FedEx fleet restructure poses threat to freighter operators

Integrated parcel carrier seeks alternative uses for surplus jets amid profit squeeze

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FedEx has more cargo jets than it needs for its express package network. Some of those planes will now be used to try and capture a larger share of the general cargo market. In doing so, FedEx will go head to head with all-cargo carriers like Atlas Air, Cathay Pacific and Nippon Cargo Airlines.

FedEx has portrayed its new air network redesign in terms of streamlining the high-cost overnight parcel operation, but internal communications show the express delivery giant also sees an opportunity to aggressively go after heavyweight cargo booked by logistic providers to offset slower growth in the main express product and declining postal business.

FedEx Express (NYSE: FDX) historically has concentrated on moving small parcels by air. It gives general cargo — dry goods, hardware, textiles and other everyday items — low priority. Freight forwarders are careful about tendering shipments to the airline because third-party shipments can be left behind when a plane is full of shipments from FedEx customers.

Dedicating fixed space to third-party freight would be a big change and a potential threat to other cargo airlines, experts say.

“If they change strategy and decide that [hypothetically] one third of every FedEx plane, or a group of planes, is now reserved for general heavy cargo and will not be subjected to any offload that would have a huge impact,” said a senior executive at a global freight broker who asked not to be named because of company rules against speaking with the media. “Freight carriers like Cargolux, Qatar Airways, Lufthansa and Emirates, they would not like to see that at all because if you fly freighters you need every single kilo. You don’t have, like FedEx or UPS, another moneymaker, which are the packages.”

In the fall of 2022, FedEx launched an initiative to take out $4 billion in structural costs by fiscal year 2025 and redesign the entire parcel distribution network to create greater efficiency. The air and international unit flew fewer hours in 2023, deactivated aircraft until demand returns, accelerated the retirement of older planes and flew more direct routes.

In conjunction with its latest quarterly earnings on Dec. 19, management spelled out in more detail how it plans to reconfigure airline operations.

The new strategy de-emphasizes the hub-and-spoke system originally built for speed and global connectivity. Instead, a three-pronged approach prioritizes density and improved cash flow by better segmenting shipments between owned freighters, partner airlines, road transport and deferred freight.

FedEx CEO Raj Subramaniam, during a briefing with analysts, characterized the new Tricolor network design as a way to improve efficiency, but internal company communications show it is equally designed to propel Express into sectors in which it has not traditionally operated.

The Purple network, consisting of FedEx's owned aircraft fleet, will underpin Express' high priority, high-margin international parcel business utilizing the existing hub model. This part of the network consists of direct flights from gateways such as Paris; Cologne, Germany; Osaka, Japan; and Hong Kong feeding the main night sortation hub in Memphis, Tennessee, as well as locations like Indianapolis and Newark, New Jersey.

"Capturing this priority parcel business is where FedEx Express has historically made its primary profits. However, this worldwide market segment is not projected to grow substantially. Realizing this, over the last 24 months, we have carefully evaluated our network to ensure that our traditional purple tail flying carries as much high-value priority volume as possible and that aircraft gauge and density maximize our load factors," said Justin Brownlee, senior vice president of flight operations, in a Dec. 21 memo to frontline workers obtained by FreightWaves.

A portion of FedEx's fleet will be reallocated to the so-called Orange network, which will operate off-schedule to carry heavy freight that doesn't require maximum speed and is better suited for a truck-fly-truck delivery model than flying the entire trip. These planes will fly into primary and regional sortation centers such as Newark and Oakland, California, during the daytime when workers have more time to build dense pallets.

A FedEx 767-300 freighter from Boeing on approach to George Bush Intercontinental Airport in Houston. (Photo: Jim Allen/FreightWaves)

The object is to improve aircraft utilization, feed the ground parcel and freight networks, and help decongest hubs before the priority night sortation. Customers can expect transit times of three to five days.

"Right now, we move all products — parcels and freight pallets, priority and deferred — in the same way, through an air network that is timed and structured to deliver priority goods around the world in the most expedited way possible. However, the global market is broader than just priority parcel shipments, and FedEx needs to restructure our international network to better capture freight shipments (pallets) and less time-sensitive parcels (including e-commerce) in a profitable manner," Brownlee said. "By adjusting our network to best serve the entirety of the global market, we can broaden our customer base and profitably grow revenue, which will ultimately lead to growth at our airline and increased flying."

Orange addresses an $80 billion deferred market, of which FedEx only has a 1% share.

"With this structure, FedEx can provide the outstanding service we are known for to customers needing international standard air freight logistics and do so with a cost structure that enables our sales teams to aggressively compete in this space," Brownlee said.

Upper management's previous comments about reducing use of nearly 30 widebody freighters created a misperception about air realignment's purpose, said Pat DiMento, vice president of flight operations and training, in a secretly recorded meeting with pilot evaluators several weeks ago that was shared with FreightWaves. "If we don't capture some of that middle band, we will never get their [shipper's] freight that is also in the priority range. Right now, we don't offer much in that middle band to save money for these companies. So they are trying to capture that so that we can also grow what is our priority, international business."

FedEx, UPS and DHL Express offer excess capacity on their airlines at bargain rates compared to for-hire freighter operators because the main parcel product covers the fixed cost base — much like passenger airlines enhance margins by selling available belly space to shippers. All-cargo airlines are challenged to compete with widebody passenger airlines, which often can offer lower rates because operating costs are allocated to the passenger business. The share of international cargo capacity on freighters has declined the past two years as travel picked up after the COVID crisis and passenger airlines reintroduced more flights.

But freight management companies take a risk shipping with FedEx and UPS because they are offloaded first if there isn't enough space on a flight. The best time to utilize an integrated package carrier is the summer, when they aren't as busy, according to logistics specialists.

The Orange network is already being organized. In February, FedEx plans to launch two new daytime flights from Liege, Belgium, to Memphis and Indianapolis. "We are also evaluating the right timing for additional flights from Liege to Oakland and Newark. In Europe, the Liege hub is a key part of the strategy, given its purpose-built capabilities for freight handling and optimal pallet build," Brownlee said.

He described the changes to the priority parcel network as rightsizing, rather than downsizing, the airline. Some aircraft on low-volume lanes have been parked, but the company also plans to grow in other markets this year. FedEx Express, for example, intends to start a route by September serving El Salvador and Guatemala, utilizing a Boeing 757 freighter. Management also is working to launch service to Argentina, Chile and Ecuador in April with a Boeing 767 cargo jet, subject to necessary government approvals.

Finally, FedEx will use third-party carriers — the White network — as flex capacity and to backfill imbalanced trade routes. “This isn’t an approach that costs anyone jobs or puts at risk the future of FedEx flying. Rather, it gives us extra scalable capacity … which in turn helps us grow our market share in all sectors of the global air freight market,” Brownlee said.

A FedEx employee, who asked not to be identified because of concerns about possible job retaliation, agreed the color-coded strategy actually could be a positive development for pilots, who have seen their billable flight hours sharply reduced in the past year. By handling priority shipments separately from deferred freight, FedEx can go after a greater share of the less time sensitive heavy palletized airfreight and e-commerce markets in a profitable manner.

DiMento stressed in the meeting that FedEx is “not trying to drive product down to other carriers, we’re not trying to wet-lease [outsource] anything. All of that stuff is just crazy talk.”

Can general cargo be profitable?

But logistics experts question whether FedEx can be viable long term in the general cargo sector given its elevated cost structure, including pay scales for pilots that far exceed those of international freighter operators, and the relatively low margins.

“To make a competitive product is difficult and it runs the risk of diluting your core international Express products,” said Derek Lossing, a former head of global freight procurement at Amazon who now runs Cirrus Global Advisors. “It’s not a great time to make a lot of money in air cargo because of the low rates. There’s not a lot of margin” because freight forwarders buy airport-to-airport transportation as a commodity in the wholesale market, and aren’t keen to pay a premium, he explained.

And rates, which have fallen back near 2019 levels excluding fuel surcharges, could go lower this year as more capacity enters the market. The supply of cargo space is about 7% to 13% greater year over year and 4% greater than pre-pandemic levels, primarily because of the strong return of passenger aircraft and their associated belly storage, according to the International Air Transport Association and others. More widebody passenger aircraft are expected to hit the market as China fully reopens to air travel this year.

Some Wall Street analysts believe FedEx hasn’t truly come to terms with the amount of structural cost reductions necessary to achieve decent profits. The DRIVE cost initiative is already losing steam, going from $1.4 billion in savings in the quarter ended May 31 to $600 million in the quarter ended Nov. 30. In Express, expense reduction went from $500 million to $200 million over the same six-month period. FedEx Express’ operating margin was an all-time low of about 2.2% in the prior quarter. Meanwhile, management guidance suggests the next two quarters could be the worst ever for Express profitability.

FedEx has 407 mainline aircraft in its fleet, while rival UPS operates about 290 aircraft, according to fact sheets from each company.

“We applaud management for trying something new with the air network, but suspect this is lending back to the FedEx of old, focused on service improvements. While reallocating air capacity to improve transit times is admirable, the overarching and long-term problem at Express has been and remains excess network capacity," said Barclays transportation analyst Brandon Oglenski, in a research report. "While it may initially hurt, we think true margin improvement and finally earning returns in excess of the high levels of capital required to run Express would take a structural 20%-to-30% reduction in capacity from current operations, which just does not seem to be in the cards with current management plans."

Cargo jets at the FedEx terminal in Los Angeles. (Photo: Jim Allen/FreightWaves)

In the memo, Brownlee said FedEx has deferred taking down four MD-11 freighters in the second half of the fiscal year, ending May 31, because of incremental volume increases in the Asia, Middle East and Africa regions. Nonetheless, the retirement plan for the aging aircraft has not changed. One MD-11 was removed from service at the end of December and 13 more will be idled by the end of May.

During the second quarter, which ended Nov. 30, FedEx parked six aircraft — three Boeing 757s and three Airbus A300s. Since September, it also took delivery from Boeing of six new aircraft — four 767s and two 777s. The airline plans to receive four more 767s from Boeing by June.

Financial pinch

FedEx revenues in the second quarter were $22.2 billion, down $600 million from the year-earlier period as the company continued to grapple with sluggish demand and shrinking business from the U.S. Postal Service.

The Express unit struggled the most during the most recent quarter, with revenue and adjusted operating profit dropping by 6% and 49%, respectively, even as group profits increased. Adjusted operating margin dipped 1.5% year over year to 1.7%. Express revenues continue to fall faster than total revenue, partly due to lower delivery surcharges and a shift to lower-yielding services.

FedEx cut its fiscal year 2024 revenue forecast, saying it now expects a single-digit year-on-year revenue decline instead of flat revenue.

FreightWaves recently reported that FedEx Express is likely to lose half its business with the U.S. Postal Service, its largest customer, later this year when an existing contract expires. The Postal Service is converting the bulk of its mail transportation to ground services as part of a multiyear efficiency campaign while FedEx is negotiating for better terms in future contracts because its postal work barely makes money.