

CONFIDENTIAL

Prime Minister ②

Mr Prial believes this is a favourable contract for Shorts and recommends they be authorised to proceed. Policy Unit agree.

PRIME MINISTER

Content?

AT 19/17

Off Mr Prial's response  
AT  
Yes not  
17/17  
CC/PO

SHORT BROTHERS LTD: V2500 ENGINE NACELLE

Introduction

- with AT

1. In my minute of 5 July about Shorts' privatisation I alerted colleagues to the imminence of decisions required on their bid for the V2500 engine nacelle. I now seek your and colleagues' agreement to authorise Shorts' bid.

Background

2. We agreed last March that part of Shorts' corporate strategy should be to seek further aerostructures contracts. They wish now to team up with the California-based company, Rohr Industries, to offer a nacelle for the V2500 engine development by the International Aero Engine consortium. (We have already approved Rolls Royces's participation in that.) The engine is aimed at the developing generation of 140-160 seat twin-engine jets.

Proposal

3. The company's proposal has been examined by consultants, Touche Ross, who advise my Department on Shorts matters. Their report, which has been endorsed by my officials, has been distributed to officials in departments chiefly interested to provide fully detailed background.

4. Shorts have prepared their estimates on the basis of (a) the highest price they could reasonably expect to negotiate: and (b) the lowest price they would be ready to accept. On the latter basis their proposal provides an internal

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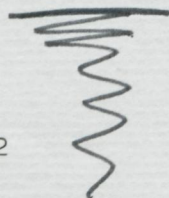
rate of return of 12.5% (after grant claimed), turnover of £117m and profit before interest of £22m after full overheads. The contract would provide some 450 jobs, although this could rise as high as 600 if order volumes exceed expectations.

5. The company have sought grants totalling £9.4m, consisting of 30% non-discretionary grant on tooling (£2,0m) and 33 $\frac{1}{3}$ % discretionary grant for product development (£7.4m). I intend however to offer the company discretionary grant at only 25% (£5.6m; aggregate £7.6m). This is in line with the SFI scheme operated by the DTI and would therefore align discretionary aid to Shorts with that which Lucas could attract if they also bid for the work. As this reduction would have only a marginal effect on profit and IRR, it should not impair the attraction of the bid to Shorts or HMG. The cost per job is within accepted norms for private sector investments in East Belfast. The aid proposed also meets the criteria of the European Commission's regional aid systems and does not require notification.

6. Provision of these grants and also the impact of the project as a whole on company finances both fall within the EFL and profit targets already agreed for 1984/85; financial forecasts for later years of the company's existing corporate plan also remain unchanged save for a marginal deterioration (£0.4m) in profitability in 1986/87.

7. The risks associated with Shorts' proposal are fully examined in the Touche Ross report. The most important are as follows:-

(a) exchange rate: Shorts have assumed an average exchange rate to 1996 of £/\$1.50. While this







seems a reasonable assumption, an average rate of £/\$1.60 would reduce profit by £7m to £15m and IRR by 3.5% to 9%; on the other hand, parity of £/\$1.40 would increase profit to £30m and IRR to 17%;

- (b) sales; Shorts have prudently decided against using IAE sales forecasts and have based their estimates of 400 sales (over which non-recurring costs would be amortised) on Department of Trade and Industry forecasts instead. DTI forecast that the V2500 engine will achieve 50% penetration on the A320. Shorts' forecasts of nacelle sales tend towards the top of DTI's estimates, and in some scenarios are above. The company has however been cautious in discounting nacelle sales to Boeing and McDonnell Douglas. But these are a distinct possibility and, if they proceed, Shorts' assumptions become quite comfortable. Indeed, should Shorts sell 500 units, on their central estimates profit would rise to £25m and IRR to 26%. On the other hand, should only 300 sales be achieved, profit and IRR are estimated to fall to £10m and 7% respectively.

#### Assessment

8. I have recently recommended that we should instruct the company, in the run-up to privatisation, to aim at terms for new work which would attract private investors. I believe that Shorts' proposals for the V2500 fulfil this. The product is mostly within their proven competence. Co-operation with Rohr should strengthen their expertise and follow the growing trend towards collaboration in



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aircraft development. But most importantly the financial terms and return are right for a project which could at peak represent over 10% of forecast aerostructures turnover. I therefore recommend that we authorise Shorts to bid for the contract as envisaged.

9. I would wish, however, to suggest two further modifications to Shorts' proposed terms in addition to reducing discretionary grant. While I would be prepared to accept final negotiated terms on the minimum basis now set out by Shorts, I will instruct them to seek better than those and to come back to me for approval if no improvement can be achieved. In particular, I will want Shorts to explore as fully as possible the scope for securing safeguards against a marked deterioration in the £/\$ exchange rate (over £/\$1.70) and also against a shortfall in sales below 400 by 1996. I would hope that the strength of the Shorts/Rohr combination, despite some strong competition, and also Shorts' unit cost advantages would permit these improvements. I will wish, however, to have colleagues' agreement that I may finally authorise Shorts to enter the contract on the basis already proposed by the company, subject only to reduction in discretionary grant.

10. Shorts and Rohr must respond to IAE's request for proposal by 23 July. I should therefore be grateful for replies from colleagues by 19 July at the latest. I am copying this minute to other members of E(A), Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

JP  
16 July 1984

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IND Policy

Nov. 80

Short Bros



CCNO



Chancellor of the Duchy of Lancaster

PRIME MINISTER

SHORT BROTHERS: V2500 ENGINE NACELLE

I have seen the Northern Ireland Secretary's minute to you of 16 July.

It would be interesting to know what effect this project will have on the company's financial position as set out in the table included in paragraph 4 of the Memorandum appended to the Northern Ireland Secretary's minute of 22 February. In particular the project will presumably require substantial capital funds, not only by way of tooling but also for working capital. The figures given in February actually showed a reduction in the cumulative external funding required after 31 March 1984 - the 1988 figure actually being £6 million less than the 1984 figure. Does this hold good if the engine nacelle order is taken? If substantial additional funds are required this may well have repercussions on the privatisation prospects.

I am copying this minute to other members of E(A), Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

A handwritten signature in blue ink, consisting of the letters 'A.C.' followed by a diagonal line.

A C

19 July 1984

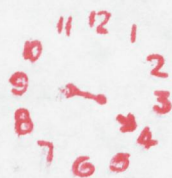


IND Pst

NOV 80

Shorts

12 JUL 1984







FROM: CHIEF SECRETARY  
DATE: 19 July 1984

NBPM

AT

20/7

PRIME MINISTER

**SHORT BROTHERS LTD: V2500 ENGINE NACELLE**

Jim Prior sent me a copy of his minute to you of 16 July.

I can endorse Jim's favourable assessment of this project, which is a distinct improvement on other Shorts projects we have seen recently. Here we have a promising collaborative venture - and collaboration, I am sure, holds the key to the future for Shorts - with a prospect of a pretty satisfactory level of profit, and acceptable downside risks. I agree that, in the run-up to privatisation, this is the sort of project that Shorts should be looking for. But I also agree that Shorts should be instructed to seek better terms than the minimum on which they have prepared their estimates, and to explore safeguards against the exchange risk, and against the risk of a shortfall in sales of below 400. Subject to that, I can agree that the company should be authorised to enter the contract on the basis set out in paragraph 9 of Jim's minute.

I am sending copies of this minute to other members of E(A), Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

PETER REES



IND Pol NOV 20



SHORTS

NOV 20 1982

20 JUL 1982



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LPS

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Trans

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file  
CC Bob Young

10 DOWNING STREET

*From the Private Secretary*

20 July 1984

Short Brothers Ltd: V2500 Engine  
Nacelle

The Prime Minister has seen your Secretary of State's minute of 16 July. Subject to the views of colleagues, she is content for Short Brothers to enter into the contract to supply the nacelle for the V2500 engine.

I am copying this letter to Private Secretaries to the Members of E(A), Len Appleyard (FCO), Richard Mottram (MOD) and to Richard Hatfield (Cabinet Office).

Andrew Turnbull

Derek Hill Esq  
Northern Ireland Office

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FCS/84/214

SECRETARY OF STATE FOR NORTHERN IRELAND

Short Brothers Limited

1. Thank you for copying to me your minutes of 5 and 16 July to the Prime Minister about Short Brothers Limited.
2. I was glad to read your recommendations on the privatisation of Shorts (and related issues), and should be grateful if you could keep me informed of developments in case there might be European Community implications to consider.
3. As for the proposal that Shorts be authorised to bid with Rohr Industries for the nacelle for the V2500 engine, there too I can go along with your recommendations.
4. I am copying this minute to the Prime Minister, members of E(A), the Secretary of State for Defence and Sir Robert Armstrong.

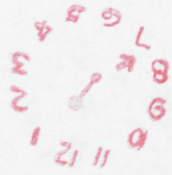
A handwritten signature in black ink, appearing to be 'G. Howe', written in a cursive style.

GEOFFREY HOWE

Foreign and Commonwealth Office  
20 July 1984



Shurt Bros.



7 1984





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2 PPS. CE NO

DEPARTMENT OF TRADE AND INDUSTRY  
1-19 VICTORIA STREET  
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01-215 5422  
SWITCHBOARD 01-215 7877

Secretary of State for Trade and Industry

NOPM

23 July 1984

AT 2417

Rt Hon James Prior MP  
Secretary of State for Northern  
Ireland  
Northern Ireland Office  
Whitehall  
London SW1

*D Jim.*

SHORTS V2500 NACELLE

I have seen a copy of your minute to the Prime Minister of 16 July in which you seek agreement to authorise Shorts to bid with Rohr for work on the V2500 nacelle. with AT

2 On the face of it, the proposal is an attractive one and I note that Touche Ross appear to be enthusiastic about it. Touche Ross did not, however, have sufficient time to perform their own market analysis. With that in mind I must say that your minute does not reflect entirely faithfully the views of this Department's market experts on market prospects. I understand that it may be possible to achieve the sales of 400 nacelles projected in the proposal but not without the V2500 being fitted to the McDonnell Douglas MD88. If this aircraft does not go ahead or if it is powered by a General Electric/SNECMA engine, the A320 would appear to be the only sales outlet for the nacelle. Experts here would not expect this to account for more than 300 units. In such circumstances the rate of return would be much less attractive and, in any event, the very attractive rate of return which would accrue from sales of 500 units looks very unlikely. I should emphasise that the views I am expressing on the prospect of Shorts achieving nacelle sales are consistent with the views expressed on likely sales of the V2500 engine when the latter was considered earlier this year.

3 I strongly agree that you should offer Shorts no more than 25% in discretionary grant. Even at that level the money available to Shorts is considerably greater than any other UK company could hope for. British Hovercraft Corporation and British Aerospace also intend to bid for some or all of the work which Shorts are seeking. I am not in a position to contemplate a comparable amount of assistance for either of those companies should they seek it. Clearly this disparity in assistance for the same project may provoke comment from other UK bidders, and you must be ready to

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CONFIDENTIAL

defend the assistance to Shorts on the basis of Shorts' special position in the economy of Northern Ireland, which is reflected in the funding powers - and the funds - available to him.

4 I do, however, accept that Shorts have considerable experience in this field and that in partnership with Rohr they must be a strong contender for the work. If it can be made clear to Shorts that we would hope for a price well above the minimum envisaged I am content that he should authorise Shorts to bid on the terms he has described.

5 Copies of this letter go to the Prime Minister, other members of E(A), Geoffrey Howe, Michael Heseltine, and to Sir Robert Armstrong.

NORMAN TEBBIT

24 JUL 1984



JH4AEV





NORTHERN IRELAND OFFICE  
WHITEHALL  
LONDON SW1A 2AZ

Private Secretary to  
Lord Cockfield  
Chancellor of the  
Duchy of Lancaster  
Privy Council Office  
68 Whitehall  
LONDON SW1

2 August 1984

Dear Private Secretary,

SHORT BROTHERS: V2500 ENGINE NACELLE

In his minute of 19 July to the Prime Minister about the V2500 project Lord Cockfield suggested that it would be helpful to know the effect the project would have on Shorts' financial position as set out in my Secretary of State's Memorandum of 22 February about the company's Corporate Plan.

The "minimum price" basis in Shorts proposal for the V2500 project has the following profit/loss and cash flow impact during the Corporate Plan period:-

<u>Year to March</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	
Profit/(loss)	(0.4)	(1.9)	(3.3)	(1.2)	£m
Cash flow	(1.0)	(3.0)	(5.9)	(1.9)	£m

In view of the normal requirement for front-end funding for new aerostructure contracts Shorts made provision in their Corporate Plan for new work. This allowance together with other savings covers the requirements for the V2500 project and other new work (eg Fokker wing contract) committed since the Plan was prepared. As noted at paragraph 6 of Mr Prior's minute of 16 July, therefore the financial forecasts in the Plan remain unchanged except for a marginal deterioration of £0.4m in profitability in the year ending 31 March 1987.

/ ... My



My Secretary of State believes that Shorts' participation on the terms he proposed should enhance prospects for disposing of the company, since it will provide a stronger product base without casting greater strain on its financial resources than shown in the Corporate Plan.

Mr Prior was grateful for his colleagues' approval to permit Shorts to bid for this project. The company has now been instructed to seek a better price than the minimum set out in its proposal and also to explore safeguards against the £/\$ exchange rate rising to over \$1.70 and a shortfall in sales below 400 by 1996.

I am copying to the Private Secretaries to the Prime Minister, other members of E( A), the Foreign and Defence Secretaries and to Sir Robert Armstrong.

*Yours sincerely,*

*Graham Sandiford*

G K SANDIFORD



IND Pa: Shorts Nov 80

-2 AUG 1981

10 11 12 1 2 3 4 5 6 7 8 9



From: THE PRIVATE SECRETARY

NBAH AF 2/8



NORTHERN IRELAND OFFICE  
WHITEHALL  
LONDON SW1A 2AZ

Private Secretary to  
Lord Cockfield  
Chancellor of the  
Duchy of Lancaster  
Privy Council Office  
68 Whitehall  
LONDON SW1

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*Graham Sandiford*

G K SANDIFORD



IND Pa: Shorts Nov 80

-2 AUG 1981

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