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12. A

PRIME MINISTER 29 March 1985

182 [90-95?]

BL

The objectives of the meeting should be to:

A. Agree BL is way off plan - cash, profits and privatisation
B. Stop the rot at Austin Rover
C. Ensure early privatisation of Unipart and Land Rover-Leyland
D. Put a limit on Varley Marshall Assurances

Time will need to be split equally between these issues. The Official Group on BL (report attached) covers these points and, whilst we have had to compromise on some detail, **we support all the Group's recommendations** (except on GM talks, see later). On reflection DTI mandarins think the recommendations too radical - you should not let them wriggle off this hook.

A. **WAY OFF PLAN**

Neither BL's financial results nor the cooperation of its management in privatising subsidiaries show any real change from past years. **The £12m loss for 1984 was £95m worse than plan and £44m worse than the 1983 outturn. On a comparable basis the new plan over the five years 1984-1988 shows profit down by £375m to just £397m and cash £206m worse.**

During the course of 1984 proposals from Volvo to acquire parts of Leyland Bus, and from DAF for a major joint venture with Leyland Trucks were rejected. BL reneged on the firm commitment to mid-1985 privatisation of Unipart despite a merchant bank being ready to undertake an immediate placing if the Unipart management had given the green light.

* All references to "profit" are to profit before interest and tax, these being the only consistent figures available.

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Today, apart from the GM bid, I am aware of two further separate bids for Land Rover and one for Self-Changing Gears. BL and DTI may well have others **but there is no doubt whatsoever that further interest could be secured if these businesses were to be genuinely for sale.**

B **STOPPING THE ROT AT AUSTIN ROVER**

Norman Tebbit will want to raise Honda building cars at Cowley. This is a red herring: it is too early to know if it would make commercial sense. If ARG think it will earn them more than the sales they will lose to Honda - fine, it will make it easier for them to live within their means but in no way alter the necessity to do so. If DTI think another Japanese assembler will create more jobs than they displace - fine, but it has no bearing on decisions on ARG.

Professor Bhattacharyya is also sceptical of the Honda deal

The ARG 1984 loss of £26m was £56m worse than plan whilst profit before tax for the five years 1984-1988 has reduced by £102m to a total of just £27m. The Official Group on BL were unanimous in considering even these diminished results highly optimistic. The BL board themselves express some scepticism but have avoided the issue by calling for a mid-year review of ARG.

For the first time for at least a decade, BL have a full modern model range, yet last year's market share of 17.7% was only the same as in 1980. They need around 25% for long term viability as a full range producer.

With gross over-capacity in Europe for the forseeable future there is no longer any real chance of ARG becoming an international full-line manufacturer without continuing and growing Government support (albeit through Varley Marshall assurances). Nor is there any prospect of a flotation. A new approach is required to at least contain borrowings to current levels (end 1984 £232m projected to rise to £457m by

60-80,000

1989). This will entail hard decisions and a smaller ARG; the main (overlapping) options are:

1. **Less extravagance:** limit model overlap and derivatives; increase model lives (the Montego has a planned life of only five years); greater use of facelifts as opposed to brand new models (consistent with much international practice). Potential saving by 1990 £500m.

2. **Investment savings:** plan for more realistic volume levels; higher plant utilisation, eg double and treble shifting. Potential saving by 1990 £150m.

3. **More international collaboration:** eg with Honda; buying in engines and gearboxes rather than making in-house. Potential saving by 1990 £250-500m.

4. **Market retreat:** fail to replace the Metro and Rover 200 and gradually become a manufacturer of medium and large cars similar to Volvo or BMW. Saving by 1990 £300m.

Critics will argue this is shortsighted and will prove far more expensive in the long term, but the evidence to date is that wholehearted support merely leads to runaway costs, the brake has to be applied some time. **So in line with the conclusions of the BL Group we recommend:**

1. **ARG be requested to develop radical plans along the lines identified above.**

2. **Such plans to reduce capital expenditure by at least £250m** (you may want to go further and link it directly to borrowings year by year so that all the promises are not stored up until 1989).

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3. No new capital expenditure projects be approved until a satisactory plan has been produced. THIS IS THE KEY: it will stop ARG playing for time and put HMG in the driving seat. You should ask that the moratorium should not be lifted or breached without your approval.

4. Work on the new plans should start immediately following Monday's meeting.

See also Professor Bhattacharyya's comments on personnel - flag C.

C EARLY PRIVATISATION

In the meeting you should avoid discussing individual company performances (see Annex) and concentrate on ensuring an end 1985 sale of Unipart, and that all bidders for parts of Land Rover-Leyland are given a chance rather than having to stand aside until after GM have decided (as Norman Tebbit would like). This would be a recipe for more delay and more losses.

History shows that none of these businesses have prospered within BL, every delay to privatisation plans has cost money as profitable companies have slipped into loss; reducing prospective sale yields and increasing borrowings. Yet once released from the public sector most companies prosper creating both profit and jobs. You should dismiss the mirage of better prospects in the future and take action now to reduce this burden (and risk) on the public purse.

Unipart privatisation ought now to proceed satisfactorily by the year end. Treasury are suggesting a flotation rather than a placing. This is always their first choice but given the unique nature of Unipart's business and the lack of cooperation within BL for selling it, a placement would seem to be the simpler (less has to be disclosed) and more reliable route if the timetable is to be met.

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We recommend you reiterate that Unipart must be sold by the year end.

For Land Rover-Leyland the GM talks represent one possibility but are unlikely to yield a firm bid before July. Other bidders exist but DTI would prefer to leave these to one side until after GM (arguing inter alia that the memorandum of understanding with BL prevents them conducting negotiations over BL's head, but this can surely be set aside). DTI must aim not just to have a bid from GM but also to have parallel bidders for each of the businesses. This will encourage GM to offer a realistic price and will give a good fall-back position should GM drop out. Of course GM must be told alternative bids are being pursued, just as we are already aware that GM are talking to MAN, DAF, and ENASA in Europe and perhaps others.

We recommend you insist that concurrent negotiations be actively pursued (both you and the Financial Secretary have recently sent Private Secrtary letters requesting this).

D LIMITING VARLEY MARSHALL ASSURANCES

If you have agreed the other areas then this should be easy. If you decide to dispense with an E(A) on BL then you should also rubber stamp those recommendations of the Group which have not been discussed.

The insidious practice whereby BL can pledge the Government's credit without any Government control whilst claiming to be free of Government support must end. The Group recommended this be best done by controlling borrowings - creditors being allowed to rise and fall dependent upon the level of business. **We recommend:**

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1. BL be given a borrowings profile for the plan period which will achieve a reduction of £300m from planned levels.

2. That the profile be as below. This is a policy unit proposal, and although generous, DTI will contest the 1985 and 1986 reductions. But to have any effect these are the most important years to impact.

	1984	1985	1986	1987	1988	1989
Plan	522	682	758	756	753	724
Proposal	442*	600	600	550	500	424

* actual

Peter Warry

PETER WARRY

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ANNEX

PERFORMANCE OF MAJOR BL SUBSIDIARIES (EXCLUDING ARG)

Unipart profit before tax for 1984 at £9m was only half that forecast mainly due to a £6m write-off representing losses concealed in past years by SU Butec. After allowing for the acquisition of Edmunds Walker the planned (1984-1988) profit before tax has reduced by £21m to £104m but is still optimistic.

Land Rover-Leyland has been signficantly helped by the exchange rate but remained in loss during 1984 (£49m) - a little better than 1983 (£66m) but rather worse than plan.

Within this **Land Rover** made a £0.6m profit in 1984 whilst plan profit (1984-1988) reduced from £142m in the 1984 plan to an optimistic £101m in the new plan.

Freight Rover is currently the most profitable manufacturing company within BL, profit in 1984 was £6m but plan profit (1984-1988) has dropped by £11m to £38m, and now looks comparatively conservative. Nevertheless, replacement of their principal models in 1989 at a cost of £64m looks difficult to justify financially and the Group have recommended alternative options be considered.

Leyland Trucks was unique in beating the 1984 plan (albeit by £1m) but the loss is still a staggering £50m. The forecast for 1984-1988 has also improved slightly to a loss of £74m (including the £50m above). Even this is optimistic. Trucks had a major review last year and so long as it remains on plan it is difficult to reopen the strategy.

Leyland Bus has shown the most dramatic collapse, the loss in 1984 was £12m and the plan (1984-1988) profit was reduced by £45m to just £8m. The Group considered even this highly optimistic and recommended all possible options for disposing of Bus be considered including those that could lead to the break-up of the business.

Land Rover-Leyland International Holdings constitutes all of the LR-L overseas companies, it made a loss before tax of £9m. Over the plan period the profit before tax more than halved from £72m to £29m. Even so the Group considered the revised forecast more vulnerable than the previous one. Politics may force the closure of Leyland Nigeria which in 1985 is planned to account for 6% of all truck sales and 5% of Land Rover sales.