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SHORT BROTHERS PLC

MEMORANDUM BY THE SECRETARY OF STATE FOR NORTHERN IRELAND

1. When we discussed Shorts on 1 December (E(A)(88) 15th meeting) I agreed to report progress in two months' time. On 10 January, an information memorandum was issued to 11 parties interested in buying the company as a single unit and preliminary proposals are expected by 17 February. E(A) agreed that I should try to dispose of the company as a whole before deciding in favour of any of the other alternatives. I shall report orally at our meeting on the latest position regarding likely bidders.
2. Since then I have received advice from Kleinwort Benson on the likely cost to the Government of privatising the company by means of sale as a whole and from Touche Ross on the likely cost of both sale as a whole and three other options. The details of these costed options as requested by E(A) are listed later in this paper. I have also received advice from Kleinwort Benson that on balance there could be benefit in an immediate capital payment into a holding company account, which should be helpful in improving the chances of a successful disposal of the company as a whole.

Costed Options

3. Whichever of the options is chosen, the Government will have no alternative but, as a minimum, to meet the existing borrowings of the company and future losses up to disposal. By June 1989 it is estimated that the borrowings alone will amount to £450m. This figure takes no account of the additional cost of contingent liabilities and other items, to which we are committed by a series of assurances given since [1972].

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4. Likely cost of disposal as a whole. Kleinwort's estimate is that the total cash cost to the Government of the sale of the company as a single unit is at least £750m and could be as high as £1000m depending upon the extent of assurances required from buyers regarding the future conduct of the business and on the handling of existing sales financing obligations. Touche's estimate is about £800m but this assumes that existing sales financing guarantees will not be called. Although the composition of the figures is different, they are broadly comparable in aggregate. Moreover, both sets of advisers agree in broad terms that a recapitalisation will cost about £600m and that a further "dowry" will be needed to persuade a buyer to take on this unattractive and loss making company.
5. These figures appear to me to be high, even given the enormous burden of debt the company already has and which will have increased further by the time of sale. Officials are probing these figures with our advisers but their preliminary view is a cost for sale of at least £600m. I shall obviously seek to achieve a sale as a whole in which that sum embraces any dowry, but the figures from Touche Ross and Kleinwort indicate the scale of this challenge. We also need to probe the figures produced for the other options for disposal which are set out below but I am satisfied that the broad relationship of costs between the options is right - any other form of disposal is likely to cost appreciably more than sale as a whole.
6. Likely cost* of alternative approaches. Touche's estimates of the cost of pursuing these, are as follows:-
 - i) Selling off the missiles division separately.
Restructuring the aircraft and aerostructures divisions into one business and selling that off. Total expected cost, also about £750m;

* excluding any proceeds from the sale of the missile division, although these would be unlikely to alter the figures materially.

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- ii) Selling off the missiles division separately. Restructuring and selling off the aerostructures division separately. Winding down and eventually closing the aircraft division. Total expected cost, about £850m; and
 - iii) Selling off the missiles division separately. Winding down and closing the aircraft and aerostructures divisions. Total expected cost, about £1000m.
7. I did not ask Touche Ross to cost complete closure because I believe that even on a worst case approach disposal of the missiles division should be attainable. Clearly its closure would deny any potential proceeds and add to redundancy and closure costs to make the most expensive solution. Nor for the most obvious reasons have I considered the cost of seeking to continue the business in public ownership.

Recapitalisation

8. On the basis of the advice I received from Kleinwort Benson that an immediate cash transfer would enhance the chance of disposal of the business as a whole and my conclusion that a statement of our intention to recapitalise the company would not be sufficient, I wrote to the Chief Secretary on 31 January proposing a payment of £600m. That approach is the least costly of the options we are considering and would make the most positive contribution to the difficulties I face in Northern Ireland. We propose that the remainder of the sum would be paid to a trust managed by SB Realisations and arrangements would be made to restrict its use to ensure that no funds leaked out into any channels not approved by us, and that any funds not required for the purposes defined can be returned to HMG. It is understood that the EC would have no objections to this course of action.

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9. Last year was a major setback for Shorts, and in the current year the decline has continued. It is clear that the present management are not able to cope with the position, as a result of which, by virtue of our guarantees, we are incurring rapidly increasing liabilities. The company has an order book of nearly £1 bn and there is no way in which these could be suddenly abrogated, and it is therefore urgent that we transfer the ownership, management and responsibility to the private sector. Anything that can help expedite that transfer will be of enormous benefit and it is for that reason that I recommend the payment be made.

Recommendation

10. I ask colleagues to give immediate agreement to a capital payment of £600m so that I can proceed to seek a purchaser for Shorts as a whole without delay.

TK

Northern Ireland Office
6 February 1989

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