010

JF3450

CC/ NO

CONFIDENTIAL

2

Prime Minister

I will resubmit this to you with advice tomorrow.

MES 10/5

PRIME MINISTER

BRITISH STEEL CORPORATION

We were due to consider BSC's Corporate Plan in E(NI) next week; decisions are needed on approving the Plan itself, the External Financing Limit for 1983/84, and the hot strip mill investment at Port Talbot. We will be pressed to state our position on these issues during the election campaign: I also need a basis for the notification of aid to BSC up to 1985 which I have undertaken to make to Brussels by the end of May at the latest, since the Commission are required by the Steel Aids Decision to approve all state aids by the end of June. Since the E(NI) meeting will not now take place, I am seeking approval by correspondence, and I believe we should decide this week so that our campaign can properly reflect our decision.

... 2 I attach the paper which I would have put to E(NI), and detailed papers by officials on the Corporate Plan and Port Talbot hot strip mill project. In my paper I invite colleagues:

X

- to approve BSC's Corporate Plan subject to a reduction in external financing proposed for 1983/84;

- to set the EFL for 1983/84 at £325 million, an effective reduction of £100 million on BSC's proposals on the understanding that we would be prepared to take a further look if the market turns against BSC;

- to approve the Port Talbot Hot Strip Mill (HSM) investment project;

X - to take note of BSC's discussions with US Steel but not to take a decision at this point;

- to take note of the prospects for the State Aids negotiation with the Commission.

3 The EFL figure has been agreed with Leon Brittan on the basis that the Port Talbot project is approved (if it were not, the EFL would be reduced to £265m). Since the figure represents a very substantial cut in BSC's allowance for contingencies we need to be prepared to look at it again later in the year if BSC's market turns sharply down. I would also propose to include a higher allowance for contingencies in the aid notification to the Commission, since there will be no opportunity to reconsider that figure once the Commission has taken its decisions in June.

4 Besides the Port Talbot project, the Corporate Plan includes a £36 million continuous casting project at Clydesdale; this would be covered by overall approval of the Corporate Plan and does not require a separate decision.

CONFIDENTIAL

... 5 I also attach a suggested form of words on BSC issues which we can use on the campaign, which I have agreed with George Younger and Nick Edwards.

6 I very much hope that colleagues will be able to let me know by noon on Friday, 13 May whether they accept my proposals.

7 I am copying this minute and the enclosed papers to members of E(NI), to the Foreign and Commonwealth Secretary, the Secretaries of State for Scotland and Wales, the Lord President, Sir Robert Armstrong and John Sparrow.

P J.

P J

10 May 1983

Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1E 6RB

Encl

JH 688

DRAFT CAMPAIGN SPEAKING NOTE

Steel

BSC

(i) We will continue BSC's progress towards viability, by increasing efficiency, quality and service to customers. Financial support by HMG will continue to reduce as break-even and profitability are achieved.

(ii) The proposal to modernise the Hot Strip Mill at Port Talbot has been approved and will proceed, subject to formal consent by the European Commission. This is essential to improve quality, but will not increase overall strip capacity.

(iii) All this is entirely consistent with the Secretary of State for Industry's Statement on 20 December. As regards any future proposal involving a possible partnership with an American Steel company, the Government will consider that on its own merits.

Prime Minister ①

Agree Mr Jenkin's proposals ~~[illegible]~~ at X in his minute, subject to colleagues (who are, I believe, content)?

MLS 11/5

Yes

11 May 1983

MR SCHOLAR

cc Mr Mount
Mr Walters

BSC's CORPORATE PLAN

The Government has little option at this point, given its decision last December, but to give its approval to the Port Talbot project, the 1984/5 EFL (£325m) and the 1983-86 Corporate Plan.

The appraisal of the Port Talbot project looks robust, for even though much else in the Plan looks doubtful, what is not in doubt is that at the core of its business BSC will need one hot strip mill in the mid-1980s, which is competitive on cost, quality and dimensional capability; and Port Talbot is the right location for it. Shortfalls in demand will weaken the case for Llanwern or Ravenscraig but not Port Talbot.

The EFL is a demanding one: BSC's case for a higher one looks quite plausible. It should therefore exert the required pressure on BSC management.

The Corporate Plan looks as if it has been constructed by working backwards from the answer expected - break-even (before interest) by 1984/85 retaining five major steel plants. The assumptions look contrived. The historical downward trend in steel demand obligingly reverses in 1983-86. Prices rise by 7% a year in 1984-86, even though the 'price guidance system' which shelters Europe's steel industry is likely to fade away along with state aids and inefficient capacity by end-1985. (Even more optimistic alternative assumptions provide BSC with price increases of 22% in 1984/5.)

Moreover, the strength of the arguments for making Port Talbot more competitive in 1986/7 make the Plan look less plausible. In 1985/6, BSC will have excessive but technically inadequate strip mill capacity. How can BSC then break even by then in competition with technically better competitors? The Plan has to be 'approved' to secure Commission approval for the EFL and to press BSC management, but hard decisions about capacity will probably have to be faced in a year or so.

NICHOLAS OWEN

10 DOWNING STREET

From the Private Secretary

12 May 1983

c. DEmp. DEnv. FCO
DEnergy. HMT CPRS
CS-HMT CO
DTrans. LPO
DTrade WO
SO

bc. N. Owen,

British Steel Corporation

The Prime Minister has seen your Secretary of State's minute of 10 May about the British Steel Corporation's Corporate Plan.

The Prime Minister agrees, subject to the agreement of her colleagues, to your Secretary of State's proposals as set out in paragraph two of his minute.

I am sending copies of this letter to the Private Secretaries to the members of E(NI), to the Foreign and Commonwealth Secretary, the Secretaries of State for Scotland and Wales, the Lord President, Sir Robert Armstrong and John Sparrow.

MS

Jonathan Spencer, Esq.,
Department of Industry.

CONFIDENTIAL

CONFIDENTIAL

File with MCS - Nat. Ind.

NBPM

Miss Caroline Varley
Private Secretary to the
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
LONDON SW1

13 May 1983

Dear Caroline

BRITISH STEEL CORPORATION: CORPORATE PLAN TO 1986

My Secretary of State has seen the minute which yours sent to the Prime Minister on 10 May about the British Steel Corporation, and is content with his proposals.

Mr Lawson was glad to note that BSC's capital expenditure programme contains no provision for expenditure on coke ovens. He hopes that BSC will take no decision on this until the discussions with National Smokeless Fuels Limited are concluded, and that Mr Jenkin will encourage BSC to bring this about as soon as possible.

Copies of this letter go to the Private Secretaries to the other recipients of Mr Jenkin's minute.

Yours sincerely

C E Brooks

MISS C E BROOKS
Private Secretary

CONFIDENTIAL

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

2

Prime Minister

To see.

MES 16/5

From the Secretary of State

The Rt Hon Patrick Jenkin MP
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
London
SW1

13 May 1983

Dear Patrick,

BRITISH STEEL CORPORATION

I have seen a copy of your minute of 10 May seeking E(NI) approval of the BSC Corporate Plan, the 1983/84 EFL and the Port Talbot strip mill modernisation. I would not wish to dissent from your proposals on any of these issues.

I was also interested to note the current state of play on negotiations between BSC and US Steel concerning the supply of slabs from Ravenscraig to the latter's Fairless Works in Pennsylvania. As you say, we will have to look very carefully at the proposal if and when it comes to us for decision. My main concern is the effect which the political and commercial opposition to the deal in the USA, to which you refer, could have on our trade relations, not least on the question of trade in steel. I have no wish to prejudge the issue, and I can appreciate the commercial advantages for BSC which you outline. However, since it is likely that we will have to take a decision at short notice I should be grateful if my officials could continue to be kept in touch with any developments.

I am copying this letter to the recipients of your minute of 10 May.

Yours,

Arthur

LORD COCKFIELD

not Ind,
Steel, Pt 12

MAY

MB

CONFIDENTIAL

Nat. Ind CCNO

SECRETARY OF STATE FOR EMPLOYMENT

Caxton House Tothill Street London SW1H 9NF

Telephone Direct Line 01-213 6400

Switchboard 01-213 3000

NBPM

MS 12/5

Jonathan Spencer Esq MP
Private Secretary to the
Secretary of State
Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1

12 May 1983

Dear Jonathan

BRITISH STEEL CORPORATION

My Secretary of State has seen a copy of Mr Jenkin's minute to the Prime Minister of 10 May about BSC's Corporate Plan. He supports Mr Jenkin's proposals.

with MCS?

I am copying this letter to the Private Secretaries of the Prime Minister, Members of E(NI), the Foreign and Commonwealth Secretary, the Secretaries of State for Scotland and Wales, the Lord President, Sir Robert Armstrong and John Sparrow.

Yours sincerely

Diane Hodges

pp MS F M EVERISS
Private Secretary

CONFIDENTIAL

NAT IND : The Steel Industry

Pt 12

CONFIDENTIAL
COMMERCIAL IN CONFIDENCE

BRITISH STEEL CORPORATION: CORPORATE PLAN 1983/86

Memorandum by the Secretary of State for Industry

This paper considers BSC's Corporate Plan and three closely related issues: the Port Talbot hot strip mill, the possible US slab deal and the line to take in discussions in the European Community on aid for BSC up to 1985. Detailed papers by officials on the Corporate Plan and the Hot Strip Mill are annexed, and it is on these items that I am seeking approval at this point.

BSC: Progress in 1982/83

1982/83 was a bad year for the Corporation. After real improvements in 1981/82, a sharp fall in demand and output combined with continuing over-capacity and the effects of US protectionism to impose heavy pressure worldwide on market stability and prices.

The Plan presented by BSC in 1982 forecast a trading profit of £79 million before interest in 1982/83 but also proposed a contingency allowance of £175 million in view of the developing uncertainties over prices and markets. We took the view that the EFL should reflect the objective of achieving break-even and cut the contingency margin to £79 million, giving an EFL of £365 million.

However as the year progressed BSC suffered from

- sharply declining order levels, particularly in the home market;

- high imports, and declining market share;
- weakening prices from October.

Consequently BSC's home deliveries were 16% below the planned level and BSC's production of liquid steel in 1982/83 was 11.7 million tonnes compared to a planned level of 14.5 million tonnes. Home prices were on average the same as planned but export prices were 8% lower. The provisional loss for the year was £378 million and the required level of external financing was £575 million.

Against this deteriorating background, the Corporation had to re-appraise their strategy. In particular a review of the Strip Mills was undertaken to establish the scope for remedial action. This concluded that BSC's strip capacity was excessive for actual and foreseeable demand. It identified three options, involving the complete or partial closure of Ravenscraig and the concentration of strip production in South Wales, and the modernisation of the hot strip mill at Port Talbot. As demand continued to deteriorate BSC advised that if they were to have any chance of breaking even in 1983/84 it would be necessary to close Ravenscraig immediately (saving £100 million in a full year) on top of other measures they were taking to cut costs (worth £242 million in a full year). However, we agreed that the complete closure of Ravenscraig was too drastic a step to be taken immediately, and asked BSC to prepare their plan for 1983/86 on the basis that steelmaking would continue at all five major sites, and with the aim of returning the Corporation to breakeven before interest in 1984/85.

Corporate Plan 1983/86

The Plan is designed to reduce losses and to phase out the need for financial support from Government by the end of 1985 by increasing market share from 47% to 50%, maintaining manned capacity utilisation at 80%, reducing manpower to 68,000, tightening control of working capital, and concentrating capital investment on schemes to control efficiency and quality, so preserving markets.

The Plan's financial estimates are:

	1982/83 (Provisional)	1983/84	1984/85	1985/86
Trading Profit/Loss	(288)	(59)	106	100
Interest	(90)	(72)	(53)	(47)
	(378)	(131)	53	53
Contingencies		(150)	(100)	(100)
Total Profit/Loss	(378)	(281)	(47)	(47)
Cash Requirements (including contingencies)	(575)	(425)	(315)	(185)

EFLs

There is no doubting the commitment of BSC management to cost control and reduction. Also, by rejecting the option of the immediate closure of Ravenscraig, we have required them to incur costs which they regard as excessive. However, especially as a new Chairman is due to be appointed from 1 September, I believe it is important to maintain discipline within the planning assumptions which we have set. The main determinant of cash requirements in 1983/84 will be the commercial environment, ie the level of demand and the prices which can be achieved. Experience, including the experience of 1982/83, shows that apparent improvements in the market can quickly move into reverse. However there have been distinct and continuing signs of improvement in the market since the Corporate Plan was drawn up at the end of 1982, so that the assumptions on which it was based now seem to tend towards caution. Officials have assessed these assumptions in depth (paragraphs 27 to 45 of the detailed paper). This analysis suggests that movements which have already taken place point to an improvement of some £75 million in trading results in 1983/84. I believe it is right to set an EFL which takes account of these developments and of the generally more stable environment and I have agreed with the Chief Secretary that the EFL for 1983/84 should be £325 million, on the basis that the Port Talbot hot strip mill project goes ahead. This figure should be achievable provided there is no major disruption to markets, prices or production; and in that case we would need to look at it again. We do, however, need to ensure that our aid notification to the European Commission is not pitched too low, since if we had to seek an increase at a later stage the Commission would demand more capacity cuts. I therefore intend to keep a larger contingency allowance in the aid notification than is implied by our EFL of £325 million.

The EFL for 1984/85 does not have to be set until the autumn. I think it is wise to wait until we see more clearly how the market is moving and what effect the Community measures are having before settling on a figure. The position on the slab deal (see below) may also be clearer by then; if the deal takes place it would require an increase in the EFL for 1983/84.

Investment

The Plan includes four major projects which will start in 1983/84:

	£m	
	Spend in 1983/84	Total Cost
Port Talbot Hot Strip Mill	60	180
Continuous cast feedstock for medium range seamless tubes to be located at Clydesdale	12	36

	£m Spend in 1983/84	Total Cost
Modernising Bromford seamless tube plant	4	13
New slab reheat furnace, Lackenby	3	13

Of these, only the Port Talbot development requires separate Government approval. A full note by officials is attached. The main arguments are summarised below.

Port Talbot Hot Strip Mill

Strip products are sold, many after galvanising, tinplating or other forms of further treatment, to automotive manufacturers, manufacturers of domestic appliances, the construction industry, and producers of steel containers from drums to beverage cans. Reductions in steel usage in some areas through the use of thinner gauges and the substitution of aluminium and plastics is matched by growth in the use of organically coated steel for buildings.

Major customers are increasingly demanding better quality products in terms of ductility, surface, and dimensional control across a wide range of widths and gauges. These requirements are capable of being met by the modern European mills.

If BSC is to have a future in the strip business it therefore needs to be able to compete. None of the existing mills in the strip products group can meet the full range of products. The hot strip mills at Llanwern and Ravenscraig (commissioned in 1962) have a restricted gauge capability and are limited to orders of around 1500mm in width. Moreover both of these sites suffer from other disadvantages in terms of less competitive iron and steelmaking facilities, and, in the case of Ravenscraig, greater distance from the markets. Port Talbot, however, has its own deep water port, has had £375 million recently invested in iron and steelmaking facilities and in the cold mill, and is conveniently placed for the other finishing works in South Wales and the main markets in theMidlands and South East of England. Port Talbot is both actually and potentially the lowest cost site in the Strip Products Group and, with the project, can compete with the best European mills on cost and quality.

BSC have therefore proposed to invest £154m at April 1983 prices (£180m at outturn prices) in modernising and up-grading the hot strip mill at Port Talbot, thus completing the series of investments there. Without this investment BSC estimate that they will lose markets of at least 150,000 tonnes per annum.

Without the investment, the entire future of BSC in the strip business will eventually be called into question. With it, Port Talbot can become competitive with other European producers. Although the Corporate Plan does not show the Strip Products Group returning to profitability over the next three years on the assumption that demand stays close to its present level, BSC believe that if capacity in the UK were reduced into line with demand, this business can be made profitable. This is the logic underlying their discussions with US Steel.

I accept that BSC need a site which is fully competitive with the best European mills, and with the proposed investment Port Talbot can be that site. The future of the other sites will depend on the future trend of demand and prospects at those sites for cost reduction and product and quality improvements. They may well in fact benefit from the investment at Port Talbot since some of the extra orders attracted by a business with the ability to meet the most demanding requirements may be able to be met by the products of the other sites.

The project requires approval from the European Commission under the steel aids decision. The Commission have indicated that they are opposed to the increase in strip capacity which it provides for. BSC have therefore agreed to go ahead with the project with one reheating furnace in the first instance. This eliminates the capacity increase, and reduces the operational flexibility of the mill, but does not jeopardise the benefits of the investment at the levels of production assumed. From the technical point of view, a second reheater could be added later.

The modernisation of the hot strip mill at Port Talbot, taking account of improvements in efficiency and the improvement in market share is computed to yield a net present value of £337 million at a 5% discount rate, and £158 million at 10%. These figures are not substantially altered by the reduction to one reheater. I recommend we approve the project and regard it as an essential item (on the basis of no capacity increase) in our aid application.

Privatisation

We are committed to further privatisation (and have said publicly that there is in principle no part of BSC which cannot be privatised). But in present market conditions, with the private sector of the industry generally in a weak financial state and preoccupied with its own over-capacity problems, progress is inevitably slow. The creation of more arms-length Companies Act companies within BSC is an important first step. Proposals for a further "Phoenix" joint venture in engineering steels, involving Lonrho, GKN and possibly F H Lloyd, are likely to be made within the next couple of months. Discussions are also in train on new mergers which would reduce BSC's present 50% holdings in Allied Steel and Wire and in Templeborough Rolling Mills, and related minority interests in the wire industry. Progress may also be possible on tubes. However, a more fundamental measure of privatisation is not achievable without improvements in the market. This reinforces the need for success both of the European aid regime and of our domestic efforts to restore BSC to viability.

Slab Deal

Mr MacGregor has been holding discussions with Mr Roderick, Chairman of US Steel, about an arrangement whereby BSC would supply continuously cast slabs from Ravenscraig for rolling at US Steel's Fairless Works (near Philadelphia) and sale in the US market. This would involve closing the hot strip mill at Ravenscraig. The deal makes sense for both sides since the iron and steelmaking facilities at Fairless are obsolete, while BSC needs to produce more slabs than it can at present sell in its home market to make its present configuration economically viable.

The deal would involve the setting up of a joint venture into which BSC would be required to pay a capital contribution, partly in recognition of the value of the deal to them and partly to finance investment at Fairless.

The details of the arrangement and the size of BSC's initial contribution are still to be settled between US Steel and BSC. BSC envisage that their capital contribution to the joint venture could be raised offshore in a way which did not add to their EFL. Government would of course ultimately stand behind the obligation they incurred in so doing. The EFL would however have to be increased to allow for additional working capital and other expenditure in the UK.

Illustrative figures provided by BSC showing the effect of the deal on relatively optimistic and pessimistic assumptions are annexed to this paper. Commercially, the deal looks at worst reasonably attractive and at best extremely profitable.

At present the discussions are in abeyance while US Steel is dealing with political opposition in the United States. As and when proposals are made, we will be asked to give a quick decision. Clearly, we will have to look at the proposal carefully from several angles, not least of which is the possible risk of its being blocked by political or commercial opposition in the United States. However, potentially the deal is very attractive from the commercial point of view and I believe we should be prepared to support it if the risks are not too great. I will bring proposals to colleagues when the time comes.

The Community Aid Regime

The ECSC State Aids Decision requires all State Aids to be phased out by the end of 1985, with any aid granted in the meantime firmly linked to commensurate capacity reductions and restructuring on the part of the undertaking receiving the aid. The Commission have to take final decisions by 30 June on aid and restructuring proposals notified by all Member States. The State Aids Decision does not permit authorisation after that date of any aid, except for unforeseen closures.

The Commission sought final details of notifications from Member States by 1 April. I made an interim notification for the money needed to sustain BSC to end June 1983 (£550 million) in March. This was agreed with difficulty by the Commission, in return for a cut in UK capacity of 571,000 tonnes - already achieved - and a promise of a further cut of 300,000 tonnes when we make our comprehensive notification. I have undertaken to let the Commission have the comprehensive notification during May. I am under great pressure to submit it as soon as possible; as there is to be a further Steel Council on 25 May I shall be in an extremely embarrassing position if the notification has not been made in good time before then.

The precise sum to be notified to cover the period July 1983 to December 1985 is still under discussion at official level, but is likely to be in the region of £1,000 million. There is also likely to be a contingency element to cover BSC funding of rationalisation deals with the private sector, and the aid implications of the slab deal. There is no doubt that the Commission will insist that we offer more capacity cuts in return for their authorisation of this aid. Two recent developments should strengthen our hand:

(a) the revised Port Talbot Hot Strip Mill project. This eases the situation, insofar as it might even provide a small reduction of capacity rather than the originally envisaged increase of 375,000 tonnes of which the Commission are aware. (I also intend arguing that the investment in this project should not be considered as aid, any more than similar investment by a private sector company would be. However, the Commission are likely to oppose this argument, on the grounds that BSC, in its present financial situation, could not raise the money on the market on its own account, and that on its own the project would not eliminate the current losses of BSC's strip products group.)

(b) the recent decision by BSC to mothball the Hartlepool plate mill, which has a capacity of 550,000 tonnes. (It should be noted, however, that in the past the Commission have - with our support - refused to accept mothballing by others as capacity cuts.)

The negotiations with the Commission will, nonetheless, be difficult. If the slab deal materialises, it would provide a way out of these difficulties as it would bring about an overall reduction in BSC capacity through the closure of the Ravenscraig hot strip mill. However, the timing of the slab negotiations is such that we shall almost certainly have to enter the discussions with the Commission without knowing whether the deal is a firm option.

In the negotiations with the Commission we shall wish to ensure that eventual decisions are equitable as between Member States. We have to date been in the lead on capacity cuts, but the Commission are optimistic that others are now close to undertaking significant contributions. I intend to take the line that no further UK capacity cuts should be made until other Member States have caught up with us in achievements and not just in promises.

SUMMARY OF RECOMMENDATIONS

I invite colleagues:

- to approve BSC's Corporate Plan to 1986 subject to the reduction in external financing in 1983/84 which I have agreed with the Chief Secretary;

- to approve the proposed investment in the hot strip mill at Port Talbot on the basis of a single reheat furnace in the first instance;

- to take note of the current situation as regards the slab deal with US Steel;

- to take note of the line I propose to adopt in the negotiations on state aid with the European Commission.

ANNEX

POSSIBLE EFFECTS OF A SLAB DEAL WITH US STEEL

"Best case"

		1984	1985	1986	1987
			£m		
1	Initial contribution [note 1] $300 million				
2	BSC share of joint venture cash flow [note 2]	8	(5)	38	44
3	Repayment of borrowing and interest [note 1]	(40)	(38)	(36)	(33)
4	Net cashflow arising from joint ventures	(32)	(43)	2	11
5	Additional profit in UK [note 3]	77	108	104	95
6	Additional costs in UK [note 4]	(101)	(8)	(8)	-
7	Overall effect on BSC cashflow	(56)	57	105	113

"Worst case"

			£m		
1	Initial contribution [note 1] $600 million				
2	BSC share of joint venture cash flow [note 2]	(22)	(42)	(3)	3
3	Repayment of borrowing and interest [note 1]	(78)	(75)	(70)	(67)
4	Net cashflow arising from joint ventures	(100)	(117)	(73)	(64)
5	Additional profit in UK [note 3]	76	108	97	87
6	Additional costs in UK [note 4]	(101)	(8)	(8)	-
7	Overall effect on BSC cashflow	(125)	(17)	16	23

Notes: 1 The different size of the initial capital contribution reflects the current negotiating stances of BSC and US Steel. BSC would borrow the money via a subsidiary incorporated outside the UK. Repayment of the sum borrowed is included in line 3.

2 Line 2 covers 50% of the projected profits of the joint venture (the difference between "best" and "worst" case represents the difference between US Steel and BSC's profit assumptions) less US tax and customs duties and net of capital investment at Fairless.

3 Profit in the UK arises from more efficient loading of BSC plants.

4 This includes working capital (the largest item), closure costs of the Ravenscraig hot strip mill, and some capital expenditure.

BRITISH STEEL CORPORATION: PERFORMANCE IN 1982/83 AND CORPORATE PLAN FOR 1983/86

Note by the Department of Industry

INTRODUCTION

1 BSC's Corporate Plan for 1982/85 was prepared against the background of real improvements in the Corporation's performance in 1981/82 but in the shadow of growing uncertainties over market prospects for 1982/83. It was presented to the Government in December 1981; withdrawn for reassessment in January 1982 once US steel producers had launched legal actions to stem imports from Europe and elsewhere; and resubmitted in March. The Department's review of the Plan (E(NI)(82)15) was considered by Ministers on 9 June (E(NI)(82)5th meeting). On 11 June, the Secretary of State announced to Parliament that the Plan had been approved, with modifications, and that BSC's objectives for 1982/83 would be to achieve break-even before interest within an EFL of £365 million.

2 In the event, 1982/83 has proved a very difficult year for steelmakers throughout the Western world, including BSC. A sharp fall in demand and output has combined with existing over-capacity and the effects of US protectionism to impose heavy pressure worldwide on market stability and prices. By the late summer of 1982, BSC's commercial and financial position had deteriorated so seriously that a strategic review had to be carried out to assess whether the Corporation should continue to operate all five of their major integrated steelworks. On 20 December last year, the Secretary of State announced at the conclusion of the review that the Government had asked BSC to prepare their Plan for 1983/86 on the basis that steelmaking should continue at the five sites and with the objective of reaching break-even before interest in 1984/85, two years later than the previous target date.

3 The Corporate Plan for 1983/86, which was submitted on 14 February, represents the Corporation's response to the Government's decisions. This note reviews BSC's performance in 1982/83, assesses the new Plan and recommends the basis on which the Government should approve it.

THE 1982/85 PLAN

4 In 1981/82 BSC incurred a loss before interest of £231 million with external financing requirements of £766 million. This represented a major improvement over the previous year's results. The principal objectives of the 1982/85 Plan were to build on this progress so as to move the Corporation into profit and reduce cash requirements.

5 The management action programme to achieve these objectives had five main elements:

(a) Support for the European steel regime and price initiatives through BSC's active participation in the EUROFER organisation.

(b) Maintenance of high capacity utilisation through holding UK market share to at least the pre-strike level (51 per cent); through increased export sales; and through more efficient use of plant.

(c) Reduction of costs to achieve best European productivity levels - through further reductions in manpower (which would fall from 104,300 in March 1982 to 92,400 a year later and to 87,800 by March 1985); through improving the yield of finished from liquid steel (primarily by greater use of continuous casting); and through further economies in energy use.

(d) Reduction in working capital requirements through tighter control of stocks and debtors.

(e) Continued restriction of capital expenditure to schemes which would cut costs or help to maintain BSC's competitive position in important markets.

6 When Mr MacGregor resubmitted the Plan to the Government in March 1982, he proposed that the contingency margin of £100 million on both profit/loss and cash for 1982/83 should be increased to £175 million to reflect the developing uncertainty over prices and markets as a result of the US legal actions. The Government decided, however, that it would be wrong to set BSC targets for 1982/83 which assumed a serious disruption to their business on that score. The contingency margins were therefore set at a level (£79 million) which was consistent with the objective announced in February 1981 that BSC should break even before interest in 1982/83. That apart, some other alterations were made to the financial targets in the new Plan, all of which were described in E(NI)(82)15. The targets finally set for 1982/85 are summarised in the table below:

£ million

	1982/83 (Plan - March 1982)	1982/83	1983/84	1984/85
		(Plan - as approved)		
Trading profit/loss	79	79	214	314
Contingencies	(175)	(79)	(100)	(100)
	(96)	0	114	214
Interest	(84)	(84)	(67)	(51)
Total profit/(loss)	(180)	(84)	47	163
Cash requirements (including contingency)	(461)	(365)	(200)	(91)

7 Mr MacGregor made clear that the success of the Plan depended not only on the achievement of the internal cost reductions but also - and most critically - on the enforcement of discipline under the European steel regime, in particular as regards the price structure, respect for production quotas, and measures to control third-country steel imports. Market stability in Europe would in turn depend to a large extent on the outcome of the US legal actions. Beyond this, however, by the time the Plan was approved in June both BSC and the Government were paying increasing attention to the importance of a further assumption underlying the Plan - that UK steel demand, and BSC's market share within it, would hold up to forecast levels. In both areas there were developing signs of slippage.

BSC'S PERFORMANCE IN 1982/83

A. Commercial and financial performance

8 BSC ended 1981/82 with order levels, prices, production and the trend of losses all broadly consistent with the achievement of break-even before interest in 1982/83. But in March and April 1982 the first signs of difficulty emerged: order levels, particularly in the home market, turned sharply downwards. This was at first regarded as a short-term phenomenon, reflecting a temporary increase in steel imports coupled with a delay in the restocking which had been expected to take place throughout UK industry. But the downturn in BSC's sales proved to be considerably more serious than this. The tables at Annexes I and II set out the key commercial and financial features of BSC's performance in 1982/83, the main points of which are summarised in the rest of this section.

9 In the April - June quarter BSC's position deteriorated rather than improved. Orders remained depressed. Deliveries - to the home market, to the UK private sector steel producers, and to export markets - fell below Plan. Imports continued at a high rate. BSC's market share declined. And production had to be cut back so as to reduce stocks and the cash required to finance them. All this was reflected in the trading results, where the weekly rate of loss grew from only £0.5 million in March to £3.0 million in June.

10 The position slipped further in the July - September quarter. All the adverse factors noted above either intensified or continued unabated. In particular, imports reached a peak in July and pushed BSC's market share down to 42 percent (compared with the target of 51 per cent for the year as a whole). Moreover, evidence emerged for the first time that UK steel demand - which had previously held up to expectations - was in fact falling below Plan levels largely because of the continuation of destocking in all sectors of the economy, including steel users. BSC's weekly losses after interest rose to between £7 and £8 million, reflecting the effects on profitability not only of reduced sales but also of the costs of operating plant at sharply reduced output levels as BSC'sdrive to cut stocks intensified.

11 The October - December quarter saw continuing decline in most key commercial areas, accelerating over the period to reach a low point in December. In a bid to sustain output and to offset the weakness in home orders, the Corporation were obliged to seek increased export business at low prices. To make matters worse, home prices, which had so far been held at or even above Plan levels despite growing price instability in Europe, had to be cut in October as the Corporation embarked on a concerted effort to stem imports and regain market share. As a result of this combination of factors, weekly losses after interest increased to between £8.8 and £9.2 million over the quarter.

12 Since then, however, there have been some signs of recovery. In mid-January, home orders increased significantly and, though they fell off somewhat in late February, remained at a level which represented a considerable improvement over the first nine months of the financial year. Import pressure, which had peaked in July, continued to decline. The Corporation's home market share grew to 47 per cent in January and 52 per cent in February. Deliveries to both home and export markets came close to Plan. And, in response, BSC increased liquid steel production significantly: the shortfall from Plan in the weekly rate of output, which had reached 34 per cent in October - December, fell to 19 per cent in January and 4 per cent in February. Financial losses attributable to low volume therefore began to decline, though this was partly offset by continued weakness in general selling prices and by the specific drop in revenue resulting from the high proportion of low-priced export orders booked in the previous quarter and now being delivered. The weekly rate of loss after interest fell to £7.9 million in January, £6.1 million in February, and £5.6 million for March.

13 Two important determinants of BSC's fortunes in 1982/83 merit highlighting, not least because of their implications for the 1983/86 Plan:

(a) On steel prices, the table at Annex II shows that, while realised prices for home sales over the year as a whole are likely to be exactly on target, the profile is not what was planned. Instead of registering a gradual increase from quarter to quarter, prices peaked in the second quarter and then fell to well below Plan in the fourth quarter. The export picture is gloomier still, with prices having dropped consistently between each quarter so giving a significant shortfall over the year as a whole. Price prospects in 1983/84, taking account of the impact of the Community's new guidance price system and of the decline in the value of sterling, are one of the key issues in assessing the new Plan.

(b) As regards the £/DM exchange rate, the Plan assumed a rate of DM 4.30 in the first quarter of 1982/83 reducing to DM 4.10 in the fourth quarter and averaging DM 4.20 over the full year. As Annex II shows, the rate in fact stayed above Plan until October and then fell more sharply than forecast, giving an average for the financial year of DM 4.09. The DM exchange rate has thus on average been marginally more beneficial than forecast, though the practical advantage has been minimal given that the collapse in effective European prices obliged BSC to reduce their own prices in October just at the time when the decline in the value of sterling would otherwise have allowed an increase.

B. Provisional results for 1982/83

14 The table at Annex III summarises the results expected for the year. The loss is forecast at £295 million before interest and £387 million after interest. Within the total, General Steels, Strip Products and BSC Holdings have all fallen well short of Plan targets and made losses, while the likely profit in Tubes Division is below expectation (and is likely to turn into a loss in 1983/84 as a result of recent price cuts implemented in a bid to regain market share from imports).

15 As regards cash requirements, the EFL of £365 million had to be revised to £575 million in March this year. As the table at Annex IV shows, the increase results from greater losses, from exceptional items (including the financing of Sheffield Forgemasters PLC and the buy-out of an onerous contract for use of Port Talbot harbour, totalling £64 million altogether), and from an increase of £80 million in redundancy costs. As a partial offset, BSC have kept capital expenditure £34 million below Plan levels and have succeeded in cutting working capital (stocks and debtors) by £167 million.

C. Remedial measures in 1982/83 - internal

16 Against the deteriorating background described in paragraphs 8 - 12 above, the Corporation had to reappraise their strategy during the course of 1982 so as to stem the growing losses and establish a sensible basis on which to prepare their new Plan for 1983/86. Part of the process of reappraisal had already been started even before the full extent of the Corporation's difficulties became apparent during the summer of 1982. A review of the Strip Mills had been set in hand in January as a Strip Products Group exercise to identify the scope for remedial action in the event that the Group began to go seriously wide of Plan targets.

17 The review, which Mr MacGregor presented to the Secretary of State on 29 July 1982, concluded that BSC's strip capacity was excessive for actual and foreseeable demand. It identified three options involving the complete or partial closure of Ravenscraig and the transfer of Scottish strip production to South Wales. All three options would, however, depend on the prior completion of a £175 million scheme to modernise the Hot Strip Mill at Port Talbot to enable it to produce the full range of strip products in terms of quality, weight and guage. Mr MacGregor made clear that even if the project received immedia

approval from the Government and the European Commission, it could not be completed and in full operation before 1984. He therefore urged that the project should be approved quickly. At the same time he confirmed that he was not at present recommending any of the three Strip review options and that a decision on the future of Ravenscraig would not have to be made until 1984.

18 By September, however, BSC's performance and prospects had deteriorated to such an extent that Mr MacGregor warned the Secretary of State that BSC would fall well short of their targets on both profit/loss and cash, not only in 1982/83 but also in the last two years of the Plan period. The Corporation already had in hand a series of cost-saving measures, including temporary plant shut-downs, short-time working, and a new programme of previously unplanned redundancies and minor plant closures. But Mr MacGregor warned that these, on their own, seemed unlikely to be enough to reverse the decline. He was therefore asked to prepare a full catalogue of the remedial options open to him.

19 At the end of September he indicated that, in his view, it would now be necessary to go for the early closure of one of the five major plants - Ravenscraig - if BSC were to have any chance of meeting a (delayed) target of break-even in 1983/84. This closure would be on top of the existing measures to cut costs. The assessment at that stage was in fairly broad terms: Mr MacGregor was asked to set out a detailed case.

20 He presented this on 10 November. The forecast was for a loss of £380 million in 1983/84 if no remedial action were taken. BSC had already set in hand a "management action programme" which would cut costs by £242 million in a full year - £99 million through improved manufacturing efficiency; £71 million through further slimline manning; and £72 million through closure of 13 smaller plants. (But the cost saving in 1983/84 would total only £180 million.) Three options to eliminate most of (but not all) the remaining full-year cost gap of about £140 million had been identified and assessed in detail: the closure of either Ravenscraig, Teesside or Llanwern. BSC's firm recommendation was that Ravenscraig should be shut around the end of 1982, with a full-year saving of £100 million.

21 The Government had already made clear publicly that any cost-saving measures, short of a major plant closure, which BSC needed to take urgently to restore their commercial and financial position were matters for the Corporation's judgement and would go ahead. But the Government had said that they would inevitably be involved in a major strategic decision over whether to shut one of the integrated steelworks. Against this background, BSC continued to implement the rest of their cost-saving programme vigorously while the Government considered the future of the five major plants in consultation with Mr MacGregor. The results of the Government's review were announced to Parliament on 20 December 1982. BSC were asked to prepare their Plan for 1983/86 on the basis that steelmaking would continue at all five major sites and with the aim of returning the Corporation to breakeven before interest two years later than planned, in 1984/85.

D. Remedial measures in 1982/83 - external

22 BSC's difficulties in 1982 arose not just from the weakness of UK steel demand but also from the direct and indirect consequences of the US action to stem steel imports from European and other suppliers (which itself reflected the worldwide slump in steel demand). By the summer, when US anti-dumping and countervailing duites were provisionally in force, this action was having a network of undesirable effects:

(a) export sales to the USA by BSC and other European steel producers were sharply reduced;

(b) competition in other export markets was increased, with consequent pressure on realised prices;

(c) by the same token, non-EEC countries were encouraged to step up their exports of surplus steel to the Community to compensate for the partial closure of the US market;

(d) excess steel on the Community market meant that the production quotas were too high in relation to demand and European producers responded by cutting prices;

(e) this price cutting, coupled with the strength of sterling up to October, made the UK an attractive dumping ground for surplus steel from elsewhere in the Community, so eroding BSC's home market share. (As noted in paragraph 11 above, BSC were finally forced in October to cut prices in a bid to reverse the tide, a process that was helped by the weakening of sterling which also began then.)

23 The negotiated settlement to the EC/US dispute, reached on 21 October, removed the threat of anti-dumping and countervailing duties being definitively imposed against European producers in return for agreement by the Community to some limitation on future steel exports to the USA. By this time, however, the effects of the US action coupled with the intensifying downturn in European and world steel demand had combined to put heavy pressure on the Community steel market. Industry Ministers meeting at Elsinore on 18 November agreed in principle on a set of measures to restore discipline for implementation on 1 January 1983. These included tighter production quotas and the introduction of guidance prices set at a realistic level for each product category. Subsequently, the Community also agreed that the quantity of steel to be allowed in during 1983 under the Voluntary Restraint Agreements regulating imports from third countries should be reduced below 1982/levels to reflect the decline in the Community steel market. Although these remedial measures came too late to have much impact on BSC's results for 1982/83, they are clearly relevant to the prospects for 1983/84 and onwards

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E. Conclusions on performance in 1982/83

24 BSC have been faced with the task of crisis-management in 1982/83. The effects of unforeseen weakness in UK steel demand have been compounded by weak demand elsewhere, by US protectionism and by the inability of the European anti-crisis measures to maintain market discipline in the face of such pressures. Against this background, the Corporation have worked to contain losses and cash requirements through intensified action in areas under their direct control. Over the year, manpower has been reduced by 21,900 instead of 11,200 through slimlining and the unplanned closure of some smaller plants. Energy use has been kept close to Plan levels despite the adverse impact of a severe shortfall in output. Working capital and capital expenditure have been strictly controlled. And, in response to deteriorating results, BSC came forward with timely and wide-ranging proposals for remedial measures. In circumstances where all Western steel producers have faced major difficulties, it is the Department's view that in 1982/83 BSC have responded effectively to adverse developments outside their control.

CORPORATE PLAN FOR 1983/86

25 The key features of the new Plan, and the financial objectives, are set out in the table at Annex V. The overriding aim is to reduce losses and to phase out the need for financial support from Government in accordance with the European timetable for ending state subsidies to the steel industry by December 1985. The management action programme to achieve this has five broad elements:

(i) A competitive pricing strategy designed at the same time to respect the European guidance price system and to restore BSC's home market share progressively from 47 per cent in 1982/83 to 50 per cent at the end of the Plan period.

(ii) Maintenance of capacity utilisation at around 80 per cent of the level of manned capacity in 1982/83 (which equalled 15.2 million tonnes of liquid steel).

(iii) Further cost reductions - through continued slimming of manpower (to 68,000 at the end of the Plan period); through increasing productivity to West German levels; through improving the yield of finished from liquid steel; and through continued progress in reducing energy use.

(iv) Concentration of capital investment onschemes to improve efficiency and quality, so preserving markets.

(v) Tighter control of working capital (stocks and debtors).

26 In his foreword to the Plan, Mr MacGregor stresses that its success depends critically on the re-establishment of price discipline within Europeas well as on the sterling exchange

rate - both areas over which major uncertainties exist. To cater for external fluctuations outside management control - though not for any major slippage in sales volume or prices - a contingency margin of £150 million is proposed on both profit/loss and cash in 1983/84 (£100 million in each of the two succeeding years).

ASSESSMENT OF THE PLAN

A. ECONOMIC AND COMMERCIAL ASSUMPTIONS

27 As usual, sections 2 and 3 of the Plan take a fairly detailed look forward to 1986 in such crucial areas as GDP; prospects for the main steel-using industries; likely production capacity and demand for steel in the UK, Europe and the rest of the world; BSC's market share in the UK; price levels; exchange rate movements; export markets; and relative inflation levels. The assumptions have been developed and updated since mid-1982 and form the centrally-determined backdrop against which the individual businesses have made their input to the Plan. Assessment is more than usually difficult this year because of changes in important variables which have taken place before and since the Plan was completed at the end of 1982. The main points of importance to the Plan's success are considered below.

(i) Outlook for BSC's sales volume

28 In November last year, as part of the strategic reappraisal of BSC's major plant configuration, the Corporation prepared a revised view of their commercial prospects in the short and medium term. This concluded that the home and export sales forecasts upon which the 1982/85 Corporate Plan had been based were no longer realistic and that total sales volume should be revised quite sharply downwards. As a cross-check on this analysis, the Department carried out its own full review of domestic and international prospects in the steel market which found no grounds for challenging BSC's conclusions (and indeed tended to support them).

29 The sales forecasts on which the new Plan is based are very similar to (though not identical with) those presented by BSC in last November's review. Compared with the 1982/85 Plan, they are as follows:

	UK Demand by C & S	BSC Market Share	BSC to C & S	BSC to private sector	BSC Deliveries Home	BSC Deliveries Export	BSC Deliveries Tot
1982/83 - Last Plan	12.5	52	6.5	1.5	8.0	3.6	11.
- Likely outturn	11.6	47	5.4	1.2	6.6	2.6	9.
1983/84 - Last Plan	13.1	52	6.7	1.6	8.5	3.6	11.
- This Plan	11.9	48	5.6	1.4	7.0	2.3	9.
1984/85 - Last Plan	13.2	52	6.8	1.6	8.4	3.6	12.
This Plan	12.5	48	6.1	1.4	7.5	2.4	9.
1985/86 - This Plan	11.7	50	5.8	1.4	7.2	2.4	9

The shortfall in total deliveries - of 2.4 MT in 1982/83, 2.6 MT in 1983/84 and 2.1 MT in 1984/85 - is attributable in roughly equal parts to two factors:

(a) Within a somewhat smaller UK market than previously foreseen, BSC will secure a reduced share mainly as a result of import competition.

(b) Prospects for export sales have deteriorated because of declining world demand for steel exacerbated by continuing surplus capacity.

30 The Department has again reviewed the market outlook to assess the realism of the forecasts in paragraph 29 above. Extrapolating from experience of the steel market in 1982 and taking account of forecasts for economic growth at home and abroad, we are generally content that the Corporation have based their assessment of total sales volume up to 1985/86 on a consistent and defensible view of such key factors as GDP, growth in UK manufacturing output, activity in the main steel-using sectors, UK steel consumption, steel stock movements, BSC's home market share and likely export sales. If anything, however, the assumptions err towards caution. In particular:

(a) The November 1982 Industry Act Forecast - now itself regarded as slightly pessimistic (see paragraph 31(b) below) - showed marginal growth of 0.6 per cent in UK manufacturing output in 1983 compared with BSC's assumption of zero.

(b) The Department's DIS appraisal last November - again based on the Government's Autumn Economic Statement which was itself less optimistic than the recent Budget forecasts - showed no sign of the downturn which BSC assume in 1985 either in UK manufacturing output or in the main steel-using sectors (except shipbuilding).

(c) As regards growth in OECD GDP and world trade in manufactures, BSC's assumptions up to 1984 are broadly in line with the recent OECD "Economic Outlook" but their forecast of an end to growth in 1986 represents a pretty pessimistic view that recovery on a modest scale will be swiftly curtailed.

31 If developments since the Plan was completed in December are taken into account, this impression of caution on BSC's part is reinforced a little further. There are three factors which could point to some improvement in sales volumes over the Plan period:

(a) The <u>sterling exchange rate</u> has declined sharply over the last three months (the effective rate fell by about 7½ per cent between December and March). BSC have taken a view on how this may directly affect their own input and selling prices over the Plan period (discussed more fully in the next section). But the depreciation of sterling should also improve the competitiveness of the UK steel-using industries and hence increase UK steel consumption - indeed, BSC have made a rough estimate that a 10 per cent decline in sterling could swell the UK steel market by about 500,000 tonnes a year. This is a pretty speculative figure; any such increase would take place after a time lag (of perhaps 6 months); and its magnitude would of course depend on the sustained depth of the sterling depreciation (it is relevant that in April the sterling effective rate has in fact increased). For these reasons, BSC do not propose to assume any growth in forecast sales volume on exchange rate grounds over the Plan period.

(b) The forecast for growth in UK manufacturing output, published in the Financial Statement and Budget Review, now shows an increase of 1.7 per cent in 1983 and 1 per cent in the first half of 1984 compared with BSC's assumption of zero growth between 1983 and 1985. Growth of the order suggested in the FSBR would not, if achieved, lead to a major increase in steel demand but it would of course be an advantage.

(c) As noted earlier, BSC's market share recovered to 47 per cent in January and 52 percent in February. At the same time, imports fell from 27 per cent in December, to 25.9 per cent in January and only 21.9 per cent in February (the lowest level for two years). The precise reasons are unclear - tighter production quotas in Europe in the first quarter of 1983 and the weakening of sterling have probably both played a part in reducing imports. Nor is it certain that a continuing improvement has been established. But if it has, this would improve BSC's sales prospects.

31 These factors give no grounds for concluding that BSC are setting their sales targets needlessly low. But they suggest, taken with the generally cautious interpretation which BSC had already put on a number of economic indicators, that the chances of the Corporation improving on planned sales volume in 1983/84 (and perhaps afterwards) are greater than of them falling short - always providing, of course, that there is no serious breakdown in the Community's measures to maintain market stability (as regards pricing rules, production quotas and control of third-country imports).

(ii) Exchange rates and selling prices

32 As page 7 of the Plan records, the "central" exchange rate assumptions on which it was based were prepared in August 1982 and updated in October but took no account of the marked depreciation of sterling since then. Before presenting the Plan in February, BSC therefore developed a set of "alternative" exchange rate assumptions to reflect recent currency movements. The effects of this on selling prices, input costs and profit/loss in 1983/84 were assumed to be neutral but adjustments were

calculated for 1984/85 and 1985/86 which produced net profit improvements of £100 million and £75 million respectively. The validity of these alternative assumptions, and their consequences, are central to the assessment of BSC's trading results and cash requirements over the Plan period. Our analysis is as follows.

33 The central and alternative exchange rate assumptions are set out below:

	1982/83 Plan	1982/83 Latest Outlook	1983/84	1984/85	1985/86
DM/£ - Central	-	-	4.00	3.80	3.60
- Alternative	4.20	4.09	3.80	2.95	2.85
$/£ - Central	-	-	1.70	1.85	1.80
- Alternative	1.80	1.69	1.60	1.60	1.60
Sterling effective					
- Central	-	-	88	88	85
- Alternative	94	88	82	83	72

34 The tables below show the pricing assumptions on which the new Plan is based, with a single-line adjustment in the last two years to reflect the improvement that BSC now expect as a result of the revised exchange rate assumptions.

Home sales (£ per tonne)	1982/83 Q4	1982/83 YEAR	1983/84	1984/85	1985/86
General Steels	240	244	245	264	284
Strip Products	266	269	274	291	314
Holdings	616	634	636	687	736
Tubes	456	526	436	464	492
Total BSC	276	284	281	301	323
% Annual increase	-	-	-1	7	7
Total BSC*	-	-	-	343	365
% Annual increase*	-	-	-	22	6

* on alternative exchange rate assumptions.

Export sales
(£ per tonne)

	Q4 1982/83	YEAR 1982/83	1983/84	1984/85	1985/86
General Steels	210	206	207	221	238
Strip Products	249	259	262	276	295
Holdings	456	467	468	515	543
Tubes	408	447	331	351	362
Total BSC	266	273	263	280	298
% Annual increase	-	-	-4	7	6
Total BSC*	-	-	-	305	322
% Annual increase*	-	-	-	16	6

* on alternative exchange rate assumptions.

NOTE

The tables above reflect the mix of sales on which the new Plan is based. The mix is different from that in 1982/83: it is generally less rich, particularly for exports (that is, rather less opportunity is foreseen for sale of higher value-added products). As a result, these figures cannot be compared exactly with those in Annex II which record BSC's realised prices in 1982/83 against Plan levels.

35 The table at Annex VI sets out BSC's calculation of the effect of the alternative assumptions on profit/loss in 1984/85 and 1985/86. The net profit improvement is arrived at after a cautious decision to discount half the total revenue gains to reflect either BSC's inability to pass on the full exchange effect to customers or a stabilisation of sterling at 3.30 - 3.40 DM. As regards 1983/84, the Plan notes on page 32 that "a prudent view of the phasing of exchange rate changes and the timing of the achievable consequential effect on prices indicates a neutral effect on profit and loss."

36 Three main questions arise over the approach which BSC have adopted:

(a) The plausibility of the alternative exchange rate assumptions.

(b) The proposed pricing strategy - particularly in 1983/84 - against the background not only of the exchange rate assumptions but also of the Community's renewed efforts to maintain and enhance prices under the guidance price system.

(c) The implications of (a) and (b) for BSC's revenue, trading results and cash requirements.

37 On the first point, forecasting exchange rates is a notoriously hazardous business. With that proviso, Government economists consider that BSC's alternative assumptions probably overestimate the degree to which the sterling effective and the DM/£ rates will decline over the Plan period - rates somewhere between the central and alternative cases seem more likely - and that in the case of the $/£ rate the central rather than the alternative assumptions seem more appropriate in the medium term. If this view is right, then it implies that BSC's revenues in 1984/85 and 1985/86 will increase rather less than assumed in Annex VI but that this will be offset to some degree by lower rises in $-denominated input costs and in other costs affected by general UK inflation. Since the calculation at Annex VI already builds in a substantial discount on exchange rate gains, and given the imprecision of forecasting in this area particularly as the time horizon extends, we should accept the calculations in Annex VI as reasonab approximations of the likely effects of currency movements in the last two years of the Plan.

38 The position in 1983/84, however, is less clear-cut and leads on to the second main question - about BSC's immediate pricing strategy and its effects. The issue is complex. As already noted, price discipline in the Community began to disintegrate in early summer 1982. BSC decided to maintain prices for as long as possible so as to avoid contributing to a price war, preserve revenues (losses would equal about £40 million for each percent drop in price) and in the hope that the market would restabilise. In October, however, they were forced to reduce prices because the combination of price cutting by other Community producers coupled with the strength of sterling had allowed imports to make serious inroads into the UK market. By November, the general position had deteriorated so seriously that Community Industry Ministers endorsed the Commission's intention of introducing a non-mandatory guidance price system. This was implemented on 1 January 1983 and set prices for individual products, denominated in European Currency Units (ECUs), at levels roughly mid-way between the discounted prices in the market and reestablishment of the full list prices which had broadly prevailed before the collapse in May/June 1982.

39 BSC's main concern over the proposed level of the guidance prices centred on the exchange rate at which they should be converted from ECUs. Sterling had depreciated significantly since October. And the structure of BSC's prices at the year-end left them generally <u>lower</u> /than those of their European competitors for flat products (strip and plate) but <u>higher</u> for long products (sections, bar and rod). As a result, and since the proposed guidance levels generally reflected the price structure in other Member States, conversion of the guide prices from ECUs into sterling at the spot exchange rate on 1 January would have required BSC to increase their list prices significantly (by around 20 per cent) for flat products while for long products theguidance prices would have generally remained somewhere below BSC's list prices. The Corporation,

: prevailing
xchange rates

backed strongly by UK steel users, judged that the UK market would not bear a major increase on flat products. The Commission were therefore persuaded that the guidance prices should be converted into sterling at the average exchange rate in September/October/November so as to smooth the transition. The resulting prices in sterling were broadly in line with BSC's list prices for flat products and rather below for long products.

40 Although producers were meant to charge guidance prices for all deliveries from 1 January, in practice deliveries in the first quarter were made at the (lower) prices ruling at the time of contract. It was only in relation to new contracts - in effect, for delivery from April - that the question of observance of the guidance prices arose. In setting the new list prices, BSC faced a choice. Either they could abide by the letter of the European regime and increase their list prices to take account of thefurther depreciation of sterling since January: this would imply a 20 per cent increas for flat products, which was judged to be more than the market wou bear and to threaten the recent signs of recovery in BSC's home market share. Or they could implement a smaller increase and take advantage of sterling depreciation to recover market share. After discussion with the Department, they opted for a compromise. List prices for flat products were increased to guidance price levels after taking some account of sterling depreciation, but some of the increase was offset by sector rebates to main customers. Although the retention of rebates breached agreements reached in EUROFER, the Commission and other European producers acquiesced.

41 There are now signs in Europe that prices for flat products are firming. Other producers, like BSC, published price increases effective from April. For long products, the improvement has been more patchy. The Commission intended to review guidance prices in April with the aim, if the market would bear it, of increasing them on 1 July to the levels obtaining at the peak of the market a year earlier. The decision would take account of two main factors - whether the existing guidance prices were being respected; and the EMS currency realignment of 21 March (which has put pressure on the French to increase their prices, and has prompted the Germans to support a general increase in guidance levels so as to avoid a fall in their own prices resulting from the strengthening of the DM). The Commission have now decided on a two-stage increase. The first, effective from 1 April, has been limited to certain products and reflects EUROFER's wish to restore prices to last summer's levels. The second, effective from 15 May, is intended to correct disparities arising from the EMS currency realignment. If the latest ECU prices are converted into sterling at the January/February/March average exchange rate, they show significant divergences from BSC's list prices. BSC are now planning to narrow, but not eliminate, this gap by raising prices for certain products during the April-July quarter.

42 Against this background, BSC's pricing strategy for 1983/84 is highly cautious. The underlying philosophy is summarised in two parts of the Plan:

(a) "The main risk to the price assumptions could arise from a loss of patience by some [European] producers, who then try to force closures elsewhere through cut-throat price competition. It is possible that from time to time over the next few years a partial breakdown will occur, in which case prices could decline by up to 10-15% for periods of up to 6 months, as happened in 1977, 1980 and again in 1982". (Page 11).

(b) "The prospects for 1983 are not good. The guidance prices proposed by the Commission, if successfully applied, would eliminate losses for most producers, but it is questionable whether they can be realised without an improvement in the market, close alignment of supply and demand, and more effective import protection." (Page 21).

43 In practical terms, BSC propose to follow the price increases of other European producers by matching effective prices actually realised on the market. This reflects the Corporation's determination to avoid (as in 1982) losing market share by being the first to raise prices in response to European agreements and the last to drop them as a result of market instability. As the first table in paragraph 34 above shows, this means thatBSC are assuming that, despite exchange rate movements, realised home prices over 1983/84 as a whole will rise by only 1.8 per cent over the depressed level realised in quarter 4 1982/83 and will average 1 per cent less than in 1982/83 as a whole. And on export prices they are assuming a 4 per cent reduction between the two years. Despite pressure from the Department, BSC maintain that their view is "prudent". They have declined to incorporate any more optimistic assessment.

44 For the reasons explained in the footnote to the tables in paragraph 34, the price levels there are not exactly comparable with those in Annex II which show BSC's realised prices in 1982/83. Nonetheless, rough adjustment to the figures shows that BSC's home prices peaked at about £288 a tonne in quarter 1 1982/83 (£285 plus an adjustment of £3 for product mix). If the European strategy for 1983 succeeds in no more than restoring prices to the peak level achieved at that time, then £288 a tonne would represent a 2.5 per cent increase over the average level of £281 which BSC are assuming for 1983/84. This is itself a very cautious revision since it assumes no gain at all to BSC from sterling depreciation. An arbitrary revision of the same magnitude could also be made to BSC's assumption about export prices, where the effect of sterling depreciation should be much more directly beneficial. On BSC's own sensitivity analysis that a 1 per cent increase in home sales prices improves profitability by £23 million, and by £ 7 million for exports, this 2.5 per cent revision would improve profit and reduce cash requirements by a total of £ 75 million in 1983/84.

45 In the light of this assessment of exchange rates and selling prices, we recommend the following conclusions:

(a) BSC's selling price assumptions in 1983/84 are unduly cautious. This inflates BSC's likely losses and cash requirements for the year. Moreover, it is tantamount to suggesting that BSC will not respect the European guidance price system (or that it will collapse), an approach which the Commission can be expected to contest strongly in their own consideration of the Plan.

(b) On the other hand, history tends to support BSC's sceptical view of the effectiveness of the European pricing regime. The question is whether they are now being excessively pessimistic.

(c) Balancing these considerations, we should make some revision to BSC's profit and cash forecasts for 1983/84. The basis for this proposed in paragraph 43 - an adjustment of £75 million in each - is cautious but has some analytical justification. Any other basis, and particularly one on which we sought to take a view about the purely exchange rate gains which BSC may reap in home prices, would be more arbitrary still.

(d) At this stage, we should accept the estimate of price and exchange rate gains which BSC have made for 1984/85 and 1985/86 (in Annex VI), so leaving the profit and cash forecasts for those years unamended.

B. SOURCES OF IMPROVEMENT IN PROFIT AND LOSS

46 Annex VII (page 33 of the Plan) shows the forecast trend of improvement in profit/loss over the Plan period. The major turn-round is to take place between 1982/83 and 1983/84, when losses before contingencies are to decline by £247 million (from £378 million to £131 million). This is to be derived in large part from the programme of remedial measures set in hand last November (paragraph 20 above), which promised savings of at least £180 million in 1983/84 through improvements in manufacturing efficiency, further slimline manning and the closure of 13 smaller works. Since then, in developing the new Plan, each Group has identified further improvements which are described as "Group Tasks" and will yield £82 million in 1983/84. This total is made up of £9 million from selling price improvements and £43 million from reduced cost increases as a result, respectively, of revised exchange rate and inflation assumptions; £5 million from further manufacturing efficiencies; and £25 million from accelerated manpower reductions.

47 Between 1983/84 and 1984/85 a further improvement of £184 million is forecast (from a loss of £131 million to a

profit of £53 million, both before contingencies). Sources for the improvement include a further gain of about £60 million from last November's remedial programme (which was forecast to yield £180 million in 1983/84 but £242 million in a full year); £30 million from further "Group Tasks"; £100 million from the central exchange rate adjustment to input and selling prices (discussed in the last section); an unspecified contribution from the forecast increase in deliveries of 0.6 million tonnes over the previous year; and £16 million from a "further management task" which reflects a central assessment of the scope for additional manpower savings (2,400 in the year) over and above those identified by the business Groups. These gains would be offset to an extent by cost increases, amount unspecified.

48 Between 1984/85 and 1985/86 no further improvement is forecast in net profitability. Gains are identified of £40 million from centrally-determined manpower savings under the further management task" (4,000 job losses); £29.6 million from "Group Tasks"; and £75 million from the central exchange rate adjustment. These are presumably offset - again no detail is provided - by cost increases and by the forecast reduction in deliveries (of 0.3 million tonnes) compared with the previous year.

49 The profit/loss picture is presented very opaquely in the Plan because of the plethora of adjustments to the central figures - "Group Tasks", "Further Management Tasks", and "Currency Changes". Nevertheless, the principal plank of the forecast improvement lies in last November's remedial programme, a major feature of which was slimline manning and smaller plant closures, yielding £143 million out of the full-year savings of £242 million. These actions have almost all been implemented by now and therefore represent sure gains. Moreover, the overwhelming majority of further savings over the period derive from action which is under BSC management's direct control and in which they have a good track record (additional manpower cuts, energy savings, yield improvements, manufacturing efficiency), rather than from optimistic assumptions about external factors (exchange rates, prices, sales volume). We therefore judge that the Corporation have a good chance of achieving the turn-round to profitability which, even on their cautious economic and commercial assumptions, they are forecasting.

C. CAPITAL INVESTMENT PROGRAMME

50 BSC require the Government's general approval for their capital investment programme as well as specific approval for major projects costing £50 million or more in total. In 1982/83 they had planned to spend £180 million but the outturn figure is £146 million. This reflects determined efforts to save cash in the face of deteriorating results as well as the delay in starting the Port Talbot hot strip mill development and the abandonment of a major seamless tube development (on which expenditure of, respectively, £11 million and £20 million had been scheduled in 1982/83). Under the state aids rules, the investment programme also requires authorisation by the European Commission.

51 Expenditure over the new Plan period is detailed in Annex VIII. The broad breakdown is as follows:

	£ million - outturn			
	1982/83	1983/84	1984/85	1985/86
Major approved schemes underway	70	51	3	-
Major schemes starting in 1983/84	-	91	120	54
Major schemes starting after 1983/84	-	-	28	84
Minor schemes	76	82	76	76
Total	146	224	227	214

52 The investment programme for 1983/84, for which approval is now required, involves a start on four "major" projects (as defined by BSC):

	£m	
	Spend in 1983/84	Total cost
Port Talbot HSM development	60	180
Continuous-cast feedstock for medium-range seamless tubes	12	36
Modernising Bromford seamless tube plant	4	13
New slab reheat furnace, Lackenby	3	13

Of these, only the Port Talbot development requires specific Government approval and that is covered in a separate paper (E(NI)(83)). If the project does not go ahead in 1983/84 (or at all), there would be a saving of £60 million on capital expenditure in that year. As regards the only other scheme of importance - the concast development for seamless tube - the objective is to improve product cost and quality by supplying concast feedstock to the two medium-range seamless mills at Clydesdale and Bromford. The siting of the development, and hence the precise project details, have not been settled and it has yet to be approved by BSC centrally.

53 Apart from the Port Talbot hot strip mill, BSC's proposed investment programme for 1983/84 raises no major strategic issues and we recommend that it be approved.

D. PRIVATISATION

54 Following the pattern of its predecessors, the present Plan says nothing about privatisation. Progress to date has, of necessity, been piecemeal. Since it is largely dependent on third parties, some of whom are in a fairly weak financial state themselves, it is virtually impossible to forecast the likely timing or the financial consequences of any individual piece of privatisation. In the case of its non-mainstream activities, BSC set a target of completing the disposal of BSC Refractories, BSC Chemicals, BSC International and Redpath Dorman Long (RDL) by the end of 1982/83. With the exception of BSC Refractories and a few very minor holdings this has been achieved.

55 The poor market prospects for many of the main iron and steelmaking businesses has meant slow progress towards privatisation. The existence of very few potential partners even for joint ventures has added to the difficulties, and those that do exist have been cautious in their approach, often because of their own weakened state - itself often brought on by their involvement in the steel industry. In some instances, privatisation is also inhibited by the sheer scale of the BSC operation by comparison with any existing private sector involvement. It is encouraging that in 1982/83 two pieces of privatisation were achieved with a degree of institutional finance - Sheffield Forgemasters (open die forgings) and Victaulic (couplings for tubes).

56 The most significant achievements in 1982/83 were as follows:

(a) the disposal of the lossmaking RDL - a constructional steelwork business employing 3550 - to Trafalgar House;

(b) the transfer of the lossmaking River Don Works - an open die forging business employing 1800 - into Sheffield Forgemasters, a joint venture with Johnson & Firth Brown;

(c) a management buyout of Victaulic - a business employing 880 making couplings and fastenings for steel and plastic tubes;

(d) sales of land and property worth some £20 million;

(e) the return to the private sector of two of the three businesses taken over from Duport in 1981, in the form of a joint venture - British Bright Bar - with GKN and Brymill. (The third company, London Works, was closed.)

(f) the incorporation into Companies Act companies of three business activities - Tubes Stockholding (250 employees), Coated Electrodes (60 employees) - where a management buyout has just been announced - and Whiteheads (197 employees). This latter works has been the cause of considerable friction with the private sector and, under pressure, BSC has agreed to incorporation and an independent review of its activities after 1 year.

57 The prospects for 1983/84 are as follows:

(a) The main objectives for the new Chairman of BSC are to privatise BSC's assets as quickly as possible with priority in the areas of overlap with the private sector; and to ensure transparency between the operations of BSC and the private sector in the meantime.

(b) BSC hope to make progress with the disposal of BSC Refractories. A sectoral scheme involving rationalisation is being promoted by Lazards, at BSC's behest. However, a takeover bid by one of the 2 major suppliers for the other looks likely to be referred to the Monopolies and Mergers Commission which would hold up action in the immediate future.

(c) Although no formal proposal has yet been received by the Department, we understand that BSC and TI are at an advanced stage of negotiations to rationalise their small seamless tubes businesses. The present proposals involve the establishment of a single company owned 72/25 by BSC/TI. Outside this company, BSC will retain large seamless activities and TI their seamless bearings tubes activities. The rationale for BSC is to avoid the larger amount of capital expenditure which their seamless activity requires by linking up with TI's more modern facilities. It was the element of capital expenditure (some £120 million) which made unviable the earlier proposals for the merger of all BSC's Tubes activities with TI together with the introduction of private capital. With TI in poor financial shape, this limited proposal is, we understand, as far as they are prepared to go.

(d) Rationalisation of the engineering steels sector - the Pheonix II project - has been discussed on and off since late 1980. There are a number of substantial issues to be resolved but the discussions are now making considerable progress and Mr MacGregor hopes for agreement by the end of June. The new venture, which would also involve Lonrho, GKN and possibly F H Lloyd, would absorb a substantial part of BSC's engineering steels interests and may have a majority private sector shareholding. It would significantly reduce current over-capacity in the sector and provide an opportunity to pool technical know-how.

58 In each case, the financial implications of any major piece of privatisation remain largely uncertain until some measure of agreement between the parties has been reached. Typically, additional redundancy costs will be incurred by BSC before the new venture is formed. A contribution by BSC may be necessary either to balance up the assets (as in the case of Allied Steel and Wire) or as a means of providing the new venture with either working capital or funds for capital investment. A case by case examination of each major proposal on its merits will continue to be necessary throughout the Plan period.

E. EUROPEAN COMMUNITY CONSIDERATIONS

59 The 1983/86 Corporate Plan spans the end of the period - December 1985 - by which the Community state aids Decision (2320/81/ ECSC) requires that all subsidies to the steel industry in Europe should end, with any aid granted in the meantime dependent for Commission approval on restructuring involving capacity reduction and on the demonstrable prospect of viability being achieved. In accordance with the timetable under the Decision, Member States had to notify the Commission by 30 September 1982 of the total aid which they intended to provide by end-1985 and of the restructuring and capacity reduction which would be implemented in return for the Commission's approval of the aid. In March this year the Commission asked for final details by 1 April of all Member States' restructuring plans to end-1985 so as to leave them sufficient time in which to reach decisions on each of the plans by 30 June, as required under the state aids Decision.

60 As regards BSC, the Government submitted a "final application" in September last year to cover the Corporation's estimated financing needs to end-1985. These totalled £1,790 million - £1,160 for operations; £251 million for Regional Development Grants; and £379 million for repayment of foreign loans. It was made clear that this represented a best-estimate as at September 1982 and that definitive figures would have to await completion of the 1983/86 Corporate Plan a few months later. The application registered plant closures involving a <u>net</u> reduction of 891,000 tonnes a year in rolling mill capacity. The <u>gross</u> reduction of 1,266,000 tonnes a year was partly offset by notification that the Port Talbot hot strip mill development, which formed part of the detailed forecast of BSC's capital investment programme over the period, would result in an increase of 375,000 tonnes a year in hot strip capacity.

61 On 29 November 1982 the Commission authorised £400 million of the proposed aid, which was judged sufficient to meet BSC's financing needs to end-December. The main features of the authorisation were as follows:

(a) The Commission recognised a net capacity reduction of only 404,000 tonnes. The gross total of 1,266,000 tonnes was reduced by 375,000 tonnes for the increase resulting from the Port Talbot hot strip mill development; by 322,000 tonnes for closure of Shotton cold mill (which they said had already been taken into account to justify an earlier - very small - tranche of interim aid); and by 165,000 tonnes for rolled tube rounds produced at Round Oak Steelworks (on the grounds that tube products were not covered by the ECSC Treaty and so capacity reductions involving them should not be taken into account under the state aids Decision).

(b) The remaining £1,390 million could not be authorised as matters stood because:

(i) with the deterioration in the steel market, BSC would not break even in 1982/83, as planned, and its path towards viability was no longer clearly charted; and

(ii) there were no capacity reductions to justify the remaining aid.

(c) With no growth foreseen in the strip market, the increase in capacity resulting from the Port Talbot development was "not compatible with" the state aids Decision. Although the Commission had netted off the proposed capacity increase, they specified that none of the £400 million of authorised aid should be used for the project.

(d) The Commission invited the Government to submit further information and to enter negotiations over the basis on which further tranches of aid would be released.

62 In mid-December officials discussed the position informally with the Commission, outlining the further closures and job losses which were being implemented under BSC's November programme of remedial action to stem losses. The Commission considered that these would probably be enough to secure approval for a further tranche of aid sufficient to cover BSC's needs until end-June 1983. By this time a final decision had to be taken on the total aid package to end-1985. In this connection, the Commission's main concern centred on BSC's hot rolled coil capacity and, in particular, on the increase resulting from the Port Talbot project. They suggested that approval of the project would require closure of either the Ravenscraig hot strip mill or the Lackenby (Teesside) coil plate mill. As an alternative, officials canvassed the idea (already discussed inconclusively between the Secretary of State and Vice-President Davignon) that BSC and the Government would enter into a binding "contract" with the Commission to limit BSC's output of hot-rolled coil to (say) 1 million tonnes a year below the combined capacity of the Corporation's four hot strip mills. The Commission thought that this might be acceptable if the contract were to refer to the production limitation as an interim arrangement until one hot strip mill were permanently closed, and they accepted that such a closure would not take place until the Port Talbot modernisation had been completed (in 1986). Officials thought it most unlikely that the Government would be able to accept such a condition. The Commission replied that a contract which promised no eventual capacity reduction could certainly not be agreed at present because of the risk that other Member States would seek to go down the same road, so undermining the effort to achieve a real capacity cut-back in the Community.

63 Against this background, on 15 March 1983 the Government requested Commission approval for interim aid of £550 million to meet BSC's needs to end-June 1983. As counterpart capacity reductions, it was proposed that account should be taken

of the closure of Craigneuk bar mills (48,000 tonnes); the balance of capacity taken out at Round Oak (163,000 tonnes - none related to tube round production); and certain private sector closures implemented since January 1980 (360,000 tonnes). At the same time, the Commission were warned that the final and comprehensive notification of BSC's total financing needs to end-1985, to be submitted by end-May once the 1983/86 Corporate Plan had been appraised by the Government, would probably amount to £2,500 million rather than the £1,790 million envisaged in the September application. This increase of £710 million would result from greater losses of £250 million now foreseen over the period together with a rough estimate of £460 million to fund possible further privatisation and rationalisation measures (covering, inter alia, a US slab deal, Phoenix II, Allied Steel and Wire's "Anchor" project, and possible rationalisation with TI in the tubes sector). This higher figure deliberately included padding to cover any unexpected need for finance: the Government were clear that the total represented a ceiling within which they would decide precisely how much should be paid to BSC.

64 Approval for this tranche of £550 million in interim aid - which for UK budgetary reasons had to be secured before the end of March - required the Secretary of State to meet Commissioners Davignon and Andriessen to argue the case. They were concerned at being asked to give quick assent to a large amount of aid at such a crucial stage in the assessment of all Member State's restructuring plans. And they had strong doubts about BSC's eventual viability given the December decision to retain steelmaking at the five integrated steelworks. They finally agreed to release the aid on condition that they received a copy of the 1983/86 Corporate Plan together with Government confirmation of the objective of break-even in 1984/85; and that a further 300,000 tonnes in capacity reduction (details unspecified) should be forthcoming. They also pressed to be given details as soon as possible of the basis on which the Government approved the 1983/86 Corporate Plan: while 1 April was clearly impossible, mid-May was their outer limit. After consultation with BSC, the Government accepted these conditions.

65 Negotiations with the Commission to secure approval of the balance of the aid payments to end-1985 are likely to be difficult. The key issues for resolution include approval of the Port Talbot hot strip mill project, with its associated capacity increase. Conclusion of a US slab deal, involving a reduction in BSC's total hot strip capacity, would solve this problem (and probably yield approval for our total aid package as well) at one go. But we cannot count on such a deal being concluded at all, and certainly not within the timescale required for Commission approval of the aid package by end-June. The Commission regard BSC's hot strip capacity as excessive anyway. If they are to approve the Port Talbot project, very recent exploratory discussions suggest that they will require <u>either</u> that it should be modified so as to avoid a capacity increase <u>or</u> that a compensating capacity reduction should be implemented at one of BSC's other strip mills.

66 As regards the total aid package, the negotiations with the Commission will also require at an early stage identification of any cuts in capacity which BSC might be willing to make to justify the level of aid sought. The Corporation's initial stance is that no further real capacity cuts should be made. Such a position would certainly dismiss any prospect of successful negotiation with the Commission although it may be possible to find alternative ways of meeting some of their concerns either by contracting to restrict strip production or by undertaking to make unspecified capacity closures at a further date.

67 As a preliminary timetable we intend to submit the comprehensive notification (not necessarily in a definitive form) during week commencing 16May. This will probably be before Ministers have collectedly decided on either the Port Talbot project or on the amount of aid to BSC. It is also almost certainly ahead of any conclusion to the negotiations on the US slab deal.

F. CONCLUSIONS: PROFIT/LOSS TARGET AND EFL FOR 1983/84

68 BSC have met the Government's requirement of producing a Corporate Plan which respects the target of break-even in 1984/85 on the basis of continued steelmaking at the five integrated sites. The key economic and commercial assumptions on which this depends are cautious, reflecting the very difficult background in 1982 against which the Plan has been drawn up. Major disruption in the steel market, affecting sales volume or selling prices, would throw even these cautious forecasts out. But there are no signs at the moment of such disruption.

69 On the present outlook, it is possible that BSC may improve somewhat on planned results over the period - though this assessment of course becomes progressively more speculative as the time horizon extends. In the shorter term, recent improvements in UK macro-economic indicators, coupled with the effect of exchange rate movements on BSC's competitiveness against imports, suggests that there is upside potential in BSC's forecast sales volume. And the Corporation are particularly cautious over the potential improvement in selling prices resulting from the European pricing policy and the depreciation in the value of sterling. As regards cost-saving measures under direct management control, BSC have a record of setting realistic targets and achieving them: the Plan envisages further progress in this direction.

70 The table below sets out BSC's estimate of the sensitivity of the main assumptions underlying the Plan:

		Total Effect on Profit/Loss for 1983/84
		£m
Sales Price		
- Variance	+/- 1%	
Home		23
Export		7
Sales Volume (Steel Products - Average Mix)		
- Variance	+/- 1%	10

	Total Effect on Profit/Loss for 1983/84
	£m
Exchange Rates (Worked-through effect)	
- Variance £/DM rate +/- 0.10 DM	60
Manufacturing Costs	
- Materials, fuels, services and employment costs +/- 1%	26
Manufacturing Efficiencies	
- Yield liquid steel to product +/- 1% point	10
- Energy +/- 1 giga joule per tonne of liquid steel	2

Note The above financial figures provide an indication of the sensivities to change on a number of key factors. Each assessment is self-standing and no account has been taken of other effects/actions that could arise to counteract the movement in any one of these variables.

71 From our assessment of the Plan, we conclude that in most of the key areas covered by the sensitivity analysis there is insufficient basis on which to fine-tune BSC's profit/loss and cash projections to reflect our view of likely developments in 1983/84 (and still less in the two succeeding years). Sales volume may improve but the extent is quite unpredictable. And, on exchange rates, recent movements in the DM/£ relationship underline the difficulty of predicting gains and losses: while the rate in March averaged 3.60, or 0.20 below BSC's alternative assumption of 3.80, the trend has since reversed quite sharply (the rate stood at 3.83 on 19 April). Moreover, against the European background set out in Section E above, the Government would be ill-advised to take an over-optimistic view of BSC's trading results and cash requirements up to 1985. If we do so, and things go wrong, we will find it very difficult to persuade the Commission later on to breach the state aids rules by accepting an increase in funding for BSC after the cut-off date of 30 June this year.

72 Nonetheless, as explained in paragraphs 44-45 above, BSC's selling price assumptions - independently of exchange rate forecasts - appear unduly pessimistic in 1983/84. An adjustment in this area of the cautious extent proposed - reducing losses and cash requirements by £75 million each - would not only reflect our general view of the upside potential in the first year of the Plan but would also help to head off what is likely to be serious criticism from the Commission that BSC are planning on the basis of a failure in the European pricing policy (the Commission are already known to have focussed on the point). We therefore propose that the contingency margin of £150 million on both profit/loss and cash in 1983/84 should be reduced by £75 million.

73 That apart, BSC's profit/loss and cash forecasts for the whole Plan period have to be reduced by £2 million in 1983/84 and by £3 million in each succeeding year to reflect the benefit from the reduction in the National Insurance Surcharge announced in the Budget. On this basis, the revised forecasts on which the Government should base their approval of the Plan for 1983/84 are as follows (with provisional figures for the next two years):

<u>Profit and (Loss)(£m)</u>

		(PROVISIONAL)	
	1983/84	1984/85	1985/86
Proposed	(281)	(46.8)	(47.6)
Revised	(204)	(43.8)	(44.6)

<u>Cash requirements (£m)</u>

	1983/84	1984/85	1985/86
Proposed	(425)	(315)	(185)
Revised	(348)	(312)	(182)

Department of Industry
9 May 1983

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U.K. DEMAND, MARKET SHARES & BSC HOME AND EXPORT DELIVERIES - FEBRUARY 1983 (PROVISIONAL)

05/04/83

TOTAL BSC

T=000 TONNES

	DELS TO UK CONSUMERS & STOCKHOLDERS							DELIVERIES BY BSC							
	TOTAL UK DEMAND	OF WHICH IMPORTS		OF WHICH PRIVATE SECTOR		OF WHICH BSC		TO PRIVATE SECTOR	TOTAL HOME	EXPORTS EEC	EXPORTS ASS EEC	EXPORTS USA	EXPORTS ROW	EXPORTS TOTAL	TOTAL HOME & EXPORT
	T	T	%	T	%	T	%	T	T	T	T	T	T	T	T
80/1	12999	3611	27.8	3424	26.3	5965	45.9	1527	7492	682	235	232	913	2063	9554
81/2	12704	2996	23.6	3371	26.5	6338	49.9	1712	8050	741	264	427	1213	2645	10695
81/2															
JUN Q	2926	660	22.5	787	26.9	1480	50.6	371	1851	206	74	95	349	724	2574
SEP Q	3017	669	22.2	783	26.0	1564	51.8	428	1992	179	54	150	319	702	2694
DEC Q	3267	787	24.1	916	28.0	1563	47.9	465	2028	164	55	105	271	594	2622
MAR Q	3491	878	25.1	885	25.4	1728	49.5	448	2176	192	81	78	275	626	2802
YEAR	12701	2995	23.6	3371	26.5	6335	49.9	1712	8047	741	264	427	1213	2645	10693
82/3															
APR/JUN - BUDGET	3173	720	22.7	816	25.7	1636	51.6	475	2111	197	77	121	333	727	2838
- ACTUAL	3166	870	27.5	786	24.8	1510	47.7	312	1822	177	72	105	300	654	2476
- % DIFF	0	+21		-4		-8		-34	-14					-10	-13
JUL/SEP - BUDGET	2829	621	22.0	755	26.7	1452	51.3	388	1840	188	88	121	336	733	2573
- ACTUAL	2700	722	26.8	684	25.3	1294	47.9	308	1602	159	61	66	230	516	2118
- % DIFF	-5	+16		-9		-11		-21	-13					-30	-18
OCT/DEC - BUDGET	3091	691	22.4	846	27.4	1554	50.3	445	1999	206	88	120	369	782	2781
- ACTUAL	2692	734	27.3	700	26.0	1258	46.7	259	1518	172	64	70	311	617	2135
- % DIFF	-13	+ 6		-17		-19		-42	-24					-21	-23
JAN - BUDGET	1001	231	23.0	285	28.5	486	48.5	146	632	63	24	29	116	232	864
- ACTUAL	857	222	25.9	231	26.9	404	47.1	104	508	42	24	13	53	132	640
% DIFF	-14	-4		-19		-17		-29	-20					-43	-26
FEB - BUDGET	1051	244	23.2	287	27.3	520	49.4	153	673	67	26	32	119	243	916
- ACTUAL	930	204	21.9	251	26.9	476	51.2	133	609	73	27	13	104	217	826
- % DIFF	-11	-17		-13		-8		-13	-9					-11	-10
CUMULATIVE TO DATE															
APR/FEB - BUDGET	11145	2500	22.9	2990	26.0	5647	50.7	1606	7253	720	303	422	1272	2718	9971
- ACTUAL	10346	2752	26.6	2652	25.6	4942	47.8	1116	6058	624	247	268	997	2137	8195
- % DIFF	-7	+10		-11		-12		-31	-16					-21	-18

ANNEX I

ANNEX II: COMMERCIAL AND FINANCIAL OUTTURN IN 1982/83 - LOSSES, OUTPUT, EXCHANGE RATE, PRICES

1982/83

		April	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March	YEAR
1 Weekly rate of profit/loss £M (after interest)														
	Plan	(1.5)	(0)	(0)	(1.1)	(2.1)	(0)	0.1	0.6	(1.1)	0.9	0.9	1.3	(80)
	Actual	(3.4)	(1.7)	(3.0)	(8.0)	(7.2)	(7.5)	(9.2)	(8.8)	(9.0)	(7.9)	(6.1)	(6.7) P	(378) P
2 Weekly output, ,000 tonnes liquid steel														
	Plan	295	294	287	257	241	286	292	290	238	282	289.	289	14.5 MT
	Actual	272	276	250	190	188	197	193	200	152	228	278	281	11.1 P MT
	% Shortfall	8	6	13	26	22	31	34	31	36	19	4	3	23 P

(P - Provisional)

		April	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March	YEAR
3. £/DM average exchange rate														
	Actual	4.24	4.18	4.26	4.28	4.28	4.29	4.29	4.17	3.92	3.76	3.72	3.59	4.09

4. Realised steel prices, £ per tonne		← Q1 →	← Q2 →	← Q3 →	← Q4 →	YEAR
A. Home Sales						
	Plan	279	278	280	286	281
	Actual	282	285	284	274	281
B. Export Sales						
	Plan	313	317	320	325	319
	Actual	309	302	283	273	292

ANNEX II

KEY FEATURES

		1982/83	1983/84	1984/85	1985/86
Profit/(Loss)	£M				
- Trading Profit/(Loss)		(288)	(59)	106	100
- Interest		(90)	(72)	(53)	(47)
		(378)	(131)	53	53
- Contingencies		-	(150)	(100)	(100)
- Profit/(Loss)		(378)	(281)	(47)	(47)
Cash Requirements	£M	(575)	(425)	(315)	(185)
Capital Expenditure	£M Outturn	(146)	(224)	(227)	(214)
UK Market Size	M. Product tonnes	11.6	11.9	12.5	11.7
BSC Market Share	%	47	48	48	50
Deliveries	M. Product tonnes				
- Home (inc. to Private Sector)		6.6	7.0	7.5	7.2
- Export		2.6	2.3	2.4	2.4
- Total		9.2	9.3	9.9	9.6
Liquid Steel Equivalent of Deliveries	Mt.	11.8	11.7	12.3	12.0
Manpower (at end-year)	'000	81.8	75.5	71.0	68.0

CORPORATE PLAN 1983-84 TO 1985-86

ANNEX VI

ASSESSMENT OF ALTERNATIVE EXCHANGE ASSUMPTIONS

	Approx. BSC Revenues + Costs	1984/5 Assumption Change	1984/5 Gain (loss)	1985/6 Assumption Change	1985/6 Gain (loss)
Revenues	£m	%	£m	%	£m
Determined by -					
DM	2550	+28	715	+26	660
$	330	+16	50	+12½	40
Other	120	-	-	-	-
	3000		765		700
		* 50% discount	(385)		(350)
			380		350
Costs					
$ Related	(1050)	+16	(170)	+12½	(130)
Employment	(800)	+ 5	(40)	+ 7½	(60)
UK Other	(1150)	+ 5	(60)	+ 7½	(85)
	(3000)				
		Assessed impact of currency changes	100 (say)		75

Assumptions

Exchange Rates	1984/5 Plan	1984/5 Alternative	1984/5 Change %	1985/6 Plan	1985/6 Alternative	1985/6 Change %
£/DM	3.80	2.95	+28	3.60	2.85	+26
£/$	1.85	1.60	+16	1.80	1.60	+12½

General Inflation	Year over Year % Plan	Year over Year % Alternative	Change	Effective Cumulative Change %
1983/84	6½	8½	2	
1984/85	7	9	2½	5
1985/86	7	9	2	7½

* Discount - represents the effect of:

- inability to pass on full exchange effect to UK customers (customer resistance and competitive imports)

Or - £ stabilising at 3.30 to 3.40 DM

PROFIT/(LOSS) STATEMENT

£ MILLION	1982/83 BUDGET	1982/83 LATEST OUTLOOK	1983/84	1984/85	1985/86
GENERAL STEELS GROUP					
Business Results	(7.7)	(143.3)	(70.5)	(36.7)	(39.5)
Group Task	-	-	25.0	9.0	9.0
STRIP PRODUCTS GROUP					
Business Results	(36.4)	(158.6)	(118.2)	(68.6)	(80.1)
Group Task	-	-	42.0	14.0	14.0
BSC HOLDINGS					
Business Results	3.1	(36.9)	0.1	7.7	8.0
Group Task	-	-	3.1	2.0	1.6
TUBES DIVISION					
Business Results	27.0	15.8	(5.6)	10.2	21.3
Group Task	-	-	11.9	5.0	5.0
TOTAL OF GROUPS	(14.0)	(323.0)	(112.2)	(57.4)	(60.7)
FURTHER MANAGEMENT TASK	20.3	-	-	16.0	40.0
ASSESSED IMPACT OF CURRENCY CHANGES	-	-	-	100.0	75.0
TOTAL IRON & STEEL	6.3	(323.0)	(112.2)	58.6	54.3
Other Items (See Note)	(11.3)	(55.0)	(18.8)	(5.4)	(1.9)
SUB-TOTAL	(5.0)	(378.0)	(131.0)	53.2	52.4
CONTINGENCIES	(175.0)	-	(150.0)	(100.0)	(100.0)
CORPORATION	(180.0)	(378.0)	(281.0)	(46.8)	(47.6)

MEMORANDUM: INTEREST INCLUDED ABOVE	(84.4)	(90.3)	(71.7)	(52.7)	(47.4)

NOTE

Other Items includes:-

(i) BSSC together with BSC's holdings in Allied Steel and Wire, Sheffield Forgemasters and many small subsidiaries and associated companies - which, adversely affected by poor trading conditions, largely account for the worsening against Budget in 1982/83.

(ii) Centrally accounted costs not properly chargeable to individual groups and businesses.

CORPORATE PLAN 1983/84-1985/86

INVESTMENT PROGRAMME

			THIS PLAN					
BUSINESS/PROJECTS	81/ 82	82/ 83	83/ 84	84/ 85	85/ 86	86/ 87	AFTER 86/87	TOTAL: 82/3 ON
GENERAL STEELS GROUP								
SECTIONS & COMMERCIALS								
CENTRALLY-APPROVED:								
LACKENBY COIL MILL AUTO SET		1.00	0.40					
LACKENBY DEGASSER		3.90	0.90					
REDCAR COKE OVENS REBUILD		18.20	30.00	1.00				
SCUNTHORPE BILLET CASTER		7.50						
SCUNTHORPE BOS GAS RECOVERY		3.30	6.30					
APP.-PROD. NO.1 COKE REBUILD		0.80	5.10	0.90				
OTHER MAJOR SCHEMES		0.10						
SUB-TOTAL	14.80	34.80	42.70	1.90	0.00	0.00	0.00	79.40
TO BE APPROVED CENTRALLY:								
LACKENBY NO.1 PR MILL REHEAT			3.00	10.30				13.30
" BOS GAS RECOVERY						5.80	11.50	17.30
" BOS SUB LANCES						2.80	5.50	8.30
" BOS BURDEN IMPRMTS						10.20	20.30	30.50
REDCAR SINTER 400 M2 GRATE						2.20	4.50	6.70
" B/F'CE T.P. TURBINE						3.00	6.00	9.00
" COAL INJECTION						7.60	15.30	22.90
SCUNTHORPE CONCAST IMP.(BS)			4.00	1.40				5.40
" BLOOM CASTING				10.00	3.30			13.30
" NO. 1 ROD MILL DEVT			3.50	2.00				5.50
" UNIVERSAL STAND						12.00		12.00
" COAL INJECTION					8.70			8.70
" NEW SINTER PLANT				1.00	20.00	15.00		36.00
SUB-TOTAL		0.00	10.50	24.70	32.00	58.60	63.10	188.90
TOTAL LOCAL APPROVALS	10.60	13.30	17.80	10.90	11.10	11.00		
OVERALL TOTAL	25.40	48.10	71.00	37.50	43.10	69.60		
SPECIAL STEELS								
CENTRALLY-APPROVED:								
TEMPLEBOROUGH BILLET CASTER		0.30						
STOCKSBRIDGE CASTER		2.10	1.50					
SUB-TOTAL	9.70	2.40	1.50	0.00	0.00	0.00	0.00	3.90
TO BE APPROVED CENTRALLY:								
THRYBERGH BAR HEAT TREATMENT			2.00	1.00	0.50			3.50
GROUP RESTRUCTURING				4.00	8.00			12.00
SUB-TOTAL		0.00	2.00	5.00	8.50	0.00	0.00	15.50
TOTAL LOCAL APPROVALS	4.10	6.30	8.00	7.50	7.00	7.10		
OVERALL TOTAL	13.80	8.70	11.50	12.50	15.50	7.10		
PLATES								
TOTAL LOCAL APPROVALS	2.80	2.60	2.00	2.00	2.00	2.00		
OVERALL TOTAL	2.80	2.60	2.00	2.00	2.00	2.00		
OVERALL GROUP TOTAL	42.00	59.40	84.50	52.00	60.60	78.70		

14.1.83

BUSINESS/PROJECTS	81/82	82/83	83/84	84/85	85/86	86/87	AFTER 86/87	TOTAL OUTS ON
STRIP PRODUCTS GROUP								
CENTRALLY APPROVED:								
PORT TALBOT - VARIOUS								
L'CRAIG - VARIOUS								
" - DESULPHURISATION								
TINPLATE - VARIOUS								
SUB-TOTAL	78.80	26.70	0.60	0.00	0.00	0.00	0.00	27.30
TO BE APPROVED CENTRALLY:								
LLANWERN HSM COMPUTER DEVT.				0.30	5.60	2.90		8.80
" CONCAST PHASES 1&2						40.00	80.00	120.00
" NO. 6 COKE BATTERY								
PORT TALBOT HSM MODERNISAT'N			59.70	76.50	43.10	0.70		180.00
" MORFA COKE OVENS								
COATED NO. 6 GALV. LINE				1.40	16.10	10.10		27.60
TINPLATE COIL ANNEAL/FIN LNE				8.10	22.30	14.60	38.70	83.70
SUB-TOTAL		0.00	59.70	86.30	87.10	68.30	118.70	420.10
TOTAL LOCAL APPROVALS	35.30	26.20	26.20	29.20	30.90	30.90		
OVERALL GROUP TOTAL	114.10	52.90	86.50	115.50	118.00	99.20		
BSC HOLDINGS								
CENTRALLY-APPROVED:								
ICKLES RING MILL		2.20	1.70					
STRIP EXPANSION		0.10						
CUMBRIA RAIL MILL		1.00						
SUB-TOTAL	7.20	3.30	1.70	0.00	0.00	0.00	0.00	5.00
TO BE APPROVED CENTRALLY:								
CUMBRIA RAIL HARDENING				2.70				2.70
TOTAL LOCAL APPROVALS	6.80	6.50	6.50	6.40	8.10	8.10		
OVERALL TOTAL	14.00	9.80	8.20	9.10	8.10	8.		
TUBES DIVISION								
CENTRALLY-APPROVED:								
STANHOPE SPUN PIPE MODS.		3.30	2.30					
DALE SPUN PIPE MODS.			1.80	1.30				
SUB-TOTAL	0.00	3.30	4.10	1.30	0.00	0.0	0.00	8.70
TO BE APPROVED CENTRALLY:								
CORBY CENTRALISED FINISHING			1.00	1.50	0.50			3.00
HOLWELL MOULDING PLANT			2.30	4.20				6.50
SEAMLESS DEVT.:								
CONTINUOUS CASTING			12.00	18.00	6.00			36.00
MEDIUM RANGE MILL								
LARGE MILL IMPROVEMENTS, BROMFORD			4.00	5.00	4.00			13.00
SUB-TOTAL		0.00	19.30	28.70	10.50	0.00	0.00	58.50
TOTAL LOCAL APPROVALS	5.10	7.30	10.00	9.30	4.80	4.80		
OVERALL TOTAL	5.10	10.60	33.40	39.30	15.30	4.80		
OTHER BUSINESSES								
BSSC TOTAL (ALL LOCAL)	2.10	3.10	2.10	2.20	2.40	2.40		
BSC CHEMICALS/RDL	3.10	1.20						
BSC REFRACTORIES (ALL LOCAL)	0.40	0.80	0.40	0.40	0.50	0.50		
CENTRAL ITEMS (TREATED AS LO	9.60	8.60	9.00	8.10	9.20	9.20		
TOTAL	15.20	13.70	11.50	10.70	12.10	12.10		
CORPORATION TOTALS								
CENTRALLY-APPROVED	110.50	70.50	50.60	3.20	0.00	0.00		
TO BE APPROVED CENTRALLY	-	0.00	91.50	147.40	138.10	126.90		
LOCAL APPROVALS	79.90	75.90	82.00	76.00	76.00	76.00		
GRAND TOTAL	190.40	146.40	224.10	226.60	214.10	202.90		
[illegible] CORPORATE PLAN		[illegible]	142.10	160.40				

CONFIDENTIAL

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PORT TALBOT HOT STRIP MILL MODERNISATION

Paper by the Department of Industry

INTRODUCTION TO THE PROPOSAL

1. This paper considers BSC's proposal to invest £154 million at April 1983 prices (£180million at outturn prices) to up-grade and improve the hot strip mill at Port Talbot. The main items covered in the paper are:

(a) the structure and prospects of BSC's Strip Products Group;

(b) the need for investment to improve product range and quality;

(c) the reasons for basing this investment at Port Talbot

(d) a description of the project

(e) the cost savings associated with the project;

(f) the effect of the project on market share;

(g) the need for clearance from the European Commission;

(h) alternative options;

(i) conclusion.

2. The basic reason for the project is to enable BSC to roll heavier coils at Port Talbot, to extend the product range in terms of width and gauge, and achieve higher quality finishes. These capabilities are needed to meet increasingly stringent requirements from the consumers of hot rolled coil, and thus to enable BSC to maintain and improve its market share in strip products. If market share is not maintained the viability of recent investment (£375 million commissioned since 1978) in other facilities at Port Talbot will be called into question. The project also achieves significant running cost savings; while without it essential capital replacement of £39 million would be needed to continue the operation in its existing form.

SUMMARY OF BENEFITS

3. Costs and benefits have been projected over 25 years (the expected life of the enhanced mill). Discounted at 5% (the Government's basic public sector test rate) and 10% (giving a higher allowance for risks) the outcome is:

	5%	10%
Net present value of capital costs (allowing for capital costs avoided) and operating cost savings:	£129.8m	£ 40.9m
Present value of market benefits	£207m	£116.9m
Net present value of project	£336.8m	£157.8m
Net present value if plant life is reduced to 15 years	£214.8m	£113.5m
Net present value if plant life is reduced to 10 years	£127.4 m	£69.4 m

THE STRIP PRODUCTS GROUP

4. BSC's Strip Products group includes the three integrated steelworks at Llanwern, Port Talbot and Ravenscraig, the Gartcosh cold mill, the coated products works (mainly Shotton), three tinplating works in South Wales, and a number of small sheet finishing and fabricating works known as the Associated Products Group (APG). The Group had a turnover of £950 million in 1982/83 and a loss before centrally accounted costs of £85 million. It currently employs some 24,000 people.

5. BSC's coil plate mill at Lackenby (part of the General Steels Group) also produces a small amount of hot rolled coil.

6. Capacity of the three integrated works in the Strip Products Group, in terms of hot rolled coil, is set out below on the basis of capacity manned at present, the maximum level which BSC regard as sustainable with existing plant, and the figures notified to ECSC which were pitched as high as possible:

MTPA	Present manned	Maximum practicable working capacity	Capacity notified to ECSC
Llanwern	1.75	2.50	2.75
Port Talbot	1.60	2.20	2.22
Ravenscraig	1.25	1.25	1.30
	4.60	5.95	6.27

*(Footnote to paragraph 6)

(It will be noted that Ravenscraig supplies some 400 kt liquid steel equivalent in the form of slabs to the Scottish plate mills. If this could be re-sourced the hot rolled coil capability woudl become 1.6m tonnes and depending on the performance of the concast plant, further marginal improvement may also be possible. This situation, however, has implications to the capacities notified to the European Commission).

7. Production at the three integrated works is presently 4.1 million tonnes per annum of hot rolled coil. This is supplemented by 0.2 mtpa from Lackenby.Of the total, in broad terms:

1.00 mt is transferred to the Tinplate Works

0.22 mt is transferred to the works of APG

2.3 mt is sold in the domestic market as hot rolled cold reduced or galvanised product.

0.7 mt is exported

4.3 mt

8. The sectors of UK industry which provide the most imported markets for strip mills products according to Department of Industry data are

	Share of consumption of strip
Motor vehicles	25.6%
Holloware (including cans)	21.5%
Mechanical engineering	13.7%
Electrical engineering	5.9%
Construction	3.1%

A more detailed breakdown of uses for the different strip products, and BSC's market share, is at Annex 1.

PROSPECTS FOR STRIP PRODUCTS

9. Future production levels of BSC's strip products group depend on the levels of activity of the main consuming industries, the trend of steel usage in those industries, and the share of the market which BSC obtain. CSO figures show an overall decline in production levels in the consuming industries over the last ten years, but disaggregated Department of Industry forecasts for the period 1982-1985 based on the Chancellor's 1982 Autumn statement project a degree of recovery. Projections based on the 1983 Budget Statement would show a generally more optimistic outlook for manufacturing industry. The individual figures are

Sector	Change in Production 1973-1982	Projected change in net output 1982.5
Motor Vehicles	- 41%	+ 3%
Mechanical engineering	- 21%	+ 3%
Electrical engineering	+ 13%	No change
Misc. metal industries	- 37%	+ 1%
Construction	- 27%	+ 12%
All manufacturing	- 19%	+ 3%

10. Annex 2 gives BSC's own figures for UK demand for strip mills products (excluding tinplate and electrical) since 1968. It shows a peak of 5.5 million tonnes in 1973/74 falling to 3.6 million tonnes in 1982/83. Within the declining overall figure BSC's market share since 1975/76 (apart from the period affected by the steel strike) has been steady at close to 60%.

11. BSC is cautious about market prospects in the medium term, taking the view that a rising trend of import penetration, a slowing down in the growth of world trade, and a continued decline in UK industry's share of it through lack of competitiveness mean that UK manufacturing output could remain static or fall slowly. Within this, however, they expect steel intensity to remain broadly unchanged with moves towards lighter gauge and plastic in uncoated sheet applications (eg automobiles, drums) being offset by the increased use of coated sheet in buildings.

12. BSC therefore forecast the UK market for strip mills products in the medium term to be within the range from 3.5 to 3.9 million product tonnes per annum (excluding tinplate and electricals) averaging 3.7 mtpa. They expect, with the aid of a refurbished hot strip mill, to be able to retain a UK market share of around 63%, although an overall figure of above 65% is not regarded as sustainable given the open nature of the UK market (but for some individual products as Annex 1 shows figures of over 80% are achievable). As regards exports, BSC expect future levels to remain in the range of 550 - 650 thousand product tonnes per annum. In terms of hot rolled coil this level of output can be met by producing 4.1 mtpa at the integrated works, and 0.2 mtpa at Lackenby.

13. In the longer term, on a relatively optimistic view, it is difficult to foresee more than a modest growth in demand for strip mill products from UK industry. On the other hand, a continuing decline is also a possibility which cannot be ruled out. The extent of such a decline is clearly impossible to predict, but extrapolating the experience between 1973 and 1983 forward to 1981 implies a reduction in strip demand from present levels of 22%, and extrapolated over the period to 2,000 the reduction in demand would be 49%.

14. Two comments can be made about these longer term pessimistic projections. One is that they imply a scale of de-industrialisation which would amount to a major failure of Government industrial policy. Secondly, while a reduction of the order of 20% would remove any commercial case for the retention of three integrated sites, and a reduction of 50% woudl make a second site superfluous, a 50% reduction would still enable Port Talbot, if that were the sole surviving plant producing hot rolled coil to be loaded in the way assumed in this appraisal.

FINANCIAL PERFORMANCE

15. As noted in paragraph 4 above, the Strip Products Group had a loss of £85 million in 1982/83 excluding centrally accounted costs. This was £35 million better than in the previous year. BSC's projections over 3 years, consistent with their Corporate Plan, are that the losses of the strip products group will continue in the range £5 million - £20 million, before central items and contingencies, if a three site configuration is retained. Since the performance of an individual site is sensitive to loading, a 15% increase in volume would reduce losses or increase profits in the group by about £50 million per annum. With a two plant configuration the group (again excluding central items and contingencies) would move into a profit at plan volumes of between £30 and £70 million a year.

16. It should be noted, however, that the strip business is highly competitive and the UK market is wide open to European mills (shown in Annex 3) with modern, efficient facilities. The European Commission anticipates a production potential for coils in Europe of 76.5 million tonnes per annum in 1985, compared to a figure of 64.4 mtpa needed to meet expected demand levels. The steel aids regime is of course designed to reduce surplus capacity and eliminate subsidies, but clearly the prospect exists of continuing fierce price competition.

17. However, with the proposed project, Port Talbot would be able to match the best European performance in mill product costs. The strength of the competition makes it particularly important that BSC should be able to compete in terms of product range and quality, not only in the hot rolled and cold reduced markets, but also in major sectors such as tinplate which use substantial quantities of hot rolled coil as feedstock. This point is spelled out in the next section. The implication is that failure to up-grade BSC's facilities woudl make the scenario of increased losses and eventual withdrawal from the strip mill business self-fulfilling.

THE NEED FOR INVESTMENT

18. While the overall level of demand is fairly static at present, quality demands in strip mills products are growing with increasing intensity. Market demand which is being increasingly satisfied from the more modern facilities of BSC's major competitors, is moving progressively towards:

wider coils with thinner gauges

higher product quality in terms of coil shape, profile and gauge consistency

improved coil presentation

heavy coil weights

thicker gauges for heavy wall welded tubes

19. The limitations of BSC's current hot mills, compared with their competitors, can be seen from Annex 3 which sets out the key features of wide hot strip mills in BSC and its major European competitors. The annex shows that in three key areas - coil weight, mill width and number of finishing stands - BSC will find it increasingly difficult to satisfy its markets fully from its existing facilities, which are limited as follows: (Details in Annex 4).

Llanwern and Ravenscraig

These are BSC's newest hot strip mills, commissioned in 1962. Mills of that generation have a restricted gauge capability and, in BSC's case, are also restricted to orders of around 1500mm in width.

Lackenby

This mill can roll to 1830mm width, but again has a restricted gauge range, and is in fact a coil/plate mill serving thicker and specialised hot rolled applications rather than the formable and surface critical strip market. Thus, it has no associated cold mill which limits is application in strip products.

Port Talbot

The present mill can roll to 1880mm width, but is limited on gauge range and has a low coil weight. A doubling of coil weight would remove pickle line welds from the processing of ordered coil sizes in its cold reduction mills, and in the Tinplate and Coated Products Works of Strip Products Group.

20. Investment is necessary for BSC to retain its existing markets and to compete in areas where it does not presently have the capability. Upgrading one site will benefit the Group as a whole, because if BSC cannot offer from one of its sites the full range of market needs the future of all the integrated sites in the Strip Mills Products business will progressively be at risk.* It should, however, be noted that on the basis of its view of the market, BSC believes that its commercial interests would best be served by concentrating strip production on two sites in the medium term and possibly on one site eventually.

*Conversely, the ability to meet the highest standards across the wider product range at one site would tend to improve the competitiveness of the Group as a whole, resulting in a higher level of business for all the sites.

21. The project now proposed would, in the Corporation's view, fit Port Talbot to be the core plant in their strip business into the 1990's and perhaps beyond. Without such an investment they argue that as the market for strip products becomes increasingly demanding, they will, with their present kit become increasingly uncompetitive, lose market share, and eventually be forced to withdraw from the strip market.

CHOICE OF BSC SITE FOR DEVELOPMENT

22. There are four major reasons why Port Talbot is the site at which BSC proposes that the modernisation should take place:

(a) Port Talbot is the most modernised overall of the three integrated sites in Strip Products Group, some £375m of new equipment having been commissioned since 1978 (see Annex 5 for details). In particular, the upgraded mill will enable best advantage to be taken of the recently commissioned concast plant. The concast route is eminently suited for the highest qualities of surface critical, full finish, material. The present mill is unable to handle such material over 1250mm wide due to limitations in mill power and configuration.

(b) Port Talbot is BSC's only site where there could be a fully modernised wide hot mill working in conjunction with an already fully modernised wide cold mill.

(c) In terms of transport and handling factors, the geography of Port Talbot is important in relation to:

(i) raw materials supply

(ii) supplying the Corporation's Tinplate Works in South Wales

(iii) the general distribution of the market

(d) Port Talbot is the lowest cost steel producer in Strip Products Group with the greatest potential, when the mill scheme has been completed, to match best European performance in mill product costs and quality.

The matters at points (c) and (d) above are explained more fully in Annexes 6 and 7.

THE PROJECT

23. Originally, BSC had intended to install a completely new hot strip mill at Port Talbot at a cost now estimated at some £480m which would have involved a substantial increase in capacity. On both cost and capacity grounds BSC have ruled out this option. Instead they wish to convert and improve the existing mill at a cost, including contingencies, of £154m at April 1983 prices, equivalent to £180m at out-turn prices. Expenditure would be spread over four financial years. The main items of equipment, their functions and cost, are listed at Annex 8. The project would take 3½ years to complete and would involve a number of mill shut-downs of between seven and ten days, with two longer shut-down periods (which would take the form of three week extensions to Christmas breaks). The disruption costs have been taken into acount in the assessment of costs and benefits.

24. The local management have actively progressed the detail of the scheme over recent months. Following discussions firm tenders have been received for all major items of plant and equipments. Tenders have been analysed and compared and preferred suppliers provisionally selected. Approximately £80m of business would be placed for manufacture in the UK within one month of final approval being given to the scheme.

25. The effects of the project would be:

: To double coil weights to 18kg per/mm throughout the full range of widths (the present coil size is 9kg per mm of width up to 1370mm, reducing to 5.6kg per mm at 1880mm; this imposes constraints on quality, yield and efficiency at the mill and at subsequent finishing works through such factors as the need to weld coils together, increased material handling and scrap levels).

: To extend the product range down from 1.5mm minimum gauge to 1.2mm and up from 6.25 mm maximum to 17.5 mm.

: To achieve higher quality finishes.

: To achieve cost savings.

26. Although the project is not primarily intended to increase capacit it will have the incidential effect of increasing the capacity of the mill from 2.225m tonnes per annum to 2.6m tonnes per annum. The single item of investment which gives this potential increase is the second reheating furnace, whose basic function is to handle double weight slabs.

IMPROVEMENTS IN COST AND PERFORMANCE

27. Over the last five years substantial cost reductions have been achieved at Port Talbot and a measure of the productivity improvements is given by the following man hours per tonne of liquid steel:

Year to March 1978:	12.94
Year to March 1979:	10.21
March 1982:	5.02
Best achieved July 1982:	4.54

These figures reflect a reduction in manpower from 12,484 in March 1979 to 5,319 in December 1982, whilst the present plans propose manpower at under 5,000 in 1984.

28. The converted mill will perform more efficiently than the existing mill in a number of identified respects which produce annual savings of £18.5m at April 1983 price levels. The individual elements are set out fully in Annex 9. Together they would reduce the cost of hot rolled coil from £133 to £127 per tonne at the scheme level of operation, which is consistent with the current and foreseen loading pattern between the three Works. The cost savings are not very sensitive to changed volume.

BENEFITS IN TERMS OF MARKET SHARE FROM THE PROJECT

29. The project will improve the hot rolled coil in terms of surface, dimension and metallurgical properties, will enable Port Talbot to supply large weld-free coils to tighter tolerance, to provide a full width range in continuously cast products, and to extend the product range. These improvements will affect not only the competitiveness of hot rolled coil sold from Port Talbot, but also that of the finishing works which use hot rolled coil from Port Talbot as a feedstock and sell in the automotive, tinplate and colour coated markets. Some 90% of the hot rolled coil produced at Port Talbot is processed further, either within Port Talbot's cold mill or at Strip Products Group finishing works, including Shotton.

30. Assessing the effects on sales of continuing deficiencies in respect of product range and quality inevitably contains a subjective element. Over a five year timescale, however, BSC have identified particular losses in the fields of hot rolled and cold reduced coil and tinplate, which would lead to a loss of between 10 to 15% of the expected Port Talbot output. For the purposes of this paper, we have therefore taken the conservative assumption that the market losses described in Annex 10 would build up progressively to 170,000 tonnes per annum by 1987/88 and continue at that level thereafter. The present value of these losses at current contribution levels is, at a 5% discount rate, £207.0m and at at 10% rate, £116.9m.

EUROPEAN CONSIDERATIONS

31. The Commission is expecting a comprehensive notification from the UK Government under the State Aids regime by the end of May. When this is received, it will take a final decision by the end of June on aids which may be payable to the end of 1985. In this context aid means all Government payments to BSC.

32. The Commission's declared attitude is that it will only agree to aid being paid in return for capacity reductions. In this context the Port Talbot investment raises two potential problems in that it increases BSC's financing needs and creates a potential capacity increase of 375,000 tonnes per annum. At present there are few signs of flexibility in the Commission's attitude, but the position has still to be negotiated. What is clear, however, is that if the project does not form part of a comprehensive notification, there is no mechanism for a start to be made on it while the aids regime lasts. Even if the capital funds were raised from non-Government sources - which in itself woudl be a radical departure from present practice - the interest payments would increase the required operating subsidy and thus cause the project to fall foul of the state aids rules. Any substantial delay would in any case result in a serious loss of customers.

PRIVATISATION AND THE FUTURE OF THE STRIP BUSINESS

33. Bringing one integrated site in the Strip Products Group up to fully competitive standards enhances the prospect of eventual privatisation if market conditions improve

34. At present, of course, and as envisaged in the current Corporate Plan, BSC's Strip Products Group is loss-making. If based on three integrated strip mills works, without an increase in demand over current expectations, it will be very difficult to eliminate those losses, and even if one site were closed it would not be easy. The strip business is highly competitive, however, and the UK market is wide open to European mills selling strip mills products from modern, efficient facilities. Unless BSC can compete in developing the standards of quality required by its customers, as well as on prices, the business will decline further. This applies not only to the integrated works themselves, but to major sectors such as tinplate which use substantial quantities of hot rolled coil as feedstock.

35. Therefore, unless Ministers are prepared to contemplate increasing losses and eventually withdrawal from the strip mills business, investment needs to take place to bring the business to competitive levels. Any configuration of the strip mills business is likely to include Port Talbot because of the advantages of its location and port facilities, the recent substantial investments in other parts of the works and the significantly improved performances.

36. Whether either Ravenscraig or Llanwern, or possibly both, have a medium and long term future are separate questions, which can only be answered in the light of developing circumstances and the performance which can be achieved at those sites, but there are no circumstances which can readily be envisaged in which the business would exclude Port Talbot.

ALTERNATIVE OPTIONS

37. We have considered whether it would be realistic to

(a) postpone the decision on the project

(b) consider a smaller project which satisfies the same needs but does not involve an increase in capacity.

38. We have taken the view, however, that all the expenditure needs to be committed within a few months of approval so that long lead time items will be available for installation as required. The envisaged timing of the project also assumes that work can be commenced in the 1983 summer holiday period so as to minimise disruption. Any delay to the completion of the project would pose a serious risk to the achievement of a full competitiveness since BSC believe that their position in the market is already beginning to be affected . Moreover, there is the need to secure approval from the Commission before final decisions are taken on aids and capacity up to the end of 1985.

39. At one stage plans were prepared within BSC for a project similar to the one now proposed, but without a second reheating furnace. This was rejected by the Corporation as unworkable, but BSC have been asked to think again in view of the difficulty in securing Commission approval for an increase in strip mills capacity.

RECOMMENDATION OF DOI OFFICIALS

40. The project has been examined in depth, in consultation with CPRS and Treasury officials. It passes the relevant financial tests. Only if there is a real likelihood of the UK withdrawing completely from the strip mills products business are its very strong commercial and financial attractions called into question. While BSC's strip business may contract in the medium term, complete withdrawal does not seem likely.

41. The project has a very important strategic function for BSC and failute to implement it could jeopardise the whole strip business. DoI officials therefore believe the Government should approve the project and regard it as a priority objective in negotiations with the Commission.

DoI

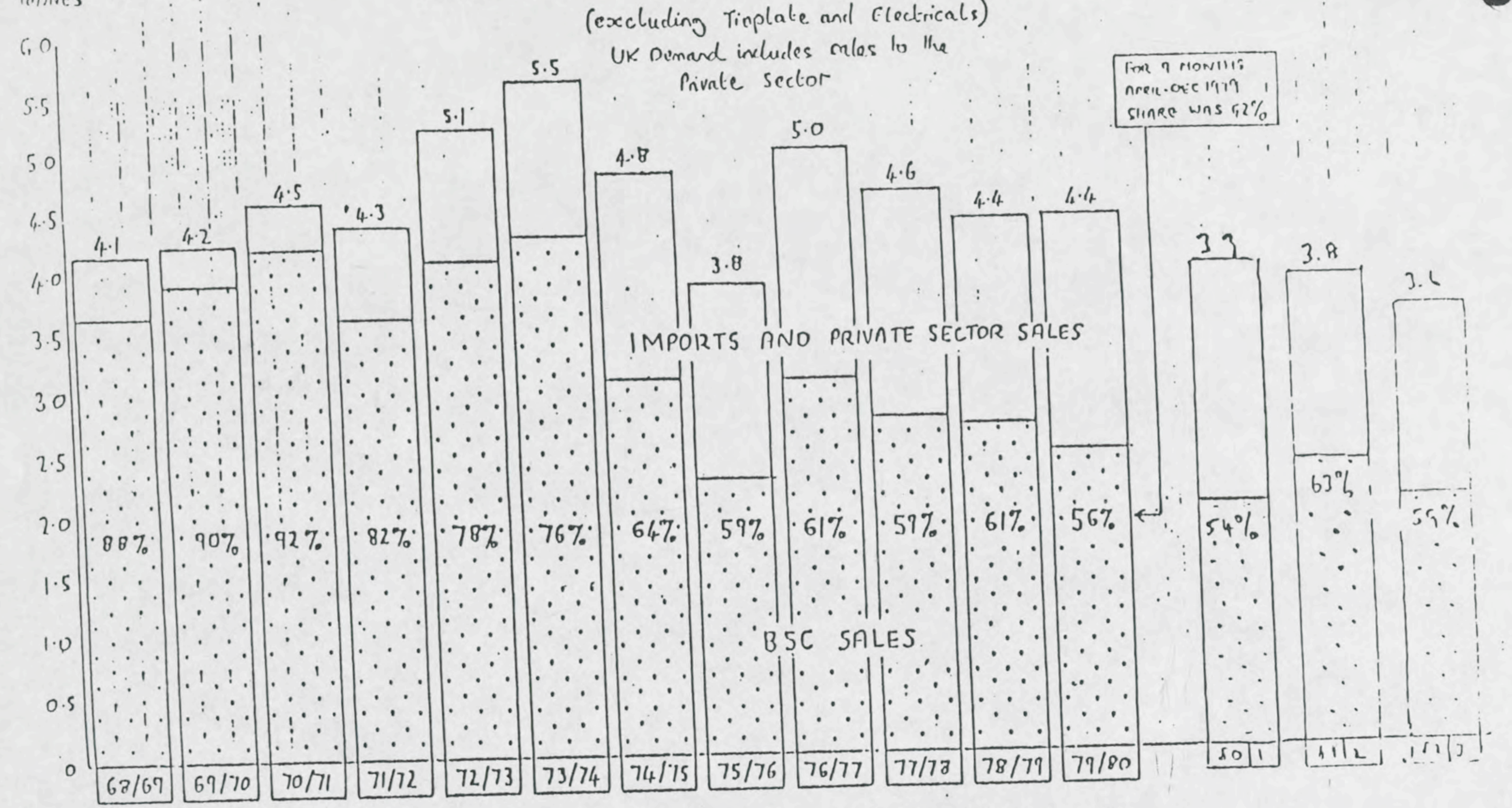
8 May 1983

CONFIDENTIAL

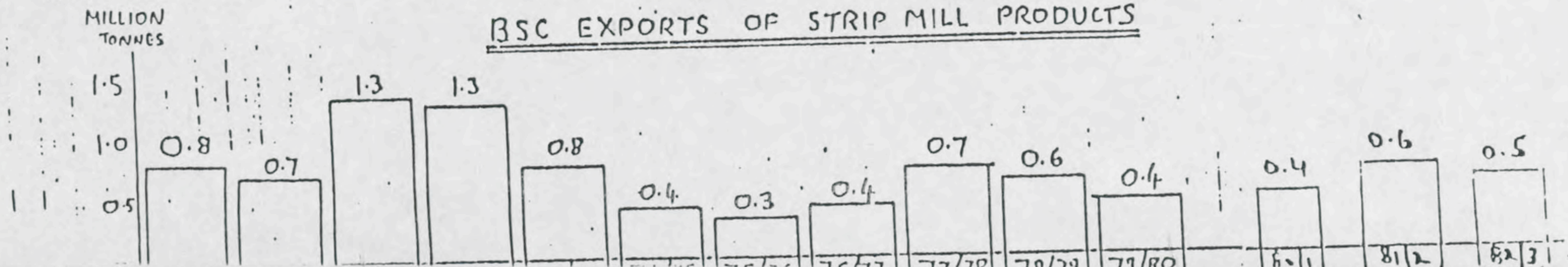
COMMERCIAL IN CONFIDENCE

Main application of	% of Strip Production	BSC Market Share
Hot Rolled	17%	55%
Re-rolling into narrow strip Tube and pipe manufacture Automotive (commercial vehicles); Mechanical engineering; Construction		
Electrozinc	5%	82%
Domestic appliances Electricity trunking Heating and ventilation		
Galvinised	12%	70%
Ceiling tile supports Purlines Lintels Garage doors Decking Ducting Section rolling		
Coated Products	6%	82%
Cladding for buildings		
Cold Rolled		
Automotive Drums Radiators Domestic appliances Private sector tubes Coil coaters Stockists	33%	65%
Tinplate	23%	around 80%
Other	6%	-

UNITED KINGDOM DEMAND AND BSC MARKET SHARE FOR STRIP MILLS PRODUCTS



BSC EXPORTS OF STRIP MILL PRODUCTS



Annex

ANNEX 3

BRITISH STEEL CORPORATION: STRIP PRODUCTS GROUP

PROPOSED PORT TALBOT HOT STRIP MILL MODERNISATION

EUROPEAN WIDE HOT STRIP MILLS

All BSC's major competitors are expected shortly to have the capability to meet the product specification and process efficiencies which the Port Talbot modernisation scheme is designed to attain. The attached table sets out the key features of the wide hot strip mills in BSC and its major competitors. It will be seen that nearly every competitor has a hot strip mill with seven finishing stands and a width of 80" or above, high coil weight and motor power, and high capacity reheat furnaces.

There are few exceptions outside the UK. In West Germany, the Krupp and Hoesch mills are each limited to 72" width but the companies are quite likely to merge with companies that operate a wider mill. In France the Sollac hot strip mill, similar in design to the Port Talbot mill, is being developed in a way similar to that proposed at Port Talbot.

FEATURES OF WIDE HOT STRIP MILLS IN BSC AND ITS MAJOR EUROPEAN COMPETITORS

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Company & Mill	Date built/ Modified	Mill Width (barrel) (mm)	Current/ planned Capa-bility (k.tonnes)	Type of Reheating Furnace+	Specific Coil Weight (kg/mm)	Maximum Coil Weight (tonnes)	No. of Finishing Stands	Strip Exit Speed (m/sec)		Finishing Stand Motor Power (000 HP)	Notes
West Germany											
Thyssen - Bruckhausen	1955/71	1500	3360	3P	18	23	7	18		56	
- Beeckerwerth	1964/72	2250	4920	5P	19	32	7	15		61	
Krupp - Bochum	1966	1800	3180	2WB,1P	19	23	7	15.5		64	
Hoesch - Dortmund	1958/73	1730	3535	3P	21	30	7	18		69	
Klockner - Bremen (No.2 mill)	1973	2300	4108	2WB	24	45	7	23		110	
Salzgitter	1964/73	2080	3120	4P	20	31	7	18		80	
France											
Usinor - Dunkirk	1964/73	2030	4800	4P	18	30	7	16.5		54	*
Sollac - Seremange - current	1953/72	2030	2800	5P	9		6	13		37	
- development	/85			IWB	16		7				
Solmer - Fos	1974	2290	4030	3WB	21	40	7	27		90	*
Holland											
Hoogovens No.1	1953	1420	1700?	3P	7	8.5	6	12		18	
No.2	1969	2235	4000?	3P	21	35	7	19		71	
Belgium											
Cockerill - Chertal	1963	2250	2600	2WB	16	30	6	16		48	
Carlam - Charleroi	1976	2235	1900?	1WB	20	40	6	17			7th stand proposed
Sidmar - Ghent	1966	2040	2610	3P	18	27	6	17		50	"
Italy											
Italsider-Taranto No.1	1964	1730	3500	3P	18	27	6	17		48	
No.2	1973	2230	4500	3WB	27	45	7	23		98	
- Cornigliano	1953	2060	1950	3P	9	14	6	11		33	
- Bagnoli	1983	1420	1000								
British Steel Corporation											
Ravenscraig	1962	1730	1686	3P	17	25	6	12.5		33	
Llanwern	1962/72	1730	2750	5P	18	27	6	17		40	
Lackenby	1968/76	2030	1220	2P	14	21	6	14		36	Coil plate mill
Port Talbot - existing	1951/66	2030	2225	5P	9	11	6	10		28	
- proposed	/85		2600	2WB	18	32	7	13		46	

+ WB = Walking beam furnace
P = Pusher furnace

* data for existing mill but developments are underway.

Rev. 27.4.83

Annex 3

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BRITISH STEEL CORPORATION: STRIP PRODUCTS GROUP

PROPOSED PORT TALBOT HOT STRIP MILL

Limitations in BSC's Hot Strip Mills' Capability

The Corporation's newest hot strip mills were commissioned in 1962 at Llanwern and Ravenscraig. Mills of that generation have a restricted gauge capability and, in BSC's case, its newest mills also have a width capability restricted to orders of around 1500mm.

With the market demand towards wider coils with thinner gauges, and higher product quality in terms of coil shape, profile and gauge consistency; and heavier coil weights, BSC will find it increasingly difficult to satisfy its markets without a hot strip mill development programme. Whilst from the table below it can be seen that some of these market requirements can be met from one mill or another, a number of them - particularly those concerned with thinner gauges at the wider widths - cannot be obtained even from the widest mill (Port Talbot) because of other limitations.

The table below sets out in broad terms the normal commercial gauge and width limitations by mill of BSC's present hot rolled and cold reduced capability:

	Coil Weight Max.* Tonnes	Mill Gauge Min. mm	Mill Gauge Max. mm	Mill Width (Product) Min. mm	Mill Width (Product) Max. mm	Year Buil[t] Modifie[d]
HR Coil						
Port Talbot:	11	1.575	6.50	686	1880	1951/6
Llanwern	27	1.575	12.70	749	1572	1962/7
Ravenscraig	25	1.575	13.00	620	1550	1962/7
Lackenby	21	2.000	12.70µ	600	1830	1968
CR Coil						
Port Talbot:						
4-stand	** 35)	0.35	2.025	686	1829	1951/8
5-stand	25)					1959/6
Llanwern	27	0.50	3.000	710	1524	1962/7
Gartcosh	25	0.46	2.650	710	1520	1961
Shotton	32	0.35	3.175	610	1370	1973
Lackenby			NO COLD MILL			

* Not necessarily fully utilised.

** Only on basis of welded coils.

µ Normal commercial qualities. Up to a maximum of 1600mm for certain off-the-mill qualities.

The above table indicates the normal limit extremes, but within these there are more specific upper and lower gauge ranges within various width bands. Hence, whilst the HS mills at Llanwern and Ravenscraig can roll as light as Port Talbot currently, they are limited in width to 1550mm -v- 1830 mm maximum at Port Talbot. Also, whilst Lackenby can roll to 1830mm, it is ostensibly a coil plate mill and its minimum gauge at that width is nearly 2 mm above that for Port Talbot. Any proposed development by BSC would seek further to reduce the minimum gauge in line with expected market demand to 1.25mm up to 1250mm which would be 15 -20% lighter than its newest hot mills. As to thicker gauges, it would be designed to roll as standard to 17.5mm which is well above Lackenby's normal commercial limits.

The table also indicates that the Port Talbot coil weight would need to be doubled in order to eliminate pickle line welds from the processing of ordered coil sizes in its cold reduction mills, and the Coating Works of Strip Products Group. The welding of the front end of one hot rolled coil to the tail end of another, results both in a high process yield loss and quality. The differences in microstructure, gauge, profile shape and width at the weld, produce an increasingly unacceptable product for the customer.

It should also be noted that the Lackenby mill was commissioned as a light coil plate mill intended to have a limited role in the production of Strip products for specialised hot rolled applications. Thus it has no association with a wide cold mill.

The cold mill at Port Talbot, which has recently been fully modernised, is the only wide one in the Corporation.

ANNEX 5

BRITISH STEEL CORPORATION: STRIP PRODUCTS GROUP

PROPOSED PORT TALBOT HOT STRIP MILL MODERNISATION

BREAKDOWN OF RECENT YEARS' MAJOR CAPITAL SPEND

	Date Commissioned	£m
Coke ovens and coal handling	1981	104
Raw materials handling	1981	15
Sinter plant	1979	28
Blast furnace enhancement	1978	7
Power plant	1982	36
Continuous casting	1982	102
Slab mill refurbishment	1982	9
Slab mill scarfer	1980	3
Reheat furnace instrumentation	1982	2
Pickle lines	1981/82	23
Cold mill conversion	1980	14
Rewind lines	1981	3
Other schemes over £200k	1978/82	29
		375

BRITISH STEEL CORPORATION: STRIP PRODUCTS GROUP

PROPOSED PORT TALBOT HOT STRIP MILL MODERNISATION

ADVANTAGES OF PORT TALBOT'S GEOGRAPHY

1.. Raw Material Supply

Port Talbot costs benefit from the Works being located on a deep water harbour enabling imports of raw materials to be directly off-loaded into the Works system. Lackenby shares this benefit, whereas Ravenscraig and Llanwern are involved in additional transport by 'merry-go-round' trains and double handling via Hunterston and Port Talbot deep water ports respectively.

2. Corporation's Tinplate Works in South Wales

This is a traditional major customer for Port Talbot with an increasing demand for high quality large coils via the concast route. Whilst it could be fed from Ravenscraig, the excessive carriage (see para. 3 below) would detract from the cost competitiveness of the finished tinplate. Lackenby is not in a position to meet the specialised quality requirements for tinplate.

3. General Distribution of the Market

A table showing current carriage rates from each of the Strip Mill Works to the main UK user areas is given below:

£/tonne	Shotton	Tinplate (S.Wales)	Birmingham	London	NE
Llanwern	7.4	3.0*	6.1	8.3	11.3
Port Talbot	8.4	2.5*	7.6	9.7	12.4
Ravenscraig	8.5	12.1	12.4	15.5	8.6
Lackenby	8.3	N/A	8.6	11.2	2.5

* Weighted average between Works in East and West Wales.

A recent analysis showed the broad distribution of UK deliveries, including intra-BSC, to be:

NE & Scotland:	10-15%
Shotton:	8-12%
Birmingham & South	75-80%

This breakdown positively indicates by reference to the carriage rates that Port Talbot and Llanwern have a clear advantage into the major Midlands (Birmingham) and Southern area (particularly tinplate) over both Ravenscraig and Lackenby, whilst carriage penalties to Shotton are similar. The favourable delivery costs at Llanwern tend to offset their additional costs on ore.

BRITISH STEEL CORPORATION: STRIP PRODUCTS GROUP

PROPOSED PORT TALBOT HOT STRIP MILL MODERNISATION

PRODUCTS COSTS

1. In considering comparisons between product costs, it is important to note that each works produces a range of hot rolled coil products for general and full finish applications. Any comparison between the average hot rolled coil costs at different works can therefore be distorted by the different mix required to be produce In practice, however, selling prices reflect the different qualiti produced and in very broad terms selling price extras for specific qualities and finishes aim to recover the product costs over and above those for base qualities. In this Annex, therefore, in order to avoid distortion in the comparisons the costs relate as closely as possible to general purpose products only.

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2. The table below sets out for 1982/83 the hot rolled coil ex-Works costs, including depreciation (but excluding central charges and Group administration costs)

	Q1 £/t	Q2 £/t	Q3 £/t	Q4 £/t	Average £/t
Llanwern	152	169	179	153	162
Port Talbot	146	162	179	167	163
Ravenscraig	162	200	201	161	177

3. BSC's Strip Products Group has considered the basis on which the most representative comparison can be drawn from recent actual costs and for this purpose have not taken into account results prior to the 1982/83 financial year. Such earlier comparisons would be strongly unfavourable to Scotland, where performance and productivity improvements were distinctly belated compared with the two South Wales plants.

4. So far as 1982/83 is concerned, the Q1 costs reflect a different plant configuration in Scotland to that which presently exists and are therefore not representative of the current situation. Q2 and Q3 were badly distorted by differential plant loadings in a period of abnormally poor demand.

5. Even Q4 is not wholly representative of a settled position because, although output levels had recovered substantially and relative loadings were not so disproportionate, exceptional costs were incurred on account of the Group's need to conserve cash to stay within the EFL. The Q4 position also shows very major improvements in cost in Scotland when compared with any previous period of time reflecting further management actions and increased plant efficiencies.

6. If the exceptional costs referred to in paragraph 5 are eliminated, then the Q4 1982/83 actual costs of hot rolled coil inclusive also fo the cost of delivery nct recovered from customers (excluded from the figures in paragraph 2 above but an important issue of disadvantage to Scotland with it much greater distance from the main markets), were:

	Including Depreciation	Excluding Depreciation
	£/tonne	£/tonne
Llanwern	153	151
Port Talbot	158	153
Ravenscraig	162	157

Even then, however, certain further exceptional costs were being incurred in South Wales in Q4 of a 'one off', non-recurring nature, particularly those associated with the commissioning of Port Talbot's new power plant. These items accounted for £1 per tonne of cost in Llanwern and £7 per tonne in Port Talbot included in the above figures.

Similarly, if January was excluded from the above Q4 costs on account of the different phasing of Christmas/New Year holidays in Scotland compared with Wales, the Ravenscraig costs in relative terms would be some £2per tonne more favourable.

7. The figures given for Ravenscraig in this Annex do not include the under-recovery of the costs of operating Hunterston, which are held centrally by BSC. The figures for Port Talbot and Llanwern include the total charges involved in operating the harbour at Port Talbot.

8. Each of the plants in BSC's Strip Products Group has an ongoing plan for reduction of its product costs. Thej 1983/84 plan is embraced in the Group's budget for that year, showing that these costs (at 1st April 1983 prices, and on the same basis as the table in paragraph 6 above)should reach the following levels by Q4 of 1983/84 at standard levels of activity.

	Including Depreciation	Excluding Depreciation
	£/tonne	£/tonne
Llanwern: all ingot route	146	144
Port Talbot: 50/50 concast/ingot	138	133
Ravenscraig: all concast	154	149

It is stressed that costs are dynamic and not static. They are subject to ongoing change. The Group believes that the above costs are representative of what is achievable at SLA.

9. The further cost reduction that would arise from implementing the Port Talbot hot strip mill development would reduce the Port Talbot hot rolled coil cost by a further £6 per conne.

ANNEX 8

BRITISH STEEL CORPORATION: STRIP PRODUCTS GROUP

PROPOSED PORT TALBOT HOT STRIP MILL MODERNISATION

MAIN ITEMS OF EQUIPMENT, FUNCTION AND COSTS

		At April 1983 Prices £m
1.	Two new reheat furnaces, capable of handling longer and heavier slabs from the continuous casting plant and slabbing mills; also improving thermal performance:	39
2.	Reversing rougher to replace existing roughing stands and enable longer and heavier slabs to be rolled:	24
3.	A coil box which will reduce energy usage and accommodate the longer breakdown bar between the reversing rougher and the finishing train:	5
4.	A seventh stand will be added to the existing finishing mill to roll lighter gauges at all widths with quality benefits:	37
5.	Two new downcoilers and a coil conveying system will be installed to handle the heavier and larger diameter coils:	17
6.	New computer controlled automotation system:	4
7.	Water treatment plant:	5
8.	Electrical distribution system:	4
9.	Other items, including site clearance, diversion of services etc.:	19
		154

BRITISH STEEL CORPORATION: STRIP PRODUCTS GROUP

PROPOSED PORT TALBOT HOT STRIP MILL

IMPROVEMENTS IN COSTS AND PERFORMANCES

The converted mill will operate more efficiently than the existing mill in a number of specific respects. For the purposes of evaluation these benefits have been converted to annual savings at April 1983 costs.

		Annual Saving £m
1.	Labour savings: By a combination of the elimination of manned effort, resiting of work positions and automation, the number of operatives will be reduced from 171 to 141:	0.3
2.	Energy saving: Installation of new furnaces will reduce fuel consumption from 25 therms/tonne to 15 therms/tonne:	5.6
3.	Yield: Doubling the length of bars will halve the number of crop ends and reduce losses from breakdowns or mishandling; improved combustion control will reduce scale. Overall mill yield improvement estimated at 1.3%:	2.1
4.	Rejections: The improved equipment will allow tighter operating control in terms of temperature, width and gauge, and reducing off-standard coils by 2.1%:	1.1
5.	Concast: Removal of reheating and roughing mill limitations will enable the mill to handle concast material over 1250mm wide, thus increasing the use of the concast route at the expense of the higher cost ingot/rolled slab route:	1.6
6.*	Subsequent processing: Processing double size hot rolled coils in cold mills, tinplate and coatings plants will give further improvements in plant performance through reduced discard levels, elimination of welds and gauge and temperature changes, and higher speeds:	6.3
7.	Substitution for present hire rolling overseas of hot rolled coil for BSC Stainless Steel:	1.5
		18.5

* Particularly in relation to this item, the savings are considered to be conservative.

BRITISH STEEL CORPORATION: STRIP PRODUCTS GROUP

PROPOSED PORT TALBOT HOT STRIP MILL MODERNISATION

LOSS OF MARKETS WITHOUT MILL DEVELOPMENT

1. HR COIL and CR WIDE COIL

Whilst quantifying market losses must be somewhat subjective, an attempt has been made to assess these and is summarised below:

			Tonnes pa	See App.1 Para. Ref.
(a)	Automotive Business			
	Lack of mill capability to produce full width range in concast quality		30,000	1(a)
(b)	Additional Heavy Gauge Business for Tubes:			
	Avoidance of imports	10,000		1(b)
	Additional business	33,000	43,000	1(b)
(c)	Additional Light Gauge Business From 7th finishing stand		50,000	1(c)
(d)	Export Markets where large unwelded coils are mandatory		25,000	1(d)
TOTAL:			148,000	

(a) Automotive Industry - say, 30,000 tonnes per annum

The Port Talbot continuous casting machine was built partly in anticipation of the growing use of killed steels by the motor industry, and linked with that an expected insistence upon continuously cast material. The Port Talbot hot mill with its present limited power cannot roll a concast slab wider than 1250mm, i.e. with allowance for side trimming which is increasingly specified by the motor industry, an ordered maximum of 1200mm. The Group's present business with the UK motor industry is approximately 200,000 tonnes of CR per annum, of which almost 50% is greater than 1200mm ordered width. Unless this constraint is removed from Port Talbot, an element of risk will overlie this proportion of the motor business, i.e. some 95,000 tonnes. That proportion would only be serviceable through the progressively less acceptable ingot route or from a single source of concast material in Scotland, but on a less economic basis (see answer to Question 2) and then only up to about 1500mm.

As the trend towards higher strength, and hence thinner, material progresses as expected with the new generation car models, the ability of the Port Talbot cold mill, recently refurbished, to handle wide and thin autobody material in higher strengths will assume greater significance. Although the whole of that 95,000 tonne proportion would not be at risk, it could be expected that some tonnage would be lost. Motor industry customers are anticipating a greater availability of continuous cast material now the Port Talbot facility is on stream, and are not expecting that to be accompanied by serious dimensional limits.

(b) Tubes Business: Imports - 10,000 tonnes per annum; additional heavy gauge -33,000 tonnes per annum

At present Lackenby is the only wholly satisfactory source for the supply of feedstock to BSC Tubes, although Ravenscraig is used as a back-up. Ravens -craig, however, has a width limitation problem over much of the range with economic repercussions - it has a maximum width which does not permit optimum slitting to 3 x 21" finished width. To overcome this problem, proposed developments would need to be on a wide mill and this would obviate occasional supply problems, thereby avoiding the need to import HR coil (with associated IR problems) estimated at 10,000 tonnes per annum.

In addition, proposed developments will enable BSC to make coil up to 17.5mm thick, which is considerably heavier than the heaviest product presently made. Port Talbot is currently virtually excluded from the important re-roller and tubes sectors because of its present limited coil weight. Removal of that limitation, through providing BSC with the enhanced flexibility of an extra source of supply, would generate an extra 33,000 tonnes of sales to those sectors.

(c) Additional markets from 7th Finishing Stand - 50,000 tonnes per annum

The provision of a seventh hot mill stand would be a response to the competition from similarly equipped mills in the EEC and elsewhere, with their capability of a high quality light gauge hot rolled product down to and even below 1.4mm thickness. This competition not only necessitates an improvement in the BSC standard of dimensional control at the lighter gauges, but also poses a threat in selected parts of the cold reduced business by substitition of hot rolled material, in the gauge range 1.2 - 2.0mm. If unable to match such a substitution, BSC risks the loss of existing business presently concentrated in the stockholder, tubemaking and automotive sectors.

A seventh stand would also confer benefits in other parts of the product range by uprating the standard of hot rolled feedstock. At present no HR material is used for direct galvanising below 2.05mm; the substitution of a better HR product for the present CR galvanised feedstock down to 1.2mm provides scope for further significant cost reduction. The improved hot rolled product will also contribute towards an achievement of lighter and wider dimensions of cold reduced and galvanised materials, in support of important new developments of demand for organic coated products in the construction industry. The total effect of this enhanced capability and the general improvement in the product available is judged to result in aggregate in a volume benefit of some 50,000 tonnes per annum.

(d) Export Markets: Mandatory Large Coils - 25,000 tonnes per annum

In export markets, the consequence of Port Talbot's low coil weights is a direct loss of business to BSC estimated at 25,000 tonnes of HR coil annually, where larger coils are mandatory. An example is the Group's regular hot rolled business with Yugoslavia, for which the total opportunity is in excess of 60,000 tonnes per annum. Because Port Talbot is unable to participate in this business, a portion of it recently had to be declined. A further example is the recent loss of Canadian business in HR on the same grounds.

2. TINPLATE

Currently, all European tinplate makers have now changed to using wholly large hot rolled coil for Tinplate manufacture, with the exception of Sollac and BSC where Port Talbot steel is involved. Whilst Sollac currently produce small hot rolled coil, when their latest planned hot mill modifications go ahead they will be producing only large coil, leaving BSC as the sole remaining European tinplate producer using small coil.

The growing importance of concast feedstock for tinplate has been overcome by the recent commissioning of the twin strand concaster at Port Talbot, but currently this is associated with unacceptable small coils. Whilst this requirement can be technically met from Ravenscraig, the punitive carriage involved makes finished tinplate manufacture uncompetitive and is not acceptable as a long term solution.

The direct manufacturing benefits of large coil - in terms of yield and speed of working, in particular - are readily assessable. Less easily quantifiable is the fact that any tinplate producer with a small hot rolled coil feed starts at a disadvantage, compared with the competition in that the use of welded coils involves the constant potential hazard of additional strip breaks at any stage in rolling or coating.

The most significant future problem of small versus large coil is likely to arise in the finished product area. The continuing pressure for cheaper, more efficient, food and beverage containers is likely to ensure that the high level of technological development in can-making techniques during recent years will be maintained.

DWI can manufacture requires significantly higher standards from the tinplate producer than ever before - in terms of steel cleanness, gauge control and overall attention to detail. Whilst an occasional DWI coil with a weld is currently acceptable - based on supplies of large hot rolled concast coil from Ravenscraig and imports - any attempt to supply all finished tinplate coils with minimum one weld is likely to meet increasingly severe resistance in the future, when weld-free coils are available from all other suppliers. All DWI lines are capable of detecting welds, but any failure to do so could result in serious tool damage and significant delays to high speed operation. All DWI manufacturers are already seeking to minimise this hazard. BSC (UK) sales to DWI beverage and pet food can manufacturer currently require some 110,000 tonnes of hot rolled coil per annum; a requirement which is anticipated to grow progressively to 140,000 tonnes during the next five years.

BSC Tinplate is currently developing export markets for DWI coils. Whilst small at present, the world-wide change in technology means a growing opportunity for two-piece cans. Since much of the development is led by American technology (e.g. American Can), our ability to take up these sales opportunities in the future would be significantly limited on the current coil size because our competitors can deliver bigger weld-free coil.

In the area of DRD technology - which is likely to become a major development for food canning - a coil feed system is already envisaged. In such a case the same demand for weld-free coil is likely. Currently, demand for DRD is equivalent to 10,000 tonnes hot rolled coil per annum, but is likely to increase to some 60,000 hot rolled coil tonnes equivalent for DRD over the next five years.

Demand for conventional coil for scroll shearing and end manufacture will continue to grow. Whilst welds are not a significant problem to the customer, each weld represents to us an additional opportunity for human error. Welds in lighter gauges cannot be effectively rolled to gauge and, consequently, there is off-gauge material either side of the weld. This off-gauge needs to be removed on the coil preparation lines and the coil rewelded; a modification in which our competitors are not involved.

CC N.O.

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CONFIDENTIAL

NBPM

MLS 12/5

The Rt Hon Patrick Jenkin MP
Secretary of State for Industry
Department of Industry
Ashdown House
123 Victoria Street
LONDON
SW1 6RB

12 May 1983

Dear Secretary of State

BRITISH STEEL CORPORATION

Thank you for sending to me a copy of your minute of ~~10~~ May to the Prime Minister about BSC's Corporate Plan and related matters. Following our discussion on 10 May with Nick Edwards I am content with what you propose and with the agreement we have now reached to have the announcement next week.

within MCS?

I am sending copies of this letter to the Prime Minister, members of E(NI), the Foreign and Commonwealth Secretary, the Secretary of State for Wales, the Lord President, and to Sir Robert Armstrong and Mr Sparrow.

Yours sincerely

[signature]

Approved by the Secretary of State
and signed in his absence

Nat. Ind. : Steel Pt. 12