We reported before on Airbus' problems with its new A400M military transport plane. It's the typical development scenario, over budget and behind schedule. Only this time, Airbus entered into fixed price contracts for its planes, meaning that any cost growth would become a loss unless contracts were renegotiated to provide additional funding. Adding complexity is the fact that the program has at least seven international participants (such as **South Africa**) while Airbus, as a subsidiary of EADS, is owned by "core shareholders" the State of France, French conglomerate Lagardère, the Spanish Government, and the German company Daimler. In other words, some of the A440M customers are also the company's owners! Another interesting aspect is the various **stories** about a recent report prepared by PricewaterhouseCoopers (PwC) that said "management had consistently underestimated the costs of the

programme
” and that the €20 billion ($28 billion) program would be overrun by at least €11 billion, or more than 50 percent of the original budget. Ouch!

At the heart of the issue is who should pay for the overrun. Airbus naturally wants to push additional funding needs back to its customers; but those same customers (some of whom are also owners) think that Airbus needs to pay for its own mistakes. The Financial Times article (link above) reported that “
Hervé
Morin, French
defence
minister, said EADS would have to bear a ‘very significant share’ of the cost overruns on a
programme
.” The PwC report allegedly said that Airbus could absorb up to €7.6 billion in overruns “without problem” – but that conclusion was rejected by Airbus, as was the entire PwC report, which was characterized as a negotiating ploy.

Meanwhile, the Airbus CEO **threatened** to cancel the entire program if its European customers didn’t provide more funding.
According to the BBC article in the link,

Ditching the A400M would cost EADS some 5.7bn euros in advance payments - more than double the 2.4bn euros it has already set aside to cover losses it expects to incur from the project. Some analysts believe, therefore, that there is too much at stake for Airbus to cancel the project.
‘Airbus's posturing over the A400M is a tactic to extract more governmental aid to secure funding to ensure that contracts can be met,’ said Saj Ahmad, an independent aerospace analyst. ‘If the A400M is terminated, Airbus faces the prospect of a several-billion-euro compensation bill that would obliterate its cash reserve and decimate its stock value.’
But others believe that the company could axe the plane to avoid further losses. ‘There will come a point where it is better for EADS to simply walk away,’ said Nomura aerospace analyst Jason Adams.
Doing so would severely damage Airbus' reputation and boost arch rival Boeing, which has seen the order book for its A400M rival, the C-17, swell.

European customers are reportedly divided on how best to proceed. The UK and France want to move ahead briskly toward completion, while Germany wants to slow the program down in order to spread the overrun over more years. Talks are underway now. According to **this report**, the airplane’s European customers “are ready to contribute” as much as €3.5 billion towards the program’s cost growth. But the offer has not (as of this date) accepted the offer, “as it falls short of the €4.4 billion it is asking for.”
In late breaking news,

this article
reports that the core funding offer is €2.0 billion, with additional tranches of "reimbursable advances" (i.e., loans) in the range of €1.0 to €1.5 billion being offered to Airbus to help close the funding gap.

There is one additional driver that is rarely mentioned. As this New York Times **article** notes—

European Aeronautic Defense & Space, the parent company of Airbus, has said it wants to clarify what its share of the more than €7 billion in A400M cost overruns will be so it can book them in its 2009 financial results, rather than carry them over into the first quarter of 2010. EADS's 2009 accounts are scheduled to be published March 9, and financial market regulations require that they be audited by an outside accounting firm — a process that normally takes about four weeks.

Last week, the international ratings agency Fitch warned that failure to reach an accord, or an agreement to EADS's disadvantage, could lead it to downgrade the company's BBB-plus credit rating. Any rating cut would increase the rate of interest EADS would have to pay on future borrowings in the capital markets. Failure to reach a solution in time for the close of EADS's 2009 accounts 'makes a downgrade more likely,' said the person with knowledge of the talks.

While Airbus' A380 commercial aircraft program is routinely discussed for its past program and supply chain management "challenges," the A400M military program is emerging as the current "financial albatross" weighing down the company. While it is easy to see (with hindsight) that early commitment to a fixed-price per aircraft was a huge misstep, we wonder what other "lessons learned" will emerge from this problem-plagued program.