



COMMERCIAL IN CONFIDENCE

JH 972

PRIME MINISTER

INMOS

When you agreed to the £10 million increase in INMOS' borrowing requirements in December you asked for a report on progress in finding a buyer. You said a special effort should be made to secure a British deal. I am now reporting where we stand.

INMOS' Present Position

2 Since December INMOS' trading position has continued to strengthen. Sales in November, December and January were above budget and on a rising trend, the current monthly rate being about £6m. Production is being built up at Newport, as it needs to be if the £97m sales target for the year is to be achieved, and improvements in yield there are ahead of plan. As a result this month Newport will for the first time ship more than 500,000 chips to assembly. The company as a whole has been in profit after interest since November, with profits also on a rising trend on target for the £7.5m profit before tax projected for 1984.

3 The company still needs substantial additional capital to finance further development. I referred in my minutes of 2 and 9 December to you of a figure of up to £75m, of which some £20m would need to be spent this year. That remains the position.



At the same time we want the BTG to dispose of its £65m investment in INMOS as soon as practicable or, if the raising of new capital for INMOS is the main priority, as I believe it must be, to have its 75% shareholding diluted to below 50% so that it is no longer standing behind INMOS' liabilities.

Outside Finance

4 In my minute to you of 2 December I referred to the interest being shown by AT&T (Western Electric). After having been told by Sir Malcolm Wilcox that the \$40m they could offer for 100% of INMOS was unrealistic, AT&T put in a revised offer of \$70m at the beginning of this month with an undertaking to provide \$100m for further development of the company, particularly in South Wales. This was shortly before my own visit to the US, where I met the Chairman of AT&T International. He reaffirmed that his company were only interested in 100%. I entirely reserved the Government's position, pointing out that the sale of what is seen as an important UK technological capability for £30m less than the taxpayer had invested would be politically difficult, particularly at a time when the US Government was imposing its control on technology exports to overseas subsidiaries of US companies. Since then the BTG Board has rejected the offer as putting a much lower value on INMOS than other offers. But the AT&T option is not closed; it is up to them to come back with an improved offer. We would then need to consider the implications of allowing INMOS to pass into foreign ownership, in particular the restrictions this could impose on the free use and sale of



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the products by UK equipment manufacturers and the damage to the Alvey programme which would be caused by the likely termination of the research work at Bristol into the transputer, in which AT&T have said they are not interested because they are already committed to a different path to the same objective. It would be difficult to dispose of the transputer work separately without access to the production facilities at Newport.

5 The reasons why I propose keeping the AT&T option open is that it has the obvious appeal of being firm, and getting the Government clear of INMOS. Moreover, for the long term INMOS needs the backing of a strong industrial company able to provide the finance that will undoubtedly be needed when the market for IC products is not as strong as it is now. The semiconductor business is one of feast and famine. That is why I am disappointed that UK industrial companies have not shown more interest, no doubt because most of them have their own sources of ICs whether in-house or external. After earlier discussions on the possibility of merging INMOS and one of their own companies MEDL, GEC made an offer in December for 51% of INMOS but were only prepared to pay a nominal sum, which they put at some £2-5m. On being told more serious offers were on the table, GEC have not pursued the matter. No other UK company has shown an interest in a majority stake, although some, including Sinclair, may take a minority position. In order to ensure that all the UK companies who could be interested in INMOS should have an opportunity at this moment to take a stake in the company, I have arranged for the BTG to write to the Chairmen concerned inviting proposals.



6 Although UK industrial companies have been slow to show interest I am encouraged by the prospect of growing financial support for INMOS from UK financial institutions. Hill Samuel have now put together a core of institutional investors who would be ready to invest £20m alongside an investment which Hill Samuel and Sir Malcolm Wilcox believe they can raise from US sources of £10-15m. The terms on which these funds would be raised would be at a price of £12 per share, which would impute a valuation of the company, before subscription of new equity, of between £80-90 million, nearly twice that set by AT&T. Hill Samuel believe that in addition to the £30-35m this would raise within the next two months they could attract a further £5-10m from other institutions outside the core group.

7 I have asked the BTG and Sir Malcolm Wilcox to pursue this route for raising further finance, allowing time for a response from the UK industrial companies. Whilst wanting them to proceed with this investigation as quickly as possible, I do not want to close the possibility of a revised offer from AT&T or from another US industrial company. I have also asked that the interest of European companies such as Siemens should be sounded out.

8 Institutional money of the sort now being investigated would not deal with the need for further funding which I referred to earlier. What I would hope, however, is that the additional institutional finance would make INMOS a more attractive



proposition for an investment by a major industrial company. I would expect the institutional financing to be followed by further investigations by the BTG and INMOS of US and European companies, if UK ones are still not interested, to see whether they would contemplate a minority stake or some form of joint venture. Alternatively, there could be a public offering of shares, possibly both in the UK and the US, after which it would be possible for the BTG to dispose of its residual shareholding. This would, however, not be possible until next year; and would not necessarily produce the sort of indepth backing that INMOS requires.

9 I do not find it easy to draw up the balance between the obvious appeal of AT&T, which is both certain and would take INMOS once and for all from our hands, and the less certain but potentially larger attraction of following the institutional route. I am persuaded, however, that it would be extremely difficult politically to defend a disposal of INMOS to AT&T, the present front-runner, against the expressed wishes of both INMOS and the BTG, for a price less than the past investment by the taxpayer, when we have an offer to finance its further development with UK money which involves no cost to the taxpayer, and which is likely to dilute the BTG's shareholding below 50%. I should be grateful if you, and others to whom I am copying this minute, could comment on whether you agree with my assessment. I shall report again once the investigations that are in hand produce a clearer picture. I fear, however, that we shall



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shortly be faced with a difficult decision, with a placement with the institutions as the more likely course.

10 I am copying this minute to Members of E(A), and to Sir Robert Armstrong.

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29 February 1984

Department of Trade and Industry

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10 DOWNING STREET

From the Private Secretary

8 March 1984

Dear Callum,

INMOS

The Prime Minister has seen your Secretary of State's minute of 29 February. This raises a number of difficult issues. While she agrees that the current offer from AT&T is too low, she feels that the alternative of an injection of institutional funds carries a number of risks. Although BTG's holding would be diluted, the Government could still find itself being asked to provide further funds for the company. The Prime Minister feels strongly that no more Government money should be put into INMOS. It is not clear, however, how the £75 million which is needed will be raised. The institutional investors appear to be providing only a part of this.

The Prime Minister feels that the ultimate objective remains to dispose of BTG's holding and she does not rule out the possibility of a complete sale to an overseas bidder on suitable terms and conditions. Before decisions are taken fuller information is needed. The Prime Minister would be grateful if your Secretary of State could set out the risks to the Government of the institutional investment route; assess the viability of INMOS as an independent company; consider whether a distinction should be made between the manufacturing facilities at Newport and the design facilities at Bristol, including the transputer; provide information on other prospective bidders and their offers. Meanwhile she hopes that negotiations with AT&T can continue to secure a better price and to achieve suitable terms to meet our concerns about technology.

When this information is available it will probably be desirable to hold a meeting of Ministers. I will be in touch to arrange this.

I am copying this letter to Private Secretaries to members of E(A), Richard Hatfield (Cabinet Office) and to Dr. Nicholson (Cabinet Office).

Yours sincerely
 Andrew Turnbull

Callum McCarthy, Esq.,
 Department of Trade and Industry.

Andrew Turnbull



cc NB

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Rt Hon Norman Tebbit MP
Secretary of State for Trade
and Industry
1 Victoria Street
London SW1

14th March 1984

De Norman

INMOS

Thank you for sending me a copy of your minute to the Prime Minister on INMOS and your report on progress in finding a buyer.

I certainly agree that any disposal of INMOS to AT&T at a price below past investment by the taxpayer would be extremely damaging politically, and it would obviously be far preferable if its further development could be financed with UK private sector funds.

You asked for comments, and I therefore confirm that I would certainly support the assessment set out in your minute.

I am copying this letter to Members of E(A), and to Sir Robert Armstrong.

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