



Mr. Alison

10 DOWNING STREET

*From the Private Secretary*

31 January 1984

*Dear Callum,*

A320 Airbus

Sir Austin Pearce called on the Prime Minister to set out the background to BAe's application for launch aid. Also present were your Secretary of State and Mr. Alison.

Sir Austin said he had asked for the opportunity to talk to the Prime Minister because his earlier presentation had been rather rushed and he was anxious that Ministers should understand fully his company's thinking. He was disturbed because it appeared that some Ministers might be under the impression that the company had asked for 100 per cent funding of the total project. It was true that the £440m. of launch aid covered the cost of design, jigs, tools and education. The company would, however, be covering the cost of additional work in progress which amounted to about one-third of the total cost of the project. He contrasted the two-thirds which BAe was therefore seeking with the 90 per cent of the total project cost which the German partners in the Consortium were likely to get from their Government.

He explained why launch aid was required. Over the past four years work in progress had increased from £500m to £1.35b. and the company was now reaching the limits of its ability to finance new projects. Profits could make only a limited contribution, partly on account of high redundancy costs, £40m in the current year. He did not think the company was in a position to increase its borrowing.

/His Board



His Board had considered making a rights issue but had concluded against this for a number of reasons. First, the share price was already low. Secondly, it was thought that a rights issue would reduce the price of the shares by around 20 per cent. Not only would this knock £40m off the value of the Treasury's holdings but it would have a severe impact on the 50,000 employees holding shares in the company. Finally, the dividend covered on an expanded equity would be very low between 1986 and 1988. The need for Government funding was particularly acute in the early years.

Sir Austin said that discussions were taking place on how launch aid might be structured in order to reduce the call on Government. It might be possible to work with a lower figure if it were phased more towards the early years. He was also prepared to consider repayments related not simply to sales of the A320 but to the company's results more generally.

If the Government offered substantially less than 100 per cent launch aid he would have to discuss the position with his Board. There would be two alternatives; a decision not to proceed or a decision to go ahead in the knowledge that the company might run into trouble in later years and have to return to Government. In his view the second approach was unacceptable.

The Prime Minister commented that even with substantial sales the rate of return would be low. Sir Austin accepted this though he believed the assumptions of market penetration in the US, 12 per cent, and outside the US, 30 per cent, were not unrealistic. The Secretary of State for Trade and Industry said he was reasonably confident about the projected size of the market, most of which was based on replacement demand. It was significant that McDonnell Douglas were considering abandoning further developments of their own aircraft and were considering becoming associated with the Airbus Consortium. There would be advantages in this as it might help open the US market. Sir Austin said he was concerned about financial control within Airbus Industrie. With a 20 per cent share, BAe had an effective veto but found it difficult to initiate proposals. All too often he found that the Germans failed to support ideas for improving financial control. The Prime Minister suggested that this was a matter which could be taken up with Chancellor Kohl.

*Yours sincerely*  
*Andrew Turnbull*

Andrew Turnbull

Callum McCarthy Esq  
Department of Trade and Industry.



PRIME MINISTER

cc Mr Redwood  
Mr Alison

Visit of Sir Austin Pearce

This should be mainly a listening meeting - giving Sir Austin Pearce a second chance to present his case. You should make clear that the Government has not yet decided on whether to support the A320 and, if it does, what level of support to offer.

Details negotiations are going on between DTI (advised by Morgan Grenfell) and BAe (advised by Kleinworts) on a financial package. It would be better not to enter on detailed negotiations but to keep the discussion on more general lines.

Having heard Sir Austin's case, you could quiz him on the following:-

- i) Why should the Government support an approach which, even on optimistic assumptions, earns less than the 5 per cent rate of return the Government seeks elsewhere in the public sector?
- ii) Why should the Government provide 100 per cent launch aid? Should the shareholders of BAe be putting up some equity for a project of this kind? What are the objections to this?

You have already seen the Policy Unit brief for this week's meeting of EA. You will also be interested to see the views of Lord Cockfield - see attached minute.

30 January 1984



From : NEVILLE TROTTER, F.C.A., J.P., M.P.



HOUSE OF COMMONS  
LONDON SW1A 0AA

MR ALISON

TRANSPORT

13th January 1984

The Rt Hon Margaret Thatcher, MP  
Prime Minister  
10 Downing Street  
London

My Dear Margaret,

May I write to add my support for British Aerospace's request for assistance in connection with the A320 aircraft. You will of course know of my long standing interest in aviation and while the matter is certainly not open and shut, it is my considered judgement that we ought to support the project. I think we should be cautious in assessing the likely sales. Having had much contact with Boeing over the last ten years I must say that they are a quite formidable company and I would expect them to be able to produce a similar plane very speedily and in large numbers at extremely competitive prices. Having said this I do not believe that it is in general good that Boeing should be in a monopoly position which they are now close to achieving and I think that the A320 should have considerable success.

If we do not support the project then the British Aerospace industry will suffer a very serious setback of a permanent nature which I do not think we should accept at this time.

Yours ever

Neville

We did so much appreciate your finding time to attend our reception. I had hoped that Susan our photographer had been able to record your conversation at ground level with Alice our little bridesmaid but the crowd of people sadly prevented her doing so.