



cc: DTI

10 DOWNING STREET

From the Private Secretary

6 May 1985

Dear Mr. Milne,

Your people were very kind in providing briefing for both the Prime Minister and the Department of Trade and Industry before her visit to Indonesia.

In the Prime Minister's various talks, President Soeharto and other members of the Indonesian Government expressed themselves as very keen to see greater co-operation between their country and Britain; and I hope that this will create a better climate for resolving the problems which you have encountered. Mr. Benjamin from the Projects and Export Policy Division of DTI also had the opportunity of mentioning your problems, along with those of several other British companies, to Dr. Sumarlin. I know that our Ambassador and his staff remain ready to give you what help they can.

Yours sincerely,
Charles Powell

Charles Powell

J. D. Milne, Esq.

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Blue Circle Industries PLC

Portland House Stag Place London SW1E 5BJ
Telephone 01-828 3456

from the Chairman

JDM/PD

14th May, 1985

Charles Powell, Esq.,
Private Secretary,
10 Downing Street,
London, S.W.1.

EDR 15/5

Dear Mr. Powell,

Thank you so much for your letter
of 6th May.

We have indeed been appreciative
of the assistance and support we have
received from the Office of the
Prime Minister and from the Department
of Trade and Industry regarding
Indonesia.

We shall do our best to keep the
Ambassador and his staff fully in the
picture and are hopeful that the
immediate problems may be successfully
overcome in the not too distant future.

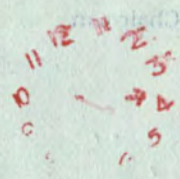
Yours sincerely,

J. D. Milne

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PHIS USK D S. B. A. I. A.



15 MAY 1985



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DRAFT LETTER FOR PS/PRIME MINISTER TO SEND TO:

J D Milne Esq
Chairman
Blue Circle Industries plc
Portland House
Stag Place
LONDON
SW1E 5BJ

Your people were very kind in providing briefing for both the Prime Minister and DTI before her visit to Indonesia.

Mr. Chris Benjamin from the Projects and Export Policy Division of DTI ^{also} had the opportunity of mentioning your problems, along with those of several other British companies, to Dr Sumarlin.

In the Prime Minister's various talks, President Soeharto and other members
[9] The Indonesian Government expressed themselves as very keen to see greater co-operation between their country and Britain; and the possible impact on others should be a helpful consideration in any support required from them in restoring your Indonesian investment to viability. *and I hope that both will create a better climate for resolving the problems which*

you have encountered. I know that our Ambassadors & his staff remain ready to give you what help they can.

ad.

JH3BQI

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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.

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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.