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Prime Minister ?
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PRIME MINISTER

28 February 1986

WHICH ROAD FOR AUSTIN ROVER?

Assuming that the Land Rover-Leyland sales come to fruition, then the Government is left with the problem of continuing to support Austin Rover or of finding someway of privatisating it. The table below sets out the performance of the company over the last two years and the forecasts that it is making for the rest of the decade.

	Actual		Forecast				£m
	1984	1985	1986	1987	1988	1989	1990
Sales	1874	2237	2492	2997	3384	3637	3780
Profit Before Interest	(26)	(4)	20	57	82	86	94
Profit After Interest & Tax	(25)	(52)	(26)	Nil	17	19	20
Cash Flow	(68)	(69)	(96)	(38)	(32)	(57)	(45)
Total Debt	232	311	407	445	477	534	579
Market Share	17.7%	17.7%	18.9%	19.4%	19.9%	20.4%	21.3%

Unfortunately, Austin Rover's forecasts have been persistently optimistic, they are already revising downwards their 1986 Corporate Plan projections. The figures below show the forecast that Austin Rover made of their profit and market share for 1985 in their 1984 and 1985 plans and what they actually achieved.

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1985	As forecast in 1984 Plan	1985 Plan	Actual
Profit Before Interest	£46m	£33m	£(4)m
Market share	22.0%	20.3%	17.7%

If similar results apply to their 1986 Corporate Plan forecasts - as seems likely - then there can be no chance of viability under the present strategy of being a fully integrated volume car manufacturer. Market share which is critical to this strategy has fluctuated between only 17.7% and 18.7% in the first five years of this decade, despite predictions that the modern model line-up would lift their share nearer 25%. They are still predicting over 21% by 1990 but it is exceedingly difficult to think of any car company from whom they are likely to take market share over these years.

New management and a new strategy could help stem the tide of losses. But even if all their existing £311m of debt is written off tomorrow, it must still be most unlikely that they can survive within the public sector without either more Government funding or more guarantees.

Disposal must be the right option. There are five basic ways that this could be encompassed.

1. Trade sale to some enterprising (or foolish) British company.

2. Consortium buy-out - a group of financial institutions probably with some management/employee participation.

3. Flotation by offer for sale to the general public.

4. Giving the company to the employees.

5. Honda taking over the business.

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Whatever option is chosen writing off the existing £311m of debt will almost certainly be necessary. Part of this debt will be borrowings directly from banks and part from BL itself. Obviously writing off the bank debts will require an injection of funds directly from HMG but some of the debts to BL will only be 'book' ones and no extra money will be necessary.

Trade sale

There is no other British car company to buy Austin Rover and none of the component suppliers are either financially strong enough or foolish enough to be likely to make such a bid. Nevertheless if a private company or an entrepreneur were interested then they might be prepared to take the company away for nothing provided it was debt free. The Government would only be able to justify such a course if the buyer were able to give convincing assurances about the future of the business which is unlikely.

Consortium buy-out

This is just about possible. Austin Rover have already held top secret discussions with banks who are prepared to consider the idea. The banks have seen some of the financial numbers but I cannot believe they know the full horror of the situation. Nevertheless the city is at present flush with funds and has been prepared to invest in some highly unlikely ventures.

With reputable bankers and both employee and management participation, such a buy-out should be politically acceptable. It may be possible to achieve merely by writing off the existing debt and requiring the bankers to put say, £200m into the company, preferably by way of a purchase price for the shares.

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Flotation

Normally companies need at least a three year track record of solid profits and cash flow together with good forward prospects for a flotation. The shares could of course be given away free although the Stock Exchange might have strong views on the matter.

But the less that is paid for the shares the more the Government would be seen to be responsible for ensuring the company did not fall quickly into receivership. Even with a £200m dowry as well as writing off the debt this would remain a hazardous exercise.

Giving the company to the employees

Superficially this sounds highly attractive, although the employees have of course far less right to the company than the taxpayers who have subsidised their jobs for the last ten years. But giving the company to the employees suffers from the same difficulties as a flotation, perhaps more so. It seems inevitable that the company would get into difficulty and Government would find it exceedingly difficult to walk away.

Selling to Honda

Honda's interest in Austin Rover is almost certainly limited to its use as a stepping stone for entering the European market. Europe is vital for Honda: it has less than 10% of the Japanese market and sells under 300,000 cars there (compared to 1.3 million by Toyota). But in the US Honda runs neck and neck with Toyota as the largest non-American importer/manufacturer selling almost double the number of cars that it does in Japan. This is clearly the strategy Honda would like to adopt in Europe.

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It has already bought a 300 acre site in Swindon where it plans to start manufacturing engines although its true aspirations must go much further. Collaboration and subcontract assembly by Austin Rover is a low cost, low risk way for Honda to establish itself in Europe. Once established it is unlikely to want to maintain the links with Austin Rover for anything other than political reasons.

Nevertheless, if the Government made absorbing Austin Rover a pre-condition of Honda's expansion into Europe, then Honda might find it a small price to pay. It could start with a 25% equity stake and increase in stages. If Honda were prepared to do this at all, then Government would only write off the existing debt and indeed may not even need to go this far.

But politically once the Americans are out of the way the Japanese may become the new bogeymen.

Conclusion

Of the 'British' solutions the consortium buy-out with management/employee participation is the best, albeit still improbable, runner. It is also the route least able to be criticised as the giving away of a priceless national asset. Graham Day should be encouraged to pursue this vigorously.

As a first step the Government could write off Austin Rover's £311m debt at the same time as writing off the residual debt left over from the Land Rover Leyland sale. This would help disguise the cost of disposing of Land Rover Leyland and also appear a very positive measure for Austin Rover. Adroit negotiation with the bankers might enable the Government to announce at the same time the ending of Varley Marshall assurances.

Peter Warry

PETER WARRY

B/F
10/3

10 DOWNING STREET

Prime Minister ?

Agree to write to DTI copied only to Treasury, along the lines suggested by Peter Warry?

DRN
28/2

I would rather discuss with Paul Channon & John Wakeham first

MT