

FROM: MINISTER OF STATE



DEPARTMENT OF ECONOMIC DEVELOPMENT

NETHERLEIGH
MASSEY AVENUE
BELFAST
BT4 2JP

Telephone 63244

COMMERCIAL IN CONFIDENCE

Barney Hayhoe Esq MP
Minister of State
Treasury Chambers
Parliament Street
LONDON
SW1P

26 September 1984

Dear Barney,

SHORTS

I should like to advise you and other colleagues of my intended agreement to terms proposed by Short Brothers Limited for a sub-contract with Boeing.

Boeing invited Shorts in the last week of August to submit a tender by 28 September for the supply of rudders, elevators and spoilers in composite materials for the 737-200 and -300 aircraft. My officials and management consultants, Touche Ross, examined the original proposals put forward by Shorts and we rejected these as the terms were unattractive. Shorts have now however revised their proposals to the point where I believe that I should endorse them.

The new terms are set out in the annex to this letter. They show that on central assumptions the project would generate a rate of return of 13%, which is robust against most risks save that of the exchange rate rising above \$1.50/£ sterling. The rate of return is similar to that on the much larger V2500 bid which we approved last July. Should both bids be successful there would be pressure on the new work provision in 1985-86. On the other hand it is a relatively small contract (£20m turnover) on work for a valued customer; and the Department of Trade and Industry is content with Shorts estimation of market potential. I believe that the company should be authorised to bid on this basis.

I think it right, however, that you and colleagues should be aware of a wider range of questions which we will have to tackle very soon in relation to Shorts.

First, as you know Shorts wish to compete for the RAF trainer for which bids are to be lodged with the MOD by 1 October. In light of the size of this tender (£180m turnover) we have told the company that we need more time to examine it fully. Their bid to the MOD on 1 October will therefore be conditional on subsequent collective Ministerial approval to its terms and I am writing to Adam Butler explaining this.

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Barney Hayhoe Esq MP
Financial Secretary to the Treasury

September 1984

Secondly, Jim Prior's minute of 5 July to the Prime Minister undertook to consult colleagues on a proposal to develop a small manufacturing facility in West Belfast aimed at defusing criticism by Irish Republicans in the USA of Shorts' recruitment policies; and also on the impact of the US Air Force's EDSA order on Shorts' finances. These could be further adversely affected by the immediate market prospects for the SD 360 which are showing a likely shortfall in target sales for the current year. Douglas Hurd will be drawing all these strands together in a further letter about Shorts' bid for the RAF trainer. I do not believe however that Shorts should be denied the opportunity to bid for the Boeing contract because of these considerations, not least in view of the contract's size and its limited impact on company finances over the next 18 months. I therefore intend to authorise the firm accordingly on Friday (28 September) and will assume that you are content unless I hear from you (and copy recipients) by lunchtime on that day.

I am copying this letter to E(A) Ministers, Geoffrey Pattie and to Sir Robert Armstrong.

*all good wishes
Y
ever*

Rle

DR RHODES BOYSON

SHORT BROTHERS LIMITED
TERMS OF THE BOEING 737 BID

Items Under Tender

1. Components to be made in composite materials for Boeing's 737 series of aircraft. The Boeing request is for an initial 150 shipsets with an additional optional quantity of 100 shipsets to be quoted separately. Each shipset is made up of a rudder, two elevators and spoilers, although Shorts may not bid for all of these.

Sales Forecasts

2. Shorts has based its forecasts on estimated deliveries of 250 shipsets in the period 1986/88 peaking at 120 (10 per month in 1987/88). DTI forecasts of sales for the period 1983/87 is 320/580 deliveries (7/12 per month) which puts the Shorts estimate of deliveries at the top end of the range. However, Boeing expects sales of 580 737/300s alone in the period 1984/88 (12 per month) and DTI believes that sales of 737/300s will continue after 1987 (345 up to 1995).

Financial Forecasts

3. Price: £77,600 per shipset
Exchange Rate: £1 = \$1.50
Internal Rate of Return: 13% at current prices.

Profitability

4.	<u>1984/85</u> £m	<u>1985/86</u> £m	<u>1986/87</u> £m	<u>1987/88</u> £m
Boeing project	-	-	<u>0.7</u>	<u>0.8</u>
Unallocated New Work Provision	<u>2.2</u>	<u>0.6</u>	<u>(0.4)</u>	<u>1.9</u>

Cash Requirements

5. Boeing project	<u>(0.2)</u>	<u>(2.3)</u>	<u>(1.6)</u>	<u>2.6</u>
Unallocated New Work Provision	<u>8.2</u>	<u>3.3</u>	<u>5.6</u>	<u>11.7</u>

EC Calculation

6. NGE = 49% (limit 75%)
 CPJ = £3,077 (limit £7,410).

Officials have agreed that the aid proposed need not be notified to the Commission, largely because it falls within the agreed limits of regional assistance.

Risks and Sensitivities

7. The two critical sensitivities are on the assumed exchange rate and labour learning rate. The assumed exchange rate is \$1.50. If this rises to \$1.60, the IRR becomes negative. If the exchange rate falls to \$1.40, the IRR becomes 28% (at \$1.30, the IRR is 45%).

The labour learning curve is based on achieving the basic hourly content for each shipset by means of an 85% curve. If only an 80% curve is achieved (requiring a far higher number of hours for the first shipset) the IRR falls to 1%. As the components of the ship sets are already in production at Boeing, it is thought to be extremely unlikely that a learning curve of 80% will be necessary.

Employment

8. Peaks at 390 in 1986/87.

Level of Assistance Proposed

	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>	<u>Total</u>
	£m	£m	£m	£m	£m
Capital Grant	0.6	0.3	-	-	0.9
Design, Development and Labour Learning Grants	-	0.4	0.4	0.1	0.9