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23 April 1986

CABINET

LAND ROVER (UK) LIMITED: PRIVATISATION

Memorandum by the Secretary of State for Trade and Industry

SUMMARY AND RECOMMENDATION

The British Leyland (BL) Board have now completed their assessment of the proposals from the four prospective purchasers and of the option of retaining the businesses with BL within a view to a later flotation or trade sale. On financial and industrial grounds, the Board have recommended retention within BL.

2. I recommend that the Board's proposal should be accepted. It would result in proceeds for BL which reflect the hoped for improvement in Land Rover's performance; would provide a period of stability for BL and, in the interim, would allow profits from the businesses concerned to help sustain BL's commercial vehicle operations whilst solutions are sought, in particular, for Leyland Trucks and Bus.

3. Subject to colleagues' views, I propose to make a statement to the House on 24 April on the lines of the draft at Annex A.

EVALUATION OF OPTIONS

4. An analysis of the financial proposals of the four bids is at Annex B. In summary these are as follows:

	Schroder	Lonrho	JCB	Aveling Barford
	£m	£m	£m	£m
Cash/cash equivalent	113	117	40	68
Deferred consideration (net present value)	30	-	45	13
Assets or business to be retained by BL (principally Freight Rover)	-	30	35	35
	143	147	120	116

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5. The JCB and Aveling Barford proposals are considerably inferior to the two other proposals and were therefore rejected by the BL Board. Not only are the total receipts by BL likely to be less than in the other cases, but, more important, the initial proceeds are very low (in both cases below the level of Land Rover's borrowings) and the future receipts could vary significantly from the figures shown.

6. The Lonrho and Schroder offers are financially very similar. Whilst the initial payments are virtually identical, Schroder's offer includes a further sum by way of deferred consideration. On the other hand the Schroder offer includes the purchase of Freight Rover, excluded from the Lonrho bid. The Schroder/Management team proposal can, on their own projections, be expected to produce results for Land Rover and Freight Rover somewhat below those in BL's 1986 Corporate Plan. The Management buyout would also be operating alone with no recourse to assistance from a parent company which the BL Board regard as a significant weakness. Lonrho would, on the other hand, bring new management, sales and marketing strengths to Land Rover and the Lonrho Group could, if necessary, provide additional funding. If the choice rested only between these two bids, the BL Board consider that, in industrial terms, Lonrho would, on balance, represent the better parent.

7. However, the proceeds of Lonrho and the Schroder/Management proposal are substantially lower than the proceeds BL considers it is likely to receive by retaining the companies and selling, either by flotation or trade sale in about two years' time. Therefore, the BL Board have unanimously and firmly recommended that the four bids should not be pursued. I attach a copy of their letter at Annex C. The course proposed would allow Land Rover's improved performance to work through into their profits, so that, by mid-1988, the proceeds from a flotation of Land Rover would in BL's view be of the order of £200 million (net present value on a basis comparable with the other bids). This is significantly in excess of the valuation placed on the business by the existing bidders. These views are shared by Hill Samuel and by Barings (the Government's financial advisers). Nor would flotation be the only option for BL - improvements in Land Rover performance could also produce a much wider range of potential trade purchases.

8. Deferred privatisation would not complicate the wider problems facing BL. The Board believe that disposal now would emphasise the isolation of Leyland Trucks, reduce its credibility and further weaken the company. Retention of Land Rover would provide a period of stability for Land Rover-Leyland and allow it to be sustained by continuing revenue from the Land Rover/Freight Rover operations.

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9. I recommend that we accept the Board's conclusions which are soundly based. If colleagues agree I propose to make a statement in the House tomorrow.

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Department of Trade and Industry

23 April 1986

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ANNEX A

DRAFT STATEMENT

When I made my statement to the House on 25 March following the ending of the talks between BL and GM on the privatisation of the main Land Rover-Leyland businesses, I made it clear that BL would continue to study alternative ways forward for all the businesses concerned. In the particular case of Land Rover and Freight Rover, BL asked for proposals to be made by 15 April. As the House is aware, four proposals were received. These were from Aveling Barford in respect of Land Rover and Range Rover; J C Bamford in respect of Land Rover, Range Rover and possibly Freight Rover; Lonrho in respect of Land Rover and Range Rover; Schrodgers (acting for a management and institutional consortium) for Land Rover, Range Rover and Freight Rover.

The BL Board have carefully considered these proposals and they have weighed them against the option of retaining Land Rover and Freight Rover within BL for a possible flotation or trade sale at a later date. The Board have concluded, on both commercial and industrial grounds, that retention of the businesses within BL pending a later sale presents a more attractive option for BL than any of the bids which have been received. The Board have therefore recommended to the Government - and the Government have accepted their recommendation - that none of the bids be pursued and that the companies be retained within BL while preparations for future privatisation are made.

I hope that the continuing speculation about the future of

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these businesses will now come to an end and that the BL Board, its management and its workforce can be allowed to concentrate on the serious task of assuring profitable growth and preparing the businesses for privatisation.

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Proposal from	Schroder Ventures (on behalf of a consortium of institutional investors and the management)	<u>Lonrho Plc</u>	<u>JC Bamford Excavators Limited</u>	<u>Aveling Barford Limited and others</u>
Offer for	Land Rover, Freight Rover, their related parts businesses and certain overseas companies.	Land Rover, its parts business and certain overseas companies.	Land Rover, its parts business and certain overseas companies. Willing to consider the inclusion of Freight Rover.	Land Rover, its parts business and certain overseas companies.
Nominal value of offer or proposal	£153 million	£117 million	Claimed to be £150 million to £175 million plus a further £25 million if Freight Rover included.	Net working capital plus a royalty on Land Rover and Range Rover sales for the next 3 years (but extending to 10 years if Santana licence terminated).
Cash element and financial liabilities to be taken over	£113 million	£117 million	£40 million	£68 million (estimated)
Non-cash or deferred element (nominal)	£40 million possibly rising to £53 million	None	Possibly £110 million to £135 million. Additional £25 million if Freight Rover included.	Possibly £17 million
Form of non-cash element	Convertible unsecured loan stock, interest free for 3 years.	-	Profit related payments.	Royalty on worldwide sales of Land Rover and Range Rover units.
Estimated present value of offer	£143 million	£147 million*	£120 million*	£116 million*
* Adjusted for Freight Rover, with an assumed value to BL of £30 million				
Business Plans	- Business to be conducted broadly in accordance with 1986 Corporate Plan.	- Land Rover to be expanded within Lonrho. - Possible involvement of minority technical partner.	- Land Rover to be run as a separate entity within the JCB Group.	- Range Rover business will either be separately disposed of or floated. - Particular strengths in Far East, China and South America claimed.
Other	- Planned flotation within 2 years when an additional £50 million would be raised. - Arrangements for employees to acquire up to 10% of the ordinary share capital of the new holding company.	- Offer conditional on net assets being not less than £115 million.	- Employee profit sharing scheme to be considered but dependent on productivity.	- Purchaser not specifically identified - Aveling Barford Limited would be a minority shareholder.

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23 April 1986

The Rt Hon Paul Channon MP
Secretary of State
Department of Trade and Industry
1 Victoria Street
London SW1

Dear Secretary of State,

As its meeting held yesterday 22 April the BL Board (excluding, of course, Mr D R G Andrews because of a conflict of interest) decided that it was in the best interests of BL that the offers for Land Rover and (in one case) Land Rover and Freight Rover be rejected and the companies retained in BL, with privatisation to take place in about two years time. Accordingly, the Board recommends that course of action to Government.

The main reasons for reaching the conclusion are:-

- o Of the four proposals received, two (Aveling Barford and JCB), were so inferior financially to the other two that they could not seriously be entertained.
- o The others, from Schroder/Management and Lonrho (the latter being only for Land Rover), are financially roughly comparable in value. However, the proceeds are substantially lower than the proceeds which BL is likely to receive by retaining the companies and selling, either by flotation or trade sale, in about two years time.

Directors: Sir Austin Bide (Chairman)
Sir Robert Hunt CBE DL (Deputy Chairman)
D R G Andrews CBE
Sir Robert Clark DSC
R Horrocks CBE
Sir John Mayhew-Sanders
B W Pomeroy

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- o This assessment takes account of future uncertainties. Thus, if flotation is precluded for any reason, even a modest improvement in performance would make it highly probable that more and stronger trade purchasers than have come forward now would then have a serious interest and they would pay a considerably higher price. The higher proceeds from a trade sale, which in any case may be desirable to give Land Rover the necessary industrial and financial support for long term viability, would overcome any deterioration in Stock Market conditions.
- o The Schroder/Management proposal envisages flotation in about two years in order to provide the necessary finance for future investment; to provide the institutions with a profit on their investment, and to enable the consortium then to pay BL the balance of the purchase price. It is clearly in the best interests of BL that all the proceeds should come to BL and its shareholders.
- o Industrially, neither Schroder/Management nor Lonrho has the potential to add significantly to Land Rover's strength, compared with retention in BL. Its sale now is not justifiable, therefore, on industrial grounds.
- o BL must take all possible actions to give Leyland Trucks a sound future. The only practical course seems to be sale to, or wide collaboration with, one or more other manufacturers. The availability of Freight Rover and Land Rover would improve the chances of deal significantly.
- o Selling Land Rover and Freight Rover now would emphasise the isolation of Leyland Trucks, reduce its credibility and further weaken the company. On the other hand retention would be the best way of providing a much needed period of greater stability for the whole enterprise. The importance of these points cannot be over-stressed.

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The meeting was unanimous in its very strong belief that the decision is the right one for BL and I was specifically asked to convey this to you. Mr Day has been consulted and although as it happened, he was not able to take part in the Board's deliberations, he has said he does not in any way feel uncomfortable with the decision.

Sincerely,

Austin Bide

Sir Austin Bide
Chairman

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