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Time to revisit the real motives behind KC-X program

A lot of hyperbole has transpired in recent months and weeks over the KC-X aerial tanker replacement program for the US Air Force. Boeing and Northrop Grumman ratcheted up their public relations campaigns and politicians and labor leaders are engaged in Op-Ed pieces, all in the name of what's best for the warfighter. But what's really at stake has very little to do with the warfighter.

Before getting to what's really at stake here, let's dispose of the ancillary issues.

- **Right size vs. more capable:** Boeing says its KC-767 tanker is right-sized for the Air Force requirements, fitting better at forward-area airports. Northrop says its larger KC-30 is more capable because it carries more fuel, more troops and more cargo and Boeing's analysis is flawed.
- **More economical vs. better performance:** Boeing says its KC-767 burns less fuel than the KC-30, a point Northrop concedes. But Northrop says the KC-30's greater capabilities make its airplane the better buy and better performer.
- **Experience vs. Risk:** Boeing says it's been delivering tankers for 75 years and has the experience, while Northrop and its partners are new entries into the market and propose building a tanker at facilities that don't yet exist with workers who have to be trained. Northrop replies that Boeing hasn't delivered a tanker since 1965 (42 years ago) and its KC-767 programs for Japan and Italy haven't been delivered, they are two and four years late respectively and fraught with technical problems. Furthermore, Northrop says the KC-767 proposed for the Air Force isn't the same version sold to Japan and Italy and therefore contains risk as well.
- **Flying the Flag--America vs. France:** Boeing has wrapped itself in the American flag, saying 85% of its entry by value will be made in America and that Northrop's entry—based on the Airbus A330—is simply exporting jobs to France. Northrop responds by saying 60% of its airplane by value will be made in America and that in reality only 69% of the KC-767 is "American" because the fuselage and tail sections are made in Japan and Italy (the latter a point Boeing's own union actually agrees with). Northrop says Alabama is about as American as you can get.
- **The best machine for the warfighter:** Both sides claim their airplane is the best airplane to support the warfighter, each trotting out retired Air Force Generals on their respective payrolls to support their contention.
- **Don't reward those bastards taking illegal subsidies:** Boeing and its surrogates are a little more subtle than that (not using the pejorative), but this has become a central theme of the Boeing campaign. Boeing accuses Airbus of receiving

“illegal” subsidies for decades for its aircraft programs, including for the A330. The argument goes that the Air Force shouldn’t award the tanker contract to a company that benefited from these subsidies. Northrop, Airbus and the latter’s parent EADS, respond that launch aid was sanctioned in a 1992 international accord signed by the USA and Europe and in any event the monies for the A330 have been repaid. The Air Force decided that the trade dispute has no bearing on its decision, but Boeing and its surrogates plow ahead anyway on this issue in preparation for taking the matter to Congress if Northrop wins any portion of the award. Congress has to appropriate the money and the entire debate has already become politically motivated—rather than dealing with the award on its merits.

- **Jobs: Boeing’s claim vs. Northrop’s claim.** Boeing says its airplane will create 44,000 direct and indirect jobs while Northrop says its plane will create 25,000 such jobs. Northrop says Boeing is using funny math, pointing to the Department of Commerce job formula methodology that concludes the KC-767 won’t create any more jobs than the KC-30. Boeing won’t show its math but says its figures are conservative, based on a year’s worth of analysis.

Those are the principal public issues. Of those, we think jobs is the most real issue but not for the broad reason of how many jobs are created; it’s really about how many jobs in a particular Congressman’s home district are created. All the rest of the issues are all just part of the public relations and political lobbying campaign. The Air Force has a reported 800-plus criteria for its selection. Size, mission capability and risk are among them but in the above as part of a public relations campaign, even these are irrelevant.

So what are the real issues?

Money, profits and cash flow—and future commercial airplane programs at Boeing and Airbus.

Before getting to our own analysis, we quote from an e-mail received from a party with a vested interest in the competition, but who is not affiliated with Northrop, Airbus, EADS, Boeing, Pratt & Whitney or GE Engines—the principal suppliers in the KC-X competition. The reference to “Part B commercial services” is about a little-remembered element of the entire tanker debate, and that is an idea to lease refueling tankers from commercial enterprises who perform the refueling. Omega Air already does some of this for the US Navy and the Air Force included this possibility in its original Request for Information (RFI), but the topic has been overshadowed by the KC-X program.

Says our e-mailer:

Wisdom is sorely lacking in the public discussions of the tanker program. These discussions are all about solutions to a need that generally ignore the warfighters’ real needs and promote the interests of manufacturers and, in the case of the “Part B commercial services” RFI from 2006, the necessarily limited dreams of commercial service providers. They fly limited missions, mostly in the US or over water, and not anywhere near combat. Published operations data for Omega verify that.

Meanwhile, guess what: we have an Air Force that is incredibly competent at operating "aging aircraft" as if they had been manufactured yesterday - that includes most of their fighting, as well as logistics, fleets. The KC-135s and the B-52s are, of course, the stand outs. The ongoing performance of the KC-135s, and their flight and ground crews, are the one simple reason why the Replacement Tanker Program has been able to stumble along unproductively (for almost a decade) through the lease scandal and through a less-than-satisfactory KC-X competition environment. These factors add up to "stay tuned to the discourse and learn" about what the country really needs to support its warfighters and dedicated tanker people.

We badly need to hear out this discourse because, so far, it has only scratched the surface of the tanker replacement challenge. We have heard plenty about the struggle for positioning on procurement of new aircraft. We are now hearing about a commercial band-aid that will allow a handful of tactical aircraft to be "trailed" for redeployment within the US the bounds of US territory. These conditions encourage initiatives that are driven hard by hardware manufacturers and their local politicians - a normal process in flush times but quite inappropriate in times of serious national security issues and overcommitted budgets. That is why we need wisdom on the scene and it should be applied after we have had more dialogue (on the tanker replacement issue) that deals with real operational issues that meet warfighters' needs and that are not commandeered by commercial interests.

The central issue for the tanker replacement program is simple - it is a solution conceived in the past, requiring an unsupportable budget, that does not match the operational needs of the warfighters. The latter are better off using what they have for now: it works, they know how and why it works, and they have a job to do that needs no further messing about. When we have a truly effective operational solution for re-capitalization that is consistent with budget realities then we will be closer to a process that is driven by the military operational commanders and not the suppliers, labor force and political supporters. The people in the field deserve no less, and the chances of an effective commercial solution being part of that solution are very small.

While we broadly agree with this writer's point, we don't agree that we should continue operating the KC-135s without an active replacement program. Although some studies concluded this is possible for several more decades, the idea of our service members relying on airplanes that were last delivered in 1965 and predating this year by many more simply is counter-intuitive to efficiency. (The same applies to the B-52, but this is another matter.) This is like the airlines relying on Boeing 707s, Douglas DC-8s, DC-9s and Boeing 727s of the same era for the backbone of the fleet today. All can get the job done and if properly maintained can pretty much fly forever—but these aren't efficient planes anymore and maintenance costs skyrocket with age.

That said, from the public process, even this isn't the issue. (The Air Force evaluation and selection is, at least for the time being, not public.)

For Boeing, it certainly wants to sell its airplane to the Air Force, reaping profits and cash flow in the process. Boeing also wants to maintain its near-monopoly in tankers (McDonnell Douglas sold 60 KC-10s to the Air Force prior to merging with Boeing and Lockheed has sold a handful of KC-130s to the Pentagon). The profits and cash flow from the KC-X will go into Boeing's pot and help fund future airplane programs. (We might add, however, that Boeing has plenty of cash flow from another source—see the stock repurchase comment, below.)

Although Northrop's name is on the side of the KC-30, the airframe is Airbus, a point lost on no one. Therefore, the real issue from Boeing's point of view and that of its supporters is to deny profits and cash flow to Airbus, which are sorely needed by the company following the cash-flow hits and loss of profits on the A380 program. With the concurrent trade dispute intended to deny Airbus launch aid for the A350 and the single-aisle successor to the A320 family, Boeing is highly motivated to keep Airbus from benefiting from the KC-30 program.

Furthermore, allowing Northrop (Airbus) to receive any portion of the KC-X contract positions the companies for follow-on tanker orders or for the next generation of tankers. The foot-in-the-door is already evident with the Air Force asking Airbus (not Northrop, but Airbus) for information on its A380 as a possible replacement for Air Force One and the C-5 cargo transports. Imagine the US President flying around in a French airplane....

That's not all. If Northrop gets the KC-30 contract, Airbus can start producing the A330-200F in Mobile (AL), right alongside the KC-30. Given the weakness of the US dollar, Airbus badly needs to shift production to a dollar-based cost center. The KC-30 production line in Mobile would enable this for the A330 freighter, which proved a popular this year for sales. Would such a US line open the way for other Airbus products to be produced here? This may sound far-fetched, but the foot-in-the-door may lead the way.

We don't fault Boeing for any of this strategy. In fact, it's exactly what Boeing should be doing, from its perspective as a corporation and for its fiduciary duty to its shareholders. But don't be fooled: while the KC-135 needs replacing, the KC-X is only a pawn on the international chessboard of commercial aviation. What the warfighter needs and what's best for him is merely a sideshow.

Speaking of Military Boeing 707s

Maybe all the KC-135s need is a spiffy paint job. Check this NATO AWACS Boeing 707 out. This looks like a brand new airplane.



c. Bjorn van der Velpen via Airliners.net

Odds and Ends

Boeing stock buybacks

Boeing this week approved another round of stock buybacks--\$7billion worth. This is on top of \$8 billion repurchased since 2004 and billions more before that.

As a long-term Boeing shareholder, we supposed we should be happy. But as a long-term visionary for new airplanes, we're not. With its risk-sharing approach to research and development of new airplanes, this \$15 billion could fund two new airplane programs right now. Airbus isn't in a position to match this.

But let's remember that the McDonnell family, the largest shareholders of Boeing, benefit most from buybacks. And they still sit on the Boeing board.

Alenia suspends shipments to Boeing

"Finmeccanica halts shipments to Boeing amid Dreamliner delays," read the headline from Bloomberg News. "Finmeccanica, the Italian company building carbon fiber pieces for Boeing's Dreamliner, has suspended shipments to Boeing until the U.S. plane maker is ready to fix a new schedule for production of the aircraft, which has been delayed."

We found this confusing. We understood from Boeing conference calls that a new schedule had been made and suppliers were on board with it. So we made some inquiries. We understand that this is part of the rescheduling to reduce travel work. Major components for only two aircraft have been received and the travel work has been a huge problem for Boeing. With the six month delay, the suppliers were asked by Boeing to keep their shipments longer to finish work and eliminate travel work.

The article sounded like schedules hadn't been arranged after all. The article was a bit confusing, and Boeing developed some credibility issues that will take some time to work out.

By Scott Hamilton, October 30, 2007