

PREM 19/2258

THE FUTURE OF ROLLS ROYCE

INDUSTRIAL POLICY

(In folder attached: Rolls Royce Pathfinder Prospectus)

PART 1: JULY 1979

PART 3: APRIL 1984.

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
<del>30.4.84</del>							
<del>6.7.84</del>							
<del>14.8.84</del>							
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PREM 19/2258

ENDS

PART 3 ends:-

DTi to ch Ex : Rolls Royce Privatization  
7 May 87

PART 4 begins:-

DTi to GDP 10 July 87



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CBG

DEPARTMENT OF TRADE AND INDUSTRY  
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PS/ Secretary of State for Trade and Industry

**CONFIDENTIAL**

Tony Kuczys Esq  
Private Secretary to the  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
London SW1P 3AG

7 May 1987

Dear Tony

N B M

**ROLLS-ROYCE PRIVATISATION**

Lord Cockfield came to see my Secretary of State last week to discuss the restrictions on foreign ownership in the Articles of Association of Rolls-Royce. He had been approached by an MEP enquiring whether those restrictions were consistent with the EEC Treaty. Lord Cockfield had no difficulty in accepting that Article 223 applied to Rolls-Royce but said that concern had been expressed that the restrictions might go further than was necessary to achieve HMG's legitimate objectives, especially when taken together with the restrictions on the nationality of directors and other provisions.

My Secretary of State explained the thinking behind the provisions, in particular the choice of 15%, and said that the Government had no doubt they were justified by Article 223. Lord Cockfield said that he would consider the matter further before deciding if any further action was appropriate.

The possibility of further action by the Commission cannot be ruled out but it appears probable that Lord Cockfield was merely going through the motions, particularly as he, had discussed with the French Government similar, though wider-ranging, proposals in their privatisation programme. My Secretary of State is satisfied that there is no need to take any action at present but considers that the Chancellor should be aware of the approach from Lord Cockfield in view of its possible relevance to future privatisations.

I am sending copies of this letter to the Private Secretaries to the Prime Minister, the Foreign Secretary and Sir Robert Armstrong.

Yours

Jeremy Godfrey

JEREMY GODFREY  
Private Secretary

JG3BAO

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ce:BG



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PS/ Secretary of State for Trade and Industry

28 April 1987

David Norgrove Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
London SW1A 2AA

N Ben.

Dear David,

As you will know, the Rolls-Royce prospectus was issued (on a restricted basis) at this morning's press conference when my Secretary of State announced the Offer for Sale price. The prospectus will be made more widely available on Thursday 30 April when it will also be published in national newspapers.

Please find enclosed two advance copies of the document for your information.

in attached folder

Yours ever,  
Michael

MICHAEL GILBERTSON  
Private Secretary

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PRIME MINISTER

PM 16/4

ml

**ROLLS-ROYCE PRIVATISATION**

We are now entering the final stages of the Rolls-Royce privatisation. The Pathfinder Prospectus was published on 8 April. The key dates in the timetable from now are 28 April when the offer price will be announced; 30 April when the Prospectus will be available; 7 May when the Offer will close and 19 May when dealings are expected to open. The Offer will be in two instalments with the second payment to be made on 23 September. The minimum application will be for 400 shares.

2 From now until dealings open, I must ask colleagues to take particular care in making any comments which could be regarded as an endorsement of Rolls-Royce shares. Investors must make their decision on the basis of the Prospectus itself. We can of course comment on the general benefits of privatisation and state our belief that Rolls-Royce will benefit from it but we should not offer any comment on Roll-Royce's prospects for which investors must be referred to the Prospectus.

3 My Private Secretary is writing separately to Departments on the question of disclosure of information during this period. But I should repeat in this note that the Government as vendor has a responsibility to ensure that material available to investors is accurate during this period. Therefore if there are any developments or statements which might be interpreted as having a material effect on Rolls-Royce's prospects we would have to see that

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supplemental listing particulars were issued which could have repercussions for the Offer. If any colleagues therefore have it in mind to make a statement which might have a material effect on Rolls-Royce I would be grateful if they would consult my Department. Moreover for these purposes, I think it would be sensible for my Department to be informed of any developments which are foreseen before the 19 May even though no statement or announcement is planned before that date.

4 Another area of concern is the legality and propriety of Ministers purchasing and holding Rolls-Royce plc shares. The advice in Annex A addresses this question and has been prepared in consultation with Sir Robert Armstrong's Office. I should be grateful if colleagues would follow these guidelines when deciding whether they should buy shares. It is of course equally important to avoid the appearance of conflict of interest and if in doubt it is obviously best to err on the side of safety.

5 Copies of this minute go to all Cabinet colleagues, to John Wakeham, Bertie Denham and Michael Havers and to Sir Robert Armstrong. I would be grateful if colleagues would circulate this guidance to all Ministers within their Departments.

PC  
PAUL CHANNON

15 April 1987

DEPARTMENT OF TRADE AND INDUSTRY

JG1AZO

## PURCHASE OF SHARES BY MINISTERS

There are two points for consideration:

- (a) whether it is proper for Ministers to purchase shares in the Rolls-Royce plc issue.
- (b) what are the constraints, either legal or of propriety in respect of the holding of Rolls-Royce plc shares.

(a) Purchase of Shares in The Rolls-Royce plc Issue

On the first question, it would clearly be ill-advised for Department of Trade and Industry Ministers to purchase shares in the forthcoming Rolls-Royce plc issue. This is because of the potential conflict of interest where Ministers are both shareholders themselves and are responsible for, or associated directly with, decisions which will affect the circumstances of shareholders immediately following the flotation, either through the share price, or matters affecting the aero-engine industry generally. For this reason, the same advice should apply in respect of MOD Ministers and Treasury Ministers who are concerned with the privatisation programme, and to the Prime Minister.

The position is less clear cut in the case of Ministers not directly concerned with the privatisation of Rolls-Royce plc. The guiding principle is that laid down in Questions of Procedure for Ministers that Ministers "must so order their affairs that no conflict arises, or appears to arise, between their private interest and public duties" and specific guidance on shareholdings is contained in paragraphs 72 and 73.



Paragraph 73 says that Ministers should "scrupulously avoid speculative investments in securities about which they have, or many be thought to have, early or confidential information likely to affect the price of those securities". The decision to privatise Rolls-Royce plc has, of course, been the subject of Cabinet and Cabinet Committee discussion and this has inevitably involved consideration of Rolls-Royce plc's prospects. Although many Ministers will not have had access to detailed financial information there is a danger that Ministers might be thought to have had access to inside knowledge. There is therefore some risk of embarrassment and the safest course would be for Ministers not to purchase shares during the initial flotation.

(b) **Subsequent Holding of Rolls-Royce plc Shares**

Here, of course, the issues are very likely those which would apply to the holding of any securities, but particularly shares held in any company where the Government continued to have substantial contractual and regulatory dealings. The legal issues are quite straightforward in broad outline:

- (i) it is a criminal offence ("insider dealing") for a Crown servant (ie a Minister or a civil servant) who has, because of his position, price sensitive information about a company's securities, to deal in them whether or not on the Stock Exchange unless he can prove he did not intend to take advantage of the information so as to make a profit or avoid a loss. Actually applying for Rolls-Royce plc shares in the initial issue does not fall within this (because, in the view of HMG solicitors, it is not "a dealing" but is, rather a direct contract with

the Secretary of State). However, it is most unlikely that a Minister (or civil servant) other than one concerned with contracts with Rolls-Royce plc will have such information because of his position per se;

- (ii) if Ministers (or civil servants) are concerned in the aero-engine industry generally a shareholding in Rolls-Royce plc may well be evidence of bias in particular decisions. Bias invalidates administrative acts and may well found an action in damages against the Crown.

Here again the advice contained in Questions of Procedure, and particularly in the paragraphs referred to above, is relevant.

Ultimately Ministers must decide for themselves whether to purchase Rolls-Royce plc shares. They will want to bear in mind that it is as important to avoid the appearance of conflict of interest as to avoid actual conflict.



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PS/ Secretary of State for Trade and Industry

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15 April 1987

Ian Andrews Esq  
Private Secretary to the  
Secretary of State for Defence  
Ministry of Defence  
Main Building  
Whitehall  
London SW1A 2HB

Dear Ian,

ROLLS-ROYCE PRIVATISATION : PUBLICITY

As you know, the Government's plans for the privatisation of Rolls-Royce are continuing and the Pathfinder Prospectus was published on 8 April.

It is now necessary to issue guidance about the release of information relevant to the sale during the period between now and the opening of dealings on 19 May.

I therefore attach a note which has been prepared by this Department about the release of such information by the DTI. I should be most grateful if you would ensure that similar arrangements are made in the Ministry of Defence, and that your officials consult one of the Air Division officials named in the note before releasing information which is relevant to the Rolls-Royce sale.

Following precedent, and because of the need to exercise tight control over the release of such information, it is necessary that disclosure should be limited within Whitehall to the DTI and the Ministry of Defence. My Secretary of State would be most grateful if the colleagues in charge of other Departments would arrange for any enquiries which their Departments might receive which are relevant to the Rolls-Royce sale to be directed to the DTI or, if there is a defence angle, to the Ministry of Defence.

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These arrangements should be brought into effect as soon as possible.

I am copying this letter and enclosures to Private Secretaries to other Ministers in charge of Departments.

*Yours ever,*

*Michael*

MICHAEL GILBERTSON  
Private Secretary

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ANNEX II

ROLLS-ROYCE : PUBLICITY

Note by Air Division

1 HMG proposes to sell its existing shareholding in Rolls-Royce at the end of April. It proposes also to subscribe for a number of new shares in Rolls-Royce and to sell those shares in the same Offer for Sale. The new shares will thus effectively raise new capital for the Company.

2 The Offer will be made by means of a Prospectus to be available from April 30, the price of the shares having been announced on April 28. A "pathfinder" or draft Prospectus was published on 8 April. This is expected to be almost identical to the final Prospectus but does not price the shares.

3 The purpose of this note, which has been prepared by Air Division, in consultation with the Department's solicitors, is to establish Guidelines for the release of information by the DTI to anyone outside Government, whether the general public or a particular person, which might be relevant to the share offer. This Guidance is effective from now until the commencement of dealings on 19 May. It should also be taken to cover however matters which are being considered before that date but which are not expected to become public until the weeks after that date.

Relevant information

4 Relevant information is information which -

(a) in any way relates to the offer for sale, its timing, terms or mechanics; or

(b) reflects on the merits of Rolls-Royce ie relates to Rolls-Royce operations, finances or prospects, or to the aero engine or aerospace industries generally, to an extent capable of influencing an investor's decision to acquire shares; or

(c) encourages or otherwise effects interest in the sale.

5 Answers given to written Parliamentary Questions are also covered by this note where they relate to Rolls-Royce or might in any way relate to the Offer of Shares in the company.

6 Within the DTI only authorised persons (see paragraph 6 below) may disclose information and disclosure may not be made by them without prior clearance with one of the following officials of Air Division - M K O'Shea, C A Varley, P G Waller. They will consult the Department's solicitors and the Company as necessary.

Disclosure by authorised persons

7 The channels of communication from DTI are limited to Ministers and specified staff in the Press Office. This means they and no other staff are authorised to release information. Similar arrangements are being made within the MoD. It has been agreed that disclosure within Whitehall shall be limited to the DTI and MoD. Other Departments are being requested to direct enquiries to

the more appropriate of these two Departments.

Detailed guidance

8 Information released by those authorised to do so will be factual in nature and avoid any expression of opinion about the prospects of the Offer or the merits of Rolls-Royce. It will refer to the fact that a prospectus will be issued which will contain details of the offer and the business and activities of Rolls-Royce and enquirers will be recommended to read it or, until the Prospectus is issued, the Pathfinder. They will be told where copies of these documents may be obtained and no additional information will be given. At no time will any information be given as to the amount of cash expected to be raised.

9 At all times care will be taken not to release information that might prejudice the success of the Offer or amount to HMG's endorsement of Rolls-Royce as "a good investment". Nor will information be released which is not in or inconsistent with the Prospectus.

AIR DIVISION  
APRIL 1987



Secretary of State for Trade and Industry

PS/

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CCBG

9 April 1987

David Norgrove Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
London SW1A 2AA

Dear David, NBBN.

As you will know, the Rolls-Royce Pathfinder prospectus was released yesterday. I enclose two copies for your information.

one given to BG  
one in folder attached

Yours ever,

Michael ✓

MICHAEL GILBERTSON  
Private Secretary

JG4ATW

~~COB~~



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Secretary of State for Trade and Industry

**CONFIDENTIAL**

9 February 1987

The Rt Hon Norman Lamont MP  
Financial Secretary to the Treasury  
Treasury Chambers  
Parliament Street  
LONDON  
SW1

N BAN

*Norman Lamont*

**ROLLS-ROYCE PRIVATISATION**

Thank you for your letter of 20 January.

I have now confirmed the feasibility of the 28 April impact day, and I am content to relinquish the fall-back option of 6 May.

I am sending copies of this letter to the Prime Minister, the Secretary of State for Defence, the Lord Privy Seal, the Lord President, the Chancellor of the Duchy of Lancaster, the Secretary of State for Transport and the Chief Whip and to Sir Robert Armstrong.

*[Handwritten signature]*

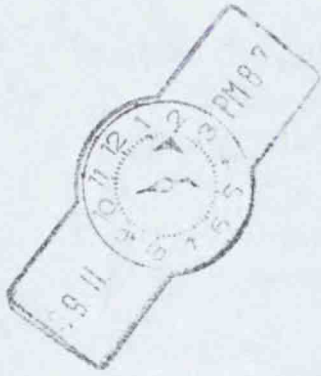
PAUL CHANNON

*Paul*

DW4BYX



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CBS

Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Paul Channon MP  
Secretary of State for Trade and Industry  
Department of Trade and Industry  
1-19 Victoria Street  
LONDON  
SW1H 0ET

20 January 1987

NBLM.

*Dear Paul*

**ROLLS-ROYCE PRIVATISATION**

I have seen your minute to the Prime Minister of 15 January.

From the viewpoint of the privatisation programme generally, I have no objection to advancing the Rolls-Royce impact day from 6 May to 28 April, if you are convinced that the shortened timetable is feasible.

However, I do not think it is desirable to keep open the 6 May slot as an alternative for as long as you wish. Private sector demand for places on the new issue queue is strong, nor is it good practice for the Government to crowd out such demand by blocking more than the single impact day necessary for an offer. I would suggest that you take steps to confirm the feasibility of the 28 April impact day with the company, and with other parties as necessary. Once this has been done, the 6 May slot should be relinquished.

Copies of this letter go to the recipients of your minute.

*Yours  
Norman*

**NORMAN LAMONT**

End pol

How Royce

PT 3





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PRIME MINISTER

Prime Minister<sup>2</sup>  
for information<sup>1</sup>

*MS*

*JHS*  
15/11

ROLLS-ROYCE PRIVATISATION

I have been reviewing the precise timing of the Rolls-Royce privatisation within the agreed April/May slot. In this connection I have had particular regard to possible political developments. There is also a possible difficulty in terms of prospectus disclosure if decisions on the European Fighter Aircraft are being reached at around the same time as the privatisation, which argues for maintaining some flexibility.

2 I have concluded that we should aim for the earliest practicable timetable in the agreed slot which, because of Easter, means that impact day would be on 28 April. On this timetable the pathfinder prospectus would be issued on about 8 April, the offer would close on 7 May and dealings would start about a week later, perhaps on 14 May. At the same time I would maintain a degree of flexibility by keeping open as a fall-back impact day on 6 May, with all the other dates about a week later than on the earlier timetable. I hope it will be possible to keep open this option until shortly before publication of the pathfinder, although this may become increasingly difficult for logistical reasons.

3 I am sending copies of this minute to the Chancellor of the Exchequer, the Secretary of State for Defence, the Lord

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Privy Seal, the Lord President, the Chancellor of the Duchy of Lancaster, the Secretary of State for Transport and the Chief Whip and to Sir Robert Armstrong.

PC

PAUL CHANNON

15 January 1987

DEPARTMENT OF TRADE AND INDUSTRY

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bc BG

10 DOWNING STREET  
LONDON SW1A 2AA

*From the Private Secretary*

10 December 1986

*Dear Catherine,*

Rolls Royce Privatisation

The Prime Minister has considered your Secretary of State's minute of 4 December which proposed to make a further announcement about privatisation of Rolls Royce.

The Prime Minister is content, subject to the views of colleagues.

I am copying this letter to the Private Secretaries to the Lord President, members of E(A) and to Trevor Woolley (Cabinet Office).

*Yours,  
David*

(DAVID NORGROVE)

Miss Catherine Bradley,  
Department of Trade and Industry.

BM



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11 B/F Tuesday.

PRIME MINISTER

Yes mb

Prime Minister!  
Agree the proposed  
announcement, subject to colleagues?  
(The Treasury are intent.)

ROLLS-ROYCE PRIVATISATION

JRW  
9/12

In March this year we discussed in E(A) <sup>attached</sup> some of the issues which arose on the privatisation of Rolls-Royce.

2 It was agreed that I impose a limit of 15 per cent on foreign shareholdings and that this provision should be protected by a Special Share held by the Government. This follows the precedent set by British Aerospace and it was agreed to be justified on the grounds of Rolls-Royce's strategic importance as the only UK manufacturer of aeroengines, and the leading European manufacturer. E(A) also agreed to further provision that the Chairman, Managing Director and at least 75 per cent of the Board should be UK citizens.

3 Two further provisions were discussed but not decided, and I was asked to settle these in consultation with Rolls-Royce, and with colleagues in the Treasury and MoD, before reporting back to E(A).

4 The first, was a proposal by Rolls-Royce for a time limited provision to impose a limit of 15 per cent on individual shareholdings protected by the Special Share. I have agreed with the company to have this provision, protected by the Special Share, but that it should expire on 1 January 1989. Whilst it is justified on the grounds that

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the company need additional protection against a predatory takeover in the immediate aftermath of privatisation, Norman Lamont and I feel that it should be strictly time limited to enable the company to adjust rapidly to life in the private sector.

5 The second outstanding provision, which E(A) endorsed in general terms, was a proposal that material disposals of the company's assets should be made subject to the Special Shareholder's consent, as an additional safeguard to prevent foreign control of strategic parts of the business.

David Trefgarne has been particularly concerned to secure this provision, which should not involve an unreasonable infringement of the company's commercial freedom. I have therefore reached agreement with the company that the Articles of Association should contain provisions requiring the Special Shareholder's consent for the disposal of 25 per cent or more of the assets of the company as a whole, or of assets employed in the nuclear business.

6 Now that a settlement has been reached on a number of important issues, I should like to press ahead with a further announcement on the privatisation which would also refer to a target timing of April/May 1987 for flotation.

7 I would envisage making this announcement by means of an arranged written PQ. I should be glad to know if you are content.

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8 Norman Lamont and I have also reached agreement with Rolls-Royce that they should have nil gearing on flotation. The implication of this on present forecasts of Rolls-Royce's 1986 results is that Rolls-Royce will retain approximately £300m of the gross proceeds of privatisation. Previous forecasts had tentatively put such proceeds in the range of £850m to £1bn on the assumption that the company would retain £100-£150m; our advisers consider that the net proceeds to HMG will not be significantly affected by the size of capital injection, as the gross proceeds can be expected to rise in accordance with the approved balance sheet. We are currently discussing with our advisers a precise form of words to include on this issue with the arranged PQ.

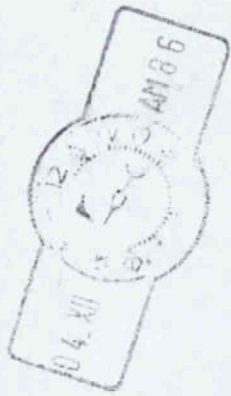
9 A copy of this minute goes to Willie Whitelaw, E(A) colleagues, and to Sir Robert Armstrong.

PAUL CHANNON

4 December 1986

DEPARTMENT OF TRADE & INDUSTRY

DW2BGU



MJD POL: Rolls Royce Pt 3,

COMMUNICATIONS  
SECTION



COMMUNICATIONS

2  
PRIME MINISTER

ROLLS ROYCE

The minute below from Mr. Channon reports that Rolls Royce and General Electric will shortly decide to terminate their current collaborative agreement. The background note attached to the minute is well worth reading and, strangely, is the place where the reason for this decision is explained.

Mr. Channon takes the view that if this is what Rolls Royce want to do, we have to trust their decision. This must be right: it would be quite extraordinary to overrule the commercial decision of a company which is about to return to private ownership. The Policy Unit agree.

DTI tell me that Sir Gordon Reece has connections with GE. They guess that he may at some stage approach you to explain the GE side of the argument.

DN

(DAVID NORGROVE)

14 November 1986

NBPN.

no please

MR NORGROVE

13 November 1986

ROLLS ROYCE/GE AGREEMENT

I have read the DTI paper recommending that Rolls Royce be allowed to terminate their collaborative agreement with GE on the grounds that the venture is not really working and is in fact inhibiting Rolls Royce's more general commercial ambitions.

It seems to me that with privatisation due before the middle of next year and the generally good track record that Francis Tombs has established at Rolls Royce that the correct thing to do in this instance is to support his proposal to disentangle from GE along the lines suggested in the Secretary of State's minute.

I do not yet have the background to comment in any detail on Rolls Royce's commercial plans with regard to different engines and how they might be developed and marketed. However I have been involved in joint venture agreements in other fields and it is always difficult when a giant is in partnership with a relative minnow. Certainly when the original hopes and intentions of a joint venture go sour the best thing in both sides' commercial interests is to disentangle as quickly and painlessly as possible.

I have discussed this with John Wybrew who agrees.



GEORGE GUISE

ROYCE ROUB POLICE AGREEMENT

[Faint, illegible text, likely a contract or agreement document]



ce BG

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PRIME MINISTER

ROLLS-ROYCE

Sir Francis Tombs has informed me that he believes it likely that Rolls-Royce and General Electric will shortly decide to terminate their current collaborative agreement. This is likely to be confirmed following talks Sir Francis is due to have with GE in the United States next Monday, 17 November.

...

I attach a background note which gives details of the present agreement between the two companies, Rolls-Royce's view of it and an assessment of the effect of its termination on their strategy.

2 Although on the face of it the termination of the agreement would represent a radical change in Rolls-Royce's strategy, Sir Francis is convinced that in the circumstances it is in the company's commercial interests. My Department has consulted our financial advisers Samuel Montagu.

Their advice is:

- (a) The immediate financial impact of withdrawal from the agreement would be favourable. Rolls-Royce estimate this at £70m over the next five years.

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(b) The overall impact on privatisation will depend to a large extent on the success with which Rolls-Royce and their advisers can present the outcome and its impact on the company's future strategy. If they can demonstrate convincingly that the general collaboration strategy is intact - and in particular if they could show that the possibility of a future collaboration with GE is not ruled out - then there need be no negative impact.

3 We cannot be certain how successful Rolls-Royce will be in presenting the decision in this light, but they would vigorously deny that termination of the GE agreement would signal the end of the collaboration strategy. They would argue that the GE agreement as it stands is not really a true collaboration but a worksharing arrangement (with the prospect of possible further collaboration in the future); the collaboration with Pratt and Whitney and European and Japanese manufacturers on the V2500 continues; there is a good chance of a new version of this engine being developed for the A340 and Boeing 7J7; and other collaborative possibilities, notably on new technology engines, are also under consideration. There is also a possibility that Rolls-Royce might continue a more limited sub-contract arrangement with GE after termination of the current agreement.

4 Although the original decision by Rolls-Royce to enter into the agreement with GE was subject to approval by the Government, at the same time as the decision to give launch aid for the V2500, we do not have power under our memorandum of understanding with Rolls-Royce to prevent them from terminating the agreement. In any event, I believe it would

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be wrong to seek to alter a commercial decision of the Board, especially with privatisation imminent. The company face a difficult decision, and I am satisfied that they have reached a justifiable commercial view. I have asked Sir Francis Tombs to consult me closely on the presentation if the agreement is indeed terminated to ensure the best possible impact from the point of view of privatisation. There may be a need for an announcement soon after the discussions with GE on Monday.

5 I am sending copies of this minute to Sir Geoffrey Howe, Nigel Lawson, Norman Tebbit, George Younger and John Moore, and to Sir Robert Armstrong.

P.C.

PAUL CHANNON

November 1986

DEPARTMENT OF TRADE AND INDUSTRY

JF 3AUR





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ROLLS-ROYCE

BACKGROUND NOTE

The current agreement between Rolls-Royce and GE, approved by the Government in February 1984 and signed in April 1984, provides for reciprocal workshares by RR on the CF6-80C (an engine series in the largest category of thrust, 56,000 lbs plus) and by GE on the RB211-535E (a series in the 35,000 - 45,000 lb thrust range designed to power medium haul aircraft). The workshare is 15 per cent with provision to increase to 25 per cent.

2 The agreement also refers to the possibility that market requirements might necessitate the development of a new engine or engines to succeed the current generation. There is some evidence that the parties also envisaged a joint programme of technology development in advance of any specific new project, though this is not specified in the agreement. These wider possibilities have not materialized, and the arrangements are in practice confined to the reciprocal 15 per cent workshares. Moreover, as a consequence of Rolls-Royce's decision to develop the RB211-524 D4D the financial arrangements have been amended so that Rolls-Royce's participation in the CF6-80C2 is effectively on a subcontract not a risk and profit-sharing basis.

Rolls-Royce current view

3 In the second half of 1985 Rolls-Royce concluded that there was considerable market potential in the development, at relatively little cost, of a version of the RB211-524, the

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D4D, which would have up to 58,000 lbs of thrust and would compete with the CF6-80C2 on certain applications. This potential had not been appreciated when agreement with GE was concluded. Rolls-Royce now wish to offer the D4D not only on the B747-400, which they see as offering substantial business for the next ten years or more, but, in a developed version, on new trijets such as the MD11 if it is launched.

4 Although the RR/GE agreement was amended early in 1986 as a consequence of the original D4D development, GE resented what they saw as action by Rolls-Royce which was contrary to the spirit of the collaborative agreement, and this resentment surfaced during and after the competition for the British Airways Boeing 747-400 order in August.

Rolls-Royce now believe that GE will only agree to continued collaboration if they undertake not to offer the D4D on specified types of new aircraft, including trijets.

Rolls-Royce believe this would be contrary to their commercial interests. It would also probably be illegal under US anti-trust law. (There is already a possibility that the Department of Justice will seek an injunction against the present agreement on anti-trust grounds, though this is uncertain). Rolls-Royce will gain a short-term financial advantage from terminating the agreement, and believe the D4D, developed and marketed without restriction, offers greater potential than the worksharing agreement with GE.

Implications for Rolls-Royce strategy

5 Termination of the agreement with GE would on the face of it represent a major and possibly damaging departure from Rolls-Royce's collaborative strategy. The strategy of

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collaboration in different sectors of the civil market was developed under Sir William Duncan's chairmanship with strong encouragement from the Government. It was seen as a means of compensating for Rolls-Royce's position as a smaller and financially weaker company than its two US competitors, by enabling it through collaboration to maintain a position in all the main sectors of the civil aircraft market.

6 Without GE, RR's ability to remain a force in the big engine market will in the short term depend on the competitiveness of the D4D and their ability to fund developments of it on their own, either from internal and commercial sources or with the help of Government launch aid. In the longer term it will depend on collaborative ventures which Rolls-Royce will need to judge on their merits at the time. The Department has consulted its technical advisers in the Ministry of Defence, who have serious misgivings about Rolls-Royce's plans. They are sceptical about the company's claims that it can develop the 524 for application on new trijets at relatively little expense using technology demonstrated in the advanced engineering programme. There must be a fear that Rolls-Royce will seek substantially greater launch aid than they would otherwise have done. However Rolls-Royce have told us that, though there may be applications for launch aid in the future, Rolls-Royce have not assumed any launch aid in the forecasts on which their plans for the D4D are based.

7 Against these strategic considerations there is a clear commercial logic, particularly in the short term, in what RR propose. It is difficult to argue against the conclusion that continued participation in the CF6-80C2, looked at in isolation, is less attractive than further development and

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marketing of the D4D (whose potential was not apparent when RR entered into the agreement with GE). Moreover a principal objective of the GE arrangements for RR was the possibility of 50/50 collaboration on a new engine, which it seems is no longer in prospect.

DEPARTMENT OF TRADE AND INDUSTRY  
12 November 1986

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PRIME MINISTER

Rolls Royce Privatisation  
(E(A)(86)13)

BACKGROUND

In this paper the Secretary of State for Trade and Industry sets out his broad proposals for privatising Rolls Royce, in accordance with the 1983 Manifesto commitment. Rolls Royce made a loss of £193 million on a turnover of £1331 million in 1983, but since then the Company's financial performance has improved sharply, with profits for 1986 forecast at £110 million on a turnover of £1905 million. Meanwhile gearing is expected to fall from about 80 per cent at the end of 1984 to about 50 per cent at the end of 1986.

2. Samuel Montagu, the Department's merchant bank advisers, judge that privatisation should be possible by flotation from September 1986 onwards (i.e. once the results for the first half of 1986 are available). After allowing for a further capital injection of £130-215 million in order to strengthen the Company's balance sheet, the net proceeds from a flotation are estimated at £625-750 million. The alternatives to flotation would be a negotiated sale either to a consortium or to a single purchaser. In view of the Company's strategic importance as a defence supplier, sale to a foreign company could not be contemplated. This leaves GEC as the only possible UK purchaser, while sale to a consortium seems unlikely to raise as much as disposal by flotation.

3. The present Cranley Onslow assurance that the Government would meet Rolls Royce's debts in the event of liquidation would be withdrawn on privatisation. Rolls Royce would then be the only major aero-engine manufacturer in the world which was not either part of a wider group (as are its US competitors Pratt and

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Whitney, and General Electric) or State-owned; in the long run some kind of merger or permanent relationship with other - possibly foreign - companies might well prove sensible, but it would be reasonable for the Government to retain some element of control over such developments. There will in any event be a continuing relationship between the Company and the Government through the provision of launch aid for new products. One such application, for the development of a more powerful version of the V2500 engine, probably associated with British Aerospace participation in the development of further aircraft types by Airbus Industrie, is likely to need to be decided before flotation can take place, not least because of the difficulty otherwise of drafting a prospectus. No immediate decisions are required, and it should be possible to deal with this matter on its merits in a normal timescale.

4. It is too soon to settle the timing of the flotation or its precise arrangements (e.g. whether the shares should be sold at a fixed price or by tender underwritten at a minimum price). The timing will be constrained by the competing claims of other privatisations (notably British Gas) and by the need to fit in with the 'Big Bang'. The Treasury's present view is that <sup>early</sup> 1987 is the best prospect, but this will need to be considered later in the light of market developments.

MAIN ISSUES

5. The main issues before the Sub-Committee are

- i. whether the privatisation should go ahead during the coming financial year; and if so,
- ii. the safeguards required to ensure the 'Britishness' of the Company and its ability to meet UK defence requirements.

6. On privatisation, general agreement seems likely that this should go ahead in the manner and on the time-scale proposed. Retention in Government ownership would not be helpful to the

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achievement of the standards of efficiency and competitiveness the Company will need to maintain to survive in a difficult world market; and there is no other UK company which could sensibly provide the wider backing Rolls Royce might wish to have in the longer run for its activities. On timing, I have enquired whether it would be possible to speed matters up and go for flotation in the summer, to fill the British Airways gap. But the need to be able to reveal the 1986 first half results seems to rule this out.

7. On safeguards the proposal is that these should (as with British Aerospace) be entrenched through Government ownership of a Special Share. The issues to be covered are

- a. restrictions on foreign ownership of the company;
- b. possible further restrictions on the size of share holdings;
- c. restrictions on the disposal of assets; and
- d. provisions concerning the Directors.

The Company's Articles of Association will be prepared so as to reflect the Government's decisions; thereafter changes in the Articles would only be possible with the agreement of the Government as Special Shareholder.

8. On foreign ownership there seems to be general agreement that this should be limited to 15 per cent of the voting equity. This will have to be justified in the EC context in terms of the requirements of defence/national security. (The same considerations would not apply to BL, while Westland was already in the private sector and not subject to any special Government powers.)

9. Limits on shareholdings (i.e. to prevent takeover): the Company have suggested that for a period of five years no shareholder should be permitted to hold more than 15 per cent of the equity. The Trade and Industry Secretary, however, sees no need to prevent a British takeover of the Company, given that

there would already be protection against foreign takeover. But the intention would be not to allocate more than 10 per cent of the shares to a single purchaser at the time of flotation, in accordance with the precedent of other recent privatisations.

10. The power to prevent disposals of assets is needed to make effective the prohibition of foreign control, and to ensure that particular activities of importance to the UK defence programme do not pass unchecked out of UK ownership. There is no dispute about the principle, but further consideration will be needed of the precise formulation. The control needs to be tight enough to cover e.g. helicopter engine manufacturing, but not so tight as to interfere unreasonably with the Company's commercial freedom. Only general approval of the concept is required at this stage; the details can be left to be settled later.

11. On provisions relating to the Directors, the Secretary of State's proposal - that the Chairman, Chief Executive and 75 per cent of the directors should be UK nationals - is a compromise between the British Aerospace provision (100 per cent UK nationals) and the Company's preference (no restrictions). The Company already has one US citizen among its directors, and Mr Channon's compromise seems sensible. Unlike British Aerospace, where the power to appoint a Government Director has been retained despite the sale of the Government's residual shareholding, in the light of the Government's contingent liability arising from British Aerospace's participation in Airbus Industrie, it is not proposed to have any power to appoint a Government Director. It might be as well to establish that there is no risk of the Government having to undertake contingent liabilities for Rolls Royce in the context of international collaboration arrangements comparable to those assumed in the case of British Aerospace/Airbus Industrie.



  
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HANDLING

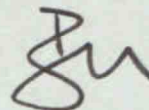
12. The Secretary of State for Trade and Industry will wish to introduce the discussion of his paper. Thereafter the - Chancellor of the Exchequer and/or the Financial Secretary, Treasury will need to comment on the financial aspects of the privatisation. The other Minister with a substantial interest is the Minister for Defence Procurement (representing the Secretary of State for Defence); the Company is important as a supplier of strategic defence equipment, and the Ministry is an extremely important customer. Other Ministers may wish to comment on the political aspects of the flotation.

CONCLUSIONS

13. You will wish the Sub-Committee to reach conclusions on

i. the principle of privatisation of Rolls Royce during the next financial year by means of a flotation, with disposal of 100 per cent of the shares; and

ii. the safeguards to be enforced through a Special Share held by the Government, covering foreign ownership, size of share holding and disposal of assets and nationality of the directors.



J B UNWIN

Cabinet Office  
19 March, 1986.

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PRIME MINISTER

19 March 1986

ROLLS ROYCE PRIVATISATION

Rolls Royce is a genuine success story: losses of £134m in 1982 have been converted into forecast profits of £110m for 1986. Orders stand at £2.5bn, equivalent to 18 months' work. RR's short-term future seems secured; it must be an ideal time for privatisation. There are two issues to be addressed: when can RR be floated, and what constraints should apply?

When can RR be floated?

RR itself will be ready as soon as the 1986 half-year results have been announced and it is able to publish a proper forecast for the full (calendar) year. This means September at the earliest.

Treasury argue that a sale of RR in September could prejudice the £7bn Gas privatisation, even though this has now been rescheduled for 21 November. They fear it would take the City's eyes off the Gas privatisation, and if the RR sale flopped, that it would seriously tarnish the Gas sale. They are also worried that the gas marketing campaign could overlap with RR's campaign to the detriment of both. Shortage of funds is not a problem, (gilt sales could easily be reduced if necessary).

These arguments treat the City as a pretty unsophisticated place. Although there is clearly some risk that early privatisation could affect the Gas and/or RR proceeds, officials inevitably take a very risk averse stance.

The alternative is not particularly attractive. January 1987 is the next possible date, but British Airways must surely have priority. With the British Airports Authority

and the Trustee Savings Bank also in the queue, RR could be pushed out into the Summer 1987 and into the possible Election season.

What Constraints Should Apply?

DTI are proposing:

1. a maximum holding by foreigners in aggregate of 15%;
2. restrictions on asset sales (apparently to guard against the sale of peripheral businesses, such as marine propulsion); and
3. that 75% of the Directors be British.

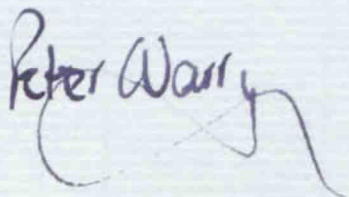
RR is the smallest of the three major aeroengine manufacturers, and the only one that is not part of a bigger group. Its survival depends upon international collaboration. So whilst it is right for DTI to recognise that RR is even more "British" than Land Rover, it is surely wrong to apply more constraints than strictly necessary. If later RR need some of the constraints removing, Government may have to agree in the face of red-blooded, "patriotic" opposition.

Recommendations

We recommend that:

1. Treasury be pressed to agree privatisation in mid-September;
2. the belt and two pairs of braces DTI propose, be reduced to just a single constraint of a maximum of 15% foreign ownership.

PETER WARRY





JF8099

Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY  
1-19 VICTORIA STREET  
LONDON SW1H 0ET  
TELEPHONE DIRECT LINE 01-215 5422  
SWITCHBOARD 01-215 7877

20 May 1985

Sir Francis Tombs  
Chairman  
Rolls-Royce Limited  
65 Buckingham Gate  
LONDON  
SW1E 6AT

*D Francis,*

CORPORATE STRATEGIC PLAN 1984-1993

Since Sir Arnold Hall submitted the new Corporate Strategic Plan we have corresponded about the idea he raised of a presentation. We have agreed, I think, that this should wait until you have formed a clearer view of the steps that will be necessary to prepare the Company for privatisation.

In the meantime I am pleased to endorse the general strategy outlined in the Plan as a sound basis on which to proceed, while recognizing that with indicative material of this type it would be unwise to place too much weight on the financial projections for the later years in particular.

The hazards identified in the Plan make your task of maximising the performance of the Company all the more challenging. But I think that the Plan contains a realistic product strategy centred on collaborative projects and I welcome the conservative line it takes in its market assumptions. The task of managing an effective advanced engineering programme with more limited resources is, I recognize, a particular challenge if the Company is to retain its ability to respond to the demands of the market and to collaborate effectively around the world. But in your preparations for privatisation further action in this and other areas to improve productivity will, I believe, be your major concern.

When we met on 30 April for a preliminary discussion on privatisation, one of the points on which we touched was



the need for a reconstruction of the Company's balance sheet to eliminate the existing negative reserves. I believe this is an issue which we should address soon, and I look forward to receiving your proposals.

*Yours  
Norman*

NORMAN TEBBIT

Copies of this letter go to the Prime Minister,  
Secretaries of State for Defence and Employment, the Foreign  
Secretary and Chief Secretary



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AJ  
14/5  
CJR

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Norman Tebbit MP  
Secretary of State  
Department of Trade and Industry  
1 - 19 Victoria Street  
London  
SW1P 3AJ

13 May 1985

*Norman Tebbit*

ROLLS ROYCE CORPORATE STRATEGIC PLAN 1984-1993

Thank you for your letter of 30 April enclosing a commentary on the above.

On the corporate plan itself, there are, as you say, no new issues for decision by Government, and the general strategy is based on that approved last year. I am therefore content for you to endorse the main elements of the new plan, while recognising the potential hazards attaching to it.

On privatisation, the Company seems to prefer a target date in the Spring of 1987, for reasons which I can understand. For the present, however, I am sure we should keep open the possibility of going to the market earlier than this, perhaps in the Autumn of 1986, subject to a decision nearer the time in the light of the privatisation programme overall.

I also note that the new Chairman intends, quite rightly, to form his own assessment of the steps that will be necessary to prepare the Company for privatisation. In this context, I think it would be right to draw his attention specifically to the need to come to an early view on the method and timing of converting what is now a private company into the public company in whose name shares will be sold. The issues here are not easy given the negative reserves (representing accumulated losses) presently held on the Company's balance sheet, and there may be a case for appointing soon a Merchant Bank to advise you on what needs to be done and when.

Copies of this letter go to the Prime Minister, Geoffrey Howe, Michael Heseltine, and Tom King.

*Norman Tebbit* *Peter Rees*

PETER REES

(NT) Doc

R. Naylor

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14 MAY 1985

For E (A) folder  
for meeting on privatisation

MR TURNBULL

10 May 1985

ROLLS ROYCE CORPORATE PLAN

RR plan to be free of all borrowings by the beginning of 1988. In that year they forecast profits of £278m after both tax and interest on a turnover a little in excess of £2 billion. This assumes a conservative exchange rate of \$1.50 to the £; if this rate were reduced to \$1.30 then 1988 profits would be £91m better. Because much of their business is long term, even a pessimistic forecast of likely orders would still yield profits of £220m in 1988.

RR have sensibly arranged collaboration agreements with other manufacturers across virtually their whole product range thereby sharing costs and minimising risks. Nevertheless, having turned the corner to profitability (£20m after tax in 1984), RR still represent something of a lumbering liability in the public sector. RR could perhaps be sold in Autumn 1986 but are definitely saleable by May 1987. Indeed, as RR sell most of their dollar revenues forward, then assuming that sterling steadies and if anything strengthens, 1987 could be the very best time to sell.

The Prime Minister may wish to strengthen Norman Tebbit's letter to RR by suggesting that he adds at the end of the first paragraph "... prepare the company for privatisation which I hope will be not later than May 1987".

  
PETER WARRY



Rolls Royce

ROLLS ROYCE CORPORATION

INVESTMENT STATEMENT FOR THE YEAR ENDED 1957

ROLLS ROYCE CORPORATION

ROLLS ROYCE CORPORATION

ROLLS ROYCE CORPORATION



*6/1/85 will be response. 4/1/85* *cc J/R*

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DEPARTMENT OF TRADE AND INDUSTRY  
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Secretary of State for Trade and Industry

30 April 1985

The Rt Hon Michael Heseltine MP  
Secretary of state for Defence  
Ministry of Defence  
Main Building  
Whitehall  
LONDON  
SW1A 2HB

*Dear Michael,*

ROLLS-ROYCE CORPORATE STRATEGIC PLAN : 1984 - 1993

Rolls-Royce's Corporate Strategic Plan is now before me for approval. The enclosed commentary (prepared by my officials and incorporating contributions from yours) highlights the key considerations.

2 The Plan outlines the strategy to be followed by the Company in the years to 1993. Its principal objective is to return to profitability in the shortest possible time and then to sustain profitability whilst maintaining the ability to participate in any sector of the market where a profitable opportunity exists. The remaining objectives of the Plan submitted and approved last year, namely to achieve independence from Government launch aid, expansion of market share and preservation of an independent design capability are restated, as fundamental to the latest Plan. As you might expect a new military engine for future fighter aircraft is identified as the most significant specific objective.

3 All three scenarios in the Plan envisage improved financial results in the short term, as a result of a stronger dollar, a higher proportion of military commercial sales, improvements in productivity, increase in turnover, reductions in commercial and administrative costs, and a reduction in R&D in real terms. The Base Plan predicts profits growing steadily and approaching £300m by 1988. Although the Plan is not designed to provide detailed financial forecasts I think increasing confidence can be attached to these projections. But as the Plan shows they are sensitive in particular to exchange rate movements.

4 Unlike last year the Plan does not present any new issues for decision by HMG, the general strategy being squarely based on the Plan approved last year following the launch of the V2500 and

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RTM322, and confirmation of the deal with GE on large civil engines.

5 As the newly appointed Chairman Sir Francis Tombs views the Plan as satisfactory on a strategic and indicative basis. But he is naturally undertaking his own analysis of the steps that will need to be taken, and the targets that will need to be set, in order to achieve the Government's privatisation objective. This may lead later in the year to a reworking of some of the assumptions on future costs, and hence some of the detailed financial forecasts. But as soon as he has formed a clearer view of the privatisation flight path I expect to review the way forward with him. The modest profits for 1984 represent a good starting point.

6 I am confident that you and the Chief Secretary will want me to write to Sir Francis in the meantime to endorse the main elements of the new Plan while recognising the potential hazards attached to any long-term strategic plan. These include uncertainty about the pace of the recovery of the world airline market; about future movement in the dollar/sterling exchange rate; about the timing and nature of the EFA engine; and in the longer term about the effect of reductions in the company's R+D on its overall engineering competence.

7 I should like to be able to approve the Corporate Plan shortly and, unless I hear from you or the Chief Secretary to the contrary, .. I propose to write to Sir Francis in the terms of the attached draft two weeks after the date of this letter.

8 I am copying this to the Prime Minister, the Foreign Secretary, the Secretary of State for Employment and the Chief Secretary.

NORMAN TEBBIT

JH3BPZ

DRAFT LETTER FROM SECRETARY OF STATE FOR TRADE AND INDUSTRY  
TO SIR FRANCIS TOMBS

ROLLS-ROYCE: CORPORATE STRATEGIC PLAN 1984-1993

Since Sir Arnold Hall submitted the new Corporate Strategic Plan we have corresponded about the idea he raised of a presentation. We have agreed, I think, that this should wait until you have formed a clearer view of the steps that will be necessary to prepare the Company for privatisation.

In the meantime I am pleased to endorse the general strategy outlined in the Plan as a sound basis on which to proceed, while recognizing that with indicative material of this type it would be unwise to place too much weight on the financial projections for the later years in particular.

The hazards identified in the Plan make your task of maximising the performance of the Company all the more challenging. But I think that the Plan contains a realistic product strategy centred on collaborative projects and I welcome the conservative line it takes in its market assumptions. The task of managing an effective advanced engineering programme with more limited resources is, I recognize, a particular challenge if the Company is to retain its ability to respond to the demands of the market and to collaborate effectively around the world. But in your preparations for privatisation further action in this and other areas to improve productivity will, I believe, be your major concern.

NB 17

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Secretary of State for Trade and Industry

To accompany  
Norman Tebbit's  
letter 30/4/85

Rolls Royce  
Corporate Plan.  
Apologies for  
Omission.

2/5/85

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## ROLLS-ROYCE CORPORATE STRATEGIC PLAN 1984-1993

Commentary by Department of Trade & Industry

## INTRODUCTION

1 This Note provides a commentary on the main features of the Rolls-Royce (RR) Corporate Strategic Plan 1984-1993.

## STATUS OF THE PLAN

2 Sir Francis Tombs, formerly a non-executive Director of the Company, took over as RR's Chairman on 1 February 1985. He views the Plan as satisfactory on a strategic and indicative basis, but is now undertaking a review of the steps that will need to be taken, and the targets that will need to be set, in order to achieve the privatisation objective. Over the coming months this may lead to some reworking of assumptions on future costs, and hence some adjustment of the financial forecasts.

## CONTENT OF THE PLAN

3 The Plan contains fairly comprehensive financial information and an adequate discussion of the main programmes, although not surprisingly it has been necessary to seek a certain amount of supporting detail in discussions at official level with the Company. The Plan is regarded on both sides as primarily a strategic rather than a financial document, particularly as far as the second five years is concerned.

## OBJECTIVES

4 Consistent with the Government's own wishes the principal objective in the Plan is to return to profitability in the shortest possible timescale, and to sustain profitability thereafter whilst maintaining the ability to participate in any sector of the market where a profitable opportunity can be identified.

5 The remaining objectives of the previous Plan, namely independence of Government civil launch aid, expansion of market share and preservation of an independent design capability are restated as fundamental to the current Plan. These objectives remain, in our view, challenging but entirely appropriate. We also consider that Rolls-Royce are right to identify the launch of a future fighter engine as a problem requiring increasingly urgent resolution.



## MARKET CONSIDERATIONS

6. On the civil engine side, the most important engines over the period are the RB211-535E4, the CF6-80C collaboration with GE, the Tay and the V2500. Market predictions for the -535E4 are particularly difficult since it powers the Boeing 757 which sits in a particularly confused sector of the market. Sales have so far been disappointing. This is partly due to US deregulation encouraging use of smaller aircraft and partly due to a 15% real decrease in the price of jet fuel undermining the economic advantages of acquiring new and more efficient aircraft like the B757. Boeing have also been preoccupied with promoting the larger B767 in competition with the A310.

7. Sales figures for the -535 produced by DTI market analysts give an overall range for 1984-93 of 250-550. This is similar to RR's own range but the most likely figure is put at 400. However, this does not necessarily imply that the 757 will not - like the 727, whose early sales were slow - prove to sell very well. Also, as noted below, the main competitors to the 757 are aircraft in the 150 seat category, so that if -535E4 sales are modest, V2500 sales can be expected to be towards the top of their range.

8. With regard to the CF6-80C, the Plan assumes a rather narrow range of 1040-1117 for cumulative engine deliveries against DTI figures of 1250-1850. Air Division's view is that despite uncertainties about future traffic growth and the degree of deregulation worldwide (already reflected in the DTI figures) RR are underestimating the likely demand for this engine.

9. The appropriate period for deliveries of the V2500 engine is 1989-93 and RR forecast cumulative figures of 662 in the Low Plan case, 1040 in the Base Plan case and 1516 in the High Plan case. Although this range is wide, the range produced by DTI officials is even wider but generally lower. However, it is important to note that a low V2500 deliveries total would be associated with RB211-535 deliveries towards the top end of its range and vice-versa since low V2500 figures are associated with an assumed preference for larger aircraft.

10. In general terms the attainable forecasting accuracy for any category of engine beyond five years is accepted on all sides to be low. However, the Company has some confidence in an overall free-world engine sale growth rate of 3.8% pa (by value at 1984 prices) resulting in a doubling of total business by the year 2000. This projection is not out of line with DTI forecasts. Because RR are now able to compete in all sectors of the market the overall turnover figures in the Plan are much less sensitive to market breakdown than has been the case in the past.

11. On the military engine side, the most important engine developments assumed over the period are the RB199 successor and



an up-rated Pegasus. Decisions on the former are intimately linked with discussions on a new European Fighter Aircraft but the engine is likely to have a material effect on turnover only towards the end of the Plan period.

12. The Plan envisages launch towards the end of the decade of a new family of small engines: a turboprop, a turbofan for business jets, and a small military turbofan to replace the Viper and Adour. The RTM322 which has both civil and military helicopter applications has an encouragingly large potential market base. It has yet to attract its first order but its development is proceeding on target. MOD have confirmed RR's estimated military engine sales forecast as reasonable in the light of known programmes.

13. The Plan discussed various factors which impact on RR's performance in the military engine field and influence its decision making process. Of these the level of US defence expenditure is considered to have the most significant impact on the Company, with the Adour and Pegasus projects most at risk were there to be a substantial reduction. The increase in the number of countries demanding offset or countertrade as a prime condition of purchasing RR engines is identified by the Company as a worrying development although we see no realistic way of overcoming this in the near future. The volume of RR business affected by technology export embargoes is a source of concern. Here HMG's influence is limited, but there is nevertheless scope for attempting to establish sensible agreements with other nations, either generally or on individual projects, which should at least minimise the destructive effect of unilateral decisions.

#### BASE PLAN AND ALTERNATIVES

14. In a market which is perhaps more confused than it has been for several years, there is inevitably scope for debating the project and application assumptions in the various scenarios. But taken as a whole, the assumptions made by Rolls-Royce, and particularly those in the Base Plan, do not appear unreasonable. The most speculative assumptions, those concerning the launch of new engines, have little impact until towards the end of the Plan period; it should also be recalled that, as already discussed, the spreading of RR's civil product range through collaboration has much reduced the sensitivity of their turnover figures to detailed market assumptions. The exchange rate assumption (around £1 = \$1.5 for the later years of the Plan) appears reasonably conservative, and compares with an achieved figure of \$1.85 in 1984. This reflects RR's practice of selling its dollar income forward progressively, which both DTI and Treasury officials today consider a prudent procedure. Sensitivities to exchange rate movements are discussed below.

15. The improved profits forecast in the Base Plan results largely from the improvement in turnover, and from the tailing off of R&D on the major civil development programmes. By the end of the decade the Tay and the V2500 will have joined the -524 and -53584 in service, allowing the benefits of this R&D to be realised.





cash in sales. Given that RR have now reduced the Company's costs to the point where, in 1984, they were able to become profitable on a turnover of £1.4 billion, and given that further cost (including manpower) reductions are intended in the Plan period, there is nothing inherently implausible in the rapid improvement in profits forecast as turnover rises above £1.4 bn. The figures also benefit from an increase in "military commercial" (i.e. overseas military) sales, which are more profitable than sales to MOD, particularly the Pegasus and Adour programmes for the US forces.

16. The alternative scenarios show very little variation from the Base Plan in the early years, which is not unexpected given the long timescales characteristic of the business. The High Plan shows a potential for continued profit growth in real terms, whilst the Low Plan shows the Company reaching a stable, but more modest, level of profitability at a lower level of turnover.

17. RR identify a number of sensitivity factors which could materially affect their forecasts, and provide sensitivity analyses. These cover: a change in the sterling/dollar exchange rate both upwards and downwards; a worsening of 1% per annum in UK inflation, plus an improvement in US inflation of 1% per annum; a 50% reduction in the Base Plan market for the RB211-535; a total exclusion of any further productivity improvements. The greatest sensitivity is to the dollar/sterling exchange rate; a rate of £1 = \$1.7 would worsen profit by £75m in 1988, whereas a rate of \$1.3 would improve it by £91m.

18. Particular emphasis is laid, in the Company's financial projections, on reducing total R&D expenditure to around 10% of turnover and we consider that this is to be commended. However, since the objective is to be achieved whilst at the same time maintaining a competitive position across the full range of RR's products, it will be essential to secure the most effective deployment of the engineering resources concerned. Historically this has not been one of the Company's strongest points, and although valuable improvements have been made in recent years, there is still some way to go.

19. RR's objective of a continuing but more modest rundown in manpower to 36,000 by the end of 1988 (with the position remaining constant thereafter) should be welcomed and, on the basis of past experience, should be achieved without too much difficulty.

#### COLLABORATION

20. Two key elements in the Plan are the collaborative civil agreements reached in 1984 with GE, and with Pratt & Whitney, JAEC, MTU and Fiat to develop the V2500. These very significant agreements which RR have entered into on a sound commercial basis represent a coming to terms with a market dominated by the US majors. The degree of integration which has already been



established between RR and GE on the CF6-80 and RB211-535 programmes, and the rate of progress on the V2500 programme (both with regard to the development activity and the Pan Am launch order on the A320), are very encouraging.

21 In the military field, the collaborative debate centres on the arrangements for procuring a competitive new engine for EFA. The continued profitability of RR's military programme in the 1990s is also dependent on the Company establishing a strong position in this programme if it proceeds. RR's anxiety about entering into another European military engine collaboration as an equal partner with much smaller and less technically capable companies is understandable given the risks to RR's technical superiority in technology transfer to less advanced partners. There is, however, a recognition by RR that, despite these drawbacks, military collaboration amongst European companies is an essential step to enable the European industry to compete with the US giants. RR has nevertheless had preliminary discussions with P&W about collaboration on military engines (mainly VSTOL), but it is too early to predict the likely outcome whether or not a European solution to the EFA engine requirement can be achieved.

22 RR's small engine collaboration with Turbomeca, as an equal partner, in the new RTM322 is based on sound commercial considerations following their successful collaboration on the Adour. Rolls-Royce now see this as a means of moving towards a more permanent industrial accommodation which may lead to joint development of the Adour successor.

23 A Memorandum of Understanding is being signed with Piaggio under which the latter will join the RTM322 programme. A European Small Engine Agreement is also due to be signed shortly. Under the terms of this Agreement the parties (RR, Turbomeca and MTU (Germany)) undertake to promote the Turbomeca TM333, the MTU/Turbomeca MTM385, and the RTM322 for national requirements in their own countries, to avoid participation in competing engine projects, and to move towards co-ordination of their R&D and marketing.

24 These arrangements have been carefully drawn together over the last year or more by RR and are important to their plans to regenerate their small engine business. They are also very much in the spirit of the IEPG initiative in seeking to avoid duplication of expensive R&D and in harmonizing European industrial capabilities.

25 There have been two other encouraging developments since the Plan was completed. The first is the negotiation of an agreement under which P&W have the right to part-manufacture the RTM322 under licence for the North American military market. This collaboration is driven by commercial motives, with large potential benefits for both sides. The second development is that, following the RAF trainer competition, RR will partly manufacture the



Garrett TPE331 engine. This is of relatively minor significance in itself, but it should help relations with this important US manufacturer of small engines with whom other collaborative possibilities are being explored.

#### NEW PRODUCT STRATEGY

26. RR's scepticism about the early introduction of propfans appears reasonable in view of the technical challenges they present to manufacturers. We are concerned, however, that UK industry should have an adequate technology base should more optimistic predictions be fulfilled. We are therefore currently trying to get interested UK companies, including RR, together for a seminar on the issues involved

27. RR plan to maintain an advanced engineering resource in missile engine studies and gas turbine tank engines. These outlets may be important in the long-term and the Company are right to be looking into them. But neither is likely to have a significant impact on RR's results in the period covered by this Plan.

#### COMPETITIVENESS

28. The study of Rolls-Royce's competitiveness against their US competitors (in Section 7 of the Plan) has some indicative value and is reasonably encouraging. But it is difficult to draw clear conclusions about comparative productivity. Given the commercial secrecy of the US firms, this is perhaps inevitable, but we shall continue to encourage RR to pursue their studies in this area. While recognizing the heavy influence of exchange rates in the shorter term RR must remain committed to maximising their productivity.

Air Division  
DTI

April 1985

IND 201 P. 3

Ross Royce



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JU213

Secretary of State for Trade and Industry

29 March 1985

Tim Flesher Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
London SW1

*Pine Martin*

*Good Lynes for*

*Rolls Royce.*

*W 1/4*

*Dear Tim,*

ROLLS ROYCE 1984 RESULTS

The Prime Minister may like to have advance notice of the Rolls-Royce Limited results for 1984, which will be announced on 18 April. Until then, the figures are commercially confidential.

In 1984, Rolls-Royce made a profit after tax of £20m (1983: £193m loss), on turnover of £1409m (1983 £1331m). Net borrowings at the end of the year were £256m (1983 £350m), representing a gearing ratio of 80%. These figures represent an improvement on the Company's budget, as well as a massive turnaround on 1983, and have been arrived at after taking a reasonably conservative view on provisions and other semi-discretionary items. The company has had some benefit from special factors, including two large customer deposits, and from the high dollar, though the impact of the latter is limited by Rolls-Royce's policy of selling its dollar income forward, and by the existence of significant dollar borrowings. The improved position is due most importantly to the very substantial actions taken over recent years to reduce costs, particularly manpower costs, and there is good reason to expect further marked improvements in the Company's results in the next few years. These figures reflect great credit on many people associated with the Company, and particularly on the former Chairman, the late Sir William Duncan. My Secretary of State has written a letter of congratulation to the present Chairman, Sir Francis Tombs.

I am copying this letter to the Private Secretaries to the Secretary of State for Foreign and Commonwealth Affairs, the Secretary of State for Defence and the Chief Secretary.

*Yours ever,*

*Andrew Lansley*

ANDREW LANSLEY  
Private Secretary

Rolls Royce File



10 DOWNING STREET

Prime Minister

To note that DTI  
have asked Sir Arnold  
Hall of Hawk Siddeley and  
currently a non-executive  
director of Rolls Royce to  
take over as Chairman of  
Rolls for the time being following  
the death of Sir William  
Duncan.

DTI will be looking round  
for someone to take over  
permanently.

AT  
a/11



Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Norman Tebbit MP  
 Secretary of State for Trade & Industry  
 Department of Trade & Industry  
 1 Victoria Street  
 LONDON  
 SW1E 6RB

6 July 1984

*Norman Tebbit*

**ROLLS-ROYCE CORPORATE STRATEGIC PLAN 1983-1992**

Thank you for sending me a copy of your letter to Michael Heseltine, enclosing the draft of a letter that you intend to send to Sir William Duncan. (22/6)

I am generally content with the proposed draft but would like to make three points. First, I think that the letter should emphasise that the company's primary objective should be to prepare for early privatisation. As you know, our timetable envisages privatisation by 1987 and it is important that the company has at least two profitable years behind it by then.

Second, while I agree that the company should display more exchange rate sensitivity analyses in its planning process, I am satisfied with their foreign exchange management methods. As I understand it, Rolls-Royce sell forward the majority of their dollar income when firm engine contracts are signed and are working towards reducing their dollar debt to an amount equal to the dollar assets of their US subsidiary. Thus their policy is to match foreign currency assets and liabilities which seems sensible to me given the volatility of foreign exchange markets. I would not, therefore, go along completely with your first reservation.

However, I do agree with your second reservation. After a great deal of effort we have finally got the company to accept that it cannot compete head-on with the Americans in all markets and that future large engines will have to be developed as collaborative ventures. We should remind Sir William Duncan of the importance that we attach to this principle.

I am copying to the recipients of your letter to Michael Heseltine.

*Peter Rees*

PETER REES

Industrial Policy: Bus Kaye Pt 3.



CCNO  
✓

NBRN

AF 517

FCS/84/190SECRETARY OF STATE FOR TRADE & INDUSTRYRolls Royce Corporate Strategic Plan

- with AT.
1. Thank you for sending me a copy of your letter of 26 June to Michael Heseltine on the Rolls Royce Corporate Strategic Plan, together with a commentary by your officials. I am content that you should write to Bill Duncan as you propose: I agree that he deserves to be congratulated on the progress of the company so far under his tutelage. We are particularly satisfied that he has succeeded in arranging participation by Rolls Royce in the V2500 project, which looks likely to be a striking commercial success, and in forming a relationship with General Electric to produce and market big fan engines. Both decisions make sense for the company, and have the foreign policy benefit of drawing us into partnership with other leading industrialised countries in high technology development.
  2. There is, however, one important prize which is eluding Rolls Royce, and which I hope they can strive for. I think it important that Rolls and their European colleagues succeed in reaching agreement on a successor to the RB199 to power the future European fighter aircraft. I should like to see the French participate in addition to the existing British/German/Italian partnership on the Tornado, as this would remove a potential competitor from the market, make our challenge to the Americans more credible, and contribute helpfully to Anglo/French collaboration. But I appreciate that it will not be easy to bury past rivalries.

/3.



3. I am copying this letter to the Prime Minister, the Defence Secretary, the Secretary of State for Employment and the Chief Secretary.

A handwritten signature in dark ink, appearing to be 'G. Howe', written in a cursive style.

GEOFFREY HOWE

Foreign and Commonwealth Office  
6 July 1984

PERSONAL



10 DOWNING STREET

*From the Principal Private Secretary*

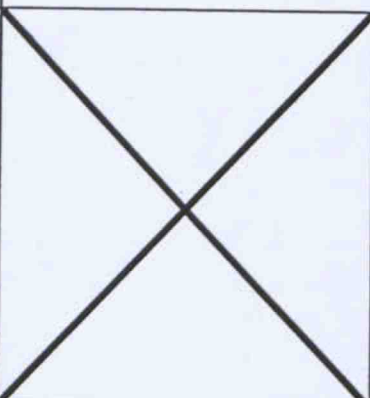
4 July, 1984.

I have shown the Prime Minister your letter of 3 July about the Rolls Royce Works at Ansty. She has read the enclosure with concern, and is grateful to you for giving her warning of it.

E. B. R. BUTLER

The Rt. Hon. Sir Michael Havers, Q.C., M.P.

NR

DEPARTMENT/SERIES <p style="text-align: center;"><i>PREM 19</i></p> ..... PIECE/ITEM ..... (one piece/item number) <i>2258</i>	Date and sign
Extract details:  <p style="text-align: center;"><i>Letter from Attorney General to Butler dated 3 July 1984.</i></p>	
CLOSED UNDER FOI EXEMPTION .....	
RETAINED UNDER SECTION 3(4) OF THE PUBLIC RECORDS ACT 1958	
TEMPORARILY RETAINED	<i>12 January 2016 Wayland</i>
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MISSING (TNA USE ONLY)	
DOCUMENT PUT IN PLACE (TNA USE ONLY)	

Prime Minister<sup>2</sup> and Treasury  
To note Policy Unit Comments on RR strategy. Unnecessary for  
you to intervene?

COMMERCIAL IN CONFIDENCE

MR TURNBULL

AT 2/7

2 July 1984

c Mr Redwood

ROLLS ROYCE LIMITED - STRATEGIC PLAN 1983-1992

1. Rolls Royce's current long-term plan gives us a latest view of the company's prospects for privatisation during the life of this Parliament, and is also Sir William Duncan's first statement of faith since taking over as Chairman.

2. Overall, we think the Prime Minister should endorse the plan, not out of enthusiasm, but because it is an honest projection of the best that RR can reasonably achieve.

3. Sir William Duncan openly acknowledges RR's historically weak trading performance and its vulnerability to uncertainties beyond its control - the £/\$ exchange rate, the profitability of airlines, and the fate of the airframe industry outside the USA.

4. His response to this shaky position has been to cut costs by:

- i. reducing head count at all levels and raising productivity;
- ii. gaining collaborative agreements with Pratt and Whitney and with General Electric in the medium and large engine sectors respectively.

✓ All credit to him. These have been major achievements running counter to the company's culture. But it remains true that, like most participants in big league aerospace, Rolls Royce still makes too little money for the risks it takes.

5. Unlike previous strategies, this plan makes it plain that Rolls Royce cannot hope to transform itself from a predominantly military engine company to one which can succeed mainly in the civil engine market.

6. Over the whole ten years, the large civil RB211 engine family will do no more than break even before depreciation and interest on more than £4 billion of sales. Real profitability derives from the current military engines (Pegasus, RB199 and Adour), which give 13% return on sales over the period); and from the retiring engines (Spey, Dart and Viper) which have both military and civil applications and yield nearly 40% on sales.

7. At below gross profit level there are three quite major presentational flaws. Firstly, no allowance is made for

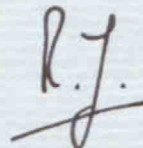
COMMERCIAL IN CONFIDENCE

depreciation and interest charges, which currently wipe £70-80 million off gross profits. Secondly, there is no balance sheet information. Thirdly, selling prices and company costs are portrayed in constant 1983 £, which makes it difficult to assess how Rolls Royce would be hit if its prices were squeezed harder than it squeezed its own costs.

8. All things considered, we judge that privatisation before 1988 will be a tough target. Even then, it would be only a partial loosening of the bonds which tie Rolls Royce to Government. For the company is now and will continue to be dependent on new military aircraft projects, the MOD funding that goes with them, and substantial assistance with R & D.

9. We recommend that the Prime Minister should:

- i. endorse the company's product strategy and the high priority which the Board attaches to profitability and privatisation;
- ii. note with concern that the RB211 family is not moving more quickly into profitability;
- iii. note with equal concern that the company will remain very dependent on funded military work;
- iv. ask for subsequent long-term plans to take proper account of financial charges (as she has asked in connection with other public sector undertakings) and to indicate shifts in the balance sheet.



ROBERT YOUNG

IND Pa. Rolls Royce Pr3

CCND



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Secretary of State for Trade and Industry

26 June 1984

BF with PM  
response 1 dayAT  
26/2

The Rt Hon M Heseltine MP  
Secretary of State for Defence  
Main Building  
Whitehall  
SW1A 2HB

D. Michael,

## ROLLS-ROYCE CORPORATE STRATEGIC PLAN : 1983-1992

Now that major decisions have been made on several projects, I should like formally to approve Rolls Royce's Corporate Strategic Plan 1983-1992. The attached commentary, prepared by my officials and discussed with yours, highlights the key considerations.

2 The Corporate Strategic Plan outlines the strategy to be followed by the company in the years to 1992. Its principal objective is a return to profitability at the earliest date and continuing and increasing profitability thereafter with a view to privatisation during the present parliament. It contains a Base Plan and two alternative scenarios, one more optimistic, and one more pessimistic (which assumes continued recession in the aviation business). All three strategies envisage improved financial results in the short term by lowering the pay bill, improving manufacturing efficiency, lowering financial expenses, tighter control of R&D and increased sales of civil engines. The Base Plan foresees profitability being reached in 1986 and increasing substantially to 1989. The Plan is not designed however to provide detailed financial forecasts, and the financial projections for profit and cash flow are in constant price terms without allowance for financing costs.

3 The Plan has since been modified by the agreed collaboration between Rolls-Royce and General Electric of the USA on large fan engines. This is likely to be of great benefit to Rolls-Royce in the longer term, although there will be a small adverse effect in the short term on cash flow and profit.

4 In his covering letter, Sir William Duncan sought the following from Government:-

- 1 Acceptance of the Company's overall strategy in the civil aero-engine market;

JH5AAN





2 Early agreement to the Company's proposals on the V2500 project; and

3 Timely actions by the Ministry of Defence on their future requirements so as to enable the Company to continue its role as supplier to HMG, British Aerospace and Westland, commencing with decisions on the RTMS22.

5 On the civil side, decisions have now been taken to approve the collaboration with General Electric and the company's participation in the V2500 and RTM322 projects, the amount of launch aid to be granted for the V2500 having just been finalised (£60m). On the military side you have offered financial support for the RTMS22 and your officials have endorsed Rolls-Royce's assumptions about the level of forecast sales to HMG in the immediate years ahead. These relate particularly to sales of RB199 and Pegasus. There are also, I understand, reasonably good prospects of Rolls-Royce's securing a satisfactory role in the production of the engine for the proposed European Fighter Aircraft, although it is still early days to be confident about the outcome.

6 Since Sir William Duncan took over as Chairman last year, he has provided a much clearer and firmer sense of direction to Rolls-Royce's management. He has done much to secure the company's long-term future by concluding complementary collaborative arrangements on large and medium sized civil engines with General Electric and Pratt and Whitney. The Prime Minister recently congratulated him on his efforts in coming to grips with RR's costs and on achieving these strategic deals.

7 I am confident that you and the Chief Secretary will want me to write to Sir William to endorse the main elements of the Corporate Plan while recognising the hazards ahead. On the military side, a limited number of key project decisions will largely determine the scale of the company's activity from the late 1980s onwards. We shall have to keep closely in touch on these and remain alert to the risks to the export programmes in the US of major importance to RR (and BAe), namely the AV8B and VTX.

8 I should like to be able to approve the Corporate Plan shortly and, unless I hear from you or the Chief Secretary to the contrary, by 5 July I propose to write to Sir William in the terms of the attached draft.

9 I am copying this to the Prime Minister, the Foreign Secretary, the Secretary of State for Employment and the Chief Secretary.

NORMAN TEBBIT

JH5AAN



COMMERCIAL IN CONFIDENCE

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Secretary of State for Trade and Industry

DRAFT

June 1984

Sir William Duncan  
Chairman  
Rolls Royce Limited  
65 Buckingham Gate  
London SW1E 6AT

ROLLS-ROYCE: CORPORATE STRATEGIC PLAN 1983-1992

On 16 December 1983 you submitted Rolls-Royce's Corporate Strategic Plan 1983-1992 and this was subsequently updated in the light of the proposed GE deal. In your covering letter you sought the following from Government:

- 1) Acceptance of the company's overall strategy in the civil aero-engine market;
- 2) Early agreement to the company's proposals on the V2500;
- 3) Timely action by the Ministry of Defence on their future requirements so as to enable the company to continue its role as supplier to HMG, British Aerospace and Westland, commencing with decisions on the RTM322.

As you well know, we have already reached decisions to approve your collaboration with General Electric and to provide launch aid for your participation in the V2500. The Ministry of Defence have agreed to offer funding support for the RTM322 project the launch of which we have also approved. I am therefore now pleased to be in a position to approve the Corporate Strategic Plan as a statement of the company's strategy for the future. As we all recognise there are undoubtedly a number of risks attached to the strategy and you have made it clear that the Plan is not intended to provide detailed financial projections. I have reservations concerning two aspects of the Plan:

- i) the sensitivity of the Plan to exchange rate assumptions and your methods of approach with respect to current exchange dealings; and
- ii) the continuing desirability of an objective (paragraph 1.4) for Rolls-Royce of "maintaining its position as one of

JH5AAQ



only three companies in the free world capable of designing and developing complete engines for all applications", in the light of your GE and PW collaborations.

Perhaps we could take these points up separately. Subject to these points, I hope you will view it as helpful if I endorse the general strategy outlined in the Plan as a sensible basis on which to proceed.

I should also like to take this opportunity to congratulate you on the progress made so far in improving the long-term prospects of the company. I look forward to the dividends becoming increasingly evident over the next few years, and wish you well in your continuing efforts.

NORMAN TEBBIT

JH5AAQ

CONFIDENTIAL

30 April 1984

PRIME MINISTER

MEETING WITH SIR WILLIAM DUNCAN

You have already declined - quite rightly - to act as an appeal judge on the matter of RR's dissatisfaction with the Government offer of launch aid for the V2500 engine.

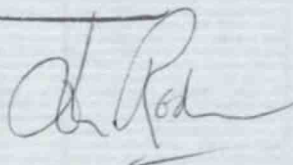
Nothing has changed in RR's circumstances which invalidates E(A)'s judgment.

The aim of the meeting should be to give Sir William support and encouragement without giving him any more money. You could reiterate how pleased you are with his move into good international collaborative projects. (With GE for the very largest engines, and with the consortium for the V2500.)

You could compliment Sir William with the way he is getting to grips with RR's costs and on the exciting profit and cash-flow projections set out in Section B Annex of the DTI briefing. His figures show that he can return Rolls Royce to the private sector, and you can encourage him to do so.

If he raises the question of dressing up the balance sheet in 1984 or 1985, you could suggest that he gets on with the task of generating profit and cash, and that the balance sheet can be re-examined prior to sale. On his figures, balance sheet gearing reduces to 16 per cent by 1987, hardly a taxing level of borrowing.

Sir William Duncan will be aware that Lord McFadzean did not get on very well with Patrick Jenkin. He has been trying to improve relations with Government. However, the combination of the V2500 settlement, and perhaps some jealousy about the amount of limelight which British Aerospace got for the A320 decision, may colour his approach at this meeting. If only Norman Tebbit had been seen as conspicuously in photographs with Sir William as he was with Sir Austin Pearce at the time of the Airbus announcement, he might have felt better about it all!



JOHN REDWOOD/ROBERT YOUNG

\* The launch aid we have offered would produce gearing of around 27 per cent in 1987, still a satisfactory position. The key to privatisation is not launch aid but cash flow. If RR generates the cash it says it will, there will be no problem, but launch aid cannot make up any weakness in this area. The market is not going to be fooled by a good balance sheet, created LARAAW by Government aid.

AT 30/4

CONFIDENTIAL

CONFIDENTIAL



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Secretary of State for Trade and Industry

27 April 1984

David Barclay Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
London SW1

Dear David,

ROLLS-ROYCE LIMITED

At his request Sir William Duncan is to discuss the position of Rolls-Royce with the Prime Minister on Tuesday 1 May. My Secretary of State is to be present.

2 My Secretary of State suggests that the Prime Minister should give Sir William a sympathetic hearing, even though it will be difficult to offer him any real comfort on the main issue of concern to him - the amount of launch aid to be provided for the V2500 engine project. There is no doubt Sir William is doing a very good Job as R-R's Chairman. The Department's contacts with the company itself and with those who do business with it confirm that since he took over last year he has provided a much clearer and firmer sense of direction to R-R's management; and he has done much to secure the company's long-term future by concluding the collaborative agreements with Pratt and Whitney (on the V2500) and with General Electric (on the larger civil engines). When he became Chairman he was told that the Government's prime objective was to return R-R to the private sector before the end of the present Parliament and he himself fully shares this objective.

3 It is regrettable therefore that his experience of negotiating launch aid with the Government, first for the E4 version of the RB211-535 and now for the V2500, has left him with the impression that he is not being given as much support and encouragement with his task as he expected when he agreed to take it on. His disappointment with the launch aid offer for the V2500 has been accentuated by the more generous treatment British Aerospace have received on the A320. Sir William was certainly given no undertaking of any sort before joining R-R that he could expect launch aid to cover a substantial part of the cost of future projects, still less a guarantee of 50 per cent launch aid. Indeed, the objectives given to him when he became Chairman make it clear that launch aid "is not a form of support which can be assumed in all cases". Nevertheless, it is fair to say that our launch aid offers on the E4 and the V2500 are for a considerably

JH3AFT



smaller proportion of project costs than the 50 per cent which had become customary in the 1970s and Sir William was not warned in advance that this was likely to be the Government's position.

4 My Secretary of State suggests therefore that the Prime Minister should express gratitude to Sir William for the excellent leadership he is giving to R-R and make it clear that it is still the Government's intention to return R-R to the private sector before 1988 if at all possible. But the overriding need to contain public expenditure generally makes it impossible to consider making more launch aid available for the V2500 than the £60 million already mentioned to Sir William.

#### Background Papers

5 There are a number of background papers which the Prime Minister may wish to look at again before the meeting with Sir William. R-R gave a presentation to the Prime Minister last November. (A copy of the material used by Sir William and an extract from the record are enclosed.) The papers subsequently circulated for E(A) cover both the collaboration with GE and the V2500 project. The conclusions of E(A) on 2 February speak for themselves.

6 I wrote to you on 5 April (as amended on 12 April) providing guidance on the company's financial results for 1983. A copy of the Chairman's Statement is enclosed.

7 To supplement this material I am now enclosing short briefs which summarise HMG's relations with the company, outline its Corporate Strategic Plan and indicate the uncertainties attaching to the latest financial forecasts (Briefs A and B). I am also enclosing a V2500 chronology and some aeroengine launch aid statistics (Briefs C-E).

8 Finally, my Secretary of State has recently sought the advice of the Department's Solicitor on the provision of financial support to public sector undertakings which it is the Government's intention to privatise. A copy of this advice, which is relevant to R-R, is also enclosed.

9 Please let me know if there is any further material you would find helpful. I am sending a copy of this letter to John Gieve in the Chief Secretary's Office.

Yours etc,  
A. Lansley

ANDREW LANSLEY  
Private Secretary



Secretary of State for Trade and Industry

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- B. ROLLS-ROYCE : CORPORATE STRATEGIC PLAN AND FINANCIAL FORECASTS.
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- I. ROLLS-ROYCE 1983 FINANCIAL RESULTS : CHAIRMAN'S STATEMENT.



**Secretary of State for Trade and Industry**

- J. LETTER DATED 5 APRIL 1984 FROM PS/SECRETARY OF STATE FOR TRADE AND INDUSTRY TO PS/PRIME MINISTER.
- K. LETTER DATED 12 APRIL 1984 FROM PS/SECRETARY OF STATE FOR TRADE AND INDUSTRY TO PS/PRIME MINISTER.
- L. PRESENTATION BY ROLLS-ROYCE TO THE PRIME MINISTER ON 16 NOVEMBER 1983.





## ROLLS-ROYCE: RELATIONS WITH HMG AND FINANCIAL SUPPORT SINCE 1979

1 In the period from end March 1979 to end March 1984 HMG have provided Rolls-Royce with a total of £714m. This comprises £364m in launch aid towards the costs of the - 524 and - 535 versions of the RB211 engine, equity payments of £305m and DTI research and development funding of £45m. It excludes MOD funding for R&D and for military development projects. Further launch aid of £10m will be paid in 1984/5 for the RB211-535 E4 engine. A table of financial information on the company for the years 1978-1983 is at Annex 1.

2 The last equity payment of £50m was made in 1982. From 1983 on the company committed itself to live without access to any further Government funding by way of equity, loans or new guarantees. Since Treasury regard any Rolls-Royce borrowing as carrying at least an implicit guarantee, this means that Rolls-Royce are also prevented from new private sector borrowing. Rolls-Royce are thus only eligible for assistance which is also available to aerospace companies in the private sector, in particular R&D assistance and civil launch aid for new projects. The company has said that it does not expect to make any further requests for civil launch aid in the foreseeable future. AS regards financing new projects, therefore, Rolls-Royce has no access to Government funds not enjoyed by private companies, whilst in other respects it is more restricted in that it is unable to raise new equity or to make new borrowings, public or private. It is thus heavily dependent on internally generated funds.

3 The company operates under objectives issued by the Secretary of State in July 1983 (Annex 2). The prime objective is that the company should be managed in such a way that it can be returned to the private sector during the course of the present Parliament. Government has recognised that a return to profitability is an essential precondition for this. HMG expects these objectives to be reflected in the Corporate Strategic Plan which Rolls-Royce are expected to submit annually. The company also submits annually a two-year Operating Plan and Budget, and provides detailed financial monitoring information quarterly.

4 The relations between Government and the company are thus necessarily complex. Government has the normal sponsorship role which it has towards a private sector company, including making available selective assistance of various kinds. But Government is also the largest single customer (through MOD); it is the shareholder with access to information and the duty to approve strategy and major investments; and it is also the company's "banker", determining its ability to raise new equity or borrowings, whereas for a private company this role is played by the financial markets.

Air Division, DTI  
17 April 1984



ANNEX 1

		£m outturn					
ROLLS-ROYCE FACTSHEET		1978	1979	1980	1981	1982	1983
Turnover	£m	763	848	1258	1443	1493	1331
Profit/Loss	£m	7	(63)	(27)	(3)	(134)	(193)
of which export sales	£m	340	350	550	610	691	na
civil	£m	353	360	527	578	610	na
military	£m	410	488	731	865	<u>883</u>	na
Equity funding	£m	7	31	94	130	50	0
Employment '000		59.9	61.4	62.4	56.4	48.6	42.2
Launch aid	£m	27.0	75.4	67.0	92.6	53.6	39.5
Levy repayments	£m	6.6	5.0	8.6	7.0	13.3	7.8
Engine deliveries (numbers)		na	na	951	1057	1114	890

Air Division  
DTI  
17 April 1984



## OBJECTIVES FOR ROLLS-ROYCE LIMITED

Although the aeroengine industry is of major military significance to the United Kingdom, in the Government's view the size and scope of Rolls-Royce's business must, like that of any other business, be determined by its ability to compete in the international market place. In this context it is the Government's prime objective to see the company managed in such a way that it can be returned to the private sector during the course of the present Parliament.

It is clear that the objective of privatisation cannot be achieved in the immediate future but, in responding to the intense competitive pressures of the aeroengine industry, the company must regard progress in bringing the company to a situation in which the Government's objective of privatisation can be met, as overriding.

Without wishing to restrict in any way collaboration on military projects with US or European partners, the Government will expect the company to meet the requirements as defined from time to time by the Ministry of Defence for military and marine engines.

Since a major benefit from past and future support of the company is the continued strength of UK aerospace equipment suppliers, the Government will expect the company to continue to operate procurement policies which pay due regard to their long term interests, provided that this is consistent with the company's international competitiveness; the Government's international obligations; and also the company's achievement of its other objectives.

The Government will also expect the company, in consultation with the workforce, to continue to improve productivity in its plants so as at least to match that achieved by its US competitors.

The company should be guided by the existing Memorandum of Understanding with the Department and in particular the provision each year of a long term corporate plan and a short term operating plan and annual budget. The Government expects these plans to be based on the objectives established above and to demonstrate the means by which the company will achieve the earliest practicable return to profitability and a proper commercial return on capital employed. In the meantime, the Government expects the company to achieve its existing financial target of dispensing with Government funds in 1983 and thereafter, save for the range of support available for industry generally and such launch aid under the 1949 Civil Aviation Act for new projects which may from time to time be agreed.

Launch aid, for which the Government will expect to receive an



appropriate return by way of levy, is provided in recognition of the very long lead times involved in aerospace projects and the degree of support available to the company's competitors. But it is not to be a form of support which can be assumed in all cases and will be considered only if projects are put forward which are consistent with the longer term objectives.

In its consideration of major development projects the Government will expect the company to invest, after consultation with HMG, only in those which will achieve a minimum of 5% return in real terms before tax; indeed, in view of the high risks attached to aerospace projects in general, the Government will be looking for a rate of return well in excess of 5% in normal circumstances. The Government will moreover expect the company to have explored modes of collaboration and co-operation with other aeroengine companies in order that those risks might be shared.



ROLLS-ROYCE: CORPORATE STRATEGIC PLAN AND FINANCIAL FORECASTS

The Corporate Strategic Plan (1983-1992) was submitted by RR in December 1983. Its principal objective is a return to profitability at the earliest date, and continuing and increasing profitability thereafter, with a view to privatisation during the present Parliament. It contains a Base Plan and two alternative scenarios, one more optimistic and one more pessimistic. All three scenarios envisage improved financial results in the short term by lowering the pay bill, improving manufacturing efficiency, lowering financial expenses, tightening control of R&D and increasing sales of civil engines. The Base Plan foresees profitability being reached in 1986, then increasing substantially to 1989. The Plan is, however, primarily a strategic rather than a financial document; it attempts to give an accurate indication of financial trends but does not attempt a detailed short-term forecast.

2 It is therefore not surprising that the Plan's figures for the earlier years have since been modified in a number of directions. The Addendum to the Plan detailing the collaboration with General Electric on large engines meant some revisions. The new Operating Plan and Budget (OPB), which gives detailed financial forecasts for 1984 and 1985, incorporates these revisions, and also the effects of more conservative sales assumptions offset by further measures to reduce costs.

3 For the purpose of discussing V2500 launch aid, Rolls-Royce have reworked their earlier 1986 and 1987 figures to bring them in line with this OPB. Thus the figures for 1984-87 in Sir William Duncan's letter of 26 March to the Prime Minister all flow recognizably from the OPB. They are not (taken as a whole) materially different from those which formed the basis for Ministerial discussion in E(A) in early February. DTI and, we understand, Treasury officials regard them as an appropriate basis on which to assess RR's V2500 launch aid requirements.

4 In order to focus on the scale of the downside risks to the achievement of RR's targets, the DTI's Industrial Development Unit (IDU) have considered four alternative scenarios (annexed). Scenario A takes the figures on page 2 of Sir William Duncan's letter but adds in V2500 launch aid at the level requested on page 3. Scenario B, based on material supplied by the company, is a "worst case" assuming continuation of the recession in civil orders, and military sales at a lower level than expected. Scenario C, prepared by the IDU, assumes a shortfall in turnover about half that assumed in Scenario B. Scenario D assumes the same turnover as C, but lower profitability in 1986 and 1987, for example as a result of lower margins or higher sales concessions being necessary to generate the increased level of sales. To reduce RR's gearing ratio to a commercially satisfactory level (ie around 50%) will thus evidently not be possible by end 1986 unless RR is able to achieve all its planned targets which include 50% launch aid for the V2500.

Air Division, DTI  
24 April 1984



## ROLLS-ROYCE TURNOVER, PROFIT AND CASH SCENARIOS AS EVALUATED BY IDU

Scenario	Description	1984	1985	1986	1987
Scenario A	<u>Using Sir William Duncan's figures but including the launch aid sought*</u>				
	Turnover	1403	1651	1900	2300
	Profit after Tax	2	27	154	248
	Cash Flow	(2)	16	103	139
	Shareholders' Funds	302	329	483	731
	Borrowings	372	356	253	114
	Gearing	123%	108%	52%	16%
Scenario B	<u>Rolls-Royce "Worst Case"</u>				
	Turnover	1353	1531	1700	2000
	Profit after Tax	(13)	(13)	74	158
	Cash Flow	(17)	(24)	23	49
	Shareholders' Funds	287	274	348	506
	Borrowings	387	411	388	339
	Gearing	135%	150%	111%	67%
Scenario C	<u>IDU Scenario Assuming Partial Shortfall on Plan</u>				
	Turnover	1378	1591	1800	2150
	Profit after Tax	(5)	9	124	203
	Cash Flow	(7)	4	83	109
	Shareholders' Funds	299	308	432	635
	Borrowings	392	388	305	196
	Gearing	131%	126%	71%	31%
Scenario D	<u>IDU Scenario Assuming Partial Shortfall on Plan and Reduced Profitability</u>				
	Turnover	1378	1591	1800	2150
	Profit after Tax	(5)	9	99	163
	Cash Flow	(7)	4	58	69
	Shareholders' Funds	299	308	407	570
	Borrowings	392	388	330	261
	Gearing	131%	126%	81%	46%
	<u>All Scenarios assume:</u>				
*	V2500 Launch Aid	10	30	50	20



## V2500 CHRONOLOGY

December 1979 - Collaboration Agreement between RR and JAEC (consortium of Japanese companies) to explore joint development of a new engine (RJ500) to power 150 seat aircraft. HMG endorsed initial phase of the Agreement.

December 1980 - RR proposals to DoI covering further design work and the start of development of the RJ500.

January 1981 - Following a MISC 25 meeting DoI informed RR that HMG did not consider the economic prospects at that stage justified the full investment proposed, without a further period to assess the market and the viability of the project.

May 1981 - Sir Keith Joseph authorised RR to continue development funding, but made it clear that HMG were unlikely to approve full launch unless RR were able to demonstrate that one or more versions of the RJ500 would also involve participation by one of the major US companies.

1982 - RR held separate exploratory talks with GE and Pratt and Whitney (P&W).

11 March 1983 - Agreement to develop the V2500 signed by RR, JAEC, P&W, MTU and Fiat, but dependant on approval by the boards of the companies and their respective governments as necessary.

31 August 1983 - RR's full business case submitted.

18 October 1983 - RR's Board approved participation in the project, provided necessary governmental approvals were obtained. RR applied for HMG's approval and for 50% launch aid support, totalling £113m at 1983 prices.

16 January 1984 - The MISC 25 recommended that participation should be approved and that an appropriate amount of launch aid should be negotiated with the company.

2 February 1984 - E(A) agreed to RR's participation in the project. Authorised to negotiate on the basis of a opening offer of £45m, the Secretary of State offered this amount to Sir William Duncan later that day. When announcing the GE collaboration the following day RR confirmed they had HMG's approval to participate also in the V2500.

12 March 1984 - At a meeting with Sir William Duncan the Secretary of State said that it might just be possible to persuade his colleagues to increase the offer to £60m, but no more, unless there could be a change in the basis of discussion. Sir William Duncan said that it was realistic to expect that the downside risk was greater than the upside potential in RR's forecasts and that he could not accept (£60m) as a reasonable outcome, since it seemed to him entirely incompatible with the basis on which he had accepted the Chairmanship. He felt he should seek to take the matter to the Prime Minister, to explain the cost of the Government's decision in terms of the privatisation objectives.

Air Division, DTI  
 Air Division, DTI  
 24 April 1984

split £10 £25 £10  
 no split was discussed.

COMPARISON OF LAUNCH AID FUNDING AND  
LEVY RECEIPTS FOR CIVIL ENGINE PROJECTS

<u>Engine</u>	<u>Approximate mid point of development</u>	<u>Launch aid (cash)</u>	<u>Launch aid as % project costs</u>	<u>Receipts to date* (cash)</u>
Dart	1949	5.5	na	12.9 <sup>x</sup>
Proteus	1950	19.45	na	2.9
Avon	1958	8.5	na	10.5 <sup>x</sup>
Conway	1960	5.7	na	7.4
Spey	1965	9.9	34.5%	24.2 <sup>x</sup>
RB211-524	1973	177.6	54.3%	27.8 <sup>x</sup>
RB211-535	1981	261.8	44.4% <sup>∅</sup>	0.8 <sup>x</sup>

\*Levy receipts may accrue over a very long period, as evidenced by the continuing receipts for the Dart

x Significant levies still being received

∅ Estimate: programme not yet completed





LAUNCH AID FOR ROLLS-ROYCE RB211 ENGINES  
1971/72 ONWARDS

<u>PROJECT</u>	<u>LAUNCH AID</u> <u>£M</u>	<u>PERIOD</u>
RB211-524	66	1972/73 - 1978/79*
RB211-524B	111	1979/80 - 1982/83
RB211-535C	192	1979/80 - 1983/84
RB211-535E4	70	1983/84 - 1984/85

Total paid since 1971	£429 million of which
Total paid since 1979	£364 million
Committed but not yet paid	£ 10 million

\* A small residual payment was made in 1981/82

Air Division, DTI  
24 April 1984

13419  
PS/Secretary of State

cc PS/Ministers  
PS/Sir Brian Hayes  
PS/Sir Anthony Rawlinson  
Mr Manzie, Dep Sec  
Mr Croft, Dep Sec  
Mr Treadgold, SBP  
Mr Hudson, Air  
Mr Rickford, Sol C  
Miss Bowe, SBP

## PRIVATISATION AND GOVERNMENT SUPPORT

Questions have arisen recently as to the lawfulness or propriety of HMG giving financial assistance for projects by publicly-owned companies which will or may be privatised in the near future, and other support by means of placing contracts with those companies. I understand that the Secretary of State would like some general legal advice on these questions since they have arisen in such cases as launch aid for Rolls Royce and ECGD credit support for Vosper Thorneycroft. Currently the question is in the Secretary of State's mind in relation to the MoD frigate orders.

2 The question in these cases is to what extent may the Government's desire to facilitate plans for privatisation of Government-owned companies be taken into account in the exercise of Ministerial discretions to grant financial assistance or to give Government contracts to the companies. Is it proper, as a matter of law, for such considerations to weigh in the balance when exercising the discretions?

3 Two cases need to be distinguished. First, cases where financial assistance is given under a specific statutory power (eg Section 1 of the Civil Aviation Act 1982 - launch aid, Sections 7 and 8 of the Industrial Development Act 1982, and guarantees under the Export Guarantees and Overseas Investment Act 1978). Secondly, cases where no specific statutory powers are involved (eg where the Government is a purchaser as in the proposed MoD frigate contracts).

4 In the first class of case - financial assistance under a specific statutory power - facilitation of privatisation is, of course, nowhere mentioned in any of the statutory criteria as being one of the purposes for the giving of assistance. One cannot, therefore, use the relevant statutory powers solely to aid privatisation. To use those powers the project in question must come within their scope as expressed in the words of the statute. Under Sections 7 and 8 Industry Act assistance can only be given for projects which qualify in the sense of meeting the statutory criteria laid down in those Sections. The same goes for launch aid under the Civil Aviation Act and also for ECGD cover. In satisfying oneself that the project meets those requirements one has to put privatisation thoughts to one side.

5 Having satisfied oneself that the project properly meets the relevant statutory criteria for assistance, does the fact that it also helps the Government's privatisation plans in any way operate as a bar to the giving of the assistance? In the RB 211 case considered by E(A) in July 1983 the Attorney General attended the

- 2 -

meeting. He is not recorded as giving any legal advice but he is known to have taken the view that no legal difficulty or impropriety arose so long as the assistance was given on the usual commercial criteria, both as to the assistance and the amount. The prospect of privatisation did not rule out assistance on this basis.

6 The more difficult question is one which arises because the statutory powers referred to above do not require assistance to be paid even though worthwhile projects meet all the relevant statutory criteria for assistance. There is at the end of the day an over-riding discretion whether to pay or not to pay. Can privatisation plans tip the balance in deciding to give assistance to projects which do properly qualify for assistance under the terms of the relevant statute? I know of no legal authority which declares that such motives could not be taken into account. The difficulties here seem to me to be political and also perhaps a matter of concern to the Public Accounts Committee. If they were to take the view at the end of the day that the money was not well spent and had been so spent for some extraneous political objective, it is also difficult to see how any possible legal challenge could be mounted unless there were any competitors who had a locus for seeking to object.

7 In the second class of case where no statutory powers are at issue, I see no possibility of any legal objection to taking into account privatisation plans in the placing of Government contracts. The objections here could only be political and once again could be the subject of Public Accounts Committee criticism if the Government does not obtain good value for its money. In the MoD frigate contracts case currently being considered, if there is little or no difference between the rival options on ordinary commercial grounds, then I see no bar to all kinds of general political objectives being taken into account in finally determining where the contracts are placed.

8 In the above I express the view that there are no legal difficulties but that there could be, depending on the circumstances, Public Accounts Committee criticism and that, of course, there may be political difficulties. I should also say that the latter political difficulties may be categorised by some as constitutional impropriety. Both in the giving of assistance under statutory powers and the placing of contracts it might be said that the Government should not be pursuing policies which have not been expressly endorsed by Parliament. (This was the argument against the last Labour Government when using its powers and Government contract position to enforce its non-statutory pay policy.) It seems to me, however, that the most that can be said for this kind of argument is that Parliament are entitled to know what are the true purposes for which Ministers are exercising their powers.

JRMallison

- for -

W C BECKETT  
Solicitor  
Room 11.10  
Ashdown House

19 April 1984



JH 762

CONFIDENTIAL

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PRIME MINISTER

ROLLS-ROYCE

I circulated on 25 January a memorandum recommending our support for Rolls-Royce's involvement in two major collaborative deals - the V2500 project with Pratt and Whitney, and a deal on larger engines with GE (E(A)(84)6). I said that I was seeking a meeting with the Chief Secretary so that I could report in advance of E(A) on the level of launch aid which it would be appropriate to make available for the V2500.

2 This Government last year gave the new Chairman of Rolls Royce, Sir William Duncan, the overriding objective of privatisation firmly linked to profitability which we said looked unlikely to be achieved unless the company collaborated with the other leading engine manufacturers. It is greatly to the credit of Sir William Duncan that he has brought very difficult and sensitive negotiations with Pratt and Whitney and, separately, GE to the point where if we can give prompt support he can deliver a civil engine strategy far superior to anything we might have thought possible even a year or so ago.

3 Rolls-Royce are not asking for any financial support in order to conclude the deal with GE although it will involve a net cash outflow of £74m (in 1983 prices) over the next five years. In



the case of the V2500 they originally requested 50% launch aid (£113m in 1983 prices, or £137m in outturn prices). But since there is a prospect of a fairly strong performance by the company beyond 1986 (if everything goes according to plan) I have put it to the Chief Secretary that in pursuing its overall corporate objectives Rolls-Royce should be able to live with launch aid of no more than £96m in outturn prices concentrated in 1984-86 (37% of total project costs).

4 The Chief Secretary's offer today of £45m would represent no more than 18% of the company's total launch costs. As such I cannot put it to Sir William Duncan as a realistic offer, since it reflects, as I understand it, the Chief Secretary's view that all we should be doing for Rolls-Royce is providing such cash as should avoid the company going into a negative cash flow.

5 I believe that the proper approach to the handling of Rolls-Royce's application is to recognise that we have given objectives to Sir William Duncan which have led him to produce an overall corporate strategy, for which in the short term the full cash resources cannot be generated internally. In short, the Chairman is continuing to do all he can to reduce unnecessary expenditure (by a further reduction in manpower and by R&D cuts) while endeavouring to set in place two major collaborative deals which represent an excellent investment for the future despite the short term cash outflow they involve. As a legitimate part



of the allocation of the company's cash resources to major corporate objectives he also has a requirement to reduce the excessive borrowings (and hence the high interest charges) of the company. Without the availability of the full amount of launch aid I have sought for the V2500 in 1986 (in addition to the two earlier years) he will not be in a position to release internally generated resources to reduce borrowings to the extent he considers appropriate in order to establish the company on a sound financial base by the end of 1986.

6 The attached table shows the effect of providing or not providing the £96m in launch aid I have concluded is required by Rolls-Royce.

7 I believe the Chief Secretary's principal argument against our investment in the V2500 at the level I have suggested (£96m during 1984-6, representing 37% of project costs) is that the company can afford to fall short of its gearing objective, even if the privatisation timetable we have in mind involves issuing a prospectus by mid-1987 (largely based on the 1986 results) with a view to privatisation later that year or in the Spring of 1988. But in my opinion getting gearing down to around 50% will be essential by end-1986. Since the V2500 is an excellent project, the prospects of a good return on our investment are such that it would be quite wrong to argue that by providing cash towards the development costs of this project we would be merely sinking more cash in the company to get its balance sheet right.



8 In the circumstance, the recommendation I would ask E(A) to endorse is that Rolls-Royce should be given the full ~~£96m~~ £96m for the V2500's development during 1984-86. If colleagues were to agree to this recommendation I would make it clear to Sir William Duncan that, in endorsing the V2500 and the GE deal, the Government could not be expected to provide launch aid support beyond this sum for any engine projects currently proposed.

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31 January 1984

Department of Trade and Industry

	£m (outturn prices)			
	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
Turnover	1340	1400	1650	1900
V2500 Gross expenditure	-	10	30	56
<u>Without launch aid</u>				
Profit(Loss) after tax	(195)	(4)	1	100
Cash flow	-	(15)	(17)	49
Net shareholders funds	300	296	297	397
Borrowings (net)	370	385	402	353
Gearing	123%	130%	135%	89%
<u>With 100% launch aid (£296m)</u>				
Profit(Loss) after tax	(195)	6	32	160
Cash flow	-	(5)	14	109
Net shareholders funds	300	306	338	498
Borrowings (net)	370	375	361	252
Gearing	123%	123%	107%	51%



DATE: 1 February 1984

PRIME MINISTER

ROLLS ROYCE: LAUNCH AID FOR THE V2500

I accept that the prospects for the V2500 are good and that it merits some launch aid. I differ from Norman Tebbit only on the amount.

2. Norman proposes 100% funding for the project in the first three years; I think that would be excessive particularly in the last year.

	(£m cash)		
	<u>1984</u>	<u>1985</u>	<u>1986</u>
Norman's proposals	10	30	56
My proposals	10	25	10

3. I attach tables showing the implications for Rolls Royce's finances of the two proposals. As you will see, the Company is expecting substantial profits and a healthy positive cash flow in 1986 without any launch aid. My proposal would improve these figures further and would produce a very marked improvement in the gearing ratio to 70% in 1986 with the prospect of paying off all loans by 1988.

4. Norman argues that the gearing ratio needs to be reduced to 50% in 1986 in order to improve prospects for privatisation. I doubt whether gearing ratios of 70% in 1986 and 27% in 1987 would be considered excessive by the market. But, in any case, I do not think we should tailor the launch aid for this project in order to prepare the balance sheet for disposal. The need for any capital reconstruction is much better considered at the time of privatisation when a decision can be made in the light of market circumstances at the time and the Company's actual results. You may recall that you took a similar view when we discussed launch aid for the Rolls Royce RB211-535 Engine at E(A) on 27 July last year.

5. I have not yet had an opportunity to discuss with Norman the repayment terms for any launch aid we may agree but, in view of the healthy prospects for the project, I propose a 5% return. We will need to pursue also the scope for finding offsetting savings within his public expenditure programme.

6. Copies of this go to members of E(A), Geoffrey Howe, Michael Heseltine and Sir Robert Armstrong.

PETER REES

TABLE 1 (No Launch Aid)

	<u>£M (Outturn Prices)</u>				
	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
1. V2500 Expenditure	10	30	56	58	52
2. Profit (Loss) after tax	(4)	1	100	220	270
3. Cashflow	(15)	(17)	49	130	170
4. Net shareholders funds	296	297	397	617	897
5. Net borrowings	385	402	353	223	53
6. Gearing (ie 5/4)	130%	135%	89%	36%	6%

TABLE 2 (Chief Secretary's proposals)

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
1. V2500 Expenditure	10	30	56	58	52
2. Launch Aid	10	25	10	0	0
3. Profit (Loss) after tax	(4)	26	110	220	270
4. Cashflow	(5)	8	59	130	170
5. Net shareholders funds	306	332	442	662	932
6. Net borrowings	375	367	308	178	8
7. Gearing (ie 6/5)	123%	110%	70%	27%	1%

TABLE 3 (Secretary of State's proposals)

	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
1. V2500 Expenditure	10	30	56	58	52
2. Launch Aid	10	30	56	0	0
3. Profit (Loss) after tax	(4)	31	160	220	270
4. Cashflow	(5)	14	109	130	170
5. Net shareholders funds	306	338	498	718	998
6. Net borrowings	375	361	252	122	(48)
7. Gearing	122%	107%	51%	17%	-

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ROLLS-ROYCE LIMITED

1983 Financial Results

Chairman's Statement

Turnover fell in 1983 to £1331 million, a drop of 16% in real terms from the 1982 level. This reflects the continuing difficulties experienced by the world's airlines despite the recovery in the US economy. Orders for new equipment depend heavily on the financial strength of individual airlines and, after three years of severe recession in the industry, it is hardly surprising that investment decisions will only be made as confidence in the continued resumption of traffic growth builds up. A further factor in the drop in sales volume, and one which affected the whole industry, was the significant fall in demand for spare parts from major airline operators, as they conserved funds by running down inventories and carrying out a greater degree of component repair within their own repair shops.

Whilst activity in the civil airline business was disappointing, military and industrial and marine business held up reasonably well. The RB199 continued to be the largest of our military programmes, but the Pegasus and Adour projects also contributed significantly to total turnover.

Primarily as a result of the drop in turnover, the after-tax loss on ordinary activities amounted to £118 million compared with a £95 million loss in 1982. This was after a substantial research and development charge of £131 million (£131 million in 1982) that reflected the peak of engineering activity on the RB211-535E4 programme, culminating with the engine being certificated in November 1983 ahead of schedule for entry into passenger service in the Boeing 757 in October 1984. Despite these adverse factors, the Company reduced its net borrowings by £17 million, and received no financial assistance from Her Majesty's Government other than funds available to industry in general or aerospace companies in particular, eg launch aid under the Civil Aviation Act 1982.

UK employment fell by approximately 5900 during the year, a reflection of the need to reduce cost to match a falling manufacturing workload whilst at the same time improving our overall efficiency. Once again this reduction was achieved entirely on a voluntary basis, and credit is due to the workforce on all sites for their co-operation during these very difficult times. Unfortunately, it will be necessary to implement further reductions in 1984 so as to reduce costs to levels which can be sustained by the Company's business. The increased charge for restructuring - up from £38 million in 1982 to £74 million in 1983 - includes provision for severance for those employees leaving the Company in 1984 on voluntary terms.

The last twelve months has seen the consolidation of major aspects of the Company's project strategy. On 31 October 1983 the formation was announced of a five-nation, five-company consortium (InternationalAero Engines) to develop and build a new engine, the V2500 for the 150-passenger commercial jet transport market. Rolls-Royce and Pratt & Whitney each have a 30% share in this project which received formal HMG approval in

Chairman's Statement continued

February 1984. The other shareholders are Japanese Aero Engines Corporation (19.9%), MTU (12.1%) and Fiat Aviazione (8%).

Also in February 1984, Rolls-Royce and General Electric (USA) announced the signature of a Memorandum of Understanding under which both companies would participate in each other's high technology commercial aero gas turbines, the RB211-535E4 and the CF6-80C2. As a result of these two new collaborative ventures, Rolls-Royce will be competing in all the major sectors of the gas turbine market for commercial aero-engines, whilst at the same time reducing the heavy financial burden associated with the launch of new engine projects.

Collaboration has been a normal feature of military engine programmes for some years, but we are continuing to pursue new possibilities, in particular to meet the new European Fighter requirement now being considered by governments and to complete development of the RTM 322, a new helicopter engine which we are convinced will find civil and military applications in a number of countries.

In December, the RB211-535C completed its first year in service as the launch engine in the Boeing 757, with a reliability record unequalled by any previous aero gas turbine produced by any manufacturer. Our higher thrust RB211 engines, the -22 and -524 versions, have also shown considerable improvements in reliability over the past year, with on-wing lives of 8000-10000 engine hours being achieved on a number of engines in airline service. These achievements are only realised as a result of a major commitment of manpower and a major investment in technical resources, but we recognise that our customers now expect levels of engine reliability and performance significantly better than those achieved in previous generation aircraft.

Although there are signs of recovery in the airline business, led by the major USA carriers, the rate of future traffic growth is still uncertain. Whilst it is becoming apparent that the large inventory of secondhand aircraft, which built up during the worst part of the recession, is now being re-absorbed into airline use, and that capacity shortages are beginning to emerge in some sectors of the market, it will be at least twelve months before orders for new equipment begin to have any noticeable effect on our manufacturing workload. In the meantime, we will continue with our programmes of cost reduction and general efficiency improvements, both of which are an integral part of the new organisation structure which was implemented during the latter part of 1983.

(Signed)

# Consolidated Profit and Loss Account

for the year ended, December 31, 1983

	Consolidated	
	1983	1982
	£m	£m
<b>Turnover</b>	1 331	1 493
Cost of sales	(1 118)	(1 225)
<b>Gross profit</b>	213	268
Selling and marketing costs	(95)	(95)
Administrative expenses	(44)	(51)
<b>Operating profit</b>	74	122
Research and development (net)	(131)	(131)
Interest payable and similar charges	(55)	(82)
Share of losses in related companies	(2)	—
<b>(Loss) on ordinary activities before taxation</b>	(114)	(91)
Taxation	(4)	(4)
<b>(Loss) on ordinary activities after taxation</b>	(118)	(95)
Attributable to minority interests	(1)	(1)
Extraordinary item	(74)	(38)
<b>(Loss) attributable to Rolls-Royce Limited</b>	(193)	(134)

	Consolidated	
	1983	1982
	£m	£m
<b>Reserves (accumulated deficit)</b>		
At January 1	(13)	121
(Loss) for the year	(193)	(134)
<b>At December 31</b>	(206)	(13)

The Company profit and loss account is not shown — Section 149(5) of Companies Act 1948.

# Consolidated Balance Sheet

at December 31, 1983

	1983		1982	
	£m	£m	£m	£m
<b>Fixed assets</b>				
Tangible assets		312		312
Investments in related companies		—		2
<b>Current assets</b>				
Stocks	513		646	
Debtors	240		263	
Cash at bank and in hand	15		18	
	<u>768</u>		<u>927</u>	
<b>Creditors — amounts falling due within one year</b>				
Bank loans, overdrafts and other borrowings	(191)		(161)	
Other creditors	(227)		(214)	
	<u>—</u>		<u>—</u>	
<b>Net current assets</b>		350		552
<b>Total assets less current liabilities</b>		<u>662</u>		<u>866</u>
<b>Creditors — amounts falling due after more than one year</b>				
Bank loans and other borrowings	(174)		(224)	
Other creditors	(54)		(49)	
	<u>—</u>		<u>—</u>	
		(228)		(273)
<b>Provisions for liabilities and charges</b>		(127)		(93)
		<u>307</u>		<u>500</u>
<b>Capital and reserves</b>				
Called up share capital		508		508
Revaluation reserve		135		138
Profit and loss account		(341)		(151)
		<u>302</u>		<u>495</u>
<b>Minority interests</b>		5		5
		<u>307</u>		<u>500</u>



DEPARTMENT OF TRADE AND INDUSTRY

1-19 VICTORIA STREET

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Secretary of State for Trade and Industry

5 April 1984

COMMERCIAL IN CONFIDENCE

A Turnbull Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
LONDON  
SW1

*Dear Andrew,*

ROLLS-ROYCE LIMITED

My predecessor wrote to yours on 28 March 1983 about Rolls-Royce's preliminary financial results for 1982. We have now heard that Rolls-Royce's preliminary results for 1983 are due to be announced on 12 April, and my Secretary of State thinks that the Prime Minister will wish to know the main points of the announcement, which include a final loss for the year of £193 million.

2 Turnover for 1983 totalled £1331 million (1982 £1493 million). Operating profit was £65 million (1982 £122 million) and the loss after tax and restructuring costs amounted, as already mentioned, to £193 million (1982 £134 million). Besides the reduced level of sales, the following are the most significant factors affecting profit:

- (i) The manpower in the company and its UK subsidiaries was reduced from 45,309 to 39,391 in the year. The costs incurred in this voluntary redundancy restructuring amount to £63 million (£44 million net of recoveries). In addition, the company has provided £30 million in respect of its restructuring plans for 1984.
- (ii) The lower value of sterling relative to the US dollar which at end 1983 was \$1.45 = £1 (1982 \$1.62 = £1), resulted in an increase of £20 million in the sterling value of RR's dollar borrowings and hence liabilities.
- (iii) A provision of £13 million has been created recognising the current reduced world market price of

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titanium relative to the cost of the company's stock. It also recognises the reduced demand for titanium in the company's manufacturing programme.

- (iv) The company has a substantial stock of used engines and modules. Although in 1983 there was some success in disposing of this stock and other possibilities are presently being pursued, the company has prudently written the inventory value down to 10 per cent of its book value. The effect of this policy was to write off £10 million in 1983.

The heavy loss for 1983 is therefore largely due to restructuring and to the provisions which Rolls-Royce have prudently taken for future restructuring and for the value of stocks.

3 The company did not receive the first payment of £25 million launch aid to the RB211-535E4 programme until January 1984. This allowed it to be taken into profit and loss, but not cash flow. Nevertheless, there was an operating cash inflow of £28 million. US\$165 million of medium-term dollar borrowings were repaid during the year. The lower value of sterling increased the sterling value of the remaining medium-term dollar borrowings, but total borrowings nevertheless reduced in the year by £17 million from £367 million to £350 million.

4 The Prime Minister also may wish to know that the company's Operating Plan and Budget forecasts an operating profit of £164 million in 1984 and £216 million in 1985. After-tax profits, adjusted to reflect the costs associated with the General Electric collaboration, are forecast of ~~£20 million~~ £20 million - 1984 and ~~£27 million~~ £27 million in 1985. This assumes launch aid payments of £5 million and £15 million respectively on the V2500; this is, of course, still under negotiation, and the figures now under discussion would lead to higher payments (£10 million and £30 million) in these two years, but much lower figures than Rolls-Royce had assumed thereafter.

5 I am sending copies of this letter to the Private Secretaries to the Secretary of State for Foreign and Commonwealth Affairs, the Chancellor of the Exchequer, the Secretary of State for Defence and Sir Robert Armstrong.

*Yours ever*

*Colman McCarthy*

M C MCCARTHY  
Private Secretary

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Secretary of State for Trade and Industry

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COMMERCIAL IN CONFIDENCE

12 April 1984

Andrew Turnbull Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
LONDON  
SW1

Dear Andrew,

ROLLS-ROYCE LIMITED

Further to my letter of 5 April I should be grateful if you would substitute the following for the second sentence in paragraph 4:

"After-tax profits (Loss), adjusted to reflect the costs associated with the General Electric collaboration, are forecast of (£3M) in 1984 and £12M in 1985".

This amendment is not of course relevant to the forthcoming announcement of Rolls-Royce's preliminary results for 1983.

2 I am sending copies of this letter to the Private Secretaries to the Secretary of State for Foreign and Commonwealth Affairs, the Chancellor of the Exchequer, the Secretary of State for Defence and Sir Robert Armstrong.

Yours ever,

ANDREW D LANSLEY  
Private Secretary

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EXTRACT FROM THE RECORD OF THE PRESENTATION TO THE  
PRIME MINISTER AND OTHER MINISTERS ON 16 NOVEMBER 1983

The Rolls-Royce Presentation

17 The presentation as given by Sir William Duncan and Mr Robins is at Annex B. Copies of the slides used to accompany the presentation are in Annex D.

18 In questions after the presentation, Mr Pattie queried Rolls-Royce's projection of market penetration for the V2500 engine. The presentation had appeared to imply that Rolls would secure greater penetration if A320 did not proceed. Mr Robins explained that Rolls-Royce were assuming a 60% market penetration for the 150-seat aircraft class as a whole, including A320. This implied engine sales of 3000 units out of a total market of 5000 units. If the A320 did not proceed, the total market would be smaller: Rolls-Royce would nonetheless expect 2200 sales of the V2500. Sir William Duncan stressed that Rolls-Royce wanted the A320 project to proceed. Beside the direct benefits to R-R, the project might stimulate Boeing and McDonnell Douglas to develop new products rather more quickly than would otherwise be the case.

19 The Prime Minister queried the Chairman's statement that all Rolls-Royce borrowing required a Government guarantee. Sir William Duncan commented that some of the US financial institutions were

uneasy about the prospective return of Rolls-Royce to the private sector. R-R's longer term loans might have to be re-negotiated nearer the time of privatisation.

20 The Secretary of State for Employment asked about the various joint ventures. How would marketing be handled? Did GE and/or Pratt & Whitney have Federal funding for development on the civil side and was HMG financial support a pre-condition for the acceptance of collaboration? What employment would arise from the joint ventures?

21 On marketing, Sir William Duncan and Mr Robins explained that the V2500 engine would be handled by staff working for the joint company: it had to be remembered that Pratt & Whitney and Rolls-Royce would remain competitors in other sectors. As for the big engines, Rolls-Royce and GE would initially respect "spheres of influence". Over the next 5 to 6 years, Rolls-Royce were bound to promote the RB211-535E4 and the RB211-524D4A against US competition. GE would simultaneously be promoting the CF6-80C. But collaboration with GE was essentially seen as a means of meeting the needs of the 1990s. It was hoped that GE and R-R would gradually evolve a pattern of cross-selling which would be the prelude to full collaboration.

22 The Prime Minister asked why collaboration with GE was envisaged. Was there not a risk that GE would use collaboration as a means of squeezing Rolls-Royce out? Sir William Duncan commented that collaboration offered both R-R and GE the chance to reduce costs - and to compete more effectively with the Pratt & Whitney 4000.

23 As regards employment, Sir William Duncan observed that some 3000 jobs in Rolls-Royce were directly affected by participation in the V2500. In addition, some 4000 jobs would be similarly affected outside Rolls-Royce. Mr Rigg stressed that the project would be sustaining jobs rather than creating new ones.

24 Mr Young asked why Rolls-Royce were pursuing collaboration on the larger engines with GE rather than Pratt & Whitney. Sir William Duncan replied that Pratt & Whitney had a dominant share: there were thus anti-trust implications. Unlike Pratt & Whitney, GE were not competing directly with the RB211-535: R-R saw some chance of a deal which could be genuinely reciprocal. Such a deal would be unattainable with Pratt & Whitney. The Chief Secretary, noting the previously-expressed view that privatisation of R-R as a whole would not be feasible in the near future, wondered whether it would still be possible to privatise the industrial marine division. Sir William Duncan replied that R-R engines were designed for aerospace applications. It would make no sense to hive-off the marine division which would continue to rely on aerospace technology. R-R wished to be able to develop collaboration with GEC on the basis of the breadth of its experience.

25 The Prime Minister was somewhat disturbed to find that there was no possibility of privatising R-R for five years. Sir William Duncan explained that the next two years would be difficult. Up to 1986/87, R-R would have a poor record of profitability. There must be doubt as to whether the company could then achieve a balance sheet which would be credible against the requirements of privatisation. But he

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did not totally discount the prospect of privatisation within five years. The Prime Minister noted that R-R would remain dependent on Government both directly for orders and for funding of the research needed for new engines. Sir William Duncan confirmed that the military side of the business would need continued Government support for orders and on the research side. The Chief Secretary wondered what would need to be done to the R-R balance sheet after two years to make privatisation possible. Sir William Duncan commented that years of good profits would be needed - not manipulation of the balance sheet.

26 The Secretary of State for Trade and Industry recalled that one of R-R's great successes since the War had been the turbo-prop Dart engine: this had had no major competitor to erode its margins or enforce costly interim developments. The position of the V2500 might be not dissimilar. It ought to be able to see off the CFM56-4 engine and achieve long-term dominance with the market. He felt that Rolls-Royce were very wise to change policy and to pursue a policy of collaboration on the big engines. The Secretary of State for Employment wondered whether the collaborative engines would have the R-R label - or whether R-R would be aligned with GE and Pratt & Whitney. Sir William Duncan commented that, in the case of the V2500, R-R would be aligned with its partners in a consortium. The R-R name would certainly be preserved on a marketing level. The Secretary of State for Employment wondered whether R-R engineers would not start to look upon the product as foreign engines. Would they need re-training on this account? Sir William Duncan recognised that the CF6-80C would be a GE engine. But, in the long-term, R-R could be identified technically with it and its successors. Mr Robins made the point that R-R were not simply a demandeur: GE wanted some of R-R's technology. The important thing for R-R was to spread the R&D base. Sir William Duncan stressed his view that the civil aero-engine market would not support three direct competitors.

27 Mr Robins also stressed that the whole of the compressor system on the V2500 engine would be provided by R-R. R-R would not lose control of this technology and would be able to use the compressor in other projects, eg to drive a prop fan in the 1990s. The advantage of the V2500 would be to keep R-R in the front line of the business. Something similar had to be worked out with GE for the bigger engines: and R-R were confident they had the technology to do this. Sir William Duncan noted that the alternative to collaboration with GE would be to stick with the RB211-524D4A until such time as R-R were pushed out of the 50,000 lbs plus market altogether. Mr Pattie confirmed that the withdrawal of R-R from "own name" participation in the bigger engines would have no military affect. MOD had certain decisions to take, but collaboration was already firmly established on the military side.

28 Sir William Duncan emphasised that R-R would not enter into collaboration with GE unless it was clear that this course would be more profitable than staying independent or getting out of the large engine market altogether.

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29 The Secretary of State for Employment recalled that he had asked whether an agreement with GE would be conditional upon HMG launch aid for further development of the CF6-80C. Sir William Duncan replied that this was not the case. The Prime Minister recalled, nonetheless, that all R-R's borrowing was subject to a Government guarantee. Was this not Government support? Mr Rigg agreed that banks would continue to rely on the comfort letters. But R-R were confident of their ability to repay - and predicted the necessary cash surpluses.

30 The Secretary of State for Trade and Industry felt that the Government should avoid displaying any lack of confidence in R-R's ability to participate, in their own right, in the large engine market. We needed to let GE think that R-R could go it alone as a means of securing the best collaborative deal.

31 At this point the Rolls-Royce party left the meeting.

Informal discussion among Ministers

32 The Prime Minister felt that R-R had sung the same song as BAe: perfect days were always in the future. Mr Lamont nonetheless commended R-R for moving towards collaboration. The Prime Minister wondered whether there was a real future for Rolls-Royce, even when they had done everything right. She felt the Government must expect to prop up the company in order to keep the technology going.

33 The Secretary of State for Trade and Industry felt that the position on launch aid and levies had been somewhat less black than might have been feared. The Secretary of State for Employment nonetheless feared that the next recovery would inevitably be followed by further slippage, making continued HMG support inevitable. The Prime Minister noted that the US industry received considerable support in the form of Defence contracts.

34 Mr Lamont felt that the Government should keep up the pressure on the company about privatisation. He was sure that Sir William Duncan wished to privatise the company and to do without further Government support. The Prime Minister felt that the Government should not lose too much sleep if it was unable to privatise R-R. The purpose of Government support to the company was to preserve a necessary technology, partly because of a political commitment and partly because of the employment implications. We had to keep R-R alive because we would otherwise lose contact with the appropriate technology base.

35 Dr Nicholson, asked by the Prime Minister for his views, observed that both BAe and R-R were operating in the area of leading edge technology with potential spin-off benefits. He personally had been impressed by Rolls-Royce's R&D effort at Derby. R-R had stated in their presentation that they were reducing their R&D spend by 25%: but they were significantly increasing their productivity. He had not had the opportunity to visit BAe. But his impression was that BAe were less competitive vis-à-vis Boeing than Rolls-Royce were vis-à-vis Pratt & Whitney. BAe seemed to be lagging behind in manufacturing and metals technology. Boeing were now saying that they could build an aircraft with only 11% by weight in aluminium - the rest would be new materials. He doubted whether BAe could achieve the same.

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36 The Prime Minister asked about the next steps in the consideration of launch aid. The Secretary of State for Trade and Industry felt that, since the Prime Minister appeared to be sympathetic towards the concept of launch aid, he would now wish to talk to British Aerospace in an attempt to reduce their bid (both as an absolute amount and as a proportion of the development costs). The Prime Minister observed that BAe's current bid appeared to be little more than a guesstimate. The Chief Secretary also felt it would be important to follow up Mr Lamont's ideas for innovative mechanisms to mobilise private sector financing.

Department of Trade and Industry  
22 November 1983

SHORTER VERSION

PRESENTATION TO MINISTERS

CHARTS ON  
SCREEN

ROLLS-ROYCE  
LOGO

MAY I FIRST INTRODUCE THE ROLLS-ROYCE TEAM WHOSE NAMES HAVE BEEN NOTIFIED TO YOU. WE ARE PRESENTING ROLLS-ROYCE'S STRATEGY, PARTICULARLY ON THE CIVIL SIDE, AND THE FINANCIAL CONSEQUENCES OF THAT STRATEGY, AGAINST A BACKGROUND OF RECENT RESULTS.

AFTER I TOOK OVER AS CHAIRMAN IN APRIL IT BECAME QUICKLY APPARENT THAT THERE WERE FOUR IMMEDIATE TASKS, LISTED IN THE FIRST CHART, TO MEET THE OBJECTIVES OF EARLY PROFITABILITY AND THEN PRIVATISATION.

CHART 1A

- TO CONTINUE COST CUTTING, NOTABLY THROUGH MANPOWER REDUCTIONS;
- TO RE-ASSESS CIVIL STRATEGY BASED ON COLLABORATION;
- TO REDUCE COST AND RISK IN RESEARCH AND DEVELOPMENT BY TIGHTER CONTROL AND BY COLLABORATION;
- TO RE-ORGANISE THE COMPANY'S STRUCTURE SO AS TO FOCUS ON PROFITABILITY BELOW THE LEVEL OF CHAIRMAN/CHIEF EXECUTIVE.

AS AN INTERIM MEASURE TO REFLECT LOWER PROSPECTIVE SALES DUE TO THE RECESSION AND WHILE STRATEGY WAS RE-ASSESSED, GROSS R & D WAS CUT BELOW PLANNED LEVEL.

A NEW MANAGEMENT ORGANISATION IS NOW BEING IMPLEMENTED.

THE FURTHER ACTIONS ARISING FROM THE IDENTIFIED TASKS ARE IN THIS PRESENTATION WHICH

CHART 1B

- ASSESSES STRENGTHS AND WEAKNESSES COMPARED WITH THE COMPETITION;
- EXAMINES THE CURRENT SITUATION;
- LOOKS AT FINANCIAL PROSPECTS;
- EXPLAINS THE STRATEGIC ISSUES BEHIND THE PROSPECTS;
- SUMMARISES THE WAY FORWARD AND WHAT WE SEEK FROM HMG.

AEROSPACE, ALTHOUGH HIT BY THE WORLD RECESSION, IS UNIVERSALLY PREDICTED TO BE A GROWTH INDUSTRY.

IN AERO-ENGINES ONLY THE US AND UK HAVE THE FULL CAPABILITY OF INDEPENDENT DESIGN AND DEVELOPMENT AND SUPPORT OF LARGE MODERN GAS TURBINE ENGINES.

THE NEXT CHART SHOWS OUR COMPETITORS' STRENGTHS CHART 2  
IE

- ADVANTAGES OF BEING PART OF MAJOR CONGLOMERATES
- SIZE OF THE US DOMESTIC AIRLINE MARKET
- THE DOMINANCE IN THE FREE WORLD OF THE US CIVIL AND MILITARY AIRCRAFT MANUFACTURERS
- THE BIG US SUPPLY INFRASTRUCTURE
- HIGHER AIRCRAFT RELATED DEFENCE EXPENDITURE
- STRONG POLITICAL SUPPORT
- LARGE PUBLIC MONEY FOR LONG-TERM RESEARCH.

OUR OWN STRENGTH IS BASED FIRST ON THE 26,000 CHART 3  
ENGINES WE HAVE IN SERVICE WITH A VERY LARGE NUMBER OF CUSTOMERS AND OUR GREATER EXPERIENCE IN LICENSING AND COLLABORATION.

FURTHERMORE, WE HAVE

- PENETRATED THE US THROUGH CIVIL PROGRAMMES LAUNCHED ON US AIRCRAFT AND ENGINES WHICH POWER US MILITARY AIRCRAFT CHART 4
- SUPPLIED ENGINES FOR ALL BAE MILITARY AIRCRAFT AND HAVE STRONG EUROPEAN MILITARY PROGRAMMES
- A SOUND UK SUPPLY NETWORK
- IMPROVING PRODUCTION EFFICIENCY AS EXEMPLIFIED BY OUR FLEXIBLE MANUFACTURING SYSTEMS
- COMPETITIVE BASIC TECHNOLOGY
- LONG-STANDING SUPPORT FROM HER MAJESTY'S GOVERNMENT IN RESEARCH AND DEVELOPMENT OF ENGINES AND IN MILITARY PURCHASES.

OUR STRATEGY BUILDS ON THESE STRENGTHS BUT RECOGNISES WEAKNESSES IN FINANCIAL RESOURCES AND IN SOME CIVIL MARKETS.

OUR STRENGTHS ENABLE US TO FORESEE A CONTINUING AND SUBSTANTIAL ROLE FOR ROLLS-ROYCE ON A SELECTIVE BASIS AND INVOLVING A GREATER DEGREE OF COLLABORATION. WE CONSIDER THE COMPANY IS IMPORTANT TO BRITAIN BUT CERTAINLY NOT REGARDLESS OF COST AND NOT NECESSARILY IN ITS PRESENT FORM.



THE NEXT CHART GIVES THE BREAKDOWN OF OUR BUSINESS ON WHICH TO BASE OUR COMMENTS ON THE FUTURE. IT SHOWS IN PARTICULAR THAT OVER HALF IS MILITARY, FOR MOD AND OVERSEAS, AND THE SIGNIFICANT SIZE OF SPARES SALES, MILITARY AND CIVIL. CHART 5

THE RAPID REDUCTION IN CIVIL BUSINESS IN RECENT YEARS, SHOWN IN THE NEXT CHART, HAS MEANT WE HAVE HAD TO CUT ACTIVITY AND COSTS, WHILE MAINTAINING AN ADEQUATE PRODUCTION BASE AND PROTECTING OUR TECHNOLOGY. CHART 6

IN PARTICULAR MANPOWER HAS FALLEN BY A THIRD SINCE 1980, RESULTING IN HIGH SHORT-TERM REDUNDANCY CHARGES BUT LARGE LONG-TERM SAVINGS. NEW MANUFACTURING TECHNIQUES TO ACCOMMODATE HIGHER WORKLOADS WHILST REDUCING TOTAL MANNING LEVELS, ARE BEING INTRODUCED READY FOR WHEN THE RECESSION IS OVER. WE BELIEVE OUR MANUFACTURING COMPETITIVENESS IS COMPARABLE, AT CURRENT EXCHANGE RATES, TO THAT OF US COMPANIES, AS CONFIRMED IN THE CURRENT NEGOTIATIONS ON COLLABORATIVE PROGRAMMES. CHART 7

THE PROJECTED TURNOVER BASED ON OUR PRODUCT STRATEGY AS IN THE NEXT CHART, WILL BE AT THE REDUCED 1983 LEVEL IN 1984 AND RECOVER THEREAFTER. TURNOVER IN THE YEARS AFTER 1987 WILL BE BROADLY AT ABOUT THE LEVEL IN THAT YEAR, DEPENDENT ON DECISIONS ON THE STRATEGY ISSUES WHICH WE DISCUSS LATER. CHART 8

A KEY ELEMENT IN COSTS IS TIGHTER CONTROL OF CIVIL RESEARCH AND DEVELOPMENT WHICH WE AIM TO REDUCE IN REAL TERMS BY UP TO A QUARTER BY 1987.

THE NEXT CHART SHOWS OUR FORECAST OF RISING PROFITABILITY. THIS FOLLOWS CURRENT LOSSES DUE TO HIGH REDUNDANCY COSTS, HIGH FINANCING COSTS, HEAVY EXPENDITURE ON R & D AND ADVERSE EFFECTS OF THE EXCHANGE RATE OF POUND AGAINST THE DOLLAR, DURING A PERIOD OF SLACKENING SALES. CHART 10

THE LATER YEARS BENEFIT FROM THE COST REDUCTIONS ALREADY REFERRED TO, LOWER FINANCIAL EXPENSES RESULTING FROM PROGRESSIVE REPAYMENT OF BORROWINGS AND LOWER INTEREST RATES, AND THE ASSUMPTION THAT FUTURE DOLLAR INCOME IS CONVERTED TO STERLING AT A RATE OF \$1.60 TO THE £1.

THE DECISION MADE IN 1980 TO SELL FORWARD DOLLAR INCOME ARISING FROM FIRM FUTURE BUSINESS ADVERSELY AFFECTED THE RESULTS FOR 1981, 1982 AND 1983. THIS OVERLAY SHOWS HOW THE OPERATING PROFIT WOULD HAVE LOOKED HAD AVERAGE SPOT EXCHANGE RATES BEEN ACHIEVED FOR EACH OF THOSE YEARS, RATHER THAN THE CONTRACTED FORWARD RATES. IT THEREFORE PUTS THE FORECAST FUTURE OPERATING PROFIT GROWTH IN A BETTER PERSPECTIVE.

OVERLAY TO  
CHART 10

DESPITE THE DIFFICULTIES SINCE 1979, THE COMPANY HAS MET THE CASH TARGETS AGREED WITH HMG.

<sup>Also</sup> THE POSITIVE CASH FLOW PROJECTIONS IN THE NEXT CHART REFLECT THE BENEFITS OF A LOWER PAY BILL, REDUCED INTEREST CHARGES AND AN ASSUMPTION OF AN EXCHANGE RATE CONTINUING AT \$1.60 TO THE £1.

CHART 11

THE PROFIT AND LOSS AND CASH PROJECTIONS ASSUME RECEIPT OF £113 MILLION (IN 1983 MONEY) OVER THE NEXT SEVEN YEARS, OF HMG FUNDING FOR OUR SHARE OF THE V2500 COLLABORATIVE ENGINE, THE SIGNIFICANCE OF WHICH WE DISCUSS UNDER PRODUCT STRATEGY. ALL OUR BORROWING REQUIRES HMG GUARANTEE AND IN THIS CASE WE NEED THIS TRADITIONAL FRONT-END LAUNCH FUNDING FOR PROFIT AND CASH REASONS. WE ARE NOT SEEKING OTHER SUCH LAUNCH FUNDING IN THE FORESEEABLE FUTURE AND THE PROPORTION OF OUR CIVIL R & D WE WILL FUND OURSELVES WILL RISE. BUT AS THIS CHART INDICATES, SUCH PAYMENTS ARE NOT ONE WAY BECAUSE LEVIES TO HMG, INCLUDING THOSE FROM MILITARY EXPORTS, ARE FORECAST TO EXCEED CIVIL LAUNCH FUNDING.

CHART 12

THE MAJOR ISSUES RELATE TO THE PRODUCT STRATEGY UNDERLYING THE FINANCIAL ESTIMATES WE HAVE PRESENTED. PRINCIPALLY, BECAUSE OF THEIR COMPLEXITY, THESE ARE CIVIL MATTERS, BUT I MUST COMMENT FIRST ON THE MILITARY SIDE, COVERING AS SHOWN EARLIER OVER HALF THE TURNOVER.

ROLLS-ROYCE PLACES VERY HIGH PRIORITY ON MEETING MOD'S NEEDS FOR ENGINES FOR FIXED WING AIRCRAFT, HELICOPTERS, AIR BREATHING MISSILES AND WARSHIPS.

CHART 13

THIS CHART INDICATES THE IMPORTANCE TO THE FUTURE OF THE COMPANY OF THE FOLLOWING DECISIONS IN THE NEXT YEAR OR SO.

- FURTHER ORDERS FOR TORNADO POWERED BY THE RB 199
- THE PROPOSED EUROPEAN FIGHTER BASED, WE HOPE, ON THE RB 199 POWERED ACA
- ON HELICOPTER PROCUREMENT WHICH WILL DETERMINE THE FUTURE OF THE PROPOSED RTM 322 HELICOPTER ENGINE AND OUR HELICOPTER BUSINESS
- THE AV8B AND ITS SUCCESSOR BASED ON THE PEGASUS
- THE US GOVERNMENT'S PROCUREMENT OF THE ADOUR POWERED HAWK FOR VTX.

ALSO WE MUST MENTION THE MILITARY MARINE AND CIVIL RR LOGO INDUSTRIAL APPLICATIONS OF AERO-ENGINES, REPRESENTING 10% OF TURNOVER. WE WILL IMPROVE PERFORMANCE IN THIS SECTOR, BY WIDENING COLLABORATION, NOTABLY WITH GEC.

WE NOW CONCENTRATE ON THE DIFFICULT STRATEGIC DECISIONS ON THE CIVIL AERO-ENGINE SIDE, BASED ON OUR CONVICTION, WHICH ACCORDS WITH THE GOVERNMENT'S VIEW, THAT FOR NEW ENGINES IN EXCESS OF 20,000 LBS THRUST THERE IS ONLY ROOM FOR TWO PROJECTS FOR EACH REQUIREMENT AND THIS MEANS EITHER NOT BEING INVOLVED OR FINDING WAYS OF COLLABORATING WITH THE US MANUFACTURERS.

RALPH ROBINS WILL NOW DESCRIBE OUR VIEW OF THE CIVIL SITUATION.

ALTHOUGH WE EXPECT ONLY A SLOW RECOVERY IN NEW AIRCRAFT ORDERS, WE PREDICT A REQUIREMENT FOR 3,400 AIRCRAFT BY 1992; HALF TO REPLACE UNECONOMIC AND TECHNICALLY OBSOLESCENT AIRPLANES.

CHART 6  
WITH  
ADDITION

TO TRANSLATE THIS INTO AN ENGINE REQUIREMENT, WE NEED TO CONSIDER FOUR MARKET SECTORS BASED ON AIRCRAFT SIZES. THIS CHART SHOWS THE ANNUAL BUSINESS IN THESE SECTORS, THE COMPETING ENGINES AND THE AIRCRAFT TO WHICH THEY ARE FITTED, AND I SHALL BE TALKING TO IT FOR SEVERAL MINUTES.

CHART 14

IN THE 110 SEAT MARKET, HAVING LAUNCHED THE TAY ENGINE FOR THE GULFSTREAM IV EXECUTIVE AIRPLANE, WE HAVE AGREED CONTRACTUAL TERMS WITH FOKKER FOR THIS ENGINE FOR THEIR DEVELOPED F28.

IN THE 150 SEAT AIRCRAFT CLASS, THE P & W REFANNED JT8D AND THE GE/SNECMA CFM56 ARE CURRENTLY ON OFFER. WITH THE FIVE NATIONAL COLLABORATIVE V2500, WE EXPECT A STRAIGHT COMPETITION WITH THE CFM56. THIS SECTOR WOULD INCLUDE THE A320.

THE COMBINED TECHNOLOGIES OF P & W AND RR PROVIDE AN ENGINE OF 12% TO 14% BETTER FUEL CONSUMPTION THAN THE CFM56 AND WE BELIEVE THIS ENGINE WILL DOMINATE THIS MARKET SECTOR.

WE HAVE ASSUMED A 60% MARKET PENETRATION AND ON OUR MARKET FORECAST THIS PRODUCES OVER 9.0% RETURN ON INVESTMENT. P & W ENVISAGE A LARGER MARKET HIGHER RETURN ON INVESTMENT.

THE LAUNCH OF THE A320 IS CLEARLY IMPORTANT IN THIS MARKET BUT THE ENGINE IS NOT DEPENDENT ON THIS AIRPLANE ALONE, AND WE BELIEVE THAT THREE-QUARTERS OF THE PREDICTED MARKET WOULD STILL BE ACHIEVED IN THE ABSENCE OF THE A320 - STILL GIVING A RETURN OF WELL IN EXCESS OF 5.0%.

IN THE THIRD SECTOR, OCCUPIED BY THE B757, WE ARE IN DIRECT COMPETITION WITH P & W. THE 535C ENGINE HAS A 2 YEARS LEAD AND HAS PERFORMED MAGNIFICENTLY IN SERVICE. HOWEVER, THE MAJOR TEST WILL COME WHEN THE 2037 AND THE 535E4 ARE BOTH IN SERVICE IN ABOUT 15 MONTHS TIME.

THE E4 DEVELOPMENT PROGRAMME HAS GONE EXCEPTIONALLY WELL AND WE HAVE STRONG REASONS TO BELIEVE THE E4 WILL BE COMPLETELY COMPETITIVE IN FUEL BURN WITH THE 2037.

757 SALES HAVE BEEN ADVERSELY AFFECTED BY THE RECESSION, BUT WE SHARE WITH BOEING THE BELIEF THAT THIS AIRPLANE WILL ACHIEVE LARGE SALES DUE TO THE FACT THAT IT OFFERS THE LOWEST FUEL CONSUMPTION PER SEAT OF ANY AIRPLANE ON OFFER. BECAUSE OF OUR TIME ADVANTAGE, GOOD SERVICE PERFORMANCE AND COMPETITIVE SPECIFICATION, WE BELIEVE WE WILL ACHIEVE OUR PREDICTED 40% MARKET SHARE.

THE FOURTH WIDE BODY SECTOR HAS PRESENTED US WITH A MAJOR STRATEGIC DECISION. ALL THREE ENGINE MANUFACTURERS HAVE MACHINES IN THIS CLASS AND ALL ARE ON OFFER IN THE 747. THE RB211 WAS THE SOLE ENGINE IN THE LOCKHEED TRISTAR, BUT THAT PROGRAMME WAS TERMINATED AT 250 AIRCRAFT AND, SO FAR, WE HAVE BEEN UNABLE TO ESTABLISH A LAUNCH BASE IN THE TWIN ENGINED AIRPLANES - A300, A310, B767.

CURRENTLY THE RB211 IS FULLY COMPETITIVE AND HAS OFFERED THE BEST FUEL CONSUMPTION FOR THE LAST 5 YEARS IN THE 747 AIRPLANE - UNFORTUNATELY DURING A PERIOD OF RECESSION WITH RESULTING LOW SALES.

BOTH OUR COMPETITORS HAVE ANNOUNCED NEW ENGINES AVAILABLE IN 1986 WHICH WOULD REQUIRE US TO UNDERTAKE SIGNIFICANT FURTHER DEVELOPMENT OF THE 524 IN ORDER TO REMAIN COMPETITIVE. WHILST SUCH A STEP IS TECHNICALLY QUITE FEASIBLE, WE HAVE REJECTED IT BECAUSE OF THE SIGNIFICANT INVESTMENT AND FINANCIAL RISK INVOLVED.

INSTEAD, WE INTEND TO CONTINUE THE ENGINEERING WORK NECESSARY TO MEET THE REQUIREMENTS OF OUR EXISTING 524 CUSTOMERS AND WE HAVE COMMENCED DETAILED NEGOTIATIONS WITH GENERAL ELECTRIC AIMED AT ACHIEVING EQUAL PARTNERSHIP IN THEIR CF6-80C2 PROGRAMME TO MEET THE BIG TURBO FAN REQUIREMENTS OF THE LATE '80s AND '90s. THIS NEGOTIATION INCLUDES THE INTRODUCTION OF GE PARTICIPATION ALSO IN THE 535E4 PROGRAMME.

WE CANNOT AT THIS STAGE BE SURE OF THE OUTCOME OF THESE NEGOTIATIONS, BUT WE BELIEVE THAT THROUGH THIS COLLABORATION WE COULD SECURE OUR LONG-TERM POSITION IN THE LARGE TURBO FAN MARKET.

I HAVE DISCUSSED TURBO FAN ENGINES ONLY, BUT WE ARE ALSO PURSUING OPPORTUNITIES IN THE TURBO PROP FIELD, WHERE THE DART HAS ACHIEVED SUCH SUCCESS, MORE THAN 8,000 ENGINES BEING DELIVERED. OUR INTENTION WILL BE TO EXPLOIT A NEW HELICOPTER ENGINE LAUNCHED FOR MILITARY PURPOSES - RTM 322 - IN COLLABORATION WITH TURBOMECA, TO PRODUCE AN ADVANCED TURBO PROP ENGINE TO REPLACE THE DART TOWARDS THE END OF THIS DECADE.

#### CHAIRMAN RESUMES

IN SUMMARY, OUR CIVIL ENGINE STRATEGY UNDERLYING THE SALES ESTIMATES IS BASED ON PARTNERSHIP WITH P & W IN THE EXISTING 5 NATION COLLABORATION ON THE 2500 AND, IF POSSIBLE, PARTNERSHIP WITH GE ON THE BIG AND INTERMEDIATE TURBOFAN SIZES. WE WILL CONTINUE EXPLOITATION OF THE MARKET BELOW THIS WITH THE TAY AND POSSIBLE TURBO PROP DERIVATIVES OF MILITARY ENGINES LIKE THE 322.

RR Logo

I AM CONFIDENT THAT THERE IS A PROFITABLE LONG-TERM BUSINESS ON THE EXISTING PRODUCT RANGE, THE ALREADY ACHIEVED AND PLANNED IMPROVEMENTS IN MANUFACTURING AND OTHER COST REDUCTIONS, THE COMPANY'S CONTINUED MILITARY BUSINESS, AND THE CIVIL PROJECT STRATEGY WHICH HAS BEEN OUTLINED.

THE DECISIONS WHICH THEREFORE ARE BEING SOUGHT IN THE COMING MONTHS FROM GOVERNMENT WITHIN THE COMPANY'S BROAD STRATEGY, AS SUMMARISED ON THE CHART, ARE:

CHART 15

- I) ACCEPTANCE OF THE COMPANY'S OVERALL STRATEGY IN THE CIVIL MARKET.
- II) EARLY AGREEMENT TO THE COMPANY'S PROPOSALS ON THE V2500 PROJECT.
- III) TIMELY ACTION BY MOD ON THEIR FUTURE REQUIREMENTS SO AS TO ENABLE THE COMPANY TO CONTINUE ITS ROLE AS SUPPLIER TO HMG, BAe AND WESTLAND, COMMENCING WITH THE RTM 322.

IN CONCLUSION I MUST EMPHASISE:

FIRST THAT IN THE SHORT RUN, BECAUSE OF THE RECESSION, THE EFFECTS OF THE EARLIER STRENGTH OF THE POUND, AND THE COST OF REDUNDANCIES, FURTHER UNSATISFACTORY RESULTS AND EROSION OF THE COMPANY'S NET WORTH ARE INEVITABLE.

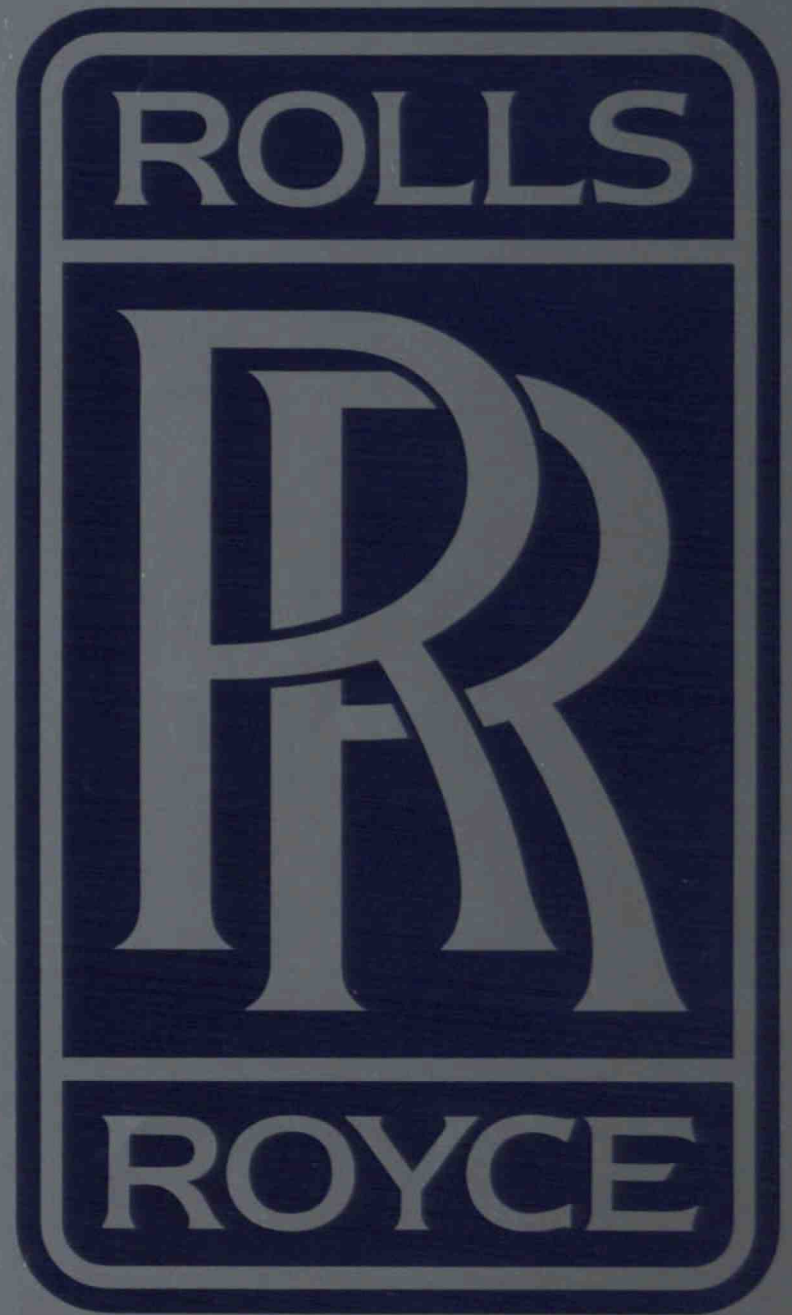
SECOND THAT WE DO HAVE CONFIDENCE THAT DESPITE THIS THE COMPANY WILL NOT IN THE FORESEEABLE FUTURE SEEK FURTHER CIVIL AVIATION ACT LAUNCH FUNDING OTHER THAN THAT FOR THE V2500, NOR WILL IT EXPECT GENERAL FINANCIAL SUPPORT FROM HMG BEYOND CONTINUED FUNDING OF BASIC RESEARCH AND SIMILAR SCHEMES WHICH ARE AVAILABLE TO INDUSTRY IN GENERAL.

THIRD I BELIEVE THAT BY 1986/87 A PROSPECTUS FOR PRIVATISATION CAN BE WRITTEN. THE LEVEL OF PROFIT FORECAST FOR 1987 IS ACHIEVABLE AND SUSTAINABLE THEREAFTER ON THE BASIS OF THE ACTIONS OUTLINED TO YOU ALTHOUGH WE RECOGNISE THAT AT THAT STAGE OUR RECORD OF RECENT YEARS MIGHT NOT LOOK TOO CONVINCING.

WHILE MUCH HAS BEEN DONE, THERE IS MUCH MORE TO BE ACHIEVED. I AM DETERMINED THAT THE COMPANY WILL TURN ITS RESULTS ROUND AND ACCOMPLISH AT LEAST WHAT HAS BEEN OUTLINED TODAY.

WE WILL MEET OUR PRIORITIES OF PROFITABILITY AND A BASIS ON WHICH TO PRIVATISE BY WHATEVER MEANS HMG AND

ANNEX D





# Presentation to Her Majesty's Government

November 1983





## **Immediate tasks**

- 1 Continue cost cutting, notably manpower reductions**
- 2 Redefine civil engine strategy, based on collaboration**
- 3 Strict control of research and development**
- 4 Restructure management and organisation**



# **Presentation content**

**1 Assessment of strengths and weaknesses**

**2 Current business and financial results**

**3 Future financial prospects**

**4 Strategic issues**

**5 Summary of the way ahead**



## Competitors' strengths

General Electric and Pratt & Whitney have advantages of :

- Being part of major conglomerates
- US Domestic airline market being 40% of the Free World
- US civil and military aircraft manufacturers control 85% of the Free World supply
- A big supply infrastructure
- High aircraft related National Defence expenditure  
£120 billion in 1982
- Strong political support and public funds for research on military and civil engines



# Gas turbine power

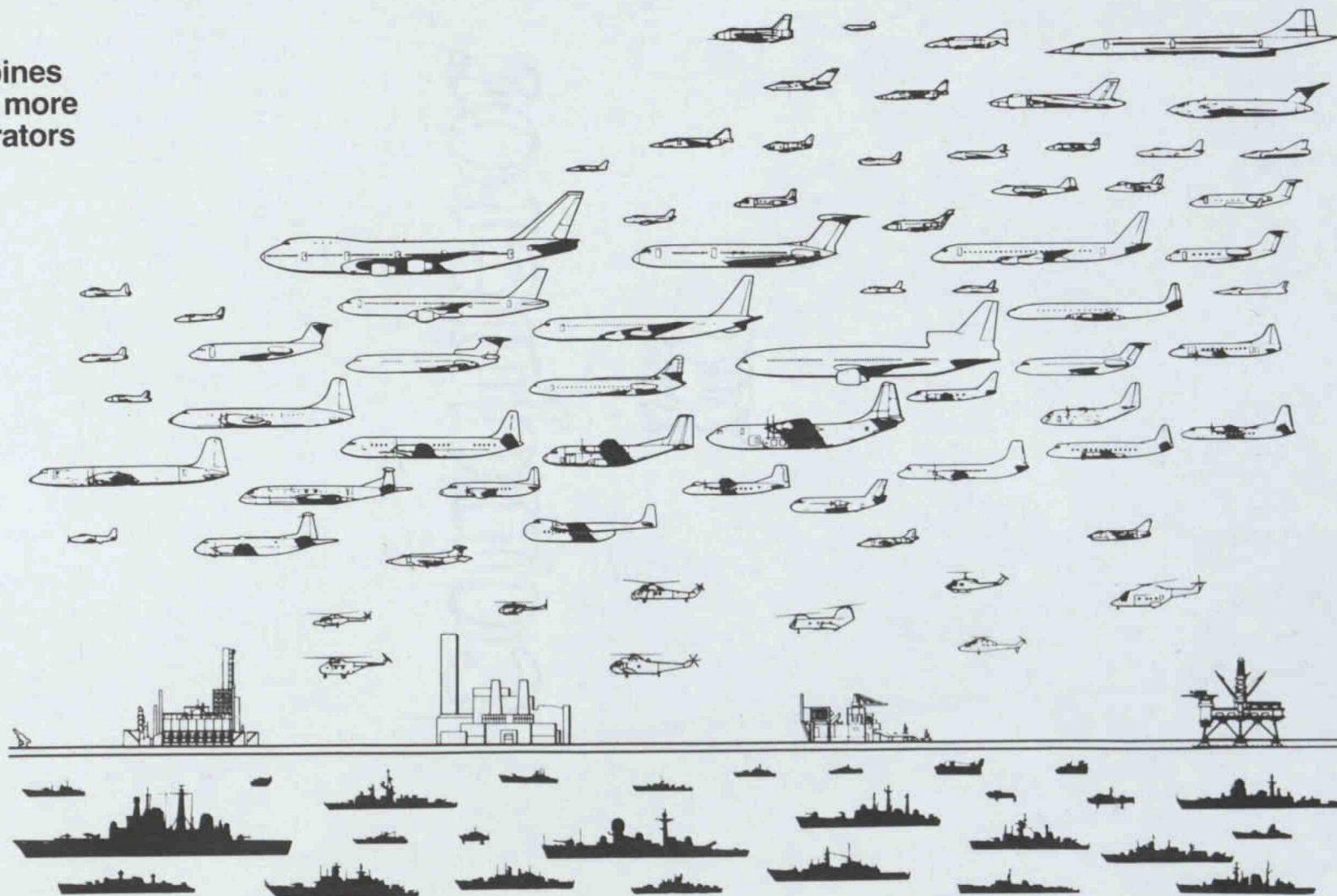
26000 gas turbines  
in service with more  
than 1200 operators

111  
Armed Forces

286  
Airlines

651  
Executive  
Operators

195  
Industrial  
and  
Marine  
Operators



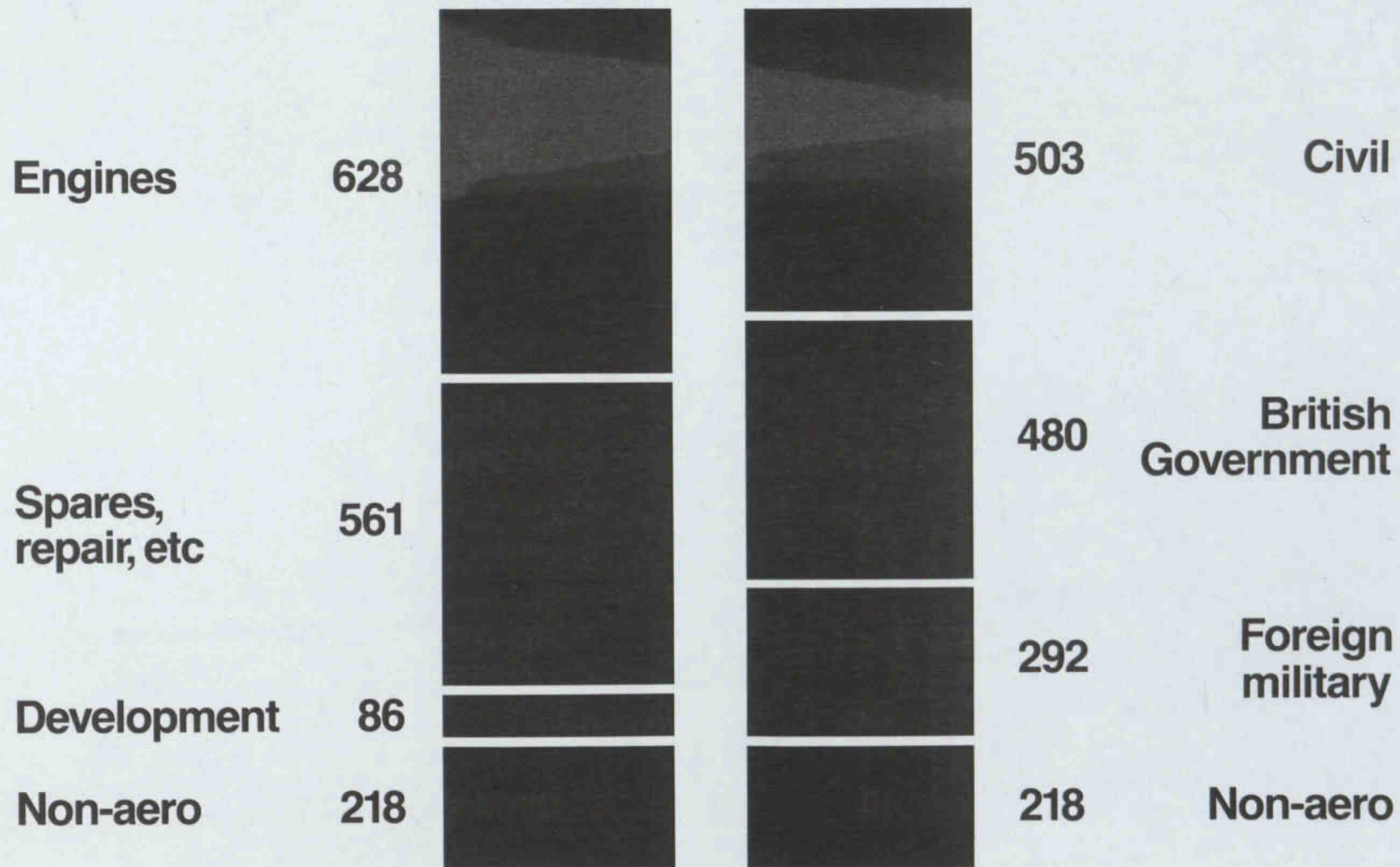


## Rolls-Royce's strengths and achievements

- **Penetration of US market**
  - Sole engine on Lockheed L1011
  - Sole engine on all Gulfstream executive aircraft
  - Launch engine on Boeing 757
  - Alternative engine for Boeing 747
  - R-R engines selected for US military programmes, Corsair A7 (Spey), Harrier and AV-8B (Pegasus), VTX/Hawk (Adour)
- **Engine supplier for all BAe military aircraft and participation in major European military programmes, eg: Pegasus, RB199, Adour, Spey, Viper**
- **Sound UK supply network**
- **Improving production efficiency**
- **Competitive basic technology**
- **HMG support as major customer**



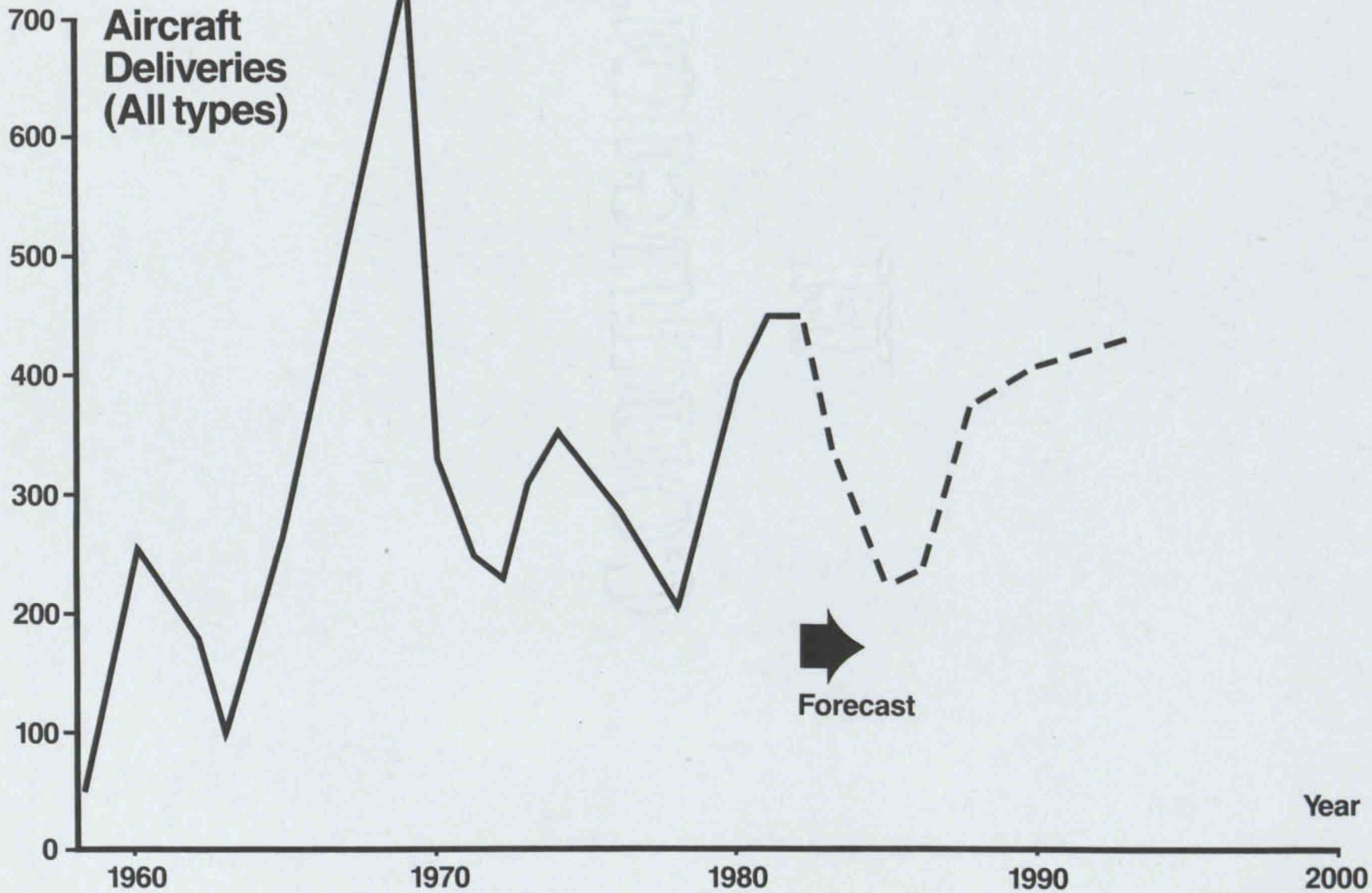
# Group sales (1982)



£1493M

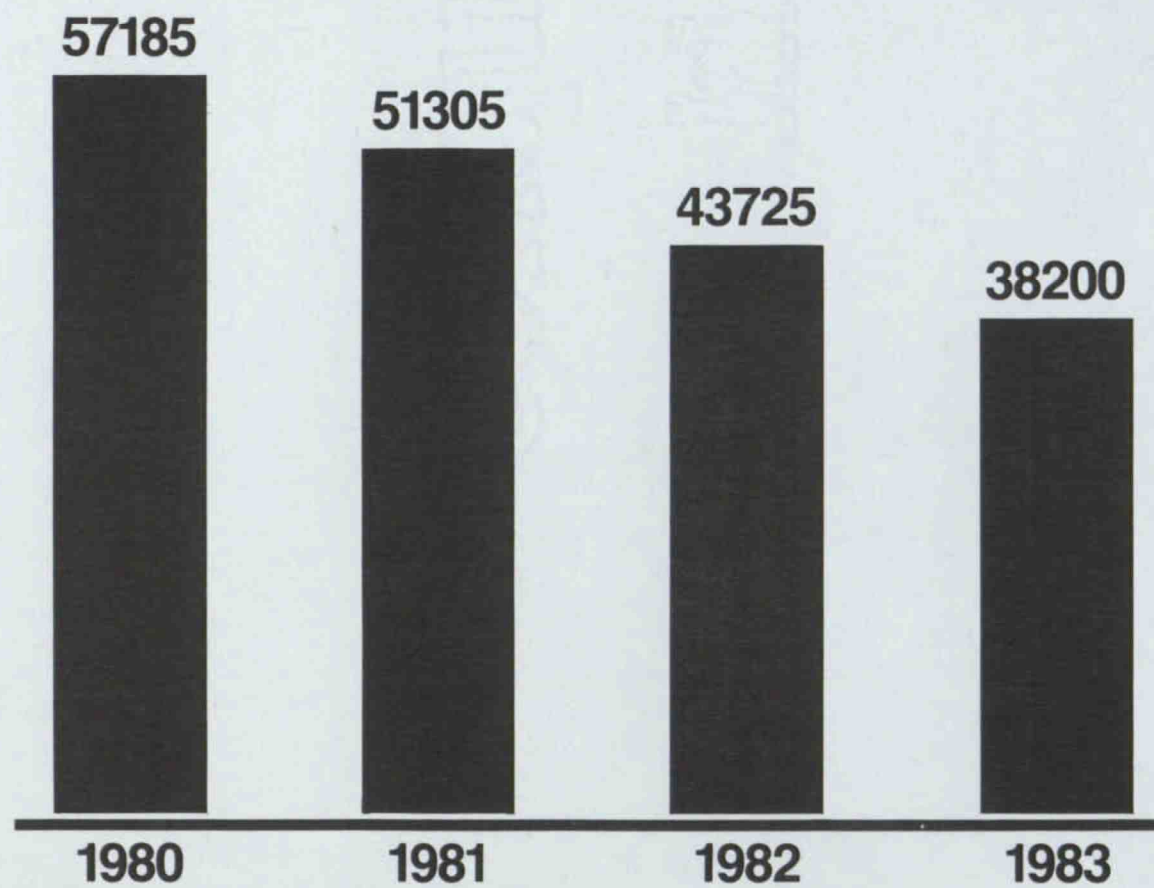


# Civil jet aircraft deliveries – Free World





## Manpower – UK



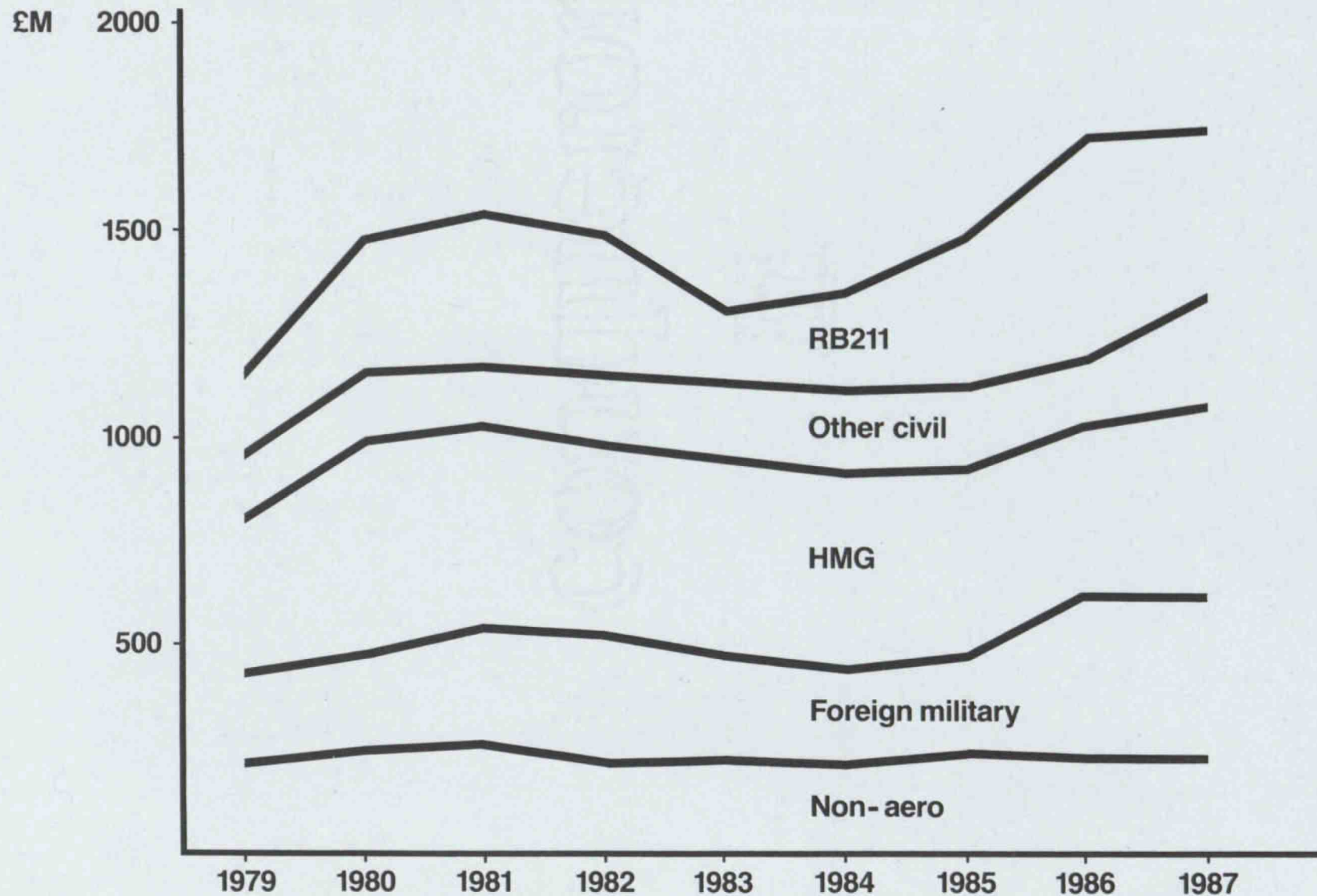
Note: Excludes approximately 5000 employed in non-gas turbine activities and overseas





# Group sales

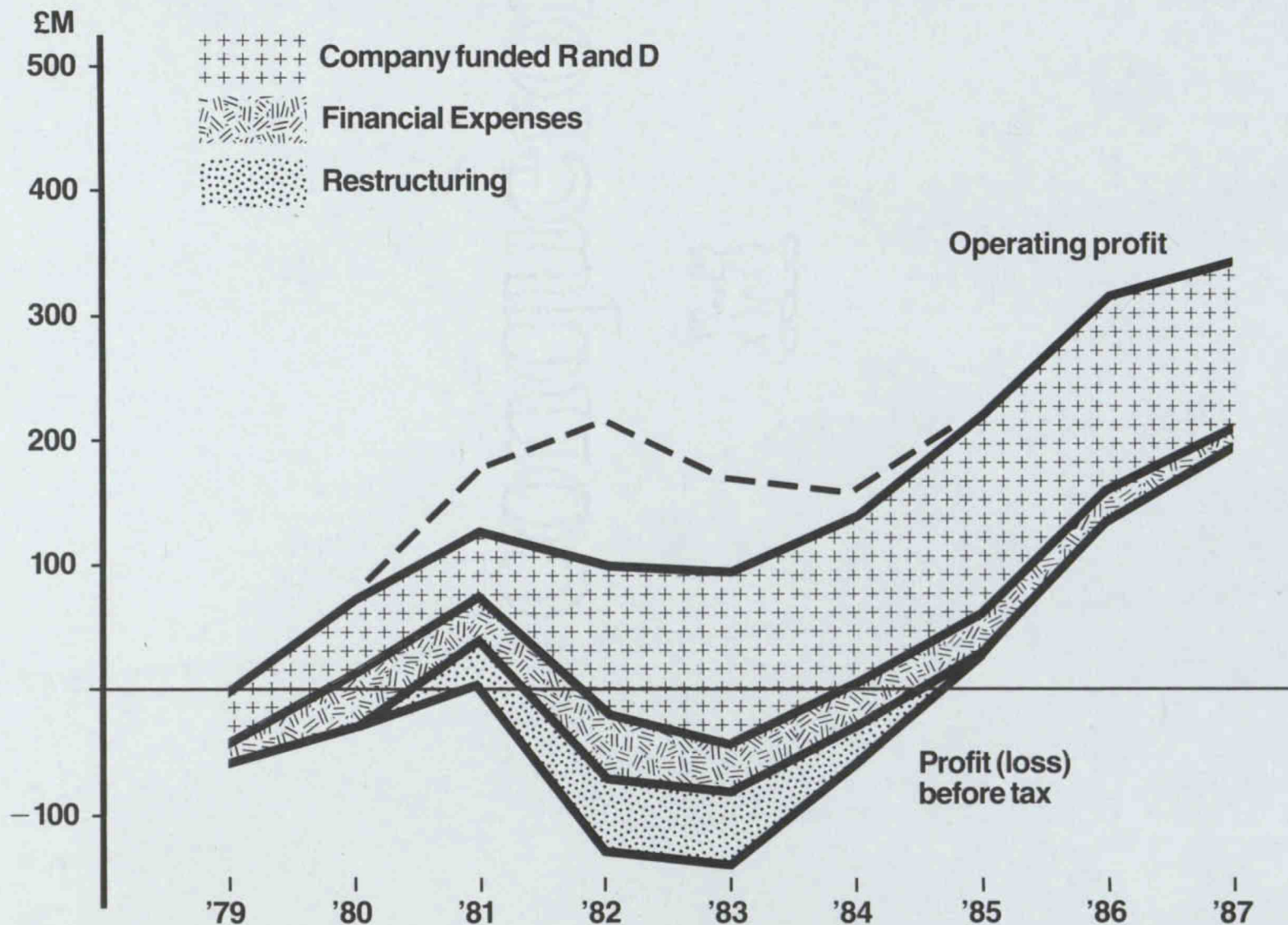
## 1982 Economic levels





# Profit and loss

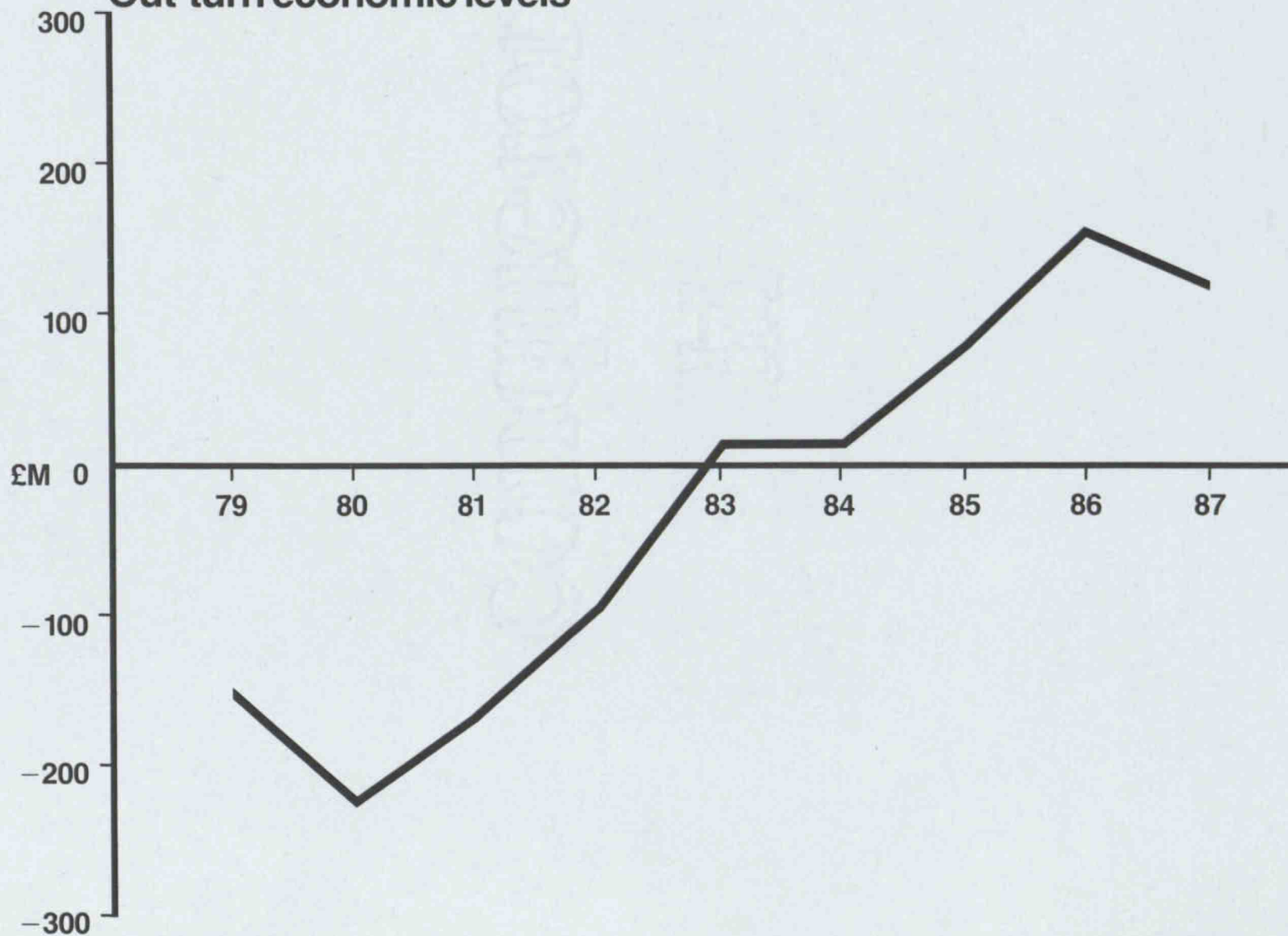
## Out turn economic levels





# Cashflow

Out turn economic levels





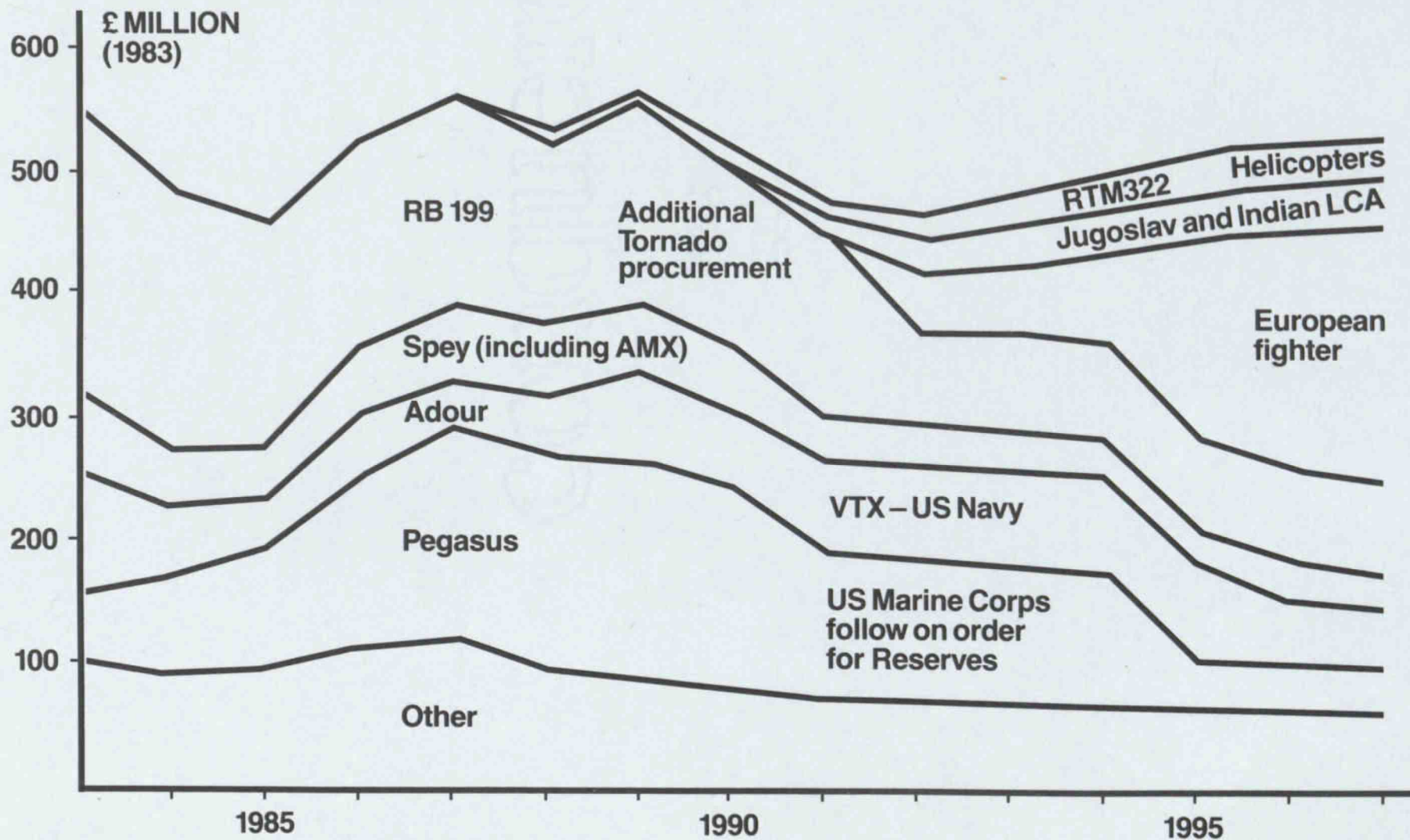
## Launch aid vs Levies

### Out turn economic levels

Launch aid	1983 £m	1984 £m	1985 £m	1986 £m	1987 £m	Total £m
RB211-535	40	35	10	—	—	85
V2500	—	6	18	25	23	72
	40	41	28	25	23	157
<b>Levies</b>						
Military	8	8	7	14	15	52
RB211 Family	4	6	11	21	17	59
Other Civil	5	6	6	5	5	27
	17	20	24	40	37	138



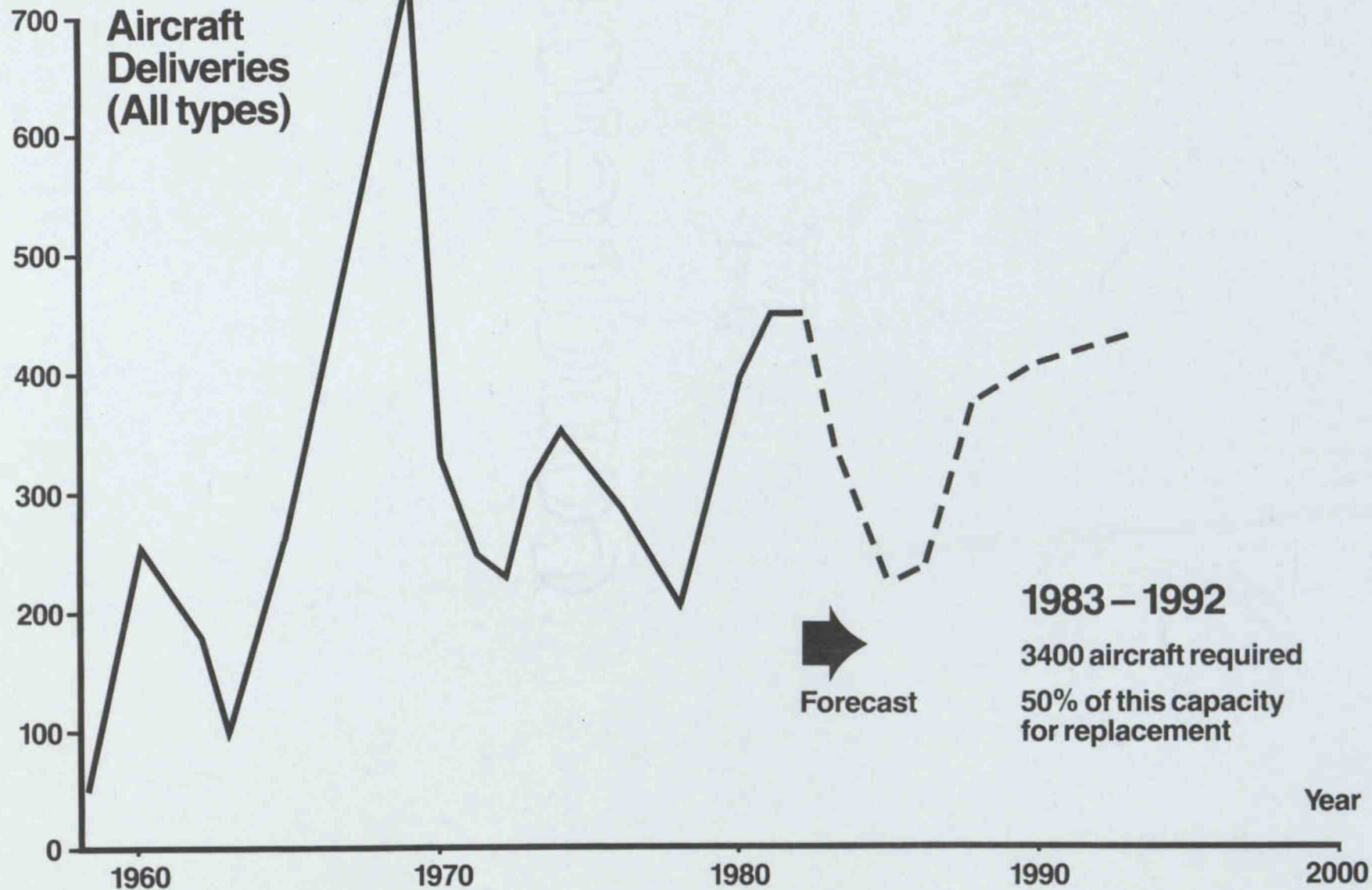
# Military engine sales forecast 1983-1997 (engines and spare parts)





# Civil jet aircraft deliveries – Free World

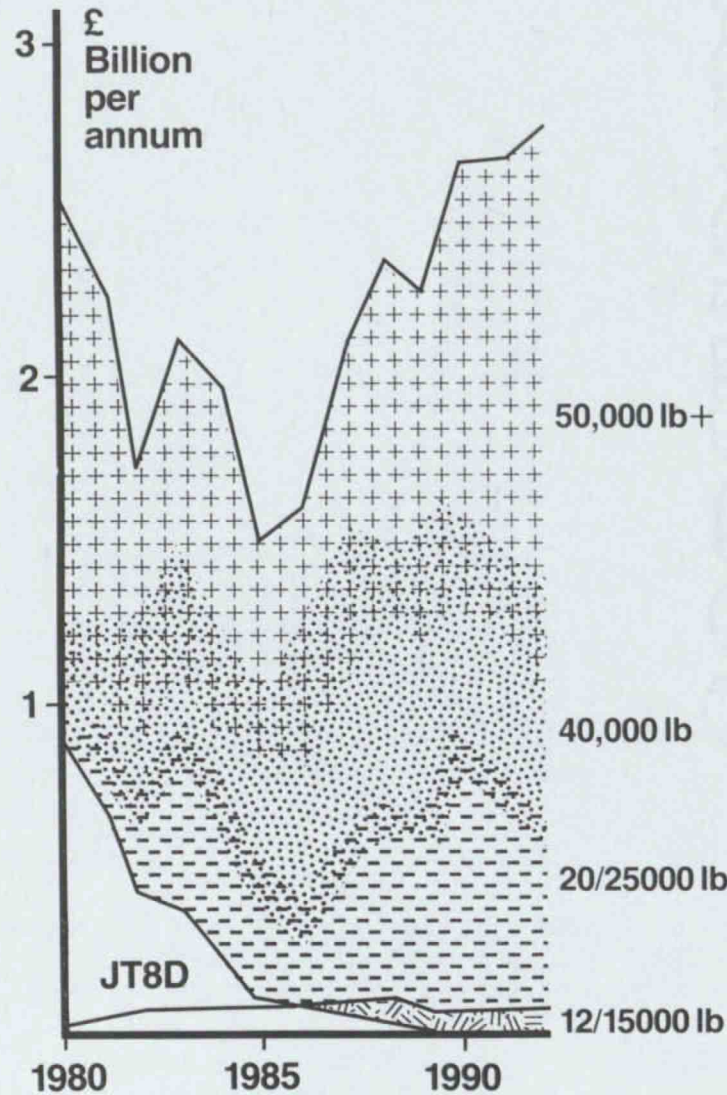
**Aircraft Deliveries (All types)**





# Civil jet transport market forecast

## Engine sales/product competition



Competing products			Aircraft applications
P&W	GE	R-R	
JT9D	CF6-50	RB211-524	Boeing 747 Douglas DC10 Lockheed L1011 Airbus A300/A310 Boeing 767
↓	↓	↓	
PW4000	CF6-80C	?	
PW2037	-	RB211-535E4	Boeing 757
Refan JT8D	CFM56	2500	Airbus A320 Boeing 737/7-7 Douglas MD80
↓ 2500	-	-	
-	-	Spey ↓ Tay	Gulfstream III/IV Fokker F28



## Decisions required of HMG in the months ahead

- Acceptance of Company's strategy for the civil market
- Launch funding for V2500
- Action on future major military programmes eg: RB199, RTM 322



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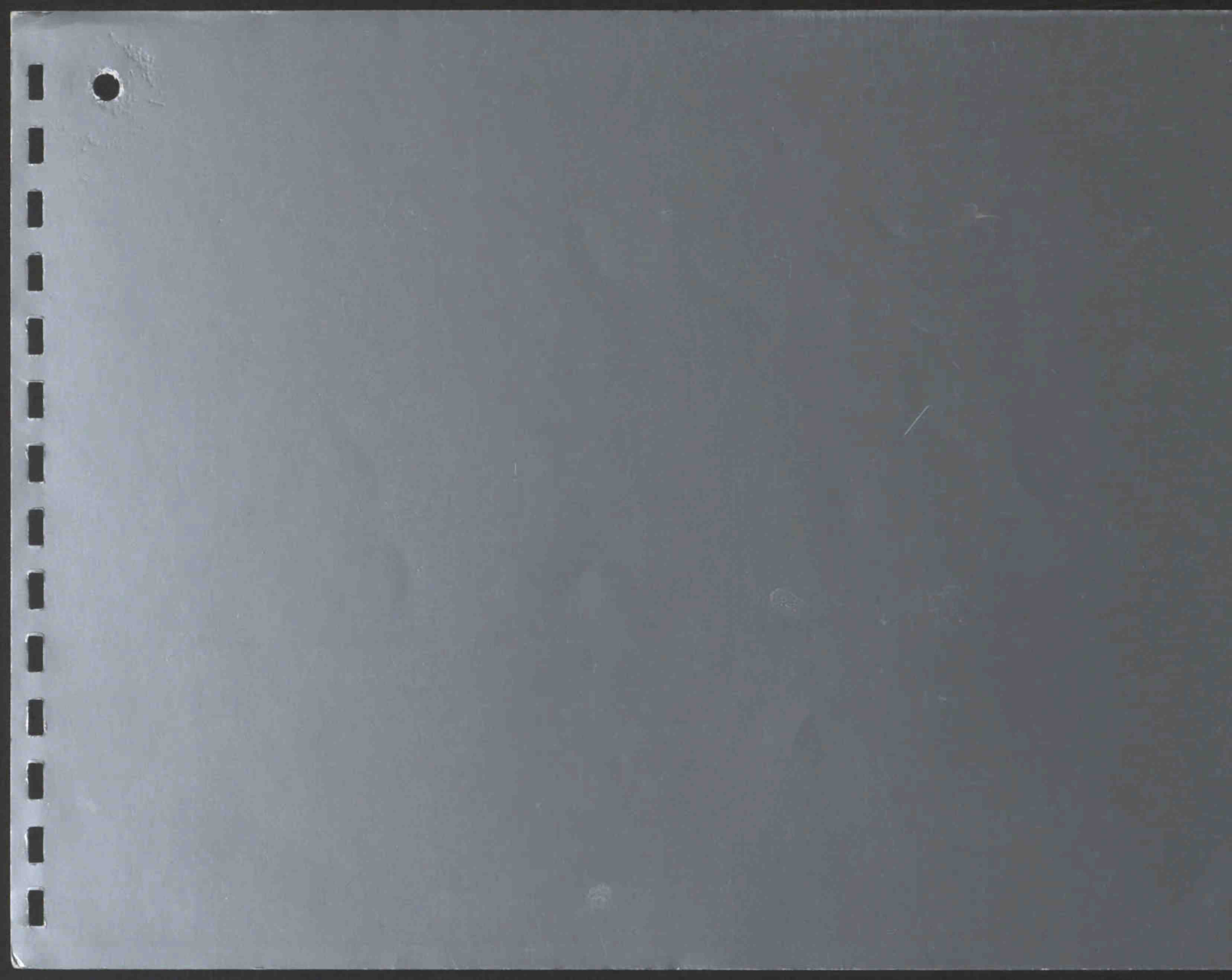
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**ROLLS-ROYCE LIMITED**

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cc No.



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1-19 VICTORIA STREET  
LONDON SW1H 0ET

Telephone (Direct dialling) 01-215) 5422  
GTN 215) .....  
(Switchboard) 215 7877

jF6325

Secretary of State for Trade and Industry

COMMERCIAL IN CONFIDENCE

12 April 1984

NBAM  
12/4

Andrew Turnbull Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
LONDON  
SW1

Dear Andrew,

ROLLS-ROYCE LIMITED

Further to my letter of 5 April I should be grateful if you would substitute the following for the second sentence in paragraph 4:

- with AT

"After-tax profits (Loss), adjusted to reflect the costs associated with the General Electric collaboration, are forecast of (£3M) in 1984 and £12M in 1985".

This amendment is not of course relevant to the forthcoming announcement of Rolls-Royce's preliminary results for 1983.

2 I am sending copies of this letter to the Private Secretaries to the Secretary of State for Foreign and Commonwealth Affairs, the Chancellor of the Exchequer, the Secretary of State for Defence and Sir Robert Armstrong.

Yours ever,  
*Andrew D Lansley*

ANDREW D LANSLEY  
Private Secretary

Ind. Ed. PTZ



Louis Loyce

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FILE  
da

10 DOWNING STREET

From the Private Secretary

6 April 1984

Dear Ruth,

I confirm that the Prime Minister is to meet Sir William Duncan, the Chairman of Rolls-Royce at 1115 on Tuesday 1 May. Your Secretary of State is to be present at the meeting.

BF |

I attach a copy of Sir William's latest letter and would be grateful if your brief could reach us by close of play on Friday 27 April.

Yours sincerely  
Caroline Ryder

Caroline Ryder

Miss Ruth Thompson,  
Department of Trade and Industry.

da



10 DOWNING STREET

AT

Set up for  
TVE 1 May  
+ SIT

CR

6/4

1.  
→ CR PA commissi broch  
for DTI to have  
3 days ahead

Briefing?

2. PA



DEPARTMENT OF TRADE AND INDUSTRY  
1-19 VICTORIA STREET  
LONDON SW1H 0ET

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GTN 215 .....  
(Switchboard) 215 7877

Secretary of State for Trade and Industry

5 April 1984

COMMERCIAL IN CONFIDENCE

A Turnbull Esq  
Private Secretary to the  
Prime Minister  
10 Downing Street  
LONDON  
SW1

*ms*  
Prime Minister <sup>(2)</sup>

The loss of £195 million is almost exactly what was forecast in the paper on the V2500 in January. As explained, up to half of the loss comes from special provisions.

Sir William Duncan is coming to see you on 1 May.

Dear Andrew,

ROLLS-ROYCE LIMITED

My predecessor wrote to yours on 28 March 1983 about Rolls-Royce's preliminary financial results for 1982. We have now heard that Rolls-Royce's preliminary results for 1983 are due to be announced on 12 April, and my Secretary of State thinks that the Prime Minister will wish to know the main points of the announcement, which include a final loss for the year of £193 million.

2 Turnover for 1983 totalled £1331 million (1982 £1493 million). Operating profit was £65 million (1982 £122 million) and the loss after tax and restructuring costs amounted, as already mentioned, to £193 million (1982 £134 million). Besides the reduced level of sales, the following are the most significant factors affecting profit:

- (i) The manpower in the company and its UK subsidiaries was reduced from 45,309 to 39,391 in the year. The costs incurred in this voluntary redundancy restructuring amount to £63 million (£44 million net of recoveries). In addition, the company has provided £30 million in respect of its restructuring plans for 1984.
- (ii) The lower value of sterling relative to the US dollar which at the end of 1983 was \$1.45 = £1 (1982 \$1.62 = £1), resulted in an increase of £20 million in the sterling value of RR's dollar borrowings and hence liabilities.
- (iii) A provision of £13 million has been created recognising the current reduced world market price of

AT 9/4



titanium relative to the cost of the company's stock. It also recognises the reduced demand for titanium in the company's manufacturing programme.

- (iv) The company has a substantial stock of used engines and modules. Although in 1983 there was some success in disposing of this stock and other possibilities are presently being pursued, the company has prudently written the inventory value down to 10 per cent of its book value. The effect of this policy was to write off £10 million in 1983.

The heavy loss for 1983 is therefore largely due to restructuring and to the provisions which Rolls-Royce have prudently taken for future restructuring and for the value of stocks.

3 The company did not receive the first payment of £25 million launch aid to the RB211-535E4 programme until January 1984. This allowed it to be taken into profit and loss, but not cash flow. Nevertheless, there was an operating cash inflow of £28 million. US\$165 million of medium-term dollar borrowings were repaid during the year. The lower value of sterling increased the sterling value of the remaining medium-term dollar borrowings, but total borrowings nevertheless reduced in the year by £17 million from £367 million to £350 million.

4 The Prime Minister also may wish to know that the company's Operating Plan and Budget forecasts an operating profit of £164 million in 1984 and £216 million in 1985. After-tax profits, (loss) adjusted to reflect the costs associated with the General Electric collaboration, are forecast of (£3 million loss) 1984 and £12 million in 1985. This assumes launch aid payments of £5 million and £15 million respectively on the V2500; this is, of course, still under negotiation, and the figures now under discussion would lead to higher payments (£10 million and £30 million) in these two years, but much lower figures than Rolls-Royce had assumed thereafter.

5 I am sending copies of this letter to the Private Secretaries to the Secretary of State for Foreign and Commonwealth Affairs, the Chancellor of the Exchequer, the Secretary of State for Defence and Sir Robert Armstrong.

*Yours ever*

*Colman McCarthy*

M C MCCARTHY  
Private Secretary



IND Pa. Ross Royce A2

APR 9 1984

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6 7 8 9 10



NBPM AT 514

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(Switchboard) 215 7877

Secretary of State for Trade and Industry

APPOINTMENTS IN CONFIDENCE

5 April 1984

Sir William Duncan CBE  
Rolls-Royce Limited  
65 Buckingham Gate  
London SW1E 6AT

*D B 11.*

*file with AT 514*

PERFORMANCE RELATED BONUS SCHEME

*was request if required*

Mr Warrington wrote to my officials on 3 January 1984 and subsequently on 11 January about the proposed performance related bonus scheme. I am replying, since this is a subject in which I have taken a personal interest.

I am happy to approve the scheme insofar as it applies to your own salary, and I note your intention to apply it also to certain senior staff. There is, however, one point which has emerged in our consideration of the scheme. This is that under the scheme as currently proposed an executive whose individual performance was less than satisfactory could still receive a bonus related to the company's overall performance. I know that you feel that the way to cope with unsatisfactory performance is not primarily through the bonus scheme, and also that only the corporate element of the scheme will operate in 1984. Nevertheless, I should be grateful if you could look again at this point in determining the future development of the scheme.

NORMAN TEBBIT

JH1AEF

IND. PR. PT 2

LOUIS LOYCE

EG APR 1984

10 11 12 3  
9 8 7 6 5 4

# ROLLS-ROYCE LIMITED

Chairman's Office



65 Buckingham Gate, LONDON SW1E 6AT  
Telex: 918091 Telephone: 01-222 9020

*ce 8/1*  
*ce 8/15*

April 5 1985

The Rt Hon Margaret Thatcher MP  
Prime Minister  
10 Downing Street  
London SW1

*Dear Prime Minister,*

Thank you very much for your kind letter of April 2 which I greatly appreciate. I fully understand the points you have made.

As you know, my first priority is to return Rolls-Royce to the private sector as quickly as possible. The speed with which I want to do this is affected by the amount of launch aid on the V2500 and, when accepting this task, there was no indication of the change in launch aid policy which is now apparent. This issue is obviously crucial to the timing.

I would therefore welcome a personal talk with you on these matters in due course.

*Yours sincerely*

*Bill Wainman*

*[A long, thin blue line drawn across the page]*

IND POE: Roma Royce

A2

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1984 JUL 15

ROMA ROYCE LIMITED





FILE

JSG

cc: DTJ  
Hud

10 DOWNING STREET

THE PRIME MINISTER

2 April, 1984

Dear Sir William,

Thank you for your letter of 26 March. May I begin by expressing my appreciation for the part you have played in defining the corporate strategy for Rolls-Royce, in establishing a place for Rolls-Royce in crucial collaborative projects, and in getting to grips with the Company's costs.

On the question of launch aid for the V2500, I must make clear that when Ministers considered the issue, they had before them a number of arguments - Rolls-Royce's need for funds to launch the project; the objective of privatising the Company; and the need to scrutinise very rigorously additional bids for public expenditure. In taking their decision on the amount of launch aid, Ministers weighed all these factors. I must also say that it would be wrong to allow myself to be seen as an appeal body against collective Ministerial decisions.

If, nevertheless, you wish to come and see me to discuss the position of Rolls-Royce, I will of course be happy to arrange such a meeting.

Yours sincerely  
Margaret Thatcher

Sir William Duncan, C.B.E.

WJ

● PART 2 ends:-

AT to Sir William Duncan 27.3.84.

PART 3 begins:-

PM to Sir William Duncan 2.4.84.



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