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*Don't hesitate so call!*



PRIME MINISTER  
BRITISH AEROSPACE

*I do not see why*

*f10s n should be injected. However it is a suspiciously approved round sum. not*

*The Chancellor is very unhappy about this. Apparently, the Chief Secretary failed to agree the case but he had explicitly approved. I think we should give him a chance to comment on Monday before finally deciding.*

1 You will recall that the next step in the process of privatisation of British Aerospace (BAe) would be the vesting of BAe as a Companies Act company, in 100 per cent Government ownership, in preparation for a subsequent flotation of the shares. When this was last discussed during October, it was reluctantly concluded that the inevitable uncertainties then prevailing about future defence expenditure ruled out the possibility of a flotation before the end of the year. The issue of vesting was therefore also deferred.

*12.  
14/12*

2 E(DL) Sub-Committee returned to these issues earlier today, and this minute informs you of their conclusions. Kleinworts, who are advising on the flotation of BAe, recommended that flotation should be in February. The feasibility of this still depends however on the degree of assurance that could be given in the sales prospectus about future defence procurement. The Secretary of State for Defence made it clear to the Sub-Committee that, while decisions would have been taken by early January about the defence Estimates for 1981-82, the consequences of the public expenditure reductions in later financial years could not become clear until later in the Spring. In the meantime he could not guarantee that projects key to the future of BAe would necessarily continue. The Sub Committee entirely accepted that decisions on the industrial implications of the defence cuts must be made in due time, and for defence reasons, and should not be dictated by the desirability of this flotation.

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/We ...





We therefore concluded that a February flotation was unlikely but even so it may just be possible that the decisions which the Secretary of State for Defence is able to take would enable Kleinwort's to advise that such a flotation was feasible. We also thought that a more realistic aim might be for flotation in Spring or Summer although we were aware that Kleinworts regard a flotation as a dwindling possibility once the February 'window' has been lost.

3 We also examined the likely proceeds of privatisation. It has always been recognised that the Company would require a substantial capital injection before flotation, since it would need sufficient resources if it is to be favourably received by the market to withstand the collapse of one of the major projects on which it is engaged. Kleinworts advise that a further £100 million of capital would need to be put in, which would offset the proceeds of sale to Government. Allowing for this, the net return to Government from a sale of half of the shares is now estimated to lie in the range of £15-30 million. This is appreciably lower than we had hoped earlier in the year. Although we would do our best to present the sale so that the £100 million capital injection to strengthen the company was clearly exposed, we would inevitably face strong criticism from our political opponents, and perhaps in the Press, for disposing of the company at a time when its market value is apparently depressed. The compensation paid on nationalisation. (£159 million), and the imputed interest on that sum amount to £215 million. In addition there has been new public investment of £110 million (equivalent to £140 million at current values). Whith the injection of the further  
/£100 million ...





£100 million immediately prior to flotation, the total public input could be presented as being as high as £450 million, against an estimated total market value of the company of £250 - 275 million. Nevertheless the Sub-Committee were conscious that the market value was unlikely to improve in the next year or two, because the company is engaged on major projects whose prospects are for the longer term. Thus if we are to make progress with our strong political commitment towards privatisation, we shall have to face fairly low sale proceeds. Treasury Ministers argued that the company's prospects were being depressed by the BAe 146 project, and that the cancellation of that project should be reconsidered. We agreed that this was not an immediate issue, and that if the Chief Secretary so wished should raise that question separately with colleagues, with a view to subsequent consideration in E Committee.

4 On balance the Sub-Committee concluded that, in view of the strength of our political commitment to privatisation of BAe, and other nationalised bodies, and the likelihood that there would be no immediate change in the market, we should continue to aim for a flotation of BAe as soon as possible in spite of the relatively low net return. We shall therefore wish to return to the question of the practicability and timing of the flotation as soon as the position on Defence orders has been clarified.

5 In the meantime the immediate question is whether, in spite of this delay to flotation, we should take the step of vesting the company from the 1st January. The political arguments on

/this ...





this point both ways. If, for reasons beyond our control, we are unable to float, we might be left with the potential embarrassment of a Companies Act company, wholly in Government ownership, for an indefinite period. The Treasury would prefer to avoid a long period between vesting and flotation. The Act did not envisage such a period, and there is no provision for giving loans to the company. They would need to borrow on the commercial market, at rates slightly higher than other Government borrowings, and this could cast some doubt on the Government's credit-worthiness for overseas borrowing. There is also a problem on the commencing capital debt of the company, which under the Act is extinguished on vesting. In the interests of a good return on flotation the remuneration of this debt should be restricted. But, if flotation is long deferred, this restriction could well attract criticism. On the other hand vesting confirms our commitment to privatisation, and makes progress along that road. The Board of BAe moreover feel strongly that we should go ahead with vesting now; and we need to secure their continuing co-operation.

6 On balance, the Sub Committee considered that it would be right to vest the new company from 1 January, and that we should maintain a clear determination to float the company as soon as possible thereafter. If you accept that view, we would suggest that an announcement of the vesting should be made by way of Written Answer as early as possible next week. The terms of that Answer would of course be cleared with you and other colleagues.



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7 I am sending copies of this minute to members of E and E(DL), to the Secretary of State for Defence and to Sir Robert Armstrong.

*White*  
for K J

(approved by the Secretary of State and signed in his absence)

12.12.80

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