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Treasury Chambers, Parliament Street, SW1P 3AG

The Rt Hon Adam Butler
Minister of State (DP)
Ministry of Defence
Whitehall
LONDON
SW1A 2HB

20 May 1985

Dear Adam.

THE PRIVATISATION PROGRAMME: ROYAL ORDNANCE

Thank you for your letter of 15 May.

July 1986 was acknowledged to be the earliest possible flotation date in the RO Corporate Plan on which we decided to vest. I was disappointed to see, just a few months later, that you believe this target may not now be met.

I fully recognise the size of the task faced by RO management, and that the company's path to the private sector will be difficult. Most of our flotations have presented difficulties of one sort or another. But that indicates the need for additional determination and effort, in both the Department and the Company. I should like to explain why I think it so important that the target date of July 1986 for privatisation of RO plc should not be allowed to slip.

As you know from the E(A) paper, the RO sale will have to fit into the privatisation programme as a whole. It cannot be viewed in isolation, and the constraints on timing are quite severe. Prospectus disclosure requirements make it very difficult to organise Government sales in October/November and February/March because of the Autumn Statement and the Budget. August and mid-December - mid-January are also normally ruled out. And for obvious reasons it will not be possible to mount a major sale in the run-up to the next election. The marketing build up to a large Government share sale typically lasts two months or longer and it is inadvisable to distract investors by mounting one offer whilst another is being marketed. Thus there is usually at least a two-month gap between Government share sales.

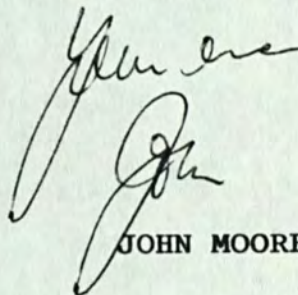
For a large scale sale like BGC the gap needs to be even longer. As the BGC sale is our main priority, other sales will have to be organised around it. We are committed to at least four major sales in the period summer 1986 - summer 1987. Their claims create a real risk that if RO is not sold next summer, it will not be sold during this Parliament.

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The question therefore is not whether July 1986 is ideal time for the RO sale. Indeed in some ways there is no ideal time, and a sole objective of maximising proceeds is not a sensible one: the market takes its own view of future profitability. The latest profit forecasts will be a factor to take into account with others, in coming later to a decision on issuing a prospectus for next July. But there will be no decision to make if management tasks are not tackled vigorously now.

You will by now have seen that E(A)'s discussion last week emphasised the need for departmental Ministers to maintain their privatisation programmes on schedule. I hope you will understand that RO can be no exception to this, and will ensure that your officials and Company management are making every possible effort to achieve the target date.

I am copying this letter to the Prime Minister and Sir Robert Armstrong. In view of the information it contains on Government sale plans, I shall be very grateful if its further circulation can be kept to a minimum.

A handwritten signature in dark ink, appearing to read 'John Moore', is written above the printed name. The signature is fluid and cursive.

JOHN MOORE

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Minister of State
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D/MIN/AB/1/8

15th May 1985

Dear Chancellor,

THE PRIVATISATION PROGRAMME: ROYAL ORDNANCE

I have seen a copy of the Chancellor's paper to be discussed at E(A) today (E(A)(85)26). The paper suggests that it is imperative that a flotation of Royal Ordnance plc takes place by next Summer. I think I should record the considerable difficulty we see with such a deadline.

The company was vested on 2nd January 1985. It inherited a Trading Fund and certain R&D establishments and has embarked on a major restructuring programme to turn itself into a successful company, able to compete in world markets. The Corporate Plan produced at the end of last year indicated the Directors' view that a successful flotation could not take place before about July 1986. This followed from the need to have available accounts for a full year's trading as a company. These will not be available until well into 1986 and there would then need to be a lead time for the flotation exercise.

But we are also very concerned about the company's ability to forecast profits with anything like sufficient accuracy to

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The Rt Hon Nigel Lawson MP

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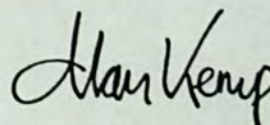
meet stock market requirements. The company are very conscious of this and the auditors, Coopers and Lybrand, have independently stressed the point to me and to my officials. A lot of management effort is presently being devoted to improving ROs' accounting and forecasting, but it will be early 1986 before they even have in place monthly accounts and some months later before the system's accuracy is proven.

Furthermore, and perhaps more importantly, if the company is to be sold at an acceptable price it has to demonstrate an ability to make profits. There are indications that the seas are going to be somewhat rougher for the company than had been anticipated, and that it may therefore take longer than we had hoped to turn itself into an attractive buy.

Against this background, they had been hoping to delay a flotation until as near the end of 1986 as practicable. If we are to meet a deadline of mid-1986 for flotation, the exercise will be the more difficult and the likely proceeds might well be affected.

I recognise the problem we face over the timing of the British Gas sale but I must enter a strong plea for some flexibility for Royal Ordnance if we are to avoid the political criticism and financial detriment we should face from an unsuccessful sale.

I am copying this to the other members of E(A) and to Sir Robert Armstrong.



Adam Butler

Approved by the Minister
and signed in his absence

15 MAY 1985

