PC

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5701
GTN 215)
(Switchboard) 01-215 7877

29 March 1985

C D Powell Esq
10 Downing Street
London SW1

Dear Charles,

PRIME MINISTER'S VISIT TO SOUTH EAST ASIA

We had a word about your letter of 22 March: I attach background on the Cable & Wireless and Blue Circle projects.

The Cable & Wireless situation is fluid, with a not unusual scenario of two British interests shooting it out at dawn and the Japanese in the bushes ready to step over the bodies. But we have asked for an update 48 hours before the Prime Minister is due to arrive. The Blue Circle situation is slightly less immediate, though clearly they would welcome an encouraging word in the right quarters if opportunity offers.

Samanalawewa awaits, of course, the outcome of the EX meeting.

I am copying this to Peter Ricketts and Terence Wood in FCO, and to Michael McCulloch in ODA.

Yours,
Cu

C B BENJAMIN

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SRI LANKA

A. Cable and Wireless

Cable and Wireless have since 1980 been working on a study for the Government on privatisation of the Colombo telephone system. They have close ties with the World Bank, who are favourably inclined to this move. Our High Commission have been supporting.

2 Despite this, in February, the Government announced its intention to privatise its State run Telecommunications Department. This was followed in March by an invitation for bids to operate the country's services, with a closing date of 30 June 1985.

3 The Japanese have been pursuing their concept of country-wide privatisation, and are also in the field. Recently British Telecom have also entered the arena, allegedly encouraged by the Finance Minister. The only gainers will be the Japanese or one of the other national single bidders.

4 Post advises that support should continue to concentrate on Cable and Wireless, though there are inevitable problems in discriminating against British Telecom.

5 Post also report that the Government are now negotiating with the Japanese (MITI) for a joint venture in which the Sri Lankans would retain a 51% equity. This betters Cable and Wireless' latest offer, which would retain a 51% interest. Cable and Wireless are seeking support from World Bank and have said that they are prepared to match MITI. There will inevitably be moves before the Prime Minister's visit.

B. Blue Circle

The state owned Cement Corporation has a 200,000 tons pc plant near Colombo, a 1.2 million tons pc plant near Jaffna and a grinding plant at Gelli. If efficiently run, these would meet domestic demand, and eliminate the need for imports. But utilisation is low and the Cement Corporation running at a loss.

2 Blue Circle have put in a proposal, subject to a detailed assessment, to the Prime Minister's office to manage the plants in return for a share of any profit - there is no question of an equity stake. Blue Circle report that a recommendation to start negotiations goes to the Sri Lankan Cabinet shortly.

Asia Trip Policy ; FOR. POL. Dec 84.

Blue Circle Industries Plc
Portland House
Stag Place
London SW1E 5BJ

INDONESIA : P T SEMEN ANDALAS INDONESIA (SAI)

Background note in preparation for the Prime Minister's Visit of April 1985

1. Blue Circle Industries (BCI), through subsidiary and associated companies, operates 48 cement works world wide, of which 36 are located outside the United Kingdom in 13 different countries. To maintain its leading position as a manufacturer of cement, BCI seeks out fresh investment opportunities in areas of growing demand for cement and its business record overseas is excellent. More than 50% of BCI's pre-tax profits come from such investments.

2. Indonesia, as the world's fifth largest nation, with a low per capita cement consumption and a strong programme of infrastructure development, was an attractive area for BCI to enter, and a logical extension to BCI's other Asian investments.

3. BCI has invested approximately US$24 million and has 26.4% of equity in a 1 million tonnes per annum cement plant located at Lho Nga, Aceh Province, Sumatra, an opportunity first offered to them by the International Finance Corporation (IFC) of Washington. Owing to a number of adverse factors beyond the control of BCI, this plant is now experiencing severe financial difficulties; the problems are judged by BCI to be so grave that SAI may be forced into liquidation within a few months.

4. The IFC were responsible for a financial and economic analysis of the investment. IFC are equity holders in and substantial lenders to SAI; other prominent institutions with interests in SAI include Cementia AG (a Swiss cement company), the Commonwealth Development Corporation, the German Development Bank DEG, the Islamic Development Bank, and the Indonesian Government-owned investment bank BAPINDO.

5. Construction commenced in 1980 and the plant was commissioned in 1983, at a total project cost of US$200 million. The principal supplier (identified after rigorous international tendering) was Mitsubishi Heavy Machinery of Japan who built the plant in its remote location which met all technical and operating requirements broadly on schedule and without any serious teething troubles. BCI who have the management contract for SAI recognise that the plant is one of the finest of its kind in the world today, ideally located for coastal Indonesian cement supply (see photographs).

6. The factors which threaten the future of SAI can be summarised as follows:

(i) Cement Market:

International: The recession and the debt problems of the developing world have resulted in a worldwide glut of cement. Cement trading has become increasingly competitive resulting in a general lowering of prices around the world - with manufacturers achieving minimal contributions to profit.

Indonesia: Following the cancellation in 1983 of a number of major infrastructure projects in Sumatra (and elsewhere in Indonesia) the demand for cement in 1984 fell by 8.4% against 1983 which in turn was 15.5% down on 1982.

(ii) Cement capacity: There has been over-investment in Indonesian cement capacity, both at government-owned plants (particularly P T Semen Padang, SAI's chief competitor) and the private sector Indocement, owned by the Liem Group. Current capacity is 16.3m tonnes per annum increasing to 18m tonnes later in 1985, against the actual 1984 consumption of 8.8m tonnes. A significant part of Indonesia's over capacity has been contracted with Government approval subsequent to BCI's decision to support SAI.

(iii) Market share: The original IFC study suggested that SAI would be able to obtain a market share of approximately 80% in its local area, whereas the company has to date failed to achieve above a 50% penetration. This has been caused by price competition from other suppliers facing similar over-capacity problems.

(iv) Cement price: Maximum cement prices in Indonesia are controlled by official guidelines set by the Government. These have failed either to keep pace with production costs or to compensate for the substantial devaluations of the Rupiah seen since 1980. Furthermore, official prices have been undercut by as much as 20% by SAI's competition who appear to be dumping their product in SAI's local market.

(v) SAI's plant was designed to use oil as a fuel (at Government's request) and it was clearly understood at the time of the original investment that any increases in the Indonesian domestic oil price would be matched by Government approval for a corresponding increase in cement prices. (Energy costs represent 72% of total variable cost.) Since 1980, however, the Rupiah oil price has increased by approximately 650% (by the steady reduction of indigenous oil subsidies) while cement prices have been allowed to increase by only 60%. Steps are being taken to convert the plant to coal firing and to secure a reliable supply of coal from Ombilin. Part coal firing will be accomplished by May 1985.

(vi) Devaluation: The consequences of 37% Rupiah devaluation are severe as the financing of SAI was arranged almost entirely in US Dollars, while its income is almost entirely in Rupiahs.

GOI

7. BCI consider that the Government of Indonesia has both a major part to play in any rescue package in addition to a strong moral obligation towards SAI. In particular, GOI help will be sought on restraining the activities of P T Semen Padang and others who under-cut cement prices in SAI's local market, in maximising the incentives offered for exports of cement and in restricting any further investment in needless cement capacity in Indonesia.

8. Negotiations have been proceeding with the Government of Indonesia, its fellow shareholders and lenders to SAI in an attempt to structure a rescue package which will allow SAI to continue operating albeit on a reduced scale in the early years. This will be achievable only if SAI manages to obtain significant concessions from all interested parties and Lazard Brothers have been retained to assist BCI in these negotiations.

9. Some sixteen months have now been spent in endeavouring to reach agreement on a proposed restructuring of the company but so far IFC have failed to produce any proposals that are acceptable to the principal parties involved - the crucial underlying problems of the cement market and the balance of the necessary contributions from lenders and equity investors being the crucial factors.

10. In the meantime, the company has been in default on its interest and capital repayment schedule since 1 January 1984 and is currently experiencing a severe cashflow crisis.

11. The collapse of SAI would reflect adversely on Blue Circle as a group, and, more importantly, such a collapse might well have unfortunate repercussions in the overall business relationships between the United Kingdom and Indonesian Governments.

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Michael Casey

P T SEMEN ANDALAS INDONESIA

PROFIT AND LOSS ACCOUNT

	Rupiah, Million			US$M*	US$M
	1983	1984	Total	Total	1985 Forecast
Profit before Depreciation	7,773	688	8,461	7.9	1.6
Depreciation	(4,526)	(11,151)	(15,677)	(14.6)	(10.9)
Profit/(Loss) after Depreciation	3,247	(10,463)	(7,216)	(6.7)	(9.3)
Interest	(11,206)	(15,514)	(26,720)	(24.9)	(16.2)
Profit/(Loss) after Interest	(7,959)	(25,977)	(33,936)	(31.6)	(25.5)
Sales Tonnages	200,000 (Part-year)	527,000			
% Capacity	N.A.	48.8%			

* Translated at end February 1985 exchange rates.

Additional Notes:

1. Investment Written Off by BCI

   Share Capital US$19m)
   Advances ⅔ x US$7m = US$4.7m) US$23.7m

2. Import Restrictions on Cement

   Total exclusion (since October 1983).

3. Export Subsidy

   Approximately US$10 per tonne since early 1984

4. Expatriates

   45 as at December 1983 - Now 29 as at March 1985

5. P T Semen Andalas is the first cement company in Indonesia to effect a conversion from oil to coal - commissioning of this coal plant is currently taking place.

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PTSAI CAPITAL

SHARE CAPITAL

	US$ M	%
Blue Circle Industries (BCI)	19.0	26.4
Cementia	9.5	13.2
P T Rencong Aceh Semen (RAS)	10.7	14.9
	39.2	54.5
Islamic Development Bank (IDB)	9.0	12.5
Commonwealth Development Corporation (CDC)	7.5	10.4
Bapindo	7.0	9.7
International Finance Corporation (IFC)	5.0	6.9
Deutsche Gesellschaft Fur Wirt Schaftliche Zusamenarbeit (DEG)	4.0	5.6
Private Development Finance Co of Indonesia (PDFCI)	0.3	0.4
	2.0	100.0%

Note: BCI and Cementia have contributed a further US$ 7 million during 1983 and 1984.

LOAN CAPITAL

	US$ M
International Finance Corporation (IFC) 'A' Loan	20.0
International Finance Corporation (IFC) 'B' Loan	28.0
Deutsche Gesellschaft Fur Wirt Schaftliche Zusamenarbeith (DEG) DM8 Million	2.4*
Commonwealth Development Corporation 'A' Loan £3.375 Million	3.7*
Commonwealth Development Corporation 'B' Loan £3.375 Million	3.7*
Private Development Finance Co of Indonesia (PDFCI) Rupiahs 750 Million	0.7*
Mitsubshi	60.0
Grindlays £1.1 Million	1.2
	116.0

SHORT TERM FACILITIES

P.T. INDOVEST	4.0	
P.T. FINCONESIA	1.0	
	5.0	of which $2.0M has been drawn down

* at end FEB 85 exchange rates.

CONFIDENTIAL

Blue Circle Industries Plc
Portland House, Stag Place
London SW1E 5BJ

MALAYSIAN/SINGAPORE COMPANIES : SITUATION REPORT

A. PERFORMANCE OF MCB

CONSOLIDATED PROFIT AND LOSS ACCOUNT

	For the year ended 30th November			
	1984	1983	1982	1981
	$000	$000	$000	$000
Operating Profit	1,804	1,478	2,049	1,340
Share of Profits of Associated Companies	44,796	47,742	36,197	17,436
Profit Before Taxation	46,600	49,220	38,246	18,776
Taxation	(16,990)	(13,433)	(7,788)	(8,120)
Profit After Taxation	29,610	35,787	30,458	10,656
Extraordinary Item	-	-	4,558	-
	29,610	35,787	35,016	10,656
Profit Unappropriated Brought Forward	98,393	70,771	43,104	37,347
Profit Available for Appropriation	128,003	106,558	78,120	48,003
Dividends	(18,312)	(8,165)	(7,349)	(4,899)
Profit Unappropriated Carried Forward	109,691	93,393	70,771	43,104

MALAYSIA

(i) Cement

Cement consumption in Peninsular Malaysia grew by some 10% in 1983 to 3.86m tonnes. For 1984, demand was expected to grow by 9% to 4.20m tonnes, but the end-year projection is now some 5/7% only.

Kedah Cement (Pulau Langkawi Plant) commissioned its plant of 1.2m tonnes in mid-1984, increasing the industry capacity to some 5m tonnes. As an interim measure, prior to the commissioning of their grinding plant in Johore planned for March 1985, Kedah Cement has entered into arrangements with 3 Singapore manufacturers (including PMCWS) to grind the excess clinker output to supplement their own existing cement grinding capacity of 600,000 tonnes for re-export into Malaysia with dispensation from export duty.

(i) Cement (Continued)

Tariff protection (of the higher of M$80 or 50% CIF) came into effect in Malaysia on 29.6.84 and this has effectively prohibited imports. Average domestic selling price remains at around $180 per tonne, unchanged since March 1981.

Kanthan Works conversion has been commissioned on schedule, and the status of the other projects is as below:-

Tasek's expansion programme of 1.5m tonnes has been shelved indefinitely.

Works at CIMA's expansion project of 600,000 tonnes had commenced, and expected completion is in second half of 1986, costing some M$260 million.

No significant progress at the Perak Hanjoong site but it is generally expected that the 1.2m tonne plant will come onstream some time in 1986.

(ii) Trading

Following the reorganisation in the top management within CMCM in 1983, the performance of this Company has improved. The ratio between cement and non-cement sales is approximately 90:10, whilst on a contribution basis the ratio is 87.5:12.5.

(iii) Property

DDSB's result for 1984 show further improvement on 1983 as rental rates for Wisma Damansara and Wisma Perdana have been substantially revised. Both buildings continue to enjoy full occupancy. The development of the third office block was temporarily shelved in view of the projected glut in supply of office space in the short to medium term.

The proposed housing development in Ipoh with IGB Corporation Bhd (formerly called Ipoh Gardens Bhd) has been resuscitated. The total development covers an area of approximately 230 acres with MCB taking a minority stake of 20%. The overall acreage includes some 40 acres of property purchased by MCB in the early 1960's. The proposed project is a mixed development of low/medium/high-cost housing and commercial. Discussions with IGB Corporation to develop the property on a joint-venture basis are in progress.

(iv) Other Activities

The layout plan for the APMC complex in PJ has been submitted to the PJ authorities for planning approval. Subject to there being no unforeseen delay, the complex is expected to be completed in late 1985. The development will be undertaken by APMC Enterprises and will provide accommodation for all companies/activities within the MCB/PMC partnership.

(iv) Other Activities (Continued)

Supermix Concrete Malaysia, incorporated in January 1983, commenced operating in September 1983. It currently has three batching plants, one each in Ipoh, Seremban and Kuala Lumpur. The Company made a maiden profit in 1984.

The performance of ACP in recent months has been adversely affected by the cut in development expenditure in the public sector. A fourth plant was set up in August 1984 in Johore as part of an overall strategy to improve the performance of this company as it is hoped that this plant will be able to secure some of the contracts for the MRT project in Singapore.

(v) Blue Circle Housing Development

This is a garden suburb development of some 2,000 homes and shophouses aimed at the junior executive and professional sector, situated four miles south east of Seremban, owned by a joint venture company Naga Sakti Sdn Bhd (NS).

The equity in Naga Sakti is held equally between a combined Malayan Cement Bhd and Blue Circle Industries holding with Sungei Gadut Development which in turn is principally controlled by His Royal Highness, DYMM Tuanku Ja'afar, the Sultan of Negri Sembilan.

The development is in two phases and 382 houses have been sold and first occupancy is expected in June 1985. The total number of houses to be built is 1,642. The management contract is held by Blue Circle Housing Development Bhd, a wholly owned subsidiary of Blue Circle Industries Plc.

(vi) Armitage Shanks Operations

Large sanitaryware plant originally established in 1964 at Petaling Jaya, Kuala Lumpur. Armitage Shanks have 54% of the equity. Approximately 50% of the output is exported to Singapore and other Far East countries. The factory was recently modernised and extended at a cost of M$13m.

SINGAPORE

(i) Cement

After the extraordinary growth experienced in 1982 and 1983, consumption in Singapore for 1984 grew at a more moderate rate to 3.4m tonnes from 3.2m tonnes in 1983. Following the emergence of the bulk cement operators (Falcon Cement and ABT) in late 1983, compounded by the withdrawal of the export tonnage to Malaysia following the imposition of tariff protection in that country, domestic selling prices have declined by some 40% to around $90 per tonne to the general market while the price to HDB has recently been further reduced to $100 per tonne from the contracted price of $105 per tonne. The sharp decline in selling prices has to some extent been cushioned by the reduction in clinker prices ex Japan.

(i) Cement (Continued)

Following the entry of the sixth manufacturer, total installed cement capacity has increased to 5.2m tonnes. Resulting from the competitive situation now prevailing, Falcon Cement has decided to cease its operations in Singapore; its commitment to the HDB being taken over by a Consortium, comprising Intraco and Indocement, who have announced plans to install a bulk cement terminal in Singapore (two other parties in this Consortium have dropped out).

(ii) Trading

Twincem's performance is closely related to that of PMCWS. The ratio between cement and non-cement sales at 93.7 is disappointing, and efforts are continuing to develop this company along the same lines as CMCM.

(iii) Other Activities

The investment in Supermix Concrete Singapore is now held by PMCWS Enterprises. Supermix Concrete Singapore continues to perform well despite the competitive situation which prevails in the readymix industry.

(iv) Armitage Shanks Operations

Very small sanitaryware plant purchased in 1979 from local Chinese manufacturer. Armitage Shanks have 100% of the equity.

Armitage Shanks also have a warehouse and marketing organisation in Singapore for the sale of UK imported bathroom products not locally produced as well as for the sale of Malaysian and locally produced products.

B. MCB'S SHARE CAPITAL

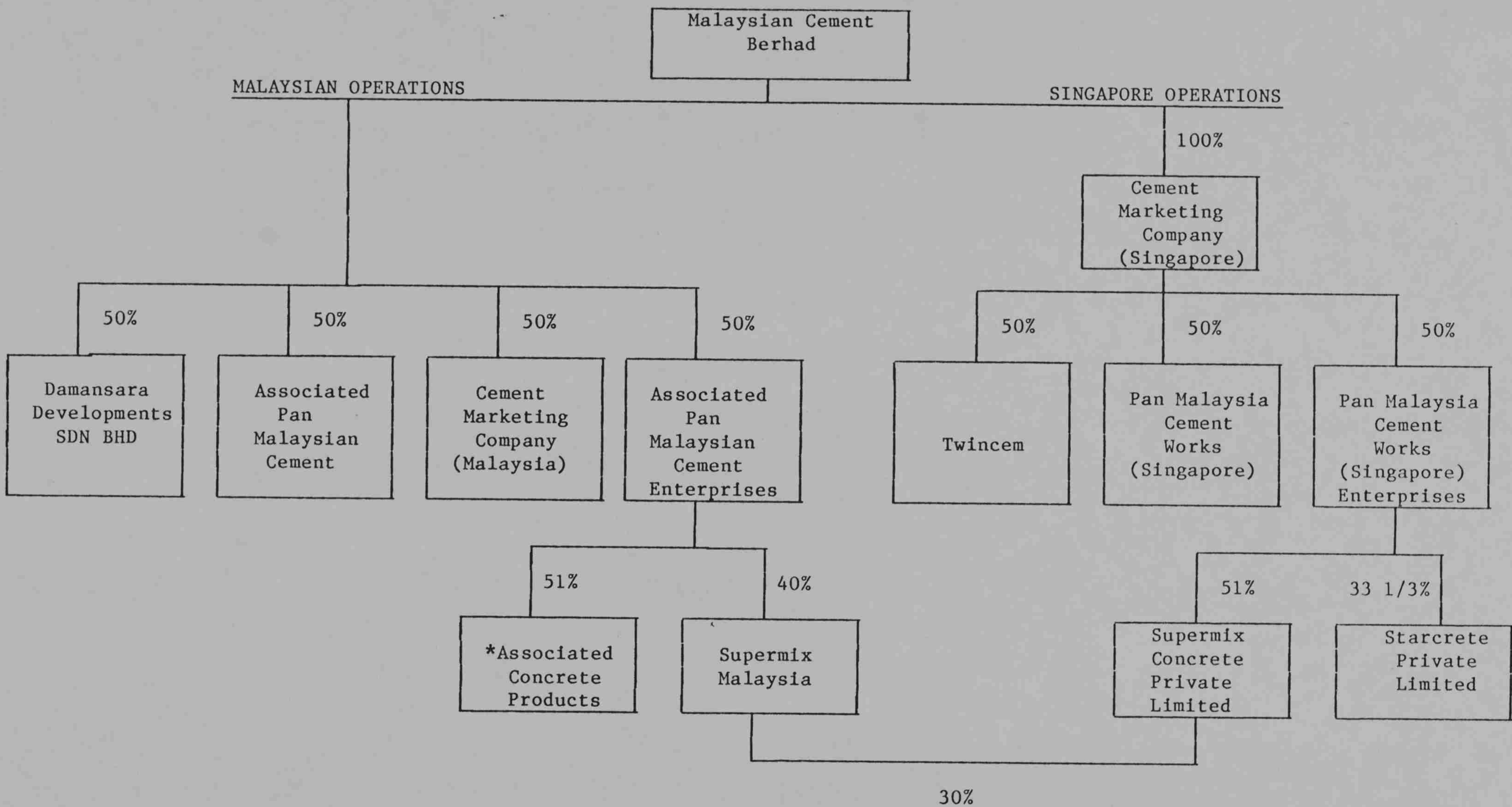
The Bonus Issue and share split from $1.00 to 50 sen par has been completed. The Special Issue of 4,447,312 shares has yet to be implemented as response is still awaited from the Bumiputra institutions in the state of Perak while the offer of the other 50% has been accepted by LUTH at the approved offer price of $1.90 per 50 sen share. The Special Issue includes an allocation of 130,000 shares to the Malaysian staff of MCB. The share price on suspension was $8.15, equivalent to $2.04 for a new share. The market price came back in on 1.10.84 at $1.96 and has since drifted with the market to $1.86.

ADS/JDM

25.3.85

<u>CORPORATE STRUCTURE</u>

The corporate structure of the Malaysian Cement Berhad Group is illustrated below:



* Application has been made to the relevant authorities to transfer this investment from Cement Marketing Co (Malaysia) to Associated Pan Malaysian Cement Enterprises.

Blue Circle Industries Plc
Portland House
Stag Place
London SW1E 5BJ

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28.3.85

SUMMARY OF BLUE CIRCLE'S INVOLVEMENT IN SRI LANKA

BCI has been monitoring the Sri Lankan cement industry for a number of years, though to date, a suitable opportunity for equity participation has not arisen.

Recently BCI were approached by the Maharaja Group regarding the possibility of an invitation from the Government to give an overall appraisal of the Sri Lankan Cement Industry. It transpired that the Sri Lankan Government was concerned about the lack of profitability of both the Sri Lanka Cement Corporation (SLCC) and Lanka Cement Limited (LCL) and the Prime Minister had appointed his Industry Secretary, Mr Paskaralingam, Chairman of both companies. Mr Paskaralingam had been set the task of inviting a competent international cement company to assist in the management of the cement industry in that country, although it was thought unlikely that foreign investment would be needed or indeed practicable at this time.

After discussion, Blue Circle offered to make a preliminary commercial/technical survey, with a view to a consultancy contract. Korean and Japanese companies are also lobbying to become advisers in this field.

The Blue Circle team which undertook the review between the 4th and the 15th March included two engineers, a financial controller, a market analyst and an Overseas Executive.

Due to political problems in the North, it was decided that the risks were too great to visit the SLCC and LCL plants in Jaffna though plant operating data was made available and the opportunity arose to interview both Corporation Managers. Visits, however, were possible to the two SLCC plants (Puttalam and Galle) in the South and it became immediately obvious that there was significant scope for increasing operating efficiencies and output.

As a result of the visit, the BCI team felt sufficiently confident to offer to provide overall management support to the cement industry of Sri Lanka. BCI submitted a proposal document to Mr Paskaralingam on 25th March outlining in general terms the management role that they would be prepared to undertake with remuneration to be based solely on a "performance basis".

Mr Paskaralingam will present the proposal document to the Cabinet on either the 3rd or 10th April for approval subject to satisfactory negotiations.

*29 March. We have just been informed that Cabinet approval has been given today. The next step will be an in depth financial investigation prior to negotiating terms.

FILE SH2AFP

10 DOWNING STREET

From the Private Secretary

22 March, 1985

Prime Minister's Visit to S.E. Asia

It has been suggested to the Prime Minister that three major pieces of business involving British companies could be brought to fruition during the Prime Minister's visit to Sri Lanka. They are:

(i) Cable and Wireless proposal for privatising the Government-owned Telecommunication system.

(ii) Blue Circle's proposal to privatise the Cement Corporation of Sri Lanka.

(iii) The Samaralawewe Project. As I recall, the ODA are considering the possibility of using ATP for this.

BF

I should be grateful for an urgent report on the prospects in all three cases, which should also be covered in the briefing for the Prime Minister's visit.

I am copying this letter to Peter Ricketts (Foreign and Commonwealth Office) and Michael McCulloch (Overseas Development Administration).

C. D. POWELL

C. B. Benjamin, Esq.,
Department of Trade and Industry