

Marked up copy for Mr. Turnbull.

PRIME MINISTER

BRITISH CALEDONIAN

I had an hour with Sir Adam Thompson, at his request, earlier this evening. He was particularly anxious to follow through the balance sheet queries you directed at him this morning.

We tackled first the three specific points you raised:

- (i) Blocked overseas balances.
The £67 million shown in BCal's latest accounts have now been almost completely cleared. Since BCal had borrowed against the balances, the remittances have been applied to reduce borrowings rather than to increase liquidity.
- (ii) Dollar borrowings.
As we thought, BCal do feel uncomfortable.
- (iii) Gearing.
Yes, it is high and will not come down much, even in the medium term. But gearing of over 200% is commonplace in airlines, and BCal gave me a table for Europe and the USA to confirm the point.

Annex 1

BCal's comments should make us feel a little easier about its short term future; but they admitted that they would have to strengthen their balance sheet soon, regardless of Government's response to the CAA's recommendation.

As background to improving the balance sheet, Adam Thompson took me through BCal's recent earnings - and its projected earnings on the assumption (unwarranted in his

view) that BA would not behave in predatory fashion once privatized. The figures are in Annex A. They exhibit great volatility in the past and great growth in the future. Adam Thompson was very confident of earnings of £14 million this year (versus £3.3 million last).

If we were to believe these figures, there would be no case for Government support to BCal.

BCal's plan (they said) was to raise new equity of £30 million late this year, mainly from existing shareholders. But the prospect of BA's being privatized, intact with its routes, kills off that possibility. So the only way forward for BCal is to press for the reallocation of profitable routes from BA and to raise much larger sums to service them. BCal's own proposals for route transfers would have required a further £150 million of equity capital and £250 million of loans. The CAA's smaller package of proposals requires some £75 million of equity and £120 million of loans. Even that is a large addition to their present £69 million of shareholders' funds and £160 million loans.

Annex 2.

BCal have given me copy letters of comfort from their financial advisers that they could raise the funds to finance BCal's own proposed route transfers. The CAA are satisfied that BCal can raise the necessary to service Saudi Arabia and Harare. We do not have evidence that the CAA package in full can be financed. BCal mentioned that they would want "a close look" at the Gatwick/Iberian routes before taking them on.

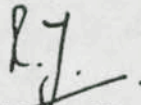
So long as route transfers could be phased, BCal do not see the likelihood of service interruptions on handover. They would offer to take on BA's dispossessed staff in the UK and overseas, but would not necessarily want the aircraft which BA might declare surplus. They do not feel that the reallocation of routes from BA to BCal poses serious

difficulties for the construction of a BA prospectus: why is it harder for BA to forecast the reductions than for BCal to forecast the gains?

We discussed other minor matters, and I was given a *Annex 3.* copy of their Five Year Plan for background information.

My conclusions are:

- (i) if BCal's £14 million profit prediction for this year is accurate, the company is not about to go bust;
- (ii) BCal's plans to expand its capital base seem to me immodest. If you believe that route transfers to BCal are, de facto, the start of Government's underwriting the future of BCal, beware the scale of ambition to be underwritten;
- (iii) the competition issues do not look different by virtue of Sir Adam Thompson's presentation to you or his discussion with me;
- (iv) the behaviour of BA post privatization is important. You could ask Mr. Ridley to explore further what restraints can be applied. He could respond to the CAA's recommendations in principle (accepting domestic deregulation and competition but rejecting the immediate transfer of routes) while announcing his intent to investigate and head off the possible abuse of dominance.


~~Robert Young~~
Policy Unit
1 August 1984

*BCal accounts also
attached as Annex 4.*

ANNEX A

BCal's Profit Record and Forecasts

	<u>Turnover</u>	<u>Profit before Tax</u>
	<u>(£m)</u>	<u>(£m)</u>
1973/74	77	(5.7)
1974/75	86	(0.3)
1975/76	117	5.6
1976/77	159	7.9
1977/78	177	12.2
1978/79	200	6.6
1979/80	252	9.7
1980/81	323	(6.2)
1981/82	401	1.5
1982/83	428	3.3

1983/84 Estimate	495	14.0

1984/85 Forecasts*	c.590	31.0
1985/86	c.640	28.0
1986/87	c.720	55.0
1987/88	c.800	81.0

* excluding route transfers



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Annex 1.

AIRLINE STATISTICS

£'M

(LOCAL CURRENCY TRANSLATED @ JULY 1984 BCAL COMPANY RATE)

EUROPEAN AIRLINES

<u>Airline</u>	<u>Accounts Date</u>	<u>Fixed Assets</u>	<u>Working Capital</u>	<u>Debt</u>	<u>Equity</u>	<u>Debt:Equity Ratio</u>
Aer Lingus	31. 3.83	121.9	33.1	121.0	40.0	3.0
Air France	31.12.82	1,148.4	(33.6)	960.3	154.9	6.2
Alitalia	31.12.82	647.4	20.0	508.7	158.8	3.2
Austrian	31.12.82	137.0	9.9	63.5	83.4	0.8
Finnair	31. 3.82	239.9	(25.8)	187.4	26.7	7.0
Iberia	31.10.82	648.2	2.7	483.6	167.3	2.9
KLM	31. 3.83	623.1	92.8	341.8	248.5	1.4
Lufthansa	31.12.82	709.1	22.4	384.1	347.7	1.1
SAS	30. 9.83	310.1	118.3	287.6	129.3	2.2
Swissair	31.12.83	672.1	77.4	412.8	263.8	1.6

Av. airline rate 2.9

AMERICAN AIRLINES

American	31.12.83			1,812.3	941.6	1.9
Delta	31.12.83			687.4	680.0	1.0
Eastern	31.12.83			1,798.1	230.9	7.8
Northwest	31.12.83			72.6	620.3	0.1
Pan Am	31.12.83			1,119.8	315.2	3.6
PSA	31.12.83			333.6	129.6	2.6
Piedmont	31.12.82			267.9	184.7	1.4
People Express	31.12.83			179.4	74.1	2.4
Southwest	31.12.83			120.0	228.5	0.5
Trans World	31.12.83			873.3	374.2	2.3
United	31.12.83			1,047.1	1,001.8	1.0
US Air	31.12.83			254.1	444.2	0.6
Western	31.12.83			336.2	63.2	5.3

Av. airline rate 2.35



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Annex 2



T.E. Boud Esq
Group Financial Director
The Caledonian Aviation Group PLC
Caledonian House
Crawley
West Sussex

July 3, 1984

Dear Trevor,

As you know, Barry Firmin visited the Bank today to discuss the latest developments in your submission to the Civil Aviation Authority for its Competition Review and in particular The Caledonian Aviation Group PLC's Business Plan dated June 1984. We have discussed previous submissions and we have given you our thoughts on those plans and specifically on the feasibility of arranging finance.

With regard to some of the recent press reports which either directly or by implication have questioned the Group's ability to:

- i) finance existing capital commitments,
- ii) finance the purchase of additional aircraft and equipment to serve additional routes transferred from British Airways, and
- iii) service the levels of debt, incorporated in the above plans,

we would say that we and other banks had already considered these points in the light of information provided by the Group earlier this year and subsequently, Bank of America, together with National Westminster, were able to arrange successfully a \$107 million facility for your two Airbus A310-200 aircraft, and a further facility for £19.6 million. Consequently I can assure you that our views on the Group's ability to raise equity and term debt to finance its BA route and aircraft acquisition plans remain unchanged; i.e. given the Group's ability to raise £150 million in equity of which you are confident, we believe you should be capable of raising £250 million in other capital markets, provided there are no adverse movements in the airline industry or in the financial markets, and that sufficient time and attention of senior management is devoted to executing this part of the plan.

We have formed the above conclusions on the following grounds:

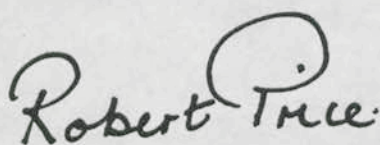
- i) The Group's plan incorporating the BA routes and its financial forecasts indicate an ability to service the debt partly as a result of improving profitability and partly due to improved leverage. Given the Group's record versus previous plans, this will enhance its credit standing.

T.E. BOUD ESQ
July 3, 1984

- ii) We believe the 85% financing for the specified aircraft over the tenors indicated in the plan will be attractive.
- iii) The effect of the Nigerian remittance situation (which, as we have discussed, has improved dramatically in the last three months) will be considerably diluted under the plan to the benefit of the Group.
- iv) We believe that the Group has the management expertise to turn the plans and financial forecasts into reality.

Given the long standing relationship between the Group and the Bank which started in the mid 1970's, you may wish us to discuss our views with others. Peter Wainwright and I would be delighted to do so.

Yours sincerely,

A handwritten signature in cursive script that reads "Robert Price". The signature is written in dark ink and is positioned above a horizontal line.

Robert N. Price
Vice President

4th July 1984

Civil Aviation Authority
Civil Aviation House
45 Kingsway
London WC2

For the attention of J. Dent Esq.

Dear Sirs,

We write to confirm that we are prepared to advise British Caledonian in raising £150 million of equity and consider that this can be achieved. This view is shared by Hoare Govett Limited as is evidenced by the signature of its Chairman, Mr. Westmacott, to this letter. The raising of this equity money must obviously be subject to certain conditions and those we have in mind are as follows:-

1. A suitable package of routes being available to British Caledonian. We have seen the package set out in the submission made to yourselves by British Caledonian dated 18th June 1984. We understand from our clients that there is no possibility of their Hong Kong route proposal being accepted but that they would be awarded another route which would have a compensating financial benefit. We understand that you have informally indicated that you consider that the revenue and traffic assumptions made by British Caledonian in their submission are fair and reasonable.
2. That the financial projections, and in particular the figures set out in section 2.3 of British Caledonian's submission, are realisable. It would be necessary in due course to have a satisfactory accountant's report, as is required in the case of all such issues, vouching inter alia for the integrity of these projections.

/

DIRECTORS

M J HAWKES (CHAIRMAN)

M W ACOMB THE EARL OF LIMERICK K B E (VICE-CHAIRMAN)

T G BARKER S R BARROW D H BENSON R J BODEN R A BROOKS D R O C CAMERON C G H CLARK D C CLEMENTI C W L CROOK J G DAVIS
M DEFRIEND J L E G DELVAUX P H P O PELET M C DEVAS M C P J G ELWES C A A P EUGSTER R T FOX M J B GREEN P GUY T H HOLLAND-BOSWORTH
J D HOWLAND JACKSON C R M KEMBALL E C MACADAM P MACARTHUR B W J MANNING R M MAYS SMITH J F NELSON R A B NICOLLE P J PARSONS D A E R PEAKE
G R PINTO P R RICKWOOD S M ROBERTSON THE LORD ROCKLEY J A SPALL J F H TROTT S J URWIN D C WAKE-WALKER W H N WILKINSON J H WILSON R N YOUNG

3. Satisfactory market conditions at the time of the fund raising; the timing of the flotation of British Airways has some relevance in this context.
4. A commitment by bankers to finance the purchase of aircraft and equipment to accommodate the routes to be transferred, which we anticipate would be conditional upon the raising of some £150 million of equity finance.

We should be glad to meet you either with or without your financial advisers at any time to discuss the matter further.

Yours faithfully,
for Kleinwort, Benson Limited

T. H. Hollands-Bosworth

Director

Yours faithfully,
for Hoare Govett Limited

A. J. G. G. G.

Chairman

CLARK D C CLE
FOX
SMITH
UNWIN

Citibank N.A.
P.O. Box 78
336 Strand
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M. Christopher S. Leslie
Vice President

5 July 1984

Mr. T. Boud,
Group Finance Director,
Caldeonian Aviation Group PLC,
Caledonian House,
Crawley
WEST SUSSEX RH10 2XA

Dear Mr. Boud,

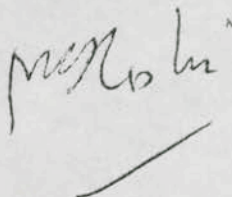
Following Barry Firmin's visit yesterday, I am writing to outline what we think is achievable in terms of loan finance for Caledonian Aviation Group ("CAG") as a result of the possible acquisition of a package of routes from British Airways. The requirement is based on the cost of acquiring aircraft, spares, and other support assets, together with various launch costs.

We believe that term finance of up to £250 million is capable of being raised, from a variety of international sources, based on the following minimum conditions -

- (i) the raising beforehand of £150 million of equity capital
- (ii) the package of routes acquired being no worse than those set out in the June 1984 presentation
- (iii) the acquisition costs of the assets being in line with free market values (the aircraft, in particular, being in line with the estimates set out in the presentation)
- (iv) the loan finance being secured by, and not exceeding, 85% of the basic hull acquisition cost of the aircraft, such aircraft to be of the type set out in the presentation
- (v) there being no material worsening of the general outlook for civil aviation, and CAG's operation in particular

If a requirement of this kind were to materialise, then, subject to the negotiation of mutually satisfactory terms, Citibank would be prepared to try to arrange a loan package of this size, in conjunction with your other major lenders. This willingness is based not only on the financial aspects of the transaction, but also on our perception of CAG management's ability and determination, which has been built up in the many years of involvement between our respective organisations.

Yours sincerely,



Hoare Govett Ltd

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London WC1V 7PB and at
27 Throgmorton Street, London EC2N 2AN & Stock Exchange
Telephone 01-404 0344
Telex 885474 and 885773
Telegraphic Address Auresco, London WC1
Facsimile No. 01-404 0342 (Group 3)

11th July 1984

For the attention of J. Dent, Esq.

Civil Aviation Authority,
Civil Aviation House,
45 Kingsway,
London, W.C.2.

Dear Sirs,

The Caledonian Aviation Group plc

We are writing further to our letter of the 4th July 1984 written to you jointly by Kleinwort Benson and ourselves.

You are aware that, with Mr. D. Reed of County Bank, we visited three leading London institutional investors last week to seek their preliminary views and support for the proposed financing of Caledonian.

Over the past two days we have visited nine further leading investment institutions in both London and Edinburgh; the latter in conjunction with Sir Adam Thomson and Mr. Trevor Boud of Caledonian for the same purpose. These institutions represented a cross section of the institutional investment market comprising insurance companies, pension funds and investment trust managers.

The response from eight out of the nine institutions was positive and we are confident that they will support the proposed financing - in several cases with units of investment well above their normal percentage.

Equally important, the response from this significant cross section of the investment community encourages us to confirm to you our belief that £150m of equity finance can be raised for the Group.

/ Contd.

Directors: R.K. Westmacott, R. West, R.J.P. Jenks, F.C.A., J.B. Brooks, R.C. Livesey, F.I.A., P.R. Meinertzhagen

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The single institution which did not give a positive response has particular restrictions on investment in unquoted companies but, nonetheless, did not rule out participation.

We would be happy to attend a meeting at your office together with Caledonian and Kleinwort Benson if it would be of help.

Yours faithfully,
for and on behalf of Hoare Govett Ltd.

R. K. Westmacott

R.K. Westmacott

Mr. Trevor E. Boud, F.C.A.,
Group Finance Director,
The Caledonian Aviation Group plc,
Caledonian House,
Crawley,
West Sussex RH10 2XA
England

July 10, 1984

Dear Sir,

I am writing on behalf of E.F. Hutton & Company Inc. ("Hutton"), of which E.F. Hutton International Inc. is a wholly-owned subsidiary, regarding the reception that could be expected for the United States portion of a public equity offering during late 1984 or early 1985 on behalf of The Caledonian Aviation Group plc ("Caledonian"). We have been made aware of Caledonian's proposal to the Civil Aviation Authority regarding the potential transfer of route authority to Caledonian, and the related £400 million in financing requirements that would ensue should Caledonian's proposal be approved in full, of which approximately £150 million would be the expected equity financing requirement. We have therefore examined the prospects for the United States portion of a public equity offering for which the proceeds would be applied to these financing needs, and assuming that Caledonian's proposal had been approved by all requisite United Kingdom governmental authorities.

It is Hutton's opinion that the United States portion of a public equity offering on behalf of Caledonian in late 1984 or early 1985 could be successfully consummated in a size ranging from approximately \$100 million to \$150 million. This opinion assumes no material adverse change in the financial condition of Caledonian or in present United States public equity market conditions.

In reaching this opinion we have considered, among other items, Caledonian's October 31, 1983 published financial statements, Caledonian's proposals to the Civil Aviation Authority regarding the transfer of route authority to Caledonian, together with Caledonian's projection of the financial results and position that would ensue should their proposal be approved in full, and Caledonian's expected financial results and position for the fiscal year ended October 31, 1984.

Cont'd...

Mr. Trevor E. Boud, F.C.A.

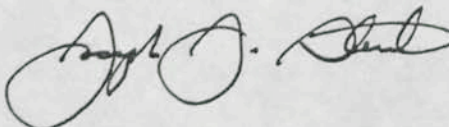
July 10, 1984

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During 1983 Hutton managed or co-managed public financing on behalf of United States airlines aggregating approximately \$1.2 billion, more than any other investment banking firm, and approximately half of the \$2.5 billion in airline public financing consummated in 1983. The substantial portion of such public offerings was equity or equity-related (i.e. convertible debt) financings, and was made on behalf of such international airline clients as Trans World Airlines, Pan American World Airways and American Airlines.

We would be pleased to answer any questions you may have regarding our opinion, and you may feel free to show this opinion to such financial or governmental institutions as you require.

Sincerely,



Joseph J. Steuert
Senior Vice President,
Head of Transportation Group,
Corporate Finance Department



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Annex 3.

THE CALEDONIAN AVIATION GROUP PLC

FIVE YEAR PLAN

18th July, 1984

THE CALEDONIAN AVIATION GROUP PLC

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THE CALEDONIAN AVIATION GROUP PLC

FLEET COMPOSITION

	<u>1983/84</u>	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>
DC 10-30	8	10	10	10	10
Boeing 747-200	1	3	3	3	3
BAC 1-11 (500)	13	10	10	10	10
Airbus A310	3*	3	3	3	3
Airbus A320	-	-	-	-	3*

*Introduced to service during year.

THE CALEDONIAN AVIATION GROUP PLC

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ACCOUNTING POLICIES

ROUTE TRANSFER PLAN

1. Initial Advertising and Promotion Costs of £5.0 million have been amortised over three years.
2. — Deferred taxation has been provided for at 35% on total profits.
No account taken of prior years deferred taxation or accumulated ACT.

SUMMARY AIRLINE PROFIT AND LOSS PROJECTION

	1983-4	1984-5	1985-6	1986-7	1987-8
Airline Baseplan Trading Profit	10,291	30,939	27,958	55,184	81,481
Add: Profits arising from New Routes/ Activities	-	14,100	36,500	44,000	52,500
	10,291	45,039	64,458	99,184	133,981
Less: Additional Finance Costs re New Routes/Activities	-	(4,517)	(6,873)	(6,067)	(5,223)
	10,291	40,522	57,585	93,117	128,758
Less: Initial Promotion & Advertising	-	(972)	(1,667)	(1,667)	(694)
	10,291	39,550	55,918	91,450	128,064
Add: Extra Interline Benefits	-	2,900	7,800	8,400	9,200
	10,291	42,450	63,718	99,850	137,264

THE CALEDONIAN AVIATION GROUP PLC

PROFIT AND LOSS ACCOUNT

YEARS ENDING 31ST OCTOBER

<u>£'000</u>	1983	1984	1985	1986	1987	1988
Turnover	428,484	495,064	641,972	751,598	841,731	945,249
Airline Trading Profit	6,394	10,291	42,450	63,718	99,850	137,264
Profit on Sale of Aircraft	1,851	8,790	-	-	-	350
Unknown Competition Factor and Provision for Exceptional Items	(5,044)	(6,200)	(10,500)	(16,000)	(25,000)	(35,000)
	3,201	12,881	31,950	47,718	74,850	102,614
Other Group Activities						
Jetsave	-	71	207	600	1,086	1,202
Helicopters	(1,478)	(1,004)	-	-	-	-
Engine Overhaul	368	38	612	376	761	854
Inclusive Tour Holidays	26	429	1,242	1,334	1,460	1,596
Hotel Operations	1,138	1,510	2,394	3,337	4,617	6,001
Holding Company Income	82	833	1,000	2,200	4,200	8,600
	3,337	14,758	37,405	55,565	86,974	120,867
Employee Profit Share	-	(738)	(1,870)	(2,778)	(4,349)	(6,043)
Profit before Taxation	3,337	14,020	35,535	52,787	82,625	114,824
Taxation	(1,211)	(4,837)	(12,437)	(18,475)	(28,919)	(40,188)
Profit after Taxation	2,126	9,183	23,098	34,312	53,706	74,636
Dividend (Gross) (4 times cover)	-	(2,296)	(5,774)	(8,578)	(13,427)	(18,659)
Net Retained Earnings	2,126	6,887	17,324	25,734	40,279	55,977

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THE CALEDONIAN AVIATION GROUP PLC

ADDITIONAL AIRCRAFT REQUIREMENT

1984-85

<u>ROUTE TRANSFER PLAN</u>				
	<u>No. of Units</u>	<u>Estimated Unit Cost</u>	<u>Average Age</u>	<u>Remaining Depreciable Life</u>
Boeing 747-200	2	\$35.0 M	7 years	9 years
Douglas DC10-30	2	\$30.0 M	5 years	11 years
Airbus A310	1	\$48.0 M	New	16 years

THE CALEDONIAN AVIATION GROUP PLC

FINANCING ASSUMPTIONS

<u>ROUTE TRANSFER PLAN</u>	<u>PERIOD OF FINANCING</u>	<u>REMAINING DEPRECIABLE LIFE</u>	<u>% OF HULL VALUE FINANCED</u>	
Boeing 747-200	8 years.	9 years.	85%)
)
)
Douglas DC10-30	8 years.	11 years.	85%)
)
)
Airbus A310	10 years.	16 years.	85%)
)

Equal repayment mortgage loans

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THE CALEDONIAN AVIATION GROUP

SUMMARY OF CAPITAL EXPENDITURE

	1983-84	1984-85	1985-86	1986-87	1987-88	Total
<u>BRITISH CALEDONIAN AIRWAYS</u>						
Airbus A310 - Aircraft (3 Units)	66,600	31,530				98,130
Spares	4,900	3,320	3,618			11,838
Airbus A320 - Aircraft (3 Units)	700		450	600	72,765	74,515
Spares					7,000	7,000
Boeing 747 - Aircraft (3 Units)		46,053		13,978		60,031
Spares		9,011				9,011
BAC 1-11 - Aircraft & Refurbishment	4,164	8,450			1,645	14,259
Douglas - Aircraft (2 Units)		39,474				39,474
DC 10-30						
Spares		1,974				1,974
General	11,620	15,000	18,500	19,500	20,500	85,120
	87,984	154,812	22,568	34,078	101,910	401,352
<u>BRITISH CALEDONIAN HELICOPTERS</u>						
	8,003	150	150	200	200	8,703
<u>CALEDONIAN AIRMOTIVE</u>						
	1,245	3,360	831	672	600	6,708
<u>CALEDONIAN HOTEL HOLDINGS</u>						
	4,214	6,793	4,923	4,988	2,782	23,700
Others	706	788	538	854	520	3,406
	102,152	165,903	29,010	40,792	106,012	443,869

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THE CALEDONIAN AVIATION GROUP PLC

SOURCE AND APPLICATION OF FUNDS

£'000	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88
<u>SOURCE OF FUNDS</u>						
Profit after Tax before Dividend	2,126	9,183	23,098	34,312	53,706	74,636
Exchange Adjustment	7	-	-	-	-	-
Items charged not requiring cash:						
Deferred Taxation	-	2,214	9,768	15,738	26,079	37,215
Regional Development Grant	(74)	(90)	(108)	(129)	(138)	(151)
Depreciation	19,120	25,359	36,408	42,833	45,934	50,283
Amortisation of Forward Costs	933	620	1,717	2,579	2,126	1,320
Amortisation of Goodwill	-	58	58	58	58	58
	22,112	37,344	70,941	95,391	127,765	163,361
Share Issue	-	-	75,000	-	-	-
Loans Received	62,732	91,489	118,555	9,594	23,186	69,681
Sale of Fixed Assets	2,409	644	-	-	-	308
Regional Development Grant	122	196	420	104	84	76
	87,375	129,673	264,916	105,089	151,035	233,426
<u>APPLICATION OF FUNDS</u>						
Purchase of Fixed Assets	14,733	102,152	165,903	29,010	40,792	106,012
Increase in Investments	2,635	-	-	-	-	-
Forward Costs Incurred	120	750	6,000	1,000	1,000	2,200
Loans Repaid	61,105	24,659	63,653	45,415	47,875	55,360
Dividend (Gross)	-	2,296	5,774	8,578	13,427	18,659
Mainstream Corporation Tax	-	-	-	-	6,495	32,960
	78,593	129,857	241,330	84,003	109,589	215,191
Increase/(Decrease) in Working Capital	8,782	(184)	23,586	21,086	41,446	18,235
	87,375	129,673	264,916	105,089	151,035	233,426

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THE CALEDONIAN AVIATION GROUP PLC

GROUP BALANCE SHEET

AS AT 31ST OCTOBER

<u>£'000</u>	1982	1983	1984	1985	1986	1987	1988
Fixed Assets	227,948	242,782	317,915	447,410	433,587	428,445	483,866
Capitalised Goodwill	-	-	1,092	1,034	976	918	860
Investments	453	3,088	1,704	1,704	1,704	1,704	1,704
Deferred Expenditure	2,674	1,861	1,991	6,274	4,695	3,569	4,449
Net Current Assets	8,986	17,768	17,584	41,170	62,256	103,702	121,937
	240,061	265,499	340,286	497,592	503,218	538,338	612,816
Share Capital and Reserves	55,425	69,233	76,120	168,444	194,178	234,457	290,434
Regional Development Grant	1,585	1,633	1,739	2,051	2,026	1,972	1,897
Deferred Taxation	-	-	2,214	11,982	27,720	47,304	51,559
Loans and Term Finance	183,051	194,633	260,213	315,115	279,294	254,605	268,926
	240,061	265,499	340,286	497,592	503,218	538,338	612,816

THE CALEDONIAN AVIATION GROUP

FINANCIAL COVENANTS

	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88
<u>Tangible Net Worth</u>						
Share Capital and Reserves	69,233	76,120	168,444	194,178	234,457	290,434
Less: Capitalised Goodwill	-	(1,092)	(1,034)	(976)	(918)	(860)
Deferred Expenditure	(1,861)	(1,991)	(6,274)	(4,695)	(3,569)	(4,449)
	67,372	73,037	161,136	188,507	229,970	285,125
<u>Debt:Equity</u>						
Consolidated Debt	194,633	260,213	315,115	279,294	254,605	268,926
Tangible Net Worth	67,372	73,037	161,136	188,507	229,970	285,125
Debt:Equity Ratio	2.9 : 1	3.6 : 1	2.0 : 1	1.5 : 1	1.1 : 1	0.9 : 1
<u>Net Current Assets</u>						
Balances at 31st October	17,768	17,584	41,170	62,256	103,702	121,937
<u>Debt Service Coverage</u>						
Debt Service Capability:						
Profit before Taxation	3,337	14,020	35,535	52,787	82,625	114,824
Add: Employee Profit Share	-	738	1,870	2,778	4,349	6,043
Finance Charges	16,350	22,730	29,530	29,618	26,094	25,520
Dépreciation & Amortisation	19,979	25,947	38,075	45,341	47,980	51,510
	39,666	63,435	105,010	130,524	161,048	197,897
Debt Service Requirements:						
Finance Charges	16,350	22,730	29,530	29,618	26,094	25,520
Loan Repayments	61,105	24,659	63,653	45,415	47,875	55,360
	77,455	47,389	93,183	75,033	73,969	80,880
Coverage	-	1.3	1.1	1.7	2.2	2.4

THE CALEDONIAN AVIATION GROUP PLC

FINANCIAL ANALYSIS

	1983-84	1984-85	1985-86	1986-87	1987-88
<u>(1) RETURN ON ASSETS EMPLOYED</u>					
Profit before Taxation	14,020	35,535	52,787	82,625	114,824
Add back: Finance Charges	22,730	29,530	29,618	26,094	25,520
	<u>36,750</u>	<u>65,065</u>	<u>82,405</u>	<u>108,719</u>	<u>140,344</u>
Assets employed at beginning of year	265,499	430,593*	497,592	503,218	538,338
Return (Baseplan in brackets)	14% (14%)	15% (12%)	17% (7%)	22% (12%)	26% (18%)
* Factored for additional assets purchased from BA mid year.					
<u>(2) RETURN ON CAPITAL EMPLOYED</u>					
Profit before Taxation	14,020	35,535	52,787	82,625	114,824
Capital employed at beginning of year	69,233	119,870*	168,444	194,178	234,457
Return (Baseplan in brackets)	20% (20%)	30% (19%)	31% (4%)	43% (21%)	49% (34%)
* Factored for equity issue made mid year.					

12.

THE CALEDONIAN AVIATION GROUP PLC

LOANS OUTSTANDING AT 31ST OCTOBER

	31.10.83		31.10.84		31.10.85		31.10.86		31.10.87		31.10.88	
	£'000	\$'000	£'000	\$'000	£'000	\$'000	£'000	\$'000	£'000	\$'000	£'000	\$'000
Caledonian Aviation Group	4,785	-	4,372	-	3,546	-	2,720	-	1,894	-	1,068	-
British Caledonian Airways	98,718	115,261	164,480	104,969	226,908	87,506	204,753	69,492	194,704	51,106	227,281	32,314
Caledonian Hotel Management	2,888	-	4,666	-	6,139	-	7,041	-	7,671	-	5,606	-
British Caledonian Helicopters	3,567	-	9,840	-	8,393	-	6,835	-	5,157	-	4,107	-
British Caledonian Travel Holdings	138	-	73	-	17	-	-	-	-	-	-	-
Caledonian Airmotive	7,019	667	7,723	-	12,542	-	12,227	-	11,557	-	9,605	-
	117,115	115,928	191,154	104,969	257,545	87,506	233,576	69,492	220,983	51,106	247,667	32,314
Exchange Rate	77,518	@ 1.4955	69,059	@ 1.52	57,570	@ 1.52	45,718	@ 1.52	33,622	@ 1.52	21,259	@ 1.52
	194,633		260,213		315,115		279,294		254,605		268,926	

BA ROUTE TRANSFERTRADING PROFIT

£'M

	1983/84	1984/85	1985/86	1986/87	1987/88
BCAL Trading Profit	10.3	20.9	7.0	32.2	55.5
Add back BA Predation Factor	-	10.0	21.0	23.0	26.0
	10.3	30.9	28.0	55.2	81.5
Additional Routes P/(L)					
New York	-	(3.0)	(1.6)	0.7	2.0
Harare	-	4.2	8.1	6.9	6.4
Saudi Arabia	-	12.9	30.0	36.4	44.1
	10.3	45.0	64.5	99.2	134.0

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BA ROUTE TRANSFER

£'M

Annual Net Turnover of BA Route Package and BCAL Route Development

	1984/85	1985/86	1986/87	1987/88
New York	20.1	36.3	41.8	46.5
Harare	14.9	25.8	27.7	30.0
Saudi Arabia	43.0	83.7	94.7	107.0
	78.0	145.8	164.2	183.5

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BA ROUTE TRANSFER

£'M

Incremental Interline Revenue

	1984/85	1985/86	1986/87	1987/88
New York	1.7	5.8	6.3	6.8
Harare	0.2	0.4	0.4	0.5
Saudi Arabia	1.0	1.6	1.7	1.9
	2.9	7.8	8.4	9.2

Note: Figures discounted by 12% to allow for commissions and passenger DOCs.

CIVIL AVIATION AUTHORITY AIRLINE COMPETITION REVIEW

16

ROUTE EVALUATION ANALYSIS

ROUTE: NEW YORK

ANALYSIS		1985	1986	1987	1988
Annual Round Trips		217	365	365	365
Annual Aircraft Hours		3,110	5,216	5,216	5,216
BCAL Forecast Passengers	000s	78.8	127.1	136.8	141.9
BCAL Forecast PLF	%	43	41	44	46
Total Net Revenue	£'M	20.1	36.3	41.8	46.5
Total Cost	£'M	23.1	37.9	41.1	44.5
Profit/Loss	£'M	(3.0)	(1.6)	0.7	2.0
Less Results of Current Operation	£'M				
Improvement of Company Result	£'M				
Operating Ratio		87	96	102	104

ASSMPTIONS

Aircraft Type & Configuration		B.747/424 F/J/Y			
Initial Direct Competition		*See Commentary Below			
New Route Discount (IGF)	%	0.7	0.82	0.88	0.91
Effect of LGW Transfer Traffic	%				
Effect of LGW Transfer Yield					
Aircraft Units Employed		1.2	1.2	1.2	1.2
Route Capital Investment	£'M	39.3	39.3	39.3	39.3
Route Start-Up Expenditure	£'M	4.0	-	-	-
Additional Interline Traffic	£'M	1.7	5.8	6.3	6.8

Licensing/Designation BCAL compete with all incumbent 3rd/4th freedom carriers and a range of 5th freedom carriers.

COMMENTARY

Despite high volume route and high cost efficient operation, results do not achieve an adequate operating ratio. This may be offset by substantial interline benefit.

* BA 21 x 747; 14 x SSC pw
 TW 21 x 747 pw
 PA 21 x 747 pw
 PE/VIRGIN 14 x 747 pw
 Others 11 x 747 pw

CIVIL AVIATION AUTHORITY AIRLINE COMPETITION REVIEW

17

ROUTE EVALUATION ANALYSIS

ROUTE: LGW-LUN-HRE (SOLUS)

ANALYSIS		<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Annual Round Trips		60	104	104	104
Annual Aircraft Hours		1,290	2,236	2,236	2,236
BCAL Forecast Passengers	000s	34.0	55.4	55.4	55.4
BCAL Forecast PLF	%	71	66	66	66
Total Net Revenue	£'M	14.9	25.8	27.7	30.0
Total Cost	£'M	10.7	18.3	20.3	21.8
Profit/Loss	£'M	4.2	7.5	7.4	8.2
Less Results of Current Operation	£'M		(0.6)	0.5	1.8
Improvement of Company Result	£'M		8.1	6.9	6.4
Operating Ratio		139	141	136	138

ASSMPTIONS

Aircraft Type & Configuration		B.747/400 F/J/Y			
Initial Direct Competition		LUN: 3 x QZ DC10, HRE: 3 x RH 707 pw			
New Route Discount (IGF)	%	5	5/0	0	0
Effect of LGW Transfer Traffic	%	0	0	0	0
Effect of LGW Transfer Yield		0	0	0	0
Aircraft Units Employed		0.5	0.5	0.5	0.5
Route Capital Investment	£'M	16.5	16.5	16.5	16.5
Route Start-Up Expenditure	£'M	0.5	-	-	-
Additional Interline Traffic	£'M	0.2	0.4	0.4	0.4

Licensing/Designation

BCAL transfers BA HRE services to LGW and operates end sector from LUN, cutting out DLA/LBV en-route stop. RH continues at LGW.

COMMENTARY

A most valuable opportunity to turn around the fortunes of Central Africa route, but high risk attached to HRE as well as LUN, requiring an OR of this magnitude. BCAL would regard HRE as prime destination on the route, with LUN as secondary, en-route stop.

CIVIL AVIATION AUTHORITY AIRLINE COMPETITION REVIEW

18.

ROUTE EVALUATION ANALYSIS

ROUTE: SAUDI ARABIA (SOLUS)

ANALYSIS		1985	1986	1987	1988
Annual Round Trips		390	676	676	676
Annual Aircraft Hours		4,993	8,655	8,655	8,655
BCAL Forecast Passengers	000s	113.1	207.5	220.4	232.9
BCAL Forecast PLF	%	40	42	45	48
Total Net Revenue	£'M	43.0	83.7	94.7	107.7
Total Cost	£'M	30.1	53.7	58.3	62.9
Profit/Loss	£'M	12.9	30.0	36.4	44.1
Less Results of Current Operation	£'M				
Improvement of Company Result	£'M				
Operating Ratio		143	156	162	170

ASSMPTIONS

Aircraft Type & Configuration		DC10/235 F/J/Y + B747/400 F/J/Y			
Initial Direct Competition		11 x SV L10 pw			
New Route Discount (IGF)	%	5	5/0	0	0
Effect of LGW Transfer Traffic	%	11.5	11.5	11.5	11.5
Effect of LGW Transfer Yield		0	0	0	0
Aircraft Units Employed		1.8	1.8	1.8	1.8
Route Capital Investment	£'M	51.8	51.8	51.8	51.8
Route Start-Up Expenditure	£'M	1.0	-	-	-
Additional Interline Traffic	£'M	1.0	1.6	1.7	1.9

Licensing/Designation BCAL take over BA routes and transfer to LGW, becoming solus UK carrier to the Kingdom. SV continue at LHR.

COMMENTARY

Extremely attractive package for BCAL and LGW, offering high level of profitability and good network synergy. But very high element of risk demands a counter-balancing network elsewhere.

Doubt that high return can be sustained to end decade and results might worsen.



10 DOWNING STREET

Annex 4.

The Caledonian Aviation Group

Caledonian House
Crawley West Sussex
RH10 2XA England

Telephone: Gatwick (0293) 27890
Cables: Scotair Gatwick Telex: 87161

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.

Cont'd...

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

Cont'd...

The Rt. Hon. Margaret Thatcher, M.P.

1st August, 1984

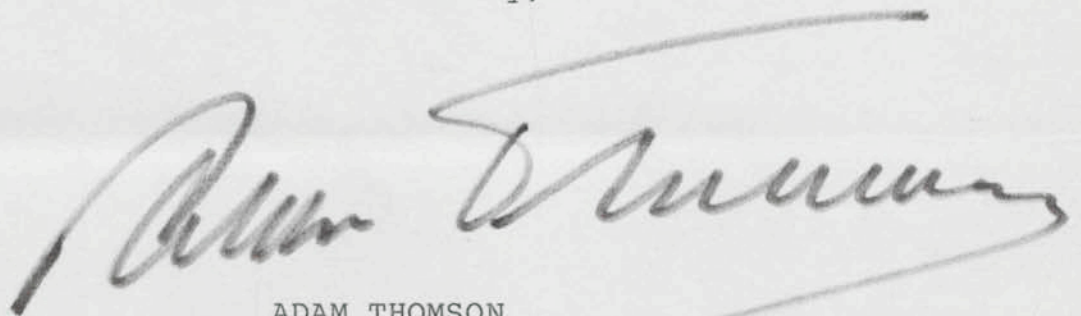
- 3 -

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 written in a cursive style with a long, sweeping underline.

ADAM THOMSON