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Air France-KLM Slows \$12 Billion Aircraft Purchase, Pressuring Rolls-Royce

By Laurence Frost and Andrea Rothman - Sep 16, 2011

Air France-KLM Group held off signing a \$12 billion order for 50 Airbus SAS and [Boeing Co. \(BA\)](#) long-haul jets as it pushes Rolls-Royce Holdings Plc for rights to provide third-party maintenance for the planes' engines.

While Air France's board yesterday backed the purchase of 25 Airbus A350s and an equal number of Boeing 787 Dreamliners, the deal is "still subject to the finalization of discussions with the manufacturers," the carrier said in a statement today.

[Europe](#)'s No. 1 airline is seeking to win work and preserve jobs at Air France Industries, one of a dwindling number of in-house service shops. Like units at [Deutsche Lufthansa AG \(LHA\)](#) and Singapore Airlines Ltd., the division counts on revenue from other carriers to cover costs. Rolls-Royce is reluctant to grant third-party rights because, like other engine makers, it makes more of a profit from maintenance than building new engines.

In delaying the contract [Air France-KLM \(AF\)](#) is aiming a "subtle push" at Rolls, London-based Morgan Stanley analyst Penny Butcher said, adding: "I'd expect the same from Lufthansa."

While Airbus's A350 is available only with Rolls-Royce turbines, engine selection for the Boeing 787-9 will be made later, according to today's statement, a decision which "offers some leverage for the negotiations in coming months," Air France long-haul fleet director Nicolas Bertrand said in an interview.

'Open Discussions'

Rolls-Royce said in a statement it welcomed Air France's decision to buy the A350 and would now "work closely" with the carrier to seal an agreement. The statement didn't mention the maintenance issue or engines for the 787, for which it offers the Trent 1000 in competition with [General Electric Co. \(GE\)](#)'s GEnx.

"We're continuing to have open discussions with Air France, including on the question of maintenance rights," Richard Hedges, a Rolls spokesman, said separately by telephone. "We're very confident that the Trent 1000 represents the best option."

Air France-KLM, which had 121 Airbus and 48 Boeing planes in its long-haul passenger fleet as of June 30, needs new jets to replace aging and inefficient models and add more capacity, and first announced an intention to place an order in 2007.

Retirement of Air France's last 10 Boeing 747 jumbos and an equal number of MD-11s from Amsterdam-based KLM was previously postponed from 2012 to 2016 -- the year deliveries from the new order will begin, with the first arrivals going to Dutch unit.

The company also has options to purchase 60 more planes, of which it expects to take at least 23 by 2024, it said today.

'No Taboos'

While contracts should be signed by the year's end, Air France is determined to be a "key" provider of maintenance for the new aircraft and engines, it said, and Bertrand added that repair rights are the last "significant issue" to be resolved.

"We're in close discussion with Rolls-Royce on the engine- maintenance conditions," he said. "We're determined to remain an important player in plane and engine maintenance. We have a significant operation that we want to preserve and expand."

There are "no taboo subjects" in the talks with Rolls, Bertrand said, with the engine choice for the 787 remaining "entirely open" between the U.K. company and Fairfield, Connecticut-based GE.

Air France doesn't currently service any Rolls-Royce turbines, the fleet being equipped solely with engines from GE and its joint ventures with Safran SA and United Technologies Corp.'s Pratt & Whitney unit, according to aviation research firm Ascend. Among aerospace suppliers, engine makers have most to gain in service revenue as highly stressed turbines need more frequent care and parts replacement than do airframes.

French Lobbying

The commercial discussions had also come under political pressure, with Air France Chief Executive Officer Pierre-Henri Gourgeon summoned in June to a meeting with French Trade Minister Pierre Lellouche to discuss a petition in which more than 100 legislators urged him to favor Airbus. Nicolas Sarkozy's government was paying "close attention" to the company's fleet plans, a spokesman also said at the time.

Air France-KLM was trading down 1.24 percent at 5.99 euros as of 10:59 a.m. in Paris. The stock has slumped 56 percent this year, the worst performance on the Bloomberg EMEA Airlines Index, as high fuel expenses and sluggish demand crimp earnings.

Airbus parent European Aeronautic, Defence & Space Co. was priced 1.35 percent lower and Rolls-Royce was little changed. Boeing stock closed 2.1 percent higher in [New York](#) yesterday.

The all-composite 787, Boeing's fastest-selling plane with 821 previous [orders](#), is due for first delivery this month to All Nippon Airways of [Japan](#), three years later than planned after struggles with the new materials and production system.

The larger Airbus A350 has a range of more than 8,000 nautical miles in its most popular version, the A350-900, which accounts for about two thirds of the 567 orders previously booked and is due for first delivery around the end of 2013.

The model, called the XWB or Extra Wide Body by Airbus, can seat 350 passengers in the largest A350-1000 variant, compared with the 787-9's maximum 290 passengers in a three-class cabin. Due to enter service in 2017, the -1000 is aimed at cracking the Boeing 777's dominance in that size category since the 1990s.

Boeing said in June it may offer a third Dreamliner model, the 787-10, for service entry by 2016, challenge the A350-900.

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