

August 2, 2008

COMMENTARY: THE WEEKEND INTERVIEW*Louis Gallois*

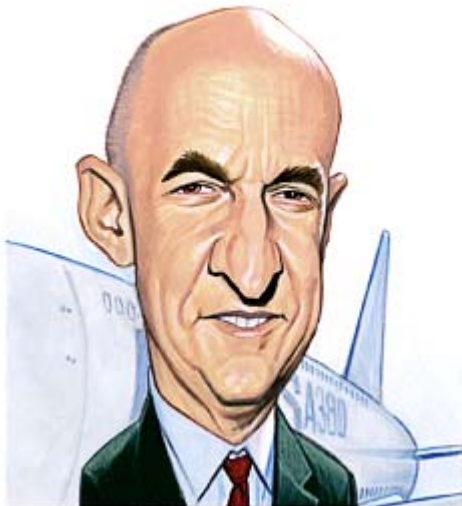
European Tankers For the U.S. Air Force? Sacre Bleu!

By **KYLE WINGFIELD**
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Farnborough, England

"Gloomy?"

Louis Gallois cocks an eyebrow, verifying that he's correctly heard an aide's assessment of his office at last month's Farnborough Air Show. Big aerospace firms like Mr. Gallois's EADS (European Aeronautic Defence & Space Co.) can have surprisingly plush headquarters at these events. Yet the aide suggests, in so many words, that the windowless patch dedicated to the 64-year-old Frenchman isn't fit for the chief executive of a company whose annual revenues exceed \$50 billion.



Ismael Roldan


Mr. Gallois waves off the suggestion and heads for a nearby conference room. He seems to have no time for pomposity: A spokesman says that, despite being one of France's most successful executives, Mr. Gallois still drives himself to work in a Peugeot. He also has no time to waste: He puts our interview on pause at one point to shake on a \$7.2 billion deal, and afterward heads to a meeting with the governor of Alabama, where EADS hopes to build the U.S. Air Force's new midair refueling tankers.

Whatever one's opinion of Mr. Gallois's office in Farnborough, "gloomy" was the right word for this edition of the biennial air show. There are a variety of reasons for the collective pall, one of which is the trans-Atlantic spat over the \$40 billion tanker deal. In June, U.S. government auditors overturned a contract for

EADS and Los Angeles-based Northrop Grumman to build the flying gas stations. The auditors cited procedural flaws, upholding a protest by the other bidder, Chicago-based Boeing Co., which had a 2004 contract to lease tankers to the Air Force canceled because of an ethics scandal.

"Patriotism!" cried some members of the U.S. Congress, cheering the overturned contract.

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"Protectionism!" charged some Europeans. Mr. Gallois's blunt assessment of the political drama: "You could go from protest to another protest to another protest. During this time, the Air Force has no airplane."

Equally blunt is his statement that the Northrop-EADS plane -- a modified version of the A330 jet made by EADS's commercial arm, Airbus -- is better than Boeing's refitted 767. "I have a big respect for Boeing as an aircraft manufacturer," he says. "But we have not lost one competition against the 767. We are winning all competitions. I don't see any reason why the U.S. Air Force could not have the best product."

Mr. Gallois's eyes dance -- no, swagger -- as he raises the "paper airplane" argument, which holds that Boeing has never built the tanker that it has offered the Pentagon. "Our airplane is existing, it's flying; we have not seen the boom system of Boeing [which connects the tanker with the aircraft being refueled]. Our boom system is working every day, tested with all airplanes."

As the tanker battle continues toward an expected conclusion by year's end, Northrop is running advertisements in the U.S. that pick up on this argument. One tag line is, "It won on that most American of values: merit." The ads don't mention Northrop's European partner.

On this count, Mr. Gallois argues that EADS's "purely European" identity is no more. "We are not European, we are not," he insists, leaning forward so that his chin draws near the tabletop. "We are becoming global. As they [Boeing] are global. Because their [tanker] has parts made in Japan, in China, in Korea, in Italy . . . Their airplane is global, our airplane is global, and we are living in that world. . . . And I think Boeing could understand that."

He laughs at the obviousness of this remark, given that Boeing indicated at Farnborough that it wants to raise the international portion of its defense business to 20% within the next five years from 13% today. "They play global on other airplanes," Mr. Gallois says. "If they want to play global, they have to play global on all fields."

As EADS becomes more global, defense is a crucial sector for the company. And with European defense budgets remaining mostly stagnant, that means the company must do more business in the U.S. Because of that, Mr. Gallois says, EADS and Airbus's plans for an assembly line in Mobile, Ala., don't hinge on their getting the tanker contract.

"It's a strategic move for us to become American citizens," he says. "And we are bringing a lot of jobs to the United States." Here he pauses and then, grinning, adds, "Perhaps it is that which is worrying Boeing. We are bringing too many jobs to the U.S.!"

Having too many jobs is not the problem that most worries aerospace industry observers these days. Airbus announced \$40 billion in new orders at Farnborough, and Boeing also had a successful show. Yet folks here seemed to sense that the same skittish credit markets and high fuel prices that have turned other sectors bearish would soon descend upon their industry -- particularly its commercial-aircraft side.

Mr. Gallois betrays no alarm. "The market is alive, but not in the way it was alive last year," he observes. "Last year, everyone was requesting airplanes. Now you have different airlines with different situations. . . ."

"You have airlines with very big difficulties -- I could say mainly in the U.S., but not only in the

U.S. And you have airlines which want to expand their fleets because they have some money for that -- it's the Middle East," Mr. Gallois says. "You have leasing companies buying airplanes at the beginning of a downturn because . . . when airlines are in difficulty, they lease airplanes instead of buying them. And you have airlines which want to replace old airplanes which are not energy-efficient." With the 247 firm orders Airbus revealed at Farnborough, and the 487 it had collected in 2008 before the show, he says "it means we're at our target [of 700 orders] for the year."

Mr. Gallois acknowledges that EADS depends too heavily on Airbus, its commercial arm. "We want to balance better at EADS," he says. "We are 60% to 65% [of EADS's revenue] with the commercial aircraft; we want to reduce to 50%. And it's a challenge, because Airbus is growing very fast." He estimates that a better defense-to-commercial ratio could double EADS's revenue by 2020, transforming the company from one of the world's mere industrial giants -- it's No. 127 on Fortune's 2008 Global 500 list -- to a true titan, inside the magazine's top 40.

But will air travel remain attractive to consumers? Mr. Gallois says traffic remains good now compared with the slowdowns after 9/11 and the SARS virus outbreak. But airfares may become unaffordable for many travelers if oil prices remain high, which Mr. Gallois thinks they will. "I don't see the oil price below \$100 for a long time," he says.

He says the aviation industry has no choice but to become more energy-efficient, and that roughly 80% of Airbus's research and technology effort is focused on energy savings. But Mr. Gallois warns against heavy-handed regulation, in particular a European Union plan to add airlines to its CO2 emissions trading scheme, requiring carbon "permits" for any flight that lands in or departs from EU territory. "I think it's not the right time to impose new burdens for airlines in addition to the oil price in Europe," he says.

Mr. Gallois offers one solution that EADS shareholders surely wouldn't object to: "Perhaps [governments] could take measures pushing airlines to replace old airplanes. You know . . . now in France we pay more if your car is [using] more energy. Perhaps we could have that for airplanes in the future."

Before joining EADS in 2006, Mr. Gallois led three businesses controlled by the French state: the engine maker Snecma; the rail company SNCF; and Aérospatiale, one of the firms that combined to form EADS. But when it comes to how government and companies interact, he believes France is not unique. "To be very frank I have now experience of four countries at least -- including the United States now," he says. "I could say there is no big difference between the different countries."

He describes the intricacies of being in a "sovereignty industry," meaning that defense contractors work with systems and information that are crucial to national security. "We have to deal with governments, even if we have to explain to them that we are a listed company and we have to work in the most efficient way."

He does allow that governments might portray their interactions with industry differently. "In France, sometimes [politicians] want to be strong" in talking about business, he says, pumping his fist. "To say, 'We are a strong influence on the companies.' And they have no more influence than the British government, the German government, the Spanish government."

Moreover, according to Mr. Gallois, "sometimes it's easier in France than in other countries" for

an executive like himself to navigate the political system. And more generally, he says, it's getting easier for executives to persuade politicians to stay out of the way: "People are more understanding of the constraint of a company which has to be as efficient as possible, as profitable as possible, only to protect its future."

Which brings us to one last interaction of the state and industry, and one last potential reason for the airline sector's gloom: the U.S.-EU battle over commercial aircraft subsidies at the World Trade Organization.

In 2005, Washington asked the WTO to find that European governments violated global trade rules in making soft loans to Airbus for new product lines. Brussels immediately countersued over the Pentagon's "cost-plus" contracts, which it says give Boeing extra money for R&D that often leads to innovations applicable to civil aircraft, and the sales tax breaks that various American states have given Boeing. Mr. Gallois says EADS is open to a negotiated settlement but that no talks are being held at the moment.

As for the fear some observers raise, that other countries will continue to subsidize their aerospace industries -- and that a subsidies battle between the U.S. and EU will only weaken their two big manufacturers -- Mr. Gallois indicates that the duopoly for large civil aircraft isn't in immediate danger of ending.

"We have to be prepared for that," he acknowledges. "One day we will have competitors in long range" just as Airbus and Boeing now have for smaller, shorter-range airplanes. But, he says, "It will not be tomorrow morning."

He speaks matter-of-factly and shrugs his shoulders, then excuses himself briefly for a glass of Champagne and that \$7.2 billion handshake. The gloom will have to come from someone else.

Mr. Wingfield is an editorial-page writer for The Wall Street Journal Europe.

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