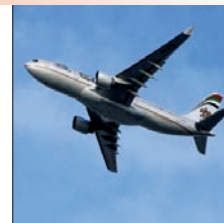


Airbus and Boeing: Beyond head-to-head



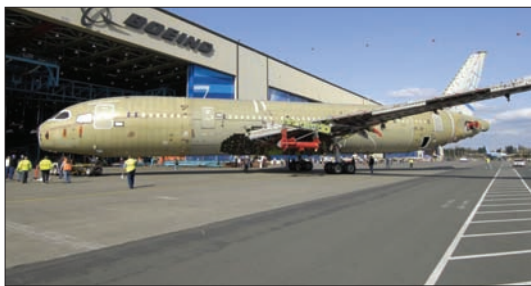
AS RECENTLY AS 18 MONTHS AGO, BOEING looked set to achieve the unthinkable: a major strategic victory over Airbus. The strength of the 787 program, a superior product-line strategy, and serious product and company structural weaknesses at Airbus seemed sure to guarantee Boeing a two-thirds market share for a decade or more.

Yet today, the picture is far more complicated. Due to 787 problems Boeing has lost much of its lead, and its long-term product line advantage is far from certain. The collapsed market for jet orders also means far less emphasis on market share. Each company faces major market and technical challenges. The great jetliner game has become much less of a head-to-head story.

The dream stumbles

When Boeing launched the 787 Dreamliner program in 2004, the company went from product development laggard to leader. After a damaging 13-year new product development hiatus, Boeing appeared to find a killer product for the best part of the market. While Airbus stumbled with its A380 super jumbo, a highly problematic program fraught with delays and cost overruns yet offering no more than marginal commercial relevance, Boeing had created the best selling jet yet launched. There were 56 orders in 2004, 232 in 2005, 160 in 2006, and 369 in 2007.

At the same time, the 737 and 777 programs ramped up to meet strong demand, and the latter plane completely vanquished the competing Airbus A340. Boeing's defense revenues as well were showing strong growth, as the company profited from the best simultaneous civil and military market upturns in decades. As Airbus struggled to launch its



Boeing moves a 787 static test airframe to its testing rig.

next-generation A350, a long-range response to the 787, it suffered a series of management scandals and crises. Christian Streiff, who resigned as Airbus CEO in October 2006 after three months, said it would take Airbus a decade to catch up with Boeing.

Yet one year later the competitive picture began to change. In September 2007 Boeing announced a 787 first-flight slip from September to November or December. However, the May 2008 in-service date was retained, calling for a new aggressive five- to six-month flight test schedule. Inevitably, the news in October was worse. The company announced a significant program restructuring, with service entry delayed until November or December 2008.

In December 2007 yet another announcement shifted the 787's first flight until the end of the second quarter of 2008, with certification and first deliveries shifted to early 2009. In March 2008 Boeing also announced that additional design work was necessary to strengthen

Delays on the 787 proved to be a boon for the A330.



the composite center wing box.

This, too, was not enough. In April 2008 Boeing announced another six-month delay, with first deliveries scheduled for the third quarter of 2009. Boeing officials said this schedule was relatively conservative, and reduced anticipated 2009 deliveries to 25 aircraft. Yet in December 2008 there was a fifth delay. First

flight was scheduled for the second quarter of 2009, with first deliveries in mid 2010. The program seemed to be spiraling downward, rivaling the A380 for sheer programmatic dysfunction.

In March 2009, Boeing reiterated its current plan for 787 production. But even as the schedule appears to stabilize, there are major concerns about the Dreamliner's technical virtues, at least for the first few years of production.

In late 2008 International Lease Finance chief Stephen Udvar-Hazy indicated that 787 weight gains would reduce the aircraft's range. Also in late 2008/early 2009, several carriers did what was previously unthinkable: canceling their 787 orders. Although the first 31 cancellations were from relatively unimportant customers with traffic and profitability concerns, they punctured the notion that the 787 was an unbeatable product, and that a delivery position was a cherished and valuable asset.

Even if the first batch of 787s offered a fuel burn improvement over current equipment, drastically cheaper fuel prices removed some of the 787's appeal relative to keeping older depreciated aircraft, particularly since an imploded cargo market reduced the resale value of those older aircraft. And the 787 delays gave some carriers the right to cancel with little or no penalty.

By March there were indications that Delta would cancel the orders it had acquired in its merger with Northwest. The

same month, Shanghai Airlines directly criticized the 787, with Chairman Zhou Chi stating that 787s “don’t fully meet the quality that Boeing touted earlier.”

There are few doubts that Boeing will be able to improve the 787’s performance during the first few years of production. But that still means an additional delay until Boeing has a competitive product that can threaten Airbus’s position in the midmarket niche. In the meantime, Boeing might find it needs to incentivize customers to take early production 787s, hurting the company’s margins and reducing its ability to quickly follow the initial 787 models with new product developments.

Airbus benefits

These 787 problems have basically been a windfall for Airbus. They have resulted in badly needed revenue and the breathing room needed to create a competitive response.

Since the 787 delays were first announced, Airbus has enjoyed record A330 demand. A total of 142 net orders were recorded in 2008, on top of 198 in 2007. The latter represent the highest order level yet achieved by any Airbus twin-aisle jet. Many of these have gone to leasing customers, who are enjoying relatively high A330 lease rates compared with a weak broader market.

It is very likely that some of Boeing’s penalty payments related to 787 delays are going directly to A330 leases, indirectly benefiting Airbus.

The most direct benefit to Airbus of the 787 delay has been time to get the A350 response right. After the resounding failure of the first four A350 proposals, including a “firm” launch of the third version that went nowhere, Airbus seems to have found a strong product with the A350 XWB. With over 450 sales, the new Airbus plane will revitalize Airbus’s midmarket twin-aisle product line, taking over from the A330 as it is eclipsed by the 787.

Of course, it will not be easy for Airbus to bring the A350 XWB to market. A comparison of the two companies’ independent research and development charts tells two very different stories. Boeing took a product development holiday, but after the 787 launch the company has ramped up very fast. It is now spending billions of dollars and a relatively high percentage of sales on the 787, plus the 747-8 and 777 Freighter. All of these have gone over budget, but there are few doubts that the company can find the necessary resources.

By contrast, Airbus has spent the past eight years spending a very healthy level of resources on product development. However, almost all of this has

gone into the largely irrelevant A380. The challenge is to keep this level of expenditure equally high in order to bring the A350 XWB to market by the target date of 2013. Jetliner deliveries will ramp down after 2009 due to a very weak air travel market, so to maintain the current level of spending Airbus might have to spend 12% or more of sales on new product development. Since Airbus parent EADS is heavily dependent on key stakeholders providing the cash, there are legitimate reasons to question the availability of resources to make the A350 XWB schedule happen on time. EADS also has the severe distraction of the disastrous A400M military transport program.

Yet here too there has been a key change over the past year. Government aid to industry has suddenly become acceptable again. Airbus needs this support more than Boeing does.

In October 2004 the U.S. filed a World Trade Organization (WTO) complaint against European subsidies to Airbus, and whether it succeeded or failed, it clearly put Europe on notice that large aid packages would no longer be tolerated. With tens of billions of dollars going to the U.S. automobile industry, and hundreds of billions of dollars going to the U.S. banking industry, it is very difficult to imagine that the international rules covering state support to industry will not be transformed, if not obliterated. Even if the U.S. wins the Boeing WTO case, any effort at enforcement would be rendered problematic by the threat of European cases in other sectors of the economy.

It is also worth noting that aerospace suddenly looks like an inexpensive and safe bet. As of March 2009 U.S. aid to General Motors and Chrysler has exceeded \$17 billion in loans, with billions more requested. This dwarfs any aid Airbus might need to make the A350 XWB happen.

In January 2009, the French government took the first step, announcing a plan to provide up to €5 billion (about \$7 billion) to support Airbus plane sales. The French government plans to inject the money into banks, which will then fi-

The start-up of construction for the A350 XWB final assembly line in Toulouse was marked by a symbolic groundbreaking with Airbus officials on January 14.



nance the aircraft sales. “The French state is not giving money to Airbus,” French trade minister Anne-Marie Idrac told Reuters. “It’s not a subsidy, which would distort competition, it’s a question of fluidity in the financing of Airbus clients where it is needed, and this in coordination with other countries who are stakeholders of Airbus.”

Predictably enough, the U.S. government has not mentioned legal action. Instead, the U.S. Export-Import Bank has announced plans to increase its support of Boeing jetliner sales.

In short, the erosion of international agreement on aid to industry will benefit Airbus’s ability to withstand the market downturn and to bring the A350 XWB to market.

Commonalities

Boeing retains some key advantages, including the 777, a better corporate financial structure, strong access to the U.S. defense market, and of course the postponed promise of the 787. Yet it is clearly no longer the likely winner in the great game with Airbus. Assuming the A350 XWB arrives by 2015, Airbus will be able to recover and maintain a solid 40-50% of the market.

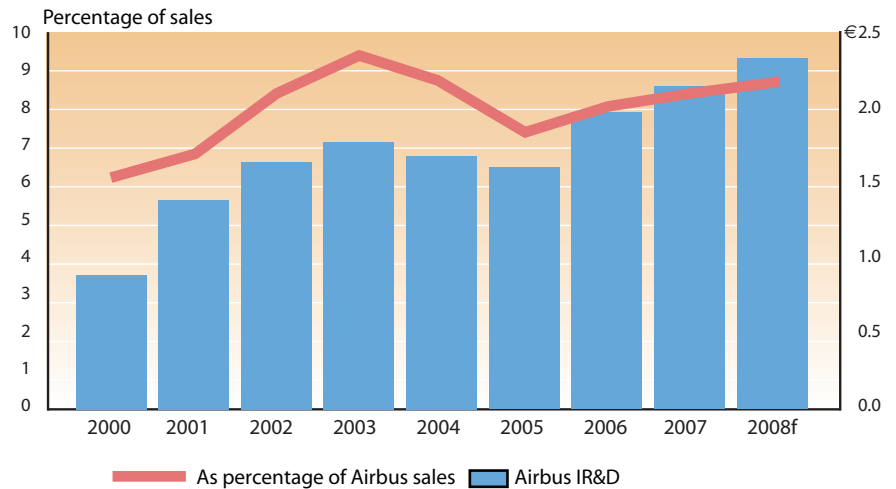
But from the standpoint of 2009, it is quite possible that this game has ceased to matter. The two companies are likely to spend the next few years not caring about each other.

For one, with over 7,300 orders on backlog, market share has suddenly become a nonissue. The orders are roughly evenly split between the two. Both sides are scrambling to rearrange orders and line up financing needed to keep deliveries at their current rates (450-500 planes for each company). Battling for new orders is irrelevant and, given the wretched state of travel demand, impossible. Even much of the vaunted 787/A350 XWB market has been decided, with only a small number of notable (and delayed) competitions remaining.

Also, there are fewer questions concerning product strategy. Boeing will need to focus on 787 program execution. The -8 and -9 will need to be followed by a -10. Airbus, of course, will spend at least the next eight years introducing the three major XWB variants,

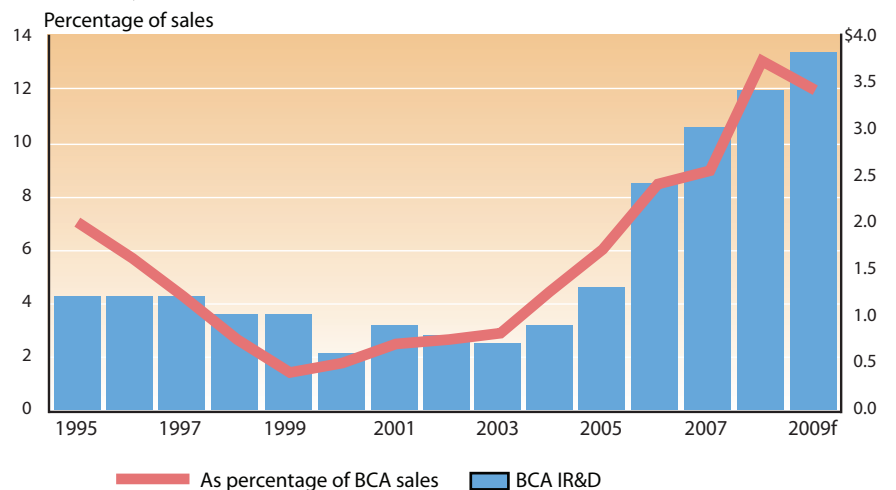
AIRBUS IR&D

IR&D in then-year billions of euros



BOEING COMMERCIAL AIRCRAFT IR&D

IR&D in then-year billions of dollars



the -800, -900, and -1000 (it will also need to resolve the A400M). If the XWB-1000 does particularly well, Boeing will need to consider a 777 replacement or upgrade, but a 777-X launch before 2014 looks unlikely, at best.

Meanwhile, on the single-aisle front, Airbus and Boeing both agree that, with inexpensive fuel, the development of new narrowbodies can and should be delayed until 2020. The only question concerns Bombardier’s CSeries. If it succeeds, Airbus and Boeing might each need to come up with a competitive response. But without that third-party fac-

tor, both companies would just keep building A320s and 737s through the next decade.



Clearly, the great Airbus-Boeing game is changing. As the industry enters a potentially severe downturn, this is much less a head-to-head competition. Instead, the two companies will face common challenges. The great game is now about backlog management, program execution, and arranging finance for hard times.

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