

The Caledonian Aviation Group

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Prime Minister

*Sir Adam has responded to
your criticisms of the B Cal
balance sheet. Bob Young has
discussed this with him - see attached note.*

From the Chairman's office

1st August, 1984

The Rt. Hon. Margaret Thatcher, M.P., *ATi/8*
Prime Minister,
10, Downing Street,
London, SW1

Dear Prime Minister,

Following our discussion earlier today I am writing to address some of the concerns you expressed regarding our Group's financial condition.

Firstly, I would mention that our record for the past eight years has shown Group profits on seven occasions and only one year of loss. Of those profits the Airline produced just over two-thirds. This has been an extremely creditable performance through a period when the world airline industry generally has experienced very poor results, of which British Airways is a prime example. Not only has British Caledonian, in common with other airlines, been affected by the world recession but in recent years has suffered deterioration of its profits as a result of factors outside the Airline's control including losses which were largely peculiar to its licensed area of operations. Such factors have included the grounding of DC 10 aircraft by the F.A.A. of the United States, exceptional devaluations of foreign currency balances and the Falklands War which alone cost us £9 million.

In the interests of creating future stability we applied for and commenced operation of several new routings, including Hong Kong, Houston, Dallas, Atlanta, Los Angeles and others, which incurred substantial development costs - without these costs our profitability would have been much greater.

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DIRECTORS: Sir Adam Thomson, C.B.E., LL.D., F.R.Ae.S., F.C.I.T. (Chairman and Chief Executive),
Sir Peter Masfield, M.A., C.Eng., F.R.Ae.S., F.C.I.T., Hon.F.A.I.A.A. (Deputy Chairman), T. E. Boud, F.C.A. (Group Finance Director), L. N. Bechick (U.S.A.),
D. A. Beety, R. M. Gibson, V.R.D., M.A., F.C.I.L., J. McWilliam, A. T. Pugh, F.R.Ae.S., Sir Iain M. Stewart, LL.D., B.Sc., L. V. D. Tindale, C.B.E., C.A.,
M. Vidockler, C.T.C. (U.S.A.), D. H. Walter, M.S.L.A.E.T., S. Young, F.C.A.

For the current financial year we are confidently forecasting a profit of £14-15 million, even after the adverse effects of political events concerning both Libya and Nigeria. Absent the privatisation of British Airways, which would have a serious adverse impact on our forward predictions, we are forecasting considerably improving results for the years ahead which would stem mainly from the maturing of our current route network.

You referred to the Group's level of gearing which stood at a ratio of debt to equity of 2.9 : 1 in our latest annual report. With the acquisition of new Airbus A310 aircraft that ratio will increase to over 3.0 : 1 by the end of our current financial year. This ratio is comfortably within the constraints imposed by the Group's lenders, who comprise major international banks and the Export-Import Bank of the U.S.A. Indeed, the Group has never been in default of such financial covenants and enjoys considerable respect within financial communities, with the consequence that the funding of capital acquisitions and working capital requirements has been obtained without difficulty.

The airline industry has traditionally operated on debt:equity ratios higher than those considered normal to other industries. Comparison with the major European airlines (excluding British Airways) shows that our last reported gearing ratio approximates to the average of that group. Our recent survey of United States carriers has shown an average airline gearing as at end December 1983 of 2.35 : 1.

On the basis of the CAA's recommendations for route transfers we, together with our Merchant Bankers - Kleinwort Benson - and Stockbrokers - Hoare Govette, have determined that a debt equity ratio in the range of 1.5 to 2.0 : 1 will be satisfactory to ensure success for the proposed private placement of new shares. The actual level within that range will depend upon the length and type of commitment entered into to secure the acquisition of the additional fleet and equipment requirements.

You referred to the overseas remittance problems which we have experienced. I have in the past written on this subject to both the Secretaries of State for Foreign and Commonwealth Affairs, and Transport. Whilst we have to be continually concerned with this problem because so many of British Caledonian's routes have since formation been associated with developing countries, the position is not as bad as may be assumed by reference to the figure of £67.4 million shown to be held overseas by our last annual report. Of that amount, only

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1st August, 1984

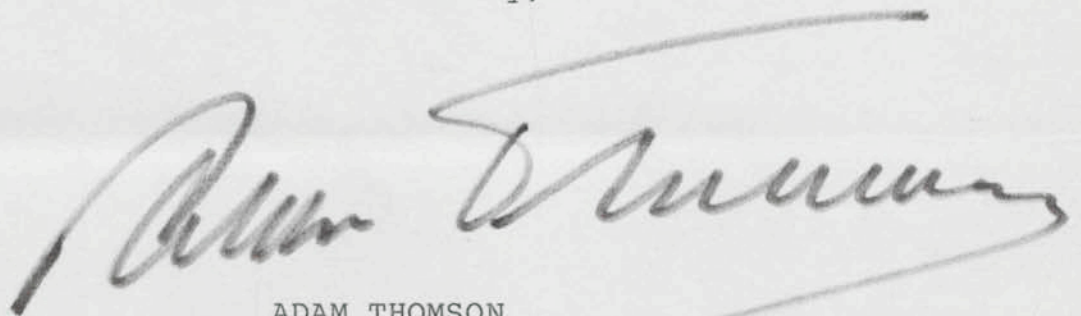
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15% remains to be received and indications are that the majority of the remainder will be received within two months. The Group's cash resources are not impaired to the full extent of balances held overseas due to the availability of U.K. bank credit facilities which are partly secured thereon.

Before making its recommendations the CAA carried out searching investigations into our Group's ability to finance and absorb the increased level of business which would result. They requested evidence of our ability to raise the necessary equity and loan finance. Their basic requirement was satisfied by a joint letter from Kleinwort Benson and Hoare Govett, who confirmed following discussions with financial institutions that the raising of £150 million could be achieved. Our ability to raise the necessary loan finance was confirmed by letters from National Westminster Bank, Bank of America and Citibank. In addition further letters were supplied by E.F. Hutton & Company Inc. and Merrill Lynch Capital Markets confirming their ability, if required, to raise substantial equity capital in the United States market. We further indicated to the CAA our confidence that other sources were also available to us.

Copies of information supplied to the CAA, or to support matters referred to in this letter, are of course available and we would be happy to provide them to whoever you may nominate.

Yours sincerely,

A large, fluid handwritten signature in dark ink, appearing to read 'Adam Thomson', is written over a horizontal line. The signature is cursive and extends across most of the width of the page.

ADAM THOMSON