



PRIME MINISTER

BAe FLOTATION

1 I have seen John Nott's minute to you of 16 January on the BAe flotation and on the defence estimates. I think it important, when we discuss this subject this afternoon, that the interactions between the two are fully understood. In essentials I believe that the draft statement which he proposes to make would solve most of the problems which we were concerned might frustrate a flotation. There are, however, three points on which I think that the statement would need to be more precise, so that a member of the public considering an investment in BAe shares would, by reading the statement and the prospectus, have a proper understanding of our intentions in the defence field as they apply to BAe.

2 The first is the question of disclosing the decision taken by Cabinet to reduce the defence budget by £200 million in each of the two later survey years. John proposes to deal with this by a statement that "The 3 per cent growth in resources will continue from the revised 1981/82 baseline". I am afraid that this is not quite explicit enough for flotation purposes. I think it would need to be expanded a little, so as to read "The 3 percent growth in defence expenditure in real terms will now be based on the reduced [or revised] 1981/82 baseline".

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3 The second is his reference to Sea Eagle. His proposed statement says simply that "contrary to some reports, development work on the Sea Eagle anti-ship missile will continue". The fuller statement of the position in his minute particularly addressed to the flotation makes clear that he has not at present gone beyond a strictly temporary reprieve. This question is so material to the flotation that it is necessary that our public statements should give a complete understanding of the position. I revert to this below.

4 The third point is that the references in the statement to the need to "look realistically at our programmes over the next year or two" give me a less severe impression than his minute which talks of a need for "a fundamental look at defence commitments, roles and capabilities". As I set out in the first paragraph we must ensure that the potential investor has a proper understanding of what we intend. This statement so soon before the flotation will be the basis on which investors will be forming their views of the market prospects for defence contractors in general and BAe in particular. I would expect the prospectus to refer to it specifically. In the light of the minute I confess to doubt whether the present draft of the statement meets that test. In the last resort it is John Nott who will have to satisfy himself that his statement does meet this onerous criterion, and can be regarded as definitive. We also need to be

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clear whether the statement supersedes any of the assurances given last week by his Permanent Secretary; if it does we would need a satisfactory restatement of the position.

5 I have referred above to the need for complete candour in the Sea Eagle position. Of the decisions which John has reached this is the only one which causes difficulty for the flotation. Because of the importance of this project as a means of developing BAe's air-launched missile technology so as to keep it competitive for further major programmes, our merchant bank advisers feel that a great degree of assurance is essential. If it were at all possible much the best course, both for the flotation and for BAe, would be to reach a firm decision now that this project could be regarded as a firm part of the programme on the basis of the proposals which BAe have made to limit and defer the costs falling on the defence budget. I do hope that John Nott could on reflection reach this view (in which case the statement could be strengthened). If, however, he cannot, and I do understand his wish to preserve options, it would be a necessary condition for flotation for the Ministry of Defence to be able to say that the present intention was that the programme should be maintained throughout 1981/2, and that their expectation was that in the event of a decision to cancel it they would take alternative steps to secure the necessary technological capability in BAe. If that were the underlying position the draft statement would need to be expanded by including the phrase "... although further decisions will be needed to confirm its place in the programme ...".



6 I have set out in full detail what is needed to enable flotation to proceed. As Norman Tebbit indicated in his minute of 7 January preparations are now far advanced for an offer on 4 February; four underwriters and three brokers are involved, and there is widespread knowledge and public comment on our plans. Kleinworts have confirmed that the defence decisions of which they were aware until Friday could be accommodated subject to the point on Sea Eagle which I have already explained, within the market capitalisation earlier foreseen (£275-300 million), not necessarily at the bottom end, and that no more than £100 million of new money will need to be raised. Thus the net proceeds seem likely to be above the bottom of the range we have contemplated. If we do not go through with it, it will be very widely known that we have pulled back at the last moment. Much worse, however, is that I must warn that in reality I see virtually no chance of a further opportunity to privatise BAe, in the life of this Parliament. The next theoretical opportunity would arise in May or June; but Kleinworts and BAe have both made clear that they do not consider the prospects nearly as good as they are now - and, in any case, there is every probability that we should be in the midst of the defence review of which John Nott has told you. I want us all to be clear therefore that to pass up our present opportunity is no mere temporary hitch, but may well be the end of a major plank of our programme, and of a Manifesto commitment.

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7 There is a further aspect to consider. If we do not go ahead with the issue, it is inevitable that many will surmise that this is because of defence uncertainties. This will enter the public domain, and might well cast doubt upon the credibility of any statement of the sort John Nott has in mind. There are therefore defence purposes, as well as our economic and political aims, to be served by proceeding with the flotation.

8 I am copying this to John Nott, the recipients of his minute of 16 January, the Attorney General with the previous papers (because of the legal responsibilities of disclosure required of the promoter of an issue), and to Sir Robert Armstrong.

*Catherine Bell*

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

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