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PRIME MINISTER

WESTLAND

This minute sets out the situation facing Westland and discusses how the Government might respond to it. The company will almost certainly go into receivership if a solution cannot be found before the end of November, although I believe the Government will need to indicate its position before that date. More immediately, the situation may affect what you can say to Mr Gandhi when he comes on 14 October about the prospective Indian order for W30-160 helicopters.

BACKGROUND

2 Following the Price Waterhouse review of the company's position, Sir John Cuckney put to my Department and to the Ministry of Defence proposals for a financial reconstruction which he believed was an essential first step in a strategy for the company's future viability. The main features of this package were:

- (i) New capital to be raised ^{from} ~~for~~ existing shareholders and a new large minority shareholder, possibly Sikorsky or a European company, with whom Westland are in discussion.
- (ii) Westland's banks to convert a substantial portion of overdraft into equity.
- (iii) The Government to underwrite 45 sales of the W30-160 helicopter in order to avoid a crippling write-off of inventory against shareholders' funds for the financial year ending 30 September 1985.



3 Officials have reviewed these proposals and the underlying financial position with Westland's staff and advisers. They have concluded:

- a) The proposed package would indeed provide a reasonable prospect of securing the company's viability in the medium term.
- b) At the other extreme, if no action is taken, receivership is likely to be unavoidable.
- c) It might be possible to construct an adequate package on the same basis as that proposed by the company, but involving a smaller number of W30-160 sales - perhaps only the 21 aircraft for the Indian Oil and Natural Gas Corporation (ONGC). This could only be substantiated, however, by discussion with the company's bankers. Annex A gives a summary of the company's financial position and the impact of a reconstruction package.

4 I do not believe that an underwriting of sales on the scale proposed by Westland would be justified. However I believe there may be a case, for the reasons set out below, for underwriting the sale of 21 helicopters if there remain good prospects of concluding the Indian order. If we decided to adopt this approach, I would envisage asking Westland to negotiate with their banks and potential partners on the assumption of firm sales of 21 W30-160s. I would say that if a reconstruction package could be put together on that basis, and if by the end of November discussions with the Indians were still in the Government's judgement active though unconcluded, the Government would be prepared to consider underwriting the sale of the 21 aircraft. However a final decision would only be made at the time in the light of an up-to-date assessment of the prospects of obtaining the ONGC order.



5 I believe Government participation in a reconstruction package should be conditional on the following assurances from Westland:

- that they would continue to participate in the EH101 programme.
- that the W30-300 programme would continue at least until the MOD's procurement timetable becomes clear in 1986.
- that they would continue to provide spares and support for the existing MOD helicopter fleet.
- that in the event of Government underwriting the company would continue to use its best endeavours to sell the aircraft.

POSSIBLE BENEFITS OF GOVERNMENT UNDERWRITING

6 I would not argue that supporting Westland should be a priority use of resources from a purely industrial point of view. Although Westland is the only UK helicopter manufacturer it is not central to the aerospace industry. Moreover, while other UK companies (notably Rolls Royce) have important business with Westland, my Department is not aware of any which is financially dependent on Westland's continued existence.

7 Nor is there a strong argument that the proposed package will improve the chances of my Department's launch aid being recovered. It would not of itself guarantee continuation of the W30-300 programme (on which £38m of the agreed £41m launch aid has been paid). That would still critically depend, I believe, on an MOD launch order. If the programme were terminated, even after a capital reconstruction, it seems unlikely that much of



the launch aid could be recovered without serious financial damage to the company. The package should secure the continuation of the EH101 programme, but only £5m of the agreed £60m launch aid for this project has so far been paid.

8 I believe the remaining arguments are:

- i) Military: that it is essential to secure support for the existing helicopter fleet and desirable to preserve an indigenous source of design, development and supply. It is of course for Michael Heseltine to advise on the strength of this argument.
- ii) International: that it will be damaging to the UK's relations with India if, after the diplomatic efforts of the last year, Westland cannot now conclude the contract for the ONGC.
- iii) Political: that if the Government does not help it will be blamed for allowing the company to go into receivership.



FOREIGN OWNERSHIP

9 At present the company most likely to be willing to take a large minority shareholding appears to be Sikorsky. No solution involving a British company is on the cards. Westland are in contact with MBB, Aerospatial and Agusta and I believe they should be encouraged to pursue the possibility of a European solution. The prospects of a European solution being developed within the timescale do not seem to be good, but I should like to get a better assessment of those prospects before responding formally to Westland's proposals. However, if it emerged that a solution involving Sikorsky was the only realistic option I do not believe we should reject the package solely on that ground, provided we obtained the assurances from the company outlined in paragraph 5 above.

FINANCE

10 It is an important feature of the approach I have outlined that the Government would only agree to underwrite W30-160 sales if it assessed the prospects of concluding the Indian order as good - in other words, if the risk of the Government incurring expenditure as a result of the underwriting was acceptable. Nonetheless, I have reluctantly concluded that I could not use any of my Department's agreed PES allocation to meet any expenditure that might result : the industrial argument for giving Westland further assistance do not justify the use of my Department's very scarce and indeed decreasing financial resources.

RECEIVERSHIP

11 If the Government decided not to participate in a package of the sort I have discussed, the company would probably go into receivership. It is by no means certain that such an outcome would be damaging to essential national interests, or more costly to the Government than participation in a reconstruction package.



The difficulty is that receivership would create an uncontrolled situation whose outcome was unpredictable.

12 Much would depend on whether a purchaser could be found for key parts of the business - continuing Lynx and Sea King production, the EH101 programme and the provision of spares and support. If so, the Government's essential procurement interests would be safeguarded. Such an outcome appears possible in view of the interest British Aerospace have expressed in acquiring certain parts of the business in the event of receivership.

13 However there would be potential costs to the Government. The Receiver might demand Government funding of his operations in order to keep the helicopter business going while a purchaser was sought. There would be indirect costs, for example, associated with ECGD exposure and redundancies. (The company is planning up to 2,700 redundancies, with possible closure of its factories at Weston and Cowes, even after a reconstruction package. The number of jobs lost would be much greater in the event of receivership). And if no purchaser could be found, receivership might result in the UK's participation in the EH101 and production of Lynx and Sea King being ended and the provision of spares and support for the current MOD helicopter fleet being jeopardised.

14 I believe it is a fairly fine judgement whether the risks involved in receivership are worth taking. On balance, I believe it would be preferable to agree to participate in a reconstruction package if the conditions I have outlined were met.



MR GANDHI'S VISIT

15 The situation clearly poses difficulties for the discussion of the ONGC order you will wish to have with Mr Gandhi during his visit. On the one hand, we must continue to do everything possible to obtain the contract. On the other hand, you are likely to be constrained in what you can say to Mr Gandhi about the future of the company, and this may make him reluctant to commit himself to the order.

16 Ideally a reconstruction package would be in place before the visit, enabling you to give firm assurances about the future of the company and to press for conclusion of the contract. However I think this is most unlikely to be achieved even if we gave Westland a clear indication of the Government's position early next week; and it could clearly only be achieved with Sikorsky as the minority partner. As I have said, I think it would be preferable to delay giving a definitive response to Westland until their discussions with possible European partners have progressed further.

17 You will therefore need careful briefing for a variety of difficult situations, which I suggest officials should put in hand. You will need to say that Westland is under new management who are considering plans for strengthening the company financially. If Mr Gandhi says he intends to purchase, you could say that the Government hopes the company's plans will be successfully implemented, and that the order will be a significant help to the company. If Mr Gandhi should press for an assurance on viability you might say that it was not for the Government to comment but note that the company has a solid base of MOD business and that we are confident in the ability of the new Chairman.



18 I believe it should be possible to deal satisfactorily with the talks on these lines. There must be a risk, however, that a non-committal response on viability will cause the prospects for the order to recede, or even disappear.

CONCLUSION

19 I recommend that our initial response to Westland should be to urge them to pursue discussions with possible European partners urgently. We should decide in the light of those discussions whether to indicate to Westland, on the lines set out in paragraphs 4 and 5 of this minute, the Government's possible willingness to participate in a reconstruction package. It will, in any event, be desirable to indicate our position to the company reasonably promptly - and certainly well in advance of the November deadline - both so that the company knows where it stands and to ensure that no question arises of a breach of Companies Act obligations.

20 You may wish to call an early meeting to discuss the situation generally, and in particular the handling of Westland during Mr Gandhi's visit.

21 I am copying this minute to the Foreign Secretary, the Chancellor of the Exchequer, the Secretary of State for Defence, the Chancellor of the Duchy of Lancaster, the Secretary of State for Employment, the Minister for Overseas Development and to Sir Robert Armstrong.

L. B.

L B

4 October 1985



Summary of Westland's financial position

In the absence of firm orders for W30-160 helicopters, Westland will need to make provisions of over £90m for inventory and commitments on the W30 and total provisions of over £110m. The impact of such provisions on the balance sheet would be as follows:

		£m
Net operating assets		123.1
Tax		(5.2)
Net borrowings		(90.6)
Minority Interest		(13.9)
Shareholders' funds	a	<u>13.4</u>
Net borrowings after deducting cash	b	<u>90.0</u>
Gearing b ÷ a		672%

2 Clearly such a gearing ratio would be insupportable. In such circumstances receivership would be precipitated by the banks refusing to provide higher facilities or by the gearing restrictions of the company's debenture stocks being breached. In practice the directors might ask the debenture holders to appoint a receiver before such a breach occurred.

Possible reconstruction package

3 A satisfactory gearing position might be achieved by the following package:

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	Addition to shareholders' funds	£m
Sale of 21 W30-160s resulting in reduced provisions	20.8	
Conversion of bank overdraft into equity	22.5	
1 for 4 rights issue	8.6	
29.9% minority shareholder	26.9	
	<u>78.8</u>	
giving the following gearing ratio:		
Shareholders' funds	a 92.2	
Net borrowings after deducting cash	b <u>32.0</u>	
Gearing $b \div a$		34.7%