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PRIME MINISTER

9 June 1988

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SUPPORT FOR DOWTY

Kenneth Clarke argues for supporting Dowty in the same paper where he states he would prefer not to have to do so. The automatic question is therefore what compulsion does he feel?

Commercial case

Clarke argues that undercarriage launch aid will give Dowty a technological lead within Europe and bring them good long term business.

Such apparent benefits evaporate if they can only be secured on unsound financing, namely that which relies upon government subsidy and is not commercially placeable with the banks or shareholders. The project does not seem particularly high risk and is small in relation to Dowty group turnover of about £38 million. Dowty's problem in pursuing this business is not the unacceptably high risk to the rest of its assets but that the return will be too low because of the sub-economic pricing required to win the contract.

Financially, Dowty's position is strong: the existing 35% gearing ratio is reasonable for such a company. Dowty's main reason for not pursuing the project without support must be that more profitable projects, probably in electronics, are available. This is to argue that government intervention via launch aid, by reducing the financing cost, will distort the return on the undercarriage work in order to make it appear comparable with alternative business.

There therefore seems to be no commercial case.

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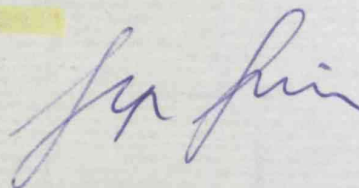
The political case

Clarke argues that, although launch aid is bad in principle, if our competitors do it so should we. That is the bankrupt argument of the centralists and the 'little England' lobbyists which Clarke himself so commendably repudiated in yesterday's HoC's debate on mergers. Where the Jones's are wrong it is far better not to keep up with them and the better course would be to put pressure on the French to reduce subsidies to Messier.

Previously, launch aid has been granted only to airframe and aero engine manufacturers (a policy confirmed in a recent Parliamentary Answer by the DTI). Should the DTI truly see exceptional special case arguments in favour of government support for Dowty, there exists the Assistance for Exceptional Projects facility under the 1982 Industrial Development Act. Clarke has ruled this out on the grounds that it would be notifiable to the EC as a state aid! Launch aid is therefore being used in this case as a device to avoid notification - the very practice we are so critical of in our European partners.

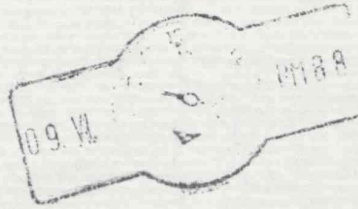
Conclusion and Recommendation

Unlike BAe's argument for launch aid last year, Dowty has the balance sheet and the capability to take this business if it could see a viable return. Even though the sum is small at £15 million, the signal it would give is that HMG speaks with a forked tongue. Near market R & D has been publicly renounced in many utterances since the last election. To admit even a small sum like this in launch aid under the wholly new category of aircraft equipment would start a whole new bandwagon. This is a try-on by Dowty which should be firmly rejected.



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