

PRIME MINISTER

Policy Unit

25 May 1984

British Aerospace

Robin suggested that I send you some thoughts on the Thorn EMI prospective bid for British Aerospace and on the possible interest of GEC in acquiring the company.

The Government's concerns are:

- (1) As a shareholder in British Aerospace.
- (2) As a buyer of military equipment keen to see competition in the supplying industries.
- (3) A general interest in the well being of major British companies.

The first two interests should be the predominant ones in coming to any decision. The interests of either the Thorn EMI or the GEC shareholders are not concerns of Government.

Thorn EMI

Thorn EMI has had a troubled history from late 1979 when under the direction of its new Chairman, Sir Richard Cave it decided to take over EMI. Prior to that date Thorn had been a marvellous example of a successful consumer electrical business built up by a dynamic first generation entrepreneur. Cave's bid for EMI led to a sharp decline in the share price and ushered in a 5-year period of lower profits per share. However, the Thorn management did eventually succeed in making sense of what was a bad bid. In mid 1980 they sold the unsuccessful scanner and hotels businesses and by 1982 were beginning to control the wayward

EMI music business which had been in prolonged difficulties after the break up of The Beatles. By 1984 Thorn was emerging as a much better group with cash flow building up again and with the defence electronics business a particular strength.

Richard Cave has now moved on and Thorn is run by Peter Laister. He was Cave's Managing Director and was obviously sympathetic to the EMI acquisition strategy. His decision to bid for British Aerospace is therefore part of the modern Thorn style and should not have unduly surprised shareholders. It has led to a sharp decline in the Thorn share price as any such major acquisition would, particularly in the light of the early difficulties with EMI. However, even if Thorn were to fail in their bid for British Aerospace the troubles for their shareholders would not now go away as they would be waiting nervously to see what else Thorn might decide to buy.

From the Thorn shareholders point of view, if the company has to make an acquisition British Aerospace is one of the best it could choose. Putting the two together produces a combination with a better balance sheet than Thorn currently has whilst offering scope for mutual development of defence hardware. British Aerospace does need a sugar daddy, particularly in the light of its decision to go ahead with a wide-ranging defence programme at the same time as taking on the A320 airbus.

The combined grouping of Thorn/British Aerospace based on 82/83 figures would have sales of £4.8 billion and profits of £200 million. This would bring it up to the same size in terms of sales as GEC but far short of GEC's impressive profit total of £670 million. In part the difference reflects the different mix of business. In the main it demonstrates how inadequate the returns are on both the Thorn and British Aerospace businesses. It will be the

task of the combined management to improve these returns. The Thorn management, particularly the Finance Director, should strengthen controls over British Aerospace. Thorn EMI's defence business is quite small, with only a quarter of the Group's total turnover outside the consumer area.

GEC

Judging by the amount of cash available both to make the acquisition and to fund British Aerospace's future requirements GEC is by far and away the stronger suitor. Judging by proven ability to manage assets and men well again GEC is ahead. GEC are becoming a little desperate to invest their enormous cash mountain. Whereas it looked clever in the mid 1970s to sit on an ever-growing cash heap as returns on cash were superior to returns on manufacturing, by the mid 1980s the position looks markedly different. GEC are now being pressurised by some of their better shareholders and by the press to do something about their idle assets.

However, GEC is much more likely to attract opposition from other defence suppliers. The Marconi business is already the dominant part of GEC's enormous structure and competitors will feel that the combination of Marconi and British Aerospace in areas like missiles and other electronic defence systems would be too strong for the UK defence market. The Government would be under pressure to refer the bid to the MMC.

Conclusion

The Government's interest as shareholder is to sell its holding. On its own British Aerospace is a bad investment. The Government cannot influence the bidding and should not try to. In one sense it is in the Government's interest to encourage or to promote an auction to develop to achieve a

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higher price.

The only difficulty is whether an MMC reference for GEC will be needed. It would be prudent for DTI/MOD - as I hope they are doing - to come to an early view on whether the case about GEC UK market dominance in some defence sectors is or is not a serious one. With Whitehall away today I do not have enough numerical information on GEC to determine this question but MOD are likely to object to a GEC purchase and they have a good case. I think either suitor makes more sense than leaving British Aerospace alone and that on all grounds, save competition grounds, GEC is the better industrial partner. The Government is lucky to be offered this way out of its residual shareholding.



John Redwood

MOD Projects in Common

British Aerospace	Thorn	GEC
ACA		X
ALARM	X	X
ASRAAM		X
Harrier I		X
Harrier II	X	X
Sea Harrier		X
Hawk		X
Jaguar		X
Lynx		X
Nimrod	X	X
Rapier		X
Tracked Rapier		
Sea Dart	X	X
Sea Eagle		X
Sea Wolf		X
Sea King	X	
Sidewinder		
Spearfish		X
Stingray		X
Striker		
Tornado		X



10 DOWNING STREET

Prime Minister

As Ministers will ultimately need to decide whether to refer a GEC bid to the MMC and whether to accept the latter's recommendations, you will want to be cautious in talking to Lord Weinstock about BAc.

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25/3

Note from John Redwood attached below

FEBB

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