

Confidential Filing

2/27

Rolls Royce V2500 Engine.

AEROSPACE

January 1984

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
<del>2.2.84</del>							
<del>29.3.84</del>							
17.5.84							
PREM 19/14/10							





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From the Minister of State for Industry

NORMAN LAMONT MP

**CONFIDENTIAL**  
**COMMERCIAL IN CONFIDENCE**

Rt Hon Peter Rees QC MP  
Chief Secretary to the Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1

Prime Minister<sup>②</sup>  
To note that V2500  
launch aid has been  
agreed at £60 million  
and announced

AT 17/5.

17 May 1984

*Dear Peter*

**ROLLS-ROYCE: V2500 LAUNCH AID**

This is to note for the record the basis of the decision on launch aid for the V2500.

At the meeting of E(A) on 2 February 1984, Norman Tebbit was authorised to negotiate launch aid for the V2500 project with the Chairman of Rolls-Royce, in consultation with the Treasury and up to a maximum of £60 million. Following a number of meetings, culminating in one on 1 May between the Prime Minister and Sir William Duncan, agreement was reached on a basis which was, I understand, acceptable to you for launch aid of £60 million (cash), spread as follows:

FY 1984/85	FY 1985/86	FY 1986/87
£10M	£25M	£25M

This aid, representing approximately  $\frac{1}{4}$  of the company's development costs, will be repayable by a 3% levy on both engines and spares. On the basis of the Rolls-Royce market forecast of 3000 engines sold over the period to 2009 (with spares sales continuing to 2018), this will yield a 5% real rate of return. Since our own estimates indicate a significantly higher number of sales than the company's forecast, HMG actually stands to achieve a rate of return well in excess of 5%.



I attach a copy of the written answer announcing the launch aid. It does not include details of the arrangements, which will remain commercially confidential.

The question of PES treatment will be pursued separately.

I am copying this letter to the Prime Minister, the other members of E(A), and Sir Robert Armstrong.

*Yours  
Norman*

NORMAN LAMONT

financial exigency. With one or two limited exceptions there has been no response and, although I appreciate that universities have had other preoccupations, I think it now probably has to be recognised that the problem is not one that they can resolve by themselves.

I continue to believe that tenure in the strongest form in which it is enjoyed in some universities cannot be justified by reference either to the need to protect academic freedom or to the case for reasonable security and continuity of employment for academics, both of which I accept. Neither requires that academics should be guaranteed continued employment until retiring age no matter how the circumstances of their university change.

I therefore propose that tenure should in future be limited. The Government is prepared to introduce legislation if this cannot be achieved voluntarily. I should say at once however that we have in mind no interference with existing contractual rights. We wish only to limit the tenure that may be granted by contracts made after some specified future date.

The Government's objective is to ensure that all universities have, in respect of all academics whose contracts are entered into after the specified date, the right—subject to appropriate procedures to protect academic freedom, to which I refer below—to terminate their appointments for redundancy and reasons of financial exigency, and to ensure that universities cannot waive that right by the terms of the contracts they grant. Before developing my proposals any further there are a number of matters on which I should welcome your views:

(a) I believe that many universities will be glad to have this matter resolved for them, especially as there is no threat of retrospective action. Given the Government's clear intention and its willingness to legislate, is there any prospect that universities will act themselves to comply with the Government's wishes, given a period of time in which to do so, and a clear indication of what changes would be acceptable; or would they prefer to have legislation? I am sceptical that legislation can be avoided, because it would take only one dissentient to make it necessary.

(b) As to the nature of legislation, I have noted your distaste for the idea of the development of a body of general law for the universities and the danger of moving inadvertently in this direction. I would therefore propose to follow precedent and proceed by way of legislation to establish and empower Commissioners (of which there would no doubt need to be more than one set for universities or groups of universities in different circumstances) to make the necessary changes to statutes. The general approach would be that once the job was done the Act would disappear from the Statute Book while the amended statutes for each university would continue in force, with subsequent amendment possible only with external approval—usually from the Privy Council—as at present. Can I assume that this approach to legislation would be more acceptable to you and your colleagues than cruder but brisker provisions that would have to remain upon the Statute Book?

(c) I do not wish the changes I propose to create any threat to academic freedom. I should be glad to know your views on, and to discuss with you, the procedures necessary to achieve this and to safeguard against abuse.

(d) In 1982 your Committee proposed that, where existing definitions of "good cause" did not provide for it, universities should be able to terminate tenured appointments for failure satisfactorily to perform the duties of the post. To what extent do universities already have this power and to what extent do those that have it use it? Should any legislation on tenure seek to make such a provision common to all universities for future appointments? If so, how would it be possible to ensure that such provisions contained adequate safeguards to protect academic freedom without rendering them unworkable?

(e) Even with action on tenure I believe it is necessary to improve and extend the probationary arrangements for new appointments, although not necessarily in the way set out in your Committee's 1982 proposals. I should be glad to know your views.

(f) There may be other ways in which statutes could usefully be clarified but in general I want to ensure that in all respects except tenure (and perhaps probation) each university's terms of employment will remain for them to determine.

When I have your views on these matters I shall report further to my colleagues before deciding how to proceed. I shall of course ensure that you are kept informed of our intentions and consulted at every stage in the preparation of any legislation.

I am anxious to be able to resolve the uncertainty about the Government's intentions as soon as possible and I look forward to hearing from you. Peter Brooke and I are of course ready to discuss these proposals if that would be helpful.

I am sending a copy of this letter to the Chairman of the UGC and to the General Secretary of the AUT, and am arranging for it to be released to the House of Commons and the Press.

## TRADE AND INDUSTRY

### Confidential Information

**Mr. Ashdown** asked the Secretary of State for Trade and Industry if British representatives attending meetings of COCOM about high technology exports disclose to other countries' representatives, including those of the United States of America, information about British companies which is not publicly available in the United Kingdom.

**Mr. Channon:** No.

### "Regional Industrial Development"

**Mr. Ward** asked the Secretary of State for Trade and Industry how many representations he has received on the White Paper, "Regional Industrial Development", Cmnd. 9111.

**Mr. Trippier:** 175, as at 4 May.

**Mr. Ward** asked the Secretary of State for Trade and Industry how many representations he has received on the White Paper, "Regional Industrial Development", Cmnd. 9111 from the area covered by the southern region of the English tourist board.

**Mr. Trippier:** None, as at 4 May.

### Film Industry

**Mr. Durant** asked the Secretary of State for Trade and Industry (1) what effect Budget action with regard to capital allowances will have on the review of the film industry; and if he will make a statement;

(2) what progress has been made by the British film industry in the last two years with existing help from the Government; and what alternative arrangements he contemplates to ensure the continuance of this progress in the light of fiscal changes proposed in the recent Budget.

**Mr. Kenneth Baker:** I will reply to my hon. Friend as soon as possible.

### Rolls-Royce (V2500)

**Mr. Hayward** asked the Secretary of State for Trade and Industry if he has now made a decision regarding launch aid support for Rolls-Royce participation in the V2500; and if he will make a statement.

**Mr. Norman Lamont:** The Government have decided to advance launch aid of £60 million in support of Rolls-Royce's participation in the international V2500 aero-engine project. This aid will be repayable by a levy on sales.

Asbestos Pass: Rolls Royce vest  
Lynne  
June 4

17 MAY 1964





10 DOWNING STREET

From the Private Secretary

Prime Minister ①

You should know that John Redwood and Bob Young are irritated by the way Sir William Duncan has been encouraged by Mr Tiddit to appeal against the E(A) decision to provide enough launch aid to get the project going, but not enough to put balance sheet in shape to be privatised by 1987. I think they have a point; E(A) took its decision quite consciously.

Nevertheless, Sir William has done a good job at RR and I recommend you agree to see him. I see no case for changing E(A) decision.

Agree?

AT  
29/3

MR TURNBULL

c Mr Redwood

ROLLS ROYCE V2500 ENGINE LAUNCH AID  
SIR WILLIAM DUNCAN'S LETTER OF 26 MARCH

1. E(A)'s brief to Mr Tebbit was:

- to make an initial offer of £45m, which he has done;
- to go to £60m if he had to, which he has at least mentioned;
- to negotiate the rate of return to HMG with the Chief Secretary (not yet done for obvious reasons);
- not to be "influenced by the Government's ultimate objective of privatising the company". That, too, he has evidently borne in mind.

2. The questions which now arise are:

- are the E(A) instructions still relevant or should we change them?
- should the Prime Minister see Sir William Duncan and if she does what should she say?

3. Should we change the E(A) instructions? Nothing substantial has changed in RR's financial or market prospects. The forecasts in Sir William's letter are closely comparable with those on which E(A) based its decision. (The Annex to this note describes the differences). In particular, net borrowings still fall below shareholders' funds in 1986 - a key point on which the Chief Secretary persuaded E(A) that launch aid should be held quite low. There is no financial case for a better offer to RR.



4. In one other respect, however, RR are on stronger ground. They feel keenly the gross inconsistency of Government's treatment of the A320 and V2500 projects. Rolls and others are very well able to assess the viability of air-frame projects pretty accurately. The frailty of the A320 commercial case is well known around UK aerospace, and the allocation of £250m of aid to it is increasingly being seen as a lavish mistake. Rolls in particular fail to see why the A320 should have had preferential treatment over the V2500 which is commercially much more attractive. Our only response can be that one possible misjudgement should not be grounds for another. We therefore recommend no increase in launch aid to the V2500 on non-financial grounds.

5. Should the Prime Minister see Sir William Duncan? My understanding is that Mr Tebbit actually suggested to Sir William Duncan to make the approach to the Prime Minister. If the Prime Minister refused, or deferred for a long time, it could put Mr Tebbit in a difficult spot. We suggest, therefore, that a meeting should take place. We recommend the following line.

- Give Sir William Duncan full credit for putting Rolls Royce into good collaborative projects and for taking tough action to put the company's internal performance in order.
- Encourage him to see privatisation as an important goal, but not one which Government will pay any price to achieve. Normal prudent funding measures must be the order of the day.
- Do not agree to an increase in launch aid beyond the ceiling of £60m. We suggest phasing of £10m in 1984, £30m in 1985 and £20m in 1986. (If the Prime Minister feels she must go beyond £60m total, we suggest a token amount only, not more than £10m, and with correspondingly stiffer repayment terms.)
- Demolish the idea that A320 and V2500 were competing for one single allocation of funds. The two have different characteristics, and each was considered on its merits.

Point out that BAe have been set onerous early repayment terms.

- Government has been both patient and generous with funds for Rolls Royce. V2500 is no exception. The amount of launch aid on offer does not diminish the company's privatisation prospects.

R.J.

ROBERT YOUNG

ROLLS-ROYCE'S FINANCIAL FORECASTS

The figures in Sir William Duncan's letter are, strictly speaking, new to Government. The 1984 and 1985 figures are taken from their newly prepared Budget/Operating Plan, not yet circulated, while those for 1986 and 1987 are slightly modified versions of the Corporate Plan numbers.

The profit and cash figures have been written down by £7m and £13m in 1984 and 1985 respectively to safeguard against the dollar weakening to \$1.60 and against reduced profits on MOD work arising from the current review.

In addition, Sir William writes out the launch aid already offered of £10m in 1984, £25m in 1985 and £10m in 1986. If we put in £60m of launch aid, phased £10m/£30m/£20m, and add back the safeguards, the financial forecast reads as follows:

£million outturn	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>
Turnover	1403	1651	1900	2300
Profit after Tax	9	40	124	228
Cash Generated	5	29	73	119

Borrowings and gearing will be slightly improved.

To note Since nationalisation in 1971, RR has had just on £1 billion in Exchequer support in money of the day terms - much more in 1984 money. Of that £1 billion, £700 million has been in launch support.

R.J.

29 March 1984



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P.01217

PRIME MINISTER

Rolls-Royce: the V2500 Project/Proposed  
Collaboration with General Electric (US)

(E(A)(84)6 and 7)

BACKGROUND

Rolls-Royce (RR) and its Japanese partners (JAEC) wish to join the US aeroengine producer Pratt and Whitney (PW) and its German and Italian partners (MTU and Fiat) to develop the V2500 engine for narrow-bodied aircraft of around 150 seat capacity. RR would undertake about 30 per cent of the work, mainly on the fan and compressors, and hold 30 per cent of the equity in the venture. RR is seeking approval of the project and launch aid at the rate of 50 per cent of total launch costs, (ie £113 million in 1983 prices or £137 million in outturn prices) to be phased over the period 1984-1991. My note as Chairman of the Official Group on Aerospace (E(A)(84)7) sets out the main considerations, brings out the common ground and areas of difference among departments, and identifies the issues for decision by Ministers.

2. Separately, and without the knowledge of PW, RR have also reached an understanding with the other major US manufacturer General Electric (GE), on the production of larger engines suitable for wide-bodied aircraft (the Boeing 747, 767, and Airbus A300/A310) and the narrow-bodied Boeing 757. The collaboration involves RR taking an immediate 15 per cent share, rising to 25 per cent, in the production of GE's engine for wide-bodied aircraft, the CF6-80C, and GE taking a similar share in the RB211-535E4 suitable for the narrow-bodied aircraft. The stated intention is that the companies should collaborate on an

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equal basis in the development of any future engines in this size category. RR are not seeking launch aid in support of this project, but it is relevant to the amount of launch aid which might be provided for the V2500.

Flag A

3. In his memorandum E(A)(84)6, the Secretary of State for Trade and Industry seeks agreement to the following:

- a. RR participation in the V2500 project;
- b. authority to offer launch aid to RR in support of the V2500;
- c. approval for RR collaboration with GE on larger civil aeroengines.

RR are keen to secure an early agreement on launch aid for the V2500, so that they can notify PW of the go-ahead of the project, at the same time as they reveal to them the proposed collaboration with GE on larger engines.

Flag B

4. Accordingly Mr Tebbit has already discussed the amount and phasing of launch aid with the Chief Secretary (his minute to you of 31 January). He seeks authority to offer RR a maximum of £96 million (37 per cent of total launch costs), equal to the development costs projected in each of the first 3 years, but with no aid thereafter as follows:

1984	1985	1986
£10 million	£30 million	£56 million

Flag C

The Chief Secretary has suggested that the maximum offered should be £45 million (18 per cent of launch costs) distributed as follows (his minute of 1 February):

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1984	1985	1986
£10 million	£25 million	£10 million

MAIN ISSUES

5. The main issues on the V2500 project are:

- i. should Rolls-Royce be given approval to participate;
- ii. if so, should Rolls-Royce be given launch aid:
- iii. the amount, phasing and conditions of any launch aid.

On collaboration with GE, the issue is:

- iv. should Rolls-Royce be given approval to cooperate with GE on the production and development of larger engines?

Participation in the V2500 project

6. The appraisals of the project undertaken by Rolls-Royce and by Departmental officials are described in sections 1 and 2 of

*Para D* — E(A)(84)7. The main points are:

- a. The project is based on the application of existing technologies to develop a more fuel-efficient engine; there are considered to be no major technical or cost overrun risks;
- b. The V2500 is expected to be the market leader over its only rival - an engine produced by GE and the French company SNECMA;
- c. The potential market is large and secure, being of a replacement nature, rather than dependent on growth in air traffic;

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d. Over a range of assumptions about the two critical factors - sales and the exchange rate - the project shows a rate of return well above the 5 per cent minimum set by the Treasury for public sector projects. On the assumption of 3,000 sales between 1989 and 2008, Rolls-Royce estimate the real return at 9.5 per cent; on the DTI sales forecast of 3,700 (which assumes, inter alia, that the A320 does not go ahead) up to 7125, the rate of return is estimated at between 12.8 per cent and 16.8 per cent. A more favourable exchange rate than the £1 : \$1.62 assumed for these estimates, would raise the return even higher.

There should therefore be no dissent from the proposal to approve RR's participation in the V2500 project.

#### The case for launch aid

7. The Chairman of RR has said that the company will not go ahead with the V2500 without launch aid. RR argue that, because their financial position is likely to be under considerable strain over the next few years, the company would be unable to finance the development expenditure on the V2500 and proceed with other planned projects. Launch aid is the only means open to the Government to assist the company while it remains wholly owned by the Government, under objectives agreed in April last year with the Chairman covering the goal of privatisation and the corporate strategy. The Treasury have therefore agreed that launch aid should in principle be made available. The dispute is over the amount.

#### Amount and phasing of launch aid

8. Mr Tebbit proposes that the Government should offer to meet the full development costs likely to be incurred on the V2500 over the first three years. This is the maximum possible in those years without leaving the Government open to the accusation from

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Rolls-Royce competitors that it is "subsidising" the company. His objective is to provide sufficient launch aid to cover development costs in full while the company's financial position is precarious, and to reduce company borrowing so as to improve the gearing ratio (borrowing/equity) to the 50 per cent level in 1986 he regards as a necessary condition for successful privatisation.

9. The Chief Secretary questions the need to provide for an improved gearing ratio and proposes that launch aid be linked mainly to cash-flow and profits. He too suggests £10 million in 1984 (the maximum but not enough to prevent a negative cash-flow), but only £25 million in 1985 (to produce a positive cash-flow) and a notional £10 million in 1986, when a profit and positive cash-flow are projected.

10. The main difference therefore arises in 1986. The Sub-Committee will need to decide how far the amount of launch aid offered should be determined mainly by reference to cash-flow and profits (as the Chief Secretary proposes) and how far to take into account the need for an improved gearing ratio (as Mr Tebbit proposes), as a prelude to privatisation. You will recall consulting the Attorney General about how far the possibility of privatisation should be taken into account in connection with RR's application for launch aid in support of the RB211-535E4.

Flage | Your summing up in the minutes of E(A)(83)3rd Meeting stated that the amount of launch aid should not be influenced by the Government's ultimate objective of privatisating RR.

11. The Sub-Committee may feel that in the circumstances it may be best not to take too mechanistic a view of the precise amount of launch aid which should be provided. One possible course would be to open discussions with RR on the basis of the figure of £45 million proposed by the Chief Secretary but to be prepared to shade the figure upwards in negotiation - say to

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£60 million which would still be less than 25 per cent of total launch costs.

Repayment terms

12. Mr Tebbit proposes that the Government should aim to recover any launch aid through a levy on engine sales, sufficient to yield a 2 per cent real return over 3,000 engine sales, and a higher return if sales exceed that figure. The Chief Secretary is likely to argue for a return of 5 per cent on 3,000 engines, and more on further sales, in view of the project's high expected rate of return. The Sub-Committee will need to reach a view.

The case for collaboration with General Electric

13. The main benefits to RR from the collaboration with GE are as follows:

- a. RR will maintain a stake in the market for the largest engines (45 per cent of the market) through the share acquired in GE's CF6-80C; its own RB211-525 is increasingly uncompetitive and could not be upgraded without an expensive redesign;
- b. sales of its RB211-535E4 are expected to be higher;
- c. the overall rate of return on the collaboration is high, although in the short term, 1984-86, RR's profitability will be reduced and the cash-flow position worsened.
- d. by collaboration with both major US aeroengine manufacturers, RR will have avoided excessive dependence on either, will be able to share the risks of staying in production of both the larger and medium-sized civil aeroengines, and will have access to the US airline market.

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14. As the proposed collaboration with GE is in line with the general strategy which the Government has encouraged RR to follow, it is unlikely that there will be dissent from the proposal, especially as no launch aid is being sought. The detailed implications may however need to be examined in due course in the context of RR's Corporate Plan.

#### HANDLING

15. You may like to suggest that the Sub-Committee consider the V2500 first and then the collaboration with GE. You will wish to ask the Secretary of State for Trade and Industry to introduce his proposals. The Chief Secretary, Treasury will then wish to put forward his suggestions on the amount and conditions of launch aid for the V2500. On both proposals, the Foreign and Commonwealth Secretary may like to comment on the wider political aspects.

#### CONCLUSIONS

16. You will wish the Sub-Committee to reach conclusions on the following:

- i. whether RR should participate in the V2500 project;
- ii. whether launch aid should be given; and, if so:
- iii. what upper limit should be placed on the amount and phasing of launch aid in the negotiations with RR;
- iv. what conditions should be set for repayment of any launch aid;
- v. whether the proposed collaboration with GE should be approved.

P L GREGSON

1 February 1984

CONFIDENTIAL



JH 770

PERSONAL AND CONFIDENTIAL

cc BT  
Top Copy on  
Aerospace 3182  
A320.

PRIME MINISTER

DISCUSSION IN E(A)

May I ask for your help in the handling of the discussion on the two aerospace projects in E(A) tomorrow.

2 My first concern is that the discussion on the A320 should not squeeze out a decision on the V2500. The decision on Rolls-Royce co-operation with GE is urgent, and the prospects for what all agree will be beneficial to Rolls Royce will be jeopardised if the news of their prospective venture leaks. So much paper has now circulated that this must be a real risk, and I therefore believe it essential that we should do all possible to resolve this question tomorrow.

3 My other concern is also on confidentiality. If there is an agreement to support the A320 within a figure which will require subsequent negotiations with BAe, it is essential, if our negotiating position in relation to BAe is to be preserved, that there should be no leak that "the Government has agreed in principle to support the A320". I think this would be very damaging indeed.



4 I shall be making both these points in the discussion,  
but I should be very grateful for your support in  
underlining them.

NT

N T

1 February 1984

Department of Trade and Industry

Top copy on: Aerospace  
March 1982: A320

W.098

1 February 1984

MR ANDREW TURNBULL

E(A) MEETING ON A320 AND V 2500, 2 February

- Attached is my brief for the Prime Minister on the technological aspects of the A320 and V2500 decisions. As you know, I have attended some of the previous Ministerial discussions on these subjects and I am of course willing to attend tomorrow's E(A) if the Prime Minister wishes me to. I have spoken about this with Peter Gregson who suggested that you might ask the Prime Minister whether she wishes me to attend, at the same time as you send my brief to her. It's hard to predict how strongly technological aspects will feature in the discussion but the Prime Minister did make clear after the British Aerospace and Rolls Royce presentations that she felt that technology was a major component of the decision.

As I say in my brief, Bob Young and I have visited a number of BAe and RR facilities over the last few weeks to inform ourselves on the technology, but I understand that Bob will not be present at tomorrow's meeting. This may increase the need for me to be there.

Perhaps you could let me know first thing tomorrow morning whether or not the Prime Minister wishes me to attend.

MBN

ROBIN B NICHOLSON

PRIME MINISTER

ROLLS ROYCE: LAUNCH AID FOR THE V2500

I accept that the prospects for the V2500 are good and that it merits some launch aid. I differ from Norman Tebbit only on the amount.

2. Norman proposes 100% funding for the project in the first three years; I think that would be excessive particularly in the last year.

(£m cash)

	<u>1984</u>	<u>1985</u>	<u>1986</u>
Norman's proposals	10	30	56
My proposals	10	25	10

3. I attach tables showing the implications for Rolls Royce's finances of the two proposals. As you will see, the Company is expecting substantial profits and a healthy positive cash flow in 1986 without any launch aid. My proposal would improve these figures further and would produce a very marked improvement in the gearing ratio to 70% in 1986 with the prospect of paying off all loans by 1988.

4. Norman argues that the gearing ratio needs to be reduced to 50% in 1986 in order to improve prospects for privatisation. I doubt whether gearing ratios of 70% in 1986 and 27% in 1987 would be considered excessive by the market. But, in any case, I do not think we should tailor the launch aid for this project in order to prepare the balance sheet for disposal. The need for any capital reconstruction is much better considered at the time of privatisation when a decision can be made in the light of market circumstances at the time and the Company's actual results. You may recall that you took a similar view when we discussed launch aid for the Rolls Royce RB211-535 Engine at E(A) on 27 July last year.

5. I have not yet had an opportunity to discuss with Norman the repayment terms for any launch aid we may agree but, in view of the healthy prospects for the project, I propose a 5% return. We will need to pursue also the scope for finding offsetting savings within his public expenditure programme.

6. Copies of this go to members of E(A), Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

PETER REES

TABLE 1 (No Launch Aid)

	<u>£M (Outturn Prices)</u>				
	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
1. V2500 Expenditure	10	30	56	58	52
2. Profit (Loss) after tax	(4)	1	100	220	270
3. Cashflow	(15)	(17)	49	130	170
4. Net shareholders funds	296	297	397	617	897
5. Net borrowings	385	402	353	223	53
6. Gearing (ie 5/4)	130%	135%	89%	36%	6%

TABLE 2 (Chief Secretary's proposals)

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
1. V2500 Expenditure	10	30	56	58	52
2. Launch Aid	10	25	10	0	0
3. Profit (Loss) after tax	(4)	26	110	220	270
4. Cashflow	(5)	8	59	130	170
5. Net shareholders funds	306	332	442	662	932
6. Net borrowings	375	367	308	178	8
7. Gearing (ie 6/5)	123%	110%	70%	27%	1%

TABLE 3 (Secretary of State's proposals)

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
1. V2500 Expenditure	10	30	56	58	52
2. Launch Aid	10	30	56	0	0
3. Profit (Loss) after tax	(4)	31	160	220	270
4. Cashflow	(5)	14	109	130	170
5. Net shareholders funds	306	338	498	718	998
6. Net borrowings	375	361	252	122	(48)
7. Gearing	122%	107%	51%	17%	-

34:66  
 24:66  
 25:66



JH 762

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cc NO

PRIME MINISTER

ROLLS-ROYCE

I circulated on 25 January a memorandum recommending our support for Rolls-Royce's involvement in two major collaborative deals - the V2500 project with Pratt and Whitney, and a deal on larger engines with GE (E(A)(84)6). I said that I was seeking a meeting with the Chief Secretary so that I could report in advance of E(A) on the level of launch aid which it would be appropriate to make available for the V2500.

2 This Government last year gave the new Chairman of Rolls Royce, Sir William Duncan, the overriding objective of privatisation firmly linked to profitability which we said looked unlikely to be achieved unless the company collaborated with the other leading engine manufacturers. It is greatly to the credit of Sir William Duncan that he has brought very difficult and sensitive negotiations with Pratt and Whitney and, separately, GE to the point where if we can give prompt support he can deliver a civil engine strategy far superior to anything we might have thought possible even a year or so ago.

3 Rolls-Royce are not asking for any financial support in order to conclude the deal with GE although it will involve a net cash outflow of £74m (in 1983 prices) over the next five years. In





the case of the V2500 they originally requested 50% launch aid (£113m in 1983 prices, or £137m in outturn prices). But since there is a prospect of a fairly strong performance by the company beyond 1986 (if everything goes according to plan) I have put it to the Chief Secretary that in pursuing its overall corporate objectives Rolls-Royce should be able to live with launch aid of no more than £96m in outturn prices concentrated in 1984-86 (37% of total project costs).

4 The Chief Secretary's offer today of £45m would represent no more than 18% of the company's total launch costs. As such I cannot put it to Sir William Duncan as a realistic offer, since it reflects, as I understand it, the Chief Secretary's view that all we should be doing for Rolls-Royce is providing such cash as should avoid the company going into a negative cash flow.

5 I believe that the proper approach to the handling of Rolls-Royce's application is to recognise that we have given objectives to Sir William Duncan which have led him to produce an overall corporate strategy, for which in the short term the full cash resources cannot be generated internally. In short, the Chairman is continuing to do all he can to reduce unnecessary expenditure (by a further reduction in manpower and by R&D cuts) while endeavouring to set in place two major collaborative deals which represent an excellent investment for the future despite the short term cash outflow they involve. As a legitimate part



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of the allocation of the company's cash resources to major corporate objectives he also has a requirement to reduce the excessive borrowings (and hence the high interest charges) of the company. Without the availability of the full amount of launch aid I have sought for the V2500 in 1986 (in addition to the two earlier years) he will not be in a position to release internally generated resources to reduce borrowings to the extent he considers appropriate in order to establish the company on a sound financial base by the end of 1986.

6 The attached table shows the effect of providing or not providing the £96m in launch aid I have concluded is required by Rolls-Royce.

7 I believe the Chief Secretary's principal argument against our investment in the V2500 at the level I have suggested (£96m during 1984-6, representing 37% of project costs) is that the company can afford to fall short of its gearing objective, even if the privatisation timetable we have in mind involves issuing a prospectus by mid-1987 (largely based on the 1986 results) with a view to privatisation later that year or in the Spring of 1988. But in my opinion getting gearing down to around 50% will be essential by end-1986. Since the V2500 is an excellent project, the prospects of a good return on our investment are such that it would be quite wrong to argue that by providing cash towards the development costs of this project we would be merely sinking more cash in the company to get its balance sheet right.



8 In the circumstance, the recommendation I would ask E(A) to endorse is that Rolls-Royce should be given the full £96m for the V2500's development during 1984-86. If colleagues were to agree to this recommendation I would make it clear to Sir William Duncan that, in endorsing the V2500 and the GE deal, the Government could not be expected to provide launch aid support beyond this sum for any engine projects currently proposed.

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31 January 1984

Department of Trade and Industry

	£m (outturn prices)			
	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Turnover	1340	1400	1650	1900
V2500 Gross expenditure	-	10	30	56
<u>Without launch aid</u>				
Profit(Loss) after tax	(195)	(4)	1	100
Cash flow	-	(15)	(17)	49
Net shareholders funds	300	296	297	397
Borrowings (net)	370	385	402	353
Gearing	123%	130%	135%	89%
<u>With 100% launch aid (£96m)</u>				
Profit(Loss) after tax	(195)	6	32	160
Cash flow	-	(5)	14	109
Net shareholders funds	300	306	338	498
Borrowings (net)	370	375	361	252
Gearing	123%	123%	107%	51%



