

PRIME MINISTER

## FLOTATION OF ROYAL ORDNANCE PLC

It is most unsatisfactory that this issue has come up so late  
in the day.

In order to make ROplc saleable, MOD have had to promise the company the 7th Challenger Regiment and have had to agree to place with them for at least 7 years all MOD requirements for explosives and propellants (the material which fires shells and ammunition, as well as rockets). Vickers are deeply concerned about the Challenger order and have written to you about it. If RO's Leeds factory gets the order jobs may have to go at the Vickers facility in Newcastle Upon Tyne.

It would be argued that privatisation will be achieved by reducing competition and at the expense of private sector business - a charge that would not be at all easy to answer.

There are also other arguments against the flotation. It may be unsuccessful. And even if it succeeds it is likely to bring in only around half of the book value of the company, which will undoubtedly be criticised by the PAC (who have been concerned about this in the past) and by critics of the privatisation programme generally.

Mr. Younger is nevertheless in favour of going ahead. I understand that the Chancellor is likely to agree, though most reluctantly.

If the flotation does not go ahead the alternative will be to break the company up and sell the constituent factories, eg to Vickers and to ICI (who have explosives interests). The Government would then be left with an unsaleable rump which it would probably eventually have to close.

This has probably now gone too far to draw back from further preparations towards flotation. But Mr. Younger should



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explain why the piecemeal sale of the company is not preferable to flotation and the Treasury and MOD should be ready to abort the flotation even at the last moment if the prospects worsen still further: a flop would be the worst of all outcomes.

*Amanda Ross*  
DUTY CLERK

pp DAVID NORGROVE

10 June 1986

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MINISTER OF STATE FOR DEFENCE PROCUREMENT

D/MIN/DGT/1/8

10th June 1986

Prime Minister

FLOTATION OF ROYAL ORDNANCE plc

George Younger has asked me to minute you on his behalf as he is out of the country today.

2. For the last 12 months we have been working towards the flotation of Royal Ordnance plc in July: this is publicly known although the actual Impact Day selected (16th July) has of course not been disclosed. This was always an ambitious time-scale for a company that was only vested in January 1985 but the objective of transferring Royal Ordnance to the private sector where it rightly belongs, is a worthwhile one. This Department, assisted by the Treasury, Rothschilds and a range of other professional advisers, has accordingly invested a great deal of effort into this enterprise with a view to achieving flotation next month. We have reached the point where we must take a final decision whether to proceed.

3. Until January 1985 Royal Ordnance operated as a Trading Fund. Major changes in its management methods, commercial outlook and financial control systems are necessary to transform it into a fully fledged plc. These changes have begun but are by no means complete. Most of the senior management below Board level remain ex-civil servants. A new Chairman (Bryan Basset) was appointed last August and a new Chief Executive (Roger Pinnington) in April. Basset is not at all effective: Pinnington shows more promise but clearly has doubts about the

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company's readiness for privatisation and whether flotation is the best route. Notwithstanding these doubts the Royal Ordnance Board, of which Lord King is nonexecutive Deputy Chairman, have committed themselves to flotation and expressed their satisfaction with the relationship that has been established with the Ministry of Defence in its procurement role. The Board have identified the path to greater efficiency and hence commercial success as lying through rationalisation of facilities and manpower reduction. Provision for the cost of this will be made in the company's Accounts, but it will require an injection of capital to carry them through: it has accordingly been agreed that at flotation the company should raise £50 million for itself.

4. Rothschilds have advised that in commercial terms flotation this year is premature. They are satisfied, however, that it should be feasible on the basis of a low-key flotation, underpinned by institutional placement: their current thinking is that some 75% of the shares should be placed firm with institutions with the residual 25% placed subject to claw back and thus available for public subscription (including employees) This approach will in their view maximise the chances of a successful issue, though there is a risk of adverse Press comment leading to a lack of public interest. They have, however, warned us that the timetable is now extremely tight and that the sheer logistics of the operation may defeat us. There is also a risk that unexpected difficulties will arise that cannot be resolved in the time available.

5. The Royal Ordnance Board believe that profits in 1986 will be approximately the same as those achieved in 1985. Given the company's forecasting history and the quality of its financial

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controls it will not be possible to include a formal profits forecast in the Prospectus. Informally some indication will have to be given but there is necessarily a risk that in the event the profit will fall short of what investors have been led to believe.

6. On the basis of the Board's view of 1986 profits Rothschilds have advised that, after allowing for the £50 million capital injection, net proceeds of £100 million should be realisable at flotation. This is very much less than we had originally hoped and could well give rise to criticism: the book value of the assets transferred in January 1985 was £206 million.

7. If flotation is to proceed we must place with Royal Ordnance on a noncompetitive basis an order for 76 Challenger tanks (to form a Seventh BAOR Regiment): this will secure the future of the Leeds factory until the end of 1989. It is clear that Vickers, who have a tank manufacturing facility in Newcastle, will raise strong and public objections about this, which we shall have to ride out. We have also had to agree to place with Royal Ordnance for a period of at least seven years all our requirements for explosives and propellants, ie not to place any procurement with overseas suppliers.

8. It is clear that this does not represent the soundest possible basis on which to float Royal Ordnance which we would have wished to achieve. George Younger has therefore considered whether he should advise you that flotation should be cancelled. He has concluded that he should not. The flotation of Royal Ordnance has for some time and publicly been part of our privatisation programme and its cancellation would be politically damaging. Equally the problems faced by Royal Ordnance in achieving full commercial viability will not go away. As a publicly owned plc it would be substantially less well placed

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to solve them: the commercial imperative would not fully apply, the better managers required could not be afforded and there could be political difficulties in carrying through a major redundancy programme. A commercial company owned by HMG is a manifest anomaly and cannot attain its full potential while fettered by public sector constraints. The opportunity to transfer Royal Ordnance to the private sector is available and should not be lightly discarded.

9. George Younger's view therefore is that, despite the difficulties and risks identified, flotation should proceed. He would, however, wish to be sure that you and other colleagues are content with this.

10. I am copying this minute to Willie Whitelaw, Norman Tebbit, Nigel Lawson, Paul Channon, Norman Lamont and Sir Robert Armstrong.



Lord Trefgarne

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