (Johnson & Johnson)

Network Effect (Mastercard)

Efficient Scale (Lockheed Martin)

Analyst considers past financial results and focuses on competitive position and future prospects to forecast future cash flows.

Assumptions are entered into Morningstar's proprietary discounted cash-flow model.

Analyst uses a discounted cash-flow model to develop a Fair Value Estimate, which serves as the foundation for the Morningstar Rating for stocks.

The analyst then evaluates the range of potential intrinsic values for the company and assigns an Uncertainty Rating: Low, Medium, High, Very High, or Extreme.

The Uncertainty Rating determines the margin of safety required before we would recommend the stock. The higher the uncertainty, the wider the margin of safety.

The current stock price relative to Morningstar's Fair Value Estimate, adjusted for uncertainty, determines the Morningstar Rating for stocks.

The Morningstar Rating for stocks is updated each evening after the market closes.

Research Methodology for Valuing Companies

Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

* Please contact a sales representative for more information.

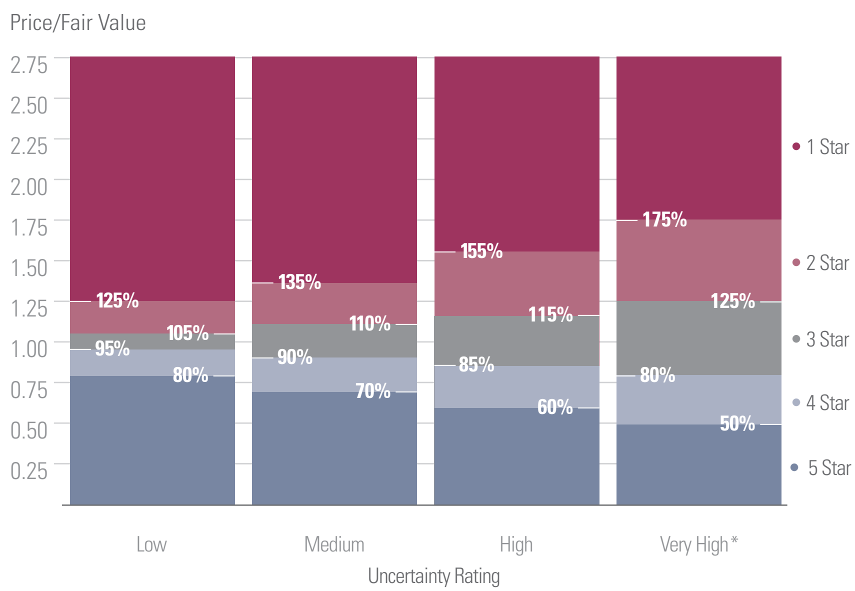
perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm's underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm's fixed cost structure.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company's future sales range, the firm's operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

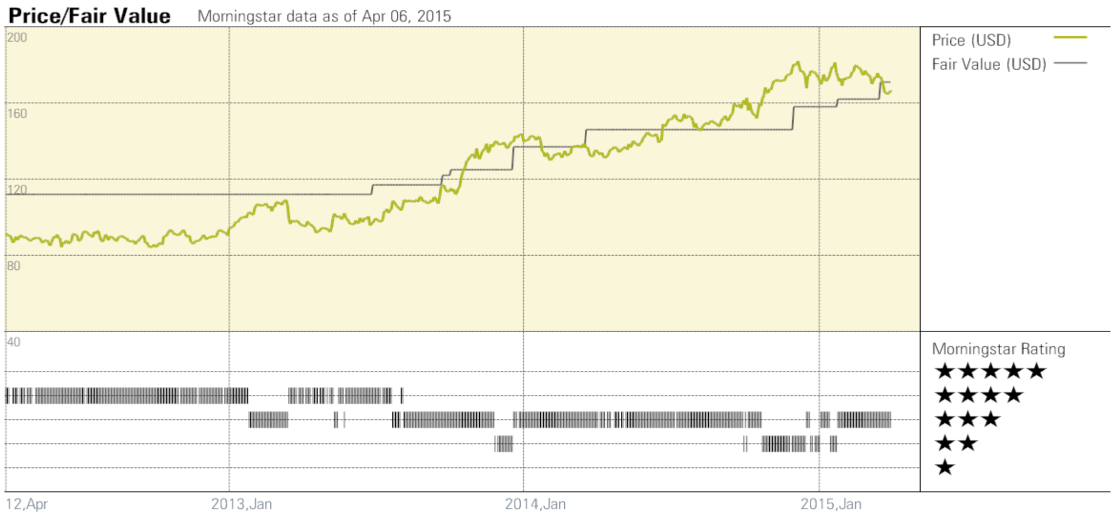
Morningstar Margin of Safety and Star Rating Bands



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

FedEx Corp FDX (NYSE) | ★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
166.67 USD	171.00 USD	119.70 USD	230.85 USD	Medium	Narrow	Positive	Standard	Transportation & Logistics



The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value.

Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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