AIRFINANCE GLOBAL

FedEx to eliminate two older fleet types

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As part of its financial recovery efforts, FedEx intends to eliminate two older aircraft types from the Federal Express fleet – its 20 remaining MD10-10s and probably also its 10 Airbus A310s – over the current and next fiscal years.

The Memphis-headquartered ground and air transport company has seen its profits decline in the last two fiscal quarters – something management has blamed largely on the slowing global economy, increasing trade tensions and policy uncertainty.

Last week FedEx reported flat revenues and a 12% decline in adjusted operating income to $1.05 billion for the three months to 31 August, its first fiscal quarter.

According to management, the main issue was "international at Express". The airline, which accounts for 52% of the company's revenue, saw its operating income plummet by 27% to $285 million. Its operating margin fell by one point to 3.2%.

FedEx again lowered its fiscal 2020 earnings forecast. Full-year EPS is now projected to be in the $11-$13 range before special items. Last fiscal year's adjusted EPS was $15.52.

In the call, one analyst noted that it was the fifth consecutive quarter of FedEx "either missing numbers or cutting guidance". The company's NYSE-listed shares plummeted by 13% on 18 September.

Having already announced a $575 million domestic-employee buyout programme at Federal Express in January, management is now focused on fleet moves.

First, Express will fully retire its 20 remaining MD10-10s by the end of the 2021 fiscal year (31 May 2021). Two of the aircraft are believed to have already left the fleet, another nine will go by next summer and the final nine will be retired in FY 2021.

Fred Smith, chairman and chief executive officer, said that Express is "highly likely" to retire also its 10 remaining A310s this year.

Smith said that the airline would also park "the equivalent capacity of seven MD11 aircraft" this year.

These moves will help facilitate a reduction in intercontinental flights after the year-end 2019 peak season to "better match supply to demand", as FedEx expects the current softness in air cargo demand to continue into 2020.

The macroeconomic and trade woes have so far hurt mainly international cargo carriers and have left passenger airlines largely unaffected. FedEx management spoke of a "divergence between the strong consumer sector and the weak factory sector" both in the US and in other countries.

FedEx is still projecting 2.3% real US GDP growth in 2019 (albeit down from a forecast of 2.5% in June), but it expects industrial production in the US to be "flat-to-negative" in the second half of 2019.

However, Wall Street is blaming FedEx's problems just as much on what one analyst called "a series of management missteps". Two key issues have been the inability to integrate TNT Express, which FedEx acquired for $4.4 billion in 2016, and continued heavy capital spending on aircraft.

Chief financial officer Alan Graf noted in the call that conditions are "especially challenging in Europe", where Federal Express and Netherlands-based TNT Express still operate "duplicate road and air networks".

TNT Express integration costs continue to drag down FedEx's profits. Those costs, which are fully allocated to the airline, amounted to $388 million in FY 2019 and are projected to be $350 million in the current year.

However, FedEx expects to complete the TNT integration by May 2020, and management is bullish about the resulting lower costs and greater size for the European business. They see strong potential to grow e-commerce and capture market share from competitors in Europe.

As to why FedEx is maintaining its full-year capital spending forecast at $5.9 billion in the current environment, Graf said that the figure would have been much higher without the rationalisation moves and that there is an imperative to continue modernising the fleet.

“The profound impact of the lower costs and higher reliability of the new twins is just remarkable,” he said.

Graf said that FedEx might seek to stretch out deliveries “a bit” but that it was important to have the benefits of the new aircraft quickly. Each new aircraft brought in is accretive to earnings.

“FedEx will unquestionably be the low-cost producer in the domestic express business because of the fleet modernisation, and that includes any new entrants into the business,” CEO Smith added.

Another reason for the continued spending is hub modernisation. Some $3 billion is being spent over multiple years to improve automation and processing capabilities at the airline’s Indianapolis and Memphis hubs.

The MD10-10s will be replaced by the Boeing 767Fs; there are currently 77 in the fleet, with another 55 scheduled for delivery over the next four years.

In the call there was no mention of the 13 MD10-30s still in the fleet, but according to analysts that type is scheduled to be retired by the end of FY 2022.

Eliminating the A310s would further simplify the fleet and facilitate cost reductions. Express operates 119 757-200Fs, which are smaller in size but could probably handle the volume of the A310s.

Express also operates 42 777Fs and has 16 on firm order. And it has 57 MD11s and 68 A300-600s, adding up to a total widebody fleet of around 406 aircraft.

The 283-strong regional fleet comprises 21 ATR72s, 25 ATR42s and 237 Cessna 208Bs. There are orders for 30 ATR-600Fs and 50 Cessna 408s, with deliveries starting in 2021 for both types.

