

PRIME MINISTER

27 July 1984

BRITISH TELECOM MEETING

Government Objectives

The objectives set out by the DTI (who are in the lead) are sensible. The main aim should be to use this enormous issue to make a substantial increase in the number of share owners in the UK. The substantial fees the City intermediaries will receive (Treasury say £140 million) could be used in part to improve the method of buying and selling securities in the UK market for private individuals.

Valuation of BT

BT is a big issue by any standards. The hawks say it is worth a lot because it has captive customers in a fast-growing area of activity, so its profits will grow year after year. The doves say that it is like the dull utility businesses in the US (the electricity businesses and the regional telephone companies). Shares in these utilities are cheap stocks paying big dividends. This is an essentially technical argument between professional advisers who are paid to get that kind of thing right. Individuals, however, may well expect a decent level of dividend, as they will be comparing it with something like a deposit account.

The third section of the agenda - public perceptions of BT - reveals from poll evidence that the public as a whole think BT is good. Opinion should be monitored and advertising targetted to meet the points it reveals.

### The Strategy

The UK institutional market will have to provide much of the buying power for the issue.

The UK institutions are a flock of sheep. They are likely to bleat and complain about the size of the issue and its terms. They are heavily influenced by press comment and market gossip, either all buying or none. The art of selling to them is to look as if you can sell a lot to somebody else, to create fear that they might be missing a good deal, and to use the fees as inducement to take more shares.

The Government has several important cards in its hands when selling to the institutions:

1. Because British Telecom is such a large issue, it will be a measurable proportion of the United Kingdom equity market in terms of the total capital value (probably more than 5 per cent). Institutions are scared stiff of owning shares that do not go up as much as the

market overall, and will therefore be reluctant to run funds with no in BT shares, in case BT does well.

2. If the institutions believe that a sizeable proportion of the issue is going to be sold to private individuals and overseas, then the amount they have to take up reduces, and so the shares in BT therefore become that much more attractive to them.

3. The impression has to be created by good press management that whatever the final valuation of the company, it is good value.

4. The institutions stand to make a packet out of the BT issues. The meeting could well discuss how best to spend this money:

(a) Could we use the fees in the form of a sales commission for those who succeed in placing a large amount of stock?

(b) Could we pay larger fees for those banks and broking firms that come up with the best ideas for creating an effective retail market, so that the small investor can be assured of a friendly, cheap way of buying and selling his shares subsequently?

The system of sale being suggested is to pre-sell the issue to the UK institutions, and then to sell shares to overseas and individual customers. Any shares sold to these latter groups would then be subtracted from the number the institutions have to buy.

A normal offer for sale involves the institutions underwriting at a stated price, ie agreeing to buy all the shares on offer at that price if there are insufficient willing applicants.

Underwritten issues may be fixed price, or may be tender offers where the applicant specifies how much above the fixed price he is prepared to pay.

These technical questions are less important than a big retail sales drive and fixing a good price.

#### The Retail Market

The retail sector should be encouraged by the offer of vouchers to offset telephone bills and the free share offer. The current terms of £18 of rent offset for £250 of shares, or 1 free share for 10 after 3 years, for up to £5,000 of investment, "costs" an estimated £100 million. Shouldn't we go much further with the inducements? Why not double these suggestions?

At this point in the discussion, you could raise the question of what action is being taken to simplify the costs and complexities of after-dealing: the banks and/or leading retailers and/or the Post Office could be used for people who do not have a stockbroker. The retail customer is going to be persuaded by a decent yield, inducements, ease of dealing and good advertising.

### Overseas

There is a problem with the US market, as the telephone utilities in the States typically sell much more cheaply than we hope to sell BT for here.

However, in the US and Japanese market, the local investment houses are used to taking stock themselves and packeting it out to their customers. Could we not pre-sell some of BT to the larger American and Japanese institutions, not underwriting this in the UK, and make them earn their fee that way? Could we sell direct to the big Middle--Eastern investment funds, with Ministerial involvement?

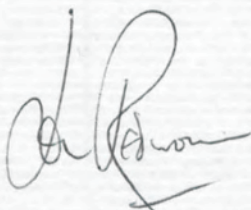
### Conclusion

The timetable is now very tight. We cannot afford any further delays, as people will not want to apply for BT very close to Christmas because the stock market winds down early.

The materials produced so far are workmanlike, but rather unimaginative. The essence of the issue must be to encourage several million individual shareholders; and to do that, the advertising campaign has to stress that:

- i. very small packages of shares can be purchased;
- ii. BT is a solid enough investment to have as a single share investment, to start somebody off;
- iii. the terms - both for a telephone subscriber and for the preferential issue of free shares - are so attractive as to be an overwhelming case for the private investor;
- iv. the arrangements made for after-sales service to the small man are attractive and accessible to him.

The meeting should also be used to test that the mechanics for selling to the institutions work.



JOHN REDWOOD



10 DOWNING STREET

From the Private Secretary

Prime Minister

DTI propose to conduct this meeting as a presentation (I think Kenneth Baker will be Master of Ceremonies) rather than a decision taking meeting. The aim is to bring you into the thinking of those running the show, but it will also provide an opportunity to test whether there are any remaining doubts about whether selling 5% is one go (albeit with staged payments) is feasible. As well as hearing from them what they hope to achieve, you should quiz them on what are the difficulties they face.

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

TELEPHONE DIRECT LINE 01-215 5422  
SWITCHBOARD 01-215 7877

JF7006

PS/  
Secretary of State for Trade and Industry

27 July 1984

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

Dear Andrew,

The Prime Minister is to have a meeting on Monday to  
discuss forthcoming aspects of the BT flotation. I  
... enclose an annotated agenda.

2 I am copying this letter and enclosure to Margaret  
O'Mara (Treasury).

Yours ever,

Andrew Lansley

ANDREW D LANSLEY  
Private Secretary

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BT FLOTATION

1 Departmental objectives

- i to transfer ownership of 51 per cent of BT's equity to the private sector;
- ii to achieve this at a defensible price;
- iii to ensure that the offer is fully subscribed (and not just fully underwritten);
- iv to encourage individuals as well as institutions to apply for shares, so that BT's subscribers are well represented among its shareholders;
- v to ensure that there is a satisfactory after market.

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2 The Task Ahead

BT's market value will depend upon the yield and price/earnings ratio chosen:

Yield (%)	6.5	7.0	7.5	8.0	8.5	
Valuation* (£m)	8,600	8,000	7,450	7,000	6,500	
Price/earnings	8.0	8.5	9.0	9.5	10.0	10.5
Valuation* (£m)	6,250	6,650	7,050	7,450	7,830	8,220

Even though we will be using an instalment basis of payment, stretching to early 1986, the demands on the market will be formidable:

- largest primary placing in London :  
    Britoil £548 million in 1982
- largest equity issue in London :  
    British Petroleum £600 million in 1981
- largest equity issue in New York :  
    A T and T \$1,060 million in 1982.

\*Assumes dividend cover of 2.0 after 35 per cent tax charge on prospective 1984-85 pre-tax earnings of £1,300 million.

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3 Public perceptions of BT

According to our MORI polls BT is well regarded by the public:

- uses modern technology/is profitable;
- provides good service to customers; *(I don't believe this)*
- as highly regarded as Sainsbury or ICI. *and certainly not this*  
*AF*

Positive image makes investment in BT attractive:

- 5% "very interested" in investing;
- 13% "fairly interested" in investing;
- of those who are interested, 39% would hope to hold shares for more than 5 years.

Reasons for interest in investing: "company of the future" (59%); "money will be secure" (57%); "successful company" (55%).

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4 The Strategy

The key to success is the UK institutional market. We propose a fixed price offer, underwritten on Impact Day. But our efforts must be supplemented by effective marketing to individuals and in overseas markets.

a UK institutions

- 350 leading institutions being cultivated;
- three major stockbrokers' reports published;
- "Pathfinder" prospectus available three weeks before Impact Day;
- "Road shows" for prospective investors by BT management;
- Commitments to subscribe will be sought from major institutions so that the Government can be confident that shares are fully subscribed.

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b Individuals

We propose putting strong emphasis on sales to individuals by:

- the offer of vouchers (pro-rata to the amount invested) which subscribers can use to offset telephone bills;
- as an alternative to vouchers, extra shares for individuals who hold shares for an extended period;
- incentives for BT employees to become shareholders;
- circulation of a leaflet on the forthcoming privatisation with telephone bills between July and September;
- vigorous efforts to develop interest among regional stock-brokers and clearing banks;
- advertising campaign starting on 20 August;
- wide circulation of "mini-prospectus" - document containing key financial information - during offer period;
- MORI studies "tracking" consumer attitudes throughout the Autumn.

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c Overseas

North American, Japanese and European sales could contribute substantially to the success of the flotation. Overseas interest would stimulate UK institutions' confidence in the flotation.

BUT

- i US underwriting practices are very different from those of the UK;
- ii US yield expectations are higher than those in the UK;
- iii we are concerned lest shares underwritten overseas - in New York or Tokyo - flow speedily back to the UK.

Consequently we propose:

- i underwriting of foreign sales in London: no overseas underwriting;
- ii registration of offer in US, Canada, Japan and Switzerland; vigorous marketing by local investment houses;
- iii rest of Europe and Middle East to be dealt with by London stockbrokers.

Overseas sales might boost UK success by some £500 million. But overseas sales will not compensate for UK disappointment.

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5 Estimated Costs

	£ million
Underwriting fees and brokers' commissions [possible range only - all arrangements still to be determined]	80 - 130
Subscriber voucher scheme and share bonus scheme	80 - 105
Employee incentives	35 - 45
Marketing (including prospectus advertising)	15
Professional advice	5
Receiving bank costs/registrar costs	8 - 12

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223 - 312

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6 The Timetable

- 17 July BT Licence was approved by House of Commons
- 25 July BT Licence was approved by House of Lords
- 5 August Licence takes effect
- 6 August BT becomes plc
- 20 August Advertising campaign begins
- [Early October : Party Conferences]
- 26 October 'Pathfinder' prospectus distributed in UK and overseas
- 29 October 'Road shows' (presentations by senior BT managers to institutions) begin - both in UK and US
- [6 November : US Presidential Election]
- 6 November State Opening of Parliament
- 15 November Size of placing and the price are determined
- 16 November Impact Day: underwriting and/or placing of shares
- 18 November Prospectus published in press  
Mini prospectus made available
- 29 November Application Lists open
- 7 December Dealings begin

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