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Minister of State

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John Moore Esq MP
Financial Secretary to the Treasury
Treasury Chambers
Parliament Street
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8 January 1986

Dear John,

NBPM.

SHORT BROS PLC

I wish to inform you and other colleagues of the current position at Short Bros, the Belfast-based aerospace company.

In July we set an EFL of £16m and a net profit target of £4.4m Following on the company's achievement of break-even (£0.5m profit) in 1984-85 after a decade of losses, we had hoped for sustained profits in this and future years. I am therefore disappointed to learn that the company is now forecasting a net loss of some £12m for 1985/86, although its EFL does not seem to be under immediate threat.

When this became apparent we immediately invited the management consultants who advise my Department on Shorts to investigate. A synopsis of their report is at Annex A. The two largest single causes of deterioration are failure to achieve assumed cost-savings through productivity and below-forecast margins on missiles because of depressed export sales - margins on sales to MOD are usually lower. In one major case sales prospects have receded because of our reluctance to grant an export licence. The company remains confident that other high-margin export sales assumed for this year are still available but will now materialise in later years. We shall clearly have to examine this carefully in the forthcoming corporate plan. Failure to reduce costs is more worrying, but the company has instituted some corrective measures aimed at reducing these losses. Not least the Director of Operations, one of the company's more senior managers, is to be dismissed. Nonetheless some sales prospects remain uncertain and Touche Ross believe that the revised forecast of £12m could yet prove optimistic.

I have written to Sir Philip Foreman to make clear how disturbing these developments are. I have also asked for the new corporate plan, which I understand is to go before the Board shortly, to include a clear and realistic plan for early recovery on a basis which will enable officials to monitor progress at key points. I have told Sir Philip moreover that we will not consider a project recently put to us for development of a utility version of the SD36o until we see how it would contribute to the company's recovery. Although the project is not without merit, it would clearly be wrong to support it at this stage.

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John Moore Esq MP
Financial Secretary to the Treasury

With regard to privatisation, colleagues decided in July that we should seek a further report from Samuel Montagu in the autumn. In subsequent discussions between your and my officials and the bank, however, it became clear that there would be much merit in arranging for the Bank's report to follow the company's new corporate plan, so that we could consider both in parallel. Our officials have therefore concluded that the Montagu report should be completed in February and I hope colleagues will be agreeable to this.

Perhaps I could take the opportunity of this letter to make a point about public references to Shorts' possible privatisation. Douglas Hurd's memorandum last July drew attention to the sensitivity of this point. There has been a number of inaccurate references in the press to our intentions which have suggested that our plans are a good deal more advanced than they are. This has served to arouse intense local political and industrial sensitivities and opposition and I fear that our task in eventually proceeding to a disposal, should we so decide, is made the harder thereby. I should therefore be grateful if colleagues making references to Shorts in the privatisation context in advance of our further collective discussion could adhere strictly to the line that, while the company is in principle a candidate for privatisation, no firm decisions have been taken about the means or timing. This line is consistent with that taken in the 1985 Public Expenditure White Paper.

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

all good wishes
Yours ever
RB

DR RHODES BOYSON MP

ANNEX A

SHORTS: 1985/86 END-YEAR FORECAST

1. Company Forecast

The company was set a profit target of £4.4m for the 1985/86 year. Following a comprehensive review of its aircraft production schedules and of the missile division the company's latest forecast shows an end-year net loss of £11.8m - an adverse variance of £16.2m in the year. Touche Ross have analysed the company's forecast and confirmed that the year-end loss will at best be £11.8m but could be worse.

2. Reasons for the Downturn

Touche Ross have indicated that the main reasons for the downturn in prospects are as follows:-

£m

(i) Failure to reduce costs

The company has now been achieving the cost reductions needed to meet projected learning curves (£4.4m). This has had a knock-on effect on production capacity and fixed overhead recovery etc (£2.9m). (7.3)

(ii) SD330 programme reduction

The company has been experiencing difficulty in selling SD330 aircraft and has decided not to commence production of more SD330s for the time being. This will improve cash-flow in 1985/86 as work-in-progress is reduced but will have an adverse effect on profitability. (3.1)

(iii) Missile margins

Missile margins are forecast to be some £7.0m below plan because of a change in sales mix, from exports to MOD, and also because export sales did not achieve planned levels of margin. The company believes that several high-margin prospects previously assumed for 1985-86 are still available for future years. (7.0)

	£m
(iv) Unrecovered overheads	
The gross cost of overheads has grown because of increased product liability insurances (£1.4m), plus the effects of inflation and increases in certain indirect labour costs.	(3.0)
(v) Interest charges	
Due to interest rates above those anticipated and a weaker cashflow profile, the interest charges for the year are likely to exceed plan by £3.4m.	(3.4)

3. Offsetting Improvements

A number of factors have helped to reduce the overall impact of the downturn in prospects:-

(i) Margin improvements	
The carry forward of 4 x SD360s into 1985/86, increased sales of spare parts and a revision of accounting treatment for 757 flap income have collectively generated improved margins totalling £4.5m.	4.5
(ii) Other changes	
Reduction in R&D expenditure, unspecified improvements in aerostructure and missile margins, plus a net saving in development costs generate a total saving of £3.1m.	3.1
NET ADVERSE VARIANCE =	(16.2)

4. Cash Flow Implications

Current forecasts show that at 31 March 1986 the company will be within the £16m EFL set by Ministers. This will be achieved primarily by the slow down of the SD330 line which is anticipated to reduce work-in-progress by about £10m by the year end.

5. Remedial Action

The company's recovery plan includes the following:-

- embargo on all non-essential overtime;

- an initial ban on all recruitment, except in areas of acute skill shortage;

- probable short-time working in some areas;

- the possibility of redundancies in some areas;

- general overhead reduction.

The effect of these actions has yet to be analysed in detail but the objective of a 10% reduction in overheads has been set by senior management.

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