

Boeing Acknowledges Growing Losses on Aerial Tanker Development Program

Written by Nick Sanders
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In February, 2011, the Pentagon awarded Boeing a \$35 billion fixed-price incentive fee (FPIF) contract to develop and deliver 179 KC-46A aerial tankers and refueling aircraft, ending a decade-long struggle to pick the contractor that would replace the US Air Force's fleet of aging KC-135 Stratotankers. At one point or another, bidders included Northrop Grumman, a Russian aircraft company, and Airbus. Boeing won and, reportedly, it won on price, aggressively bidding on modifying its 767 commercial aircraft to meet tough USAF requirements, and promising to deliver the first 18 aircraft by August, 2017.

A few months later, we [reported](#) that grumbles were surfacing that Boeing had "bought-in" to the contract, and that the company fully expected to lose as much as \$300 million on the initial contract, in order to position itself to replace the entire USAF fleet of 500 tankers and generate revenue through aftermarket sales and fleet support. Apparently, Boeing was willing to take a short-term loss in order to clear the playing field of its European rivals, and to position the company for future sole-source contract awards in the long term.

Expectations at the time were that Boeing could have to fund as much as \$700 million of aircraft development on its own dime--\$400 million as its share of the contract cost-growth/overrun and \$300 million in additional funds.

Now, four years later, Boeing [has taken](#) a \$536 million charge in recognition of its KC-46A program losses. The charge represents a reduction of about \$0.77 per share to Boeing's EPS. Apparently, the program schedule has not been slipped, but the company stated that some technical problems remain with the aircraft's integrated fuel system – *i.e.*

, the main thing that modifies the aircraft from a commercial 767 to a military KC-46A. So of course that would be the problem area, wouldn't it?

The current charge of \$536 million in addition to a \$425 program charge Boeing recorded almost exactly a year ago. That charge was related to "wiring problems" on the aircraft. In sum, Boeing has [reportedly](#) now recorded aggregate charges in excess of \$1 billion.

In the meantime, Boeing's hopes of making up some of its development losses through global sales of its aerial tankers suffered a setback recently, as South Korea [chose Airbus](#) to provide its tankers. You know, Airbus: The aircraft maker that lost to Boeing in the competition

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for the USAF aerial tanker (after first being declared the winner).
That's gotta hurt.

How lucky it is for the US Air Force that Boeing (and its shareholders) has the financial resources to absorb more than \$1 billion in losses. Many other potential bidders would not have been able to take the financial hit, and likely would have had to stop performance. So, is the lesson here that fixed-price development contracts are only suited for the biggest of contractors, the ones who can take the short-term losses in return for a hope of long-term revenue? If that's the case, then is the use of fixed-price development contracts antithetical to participation of small businesses in defense contracting?

And if small businesses are frozen out of design and development contracts because the Pentagon insists on awarding fixed-price development contracts, then what does that say about obtaining innovation? Most observers think that innovation can best be found in the smaller, more nimbler, companies—the start-ups and the just-getting-on-their-feet companies. Most observers think that innovation is inversely correlated with size and the bureaucracy and process control that comes with size. If that's true, then fixed-price development contracting is antithetical to innovation.

Who knows?

What we do know is that Boeing took a large gamble on its KC-46A aerial tanker program. Despite bigger losses than initially forecast, the company is still in the game, playing to win.