010

cc BG 11
AB/up

SECRET

PRIME MINISTER

THE ROVER GROUP

There have been developments on four separate fronts involving the Rover Group (RG). In respect of Leyland Bus and Unipart we shall need to reach early decisions but you need only take note of developments in respect of Leyland Trucks and Austin Rover.

Leyland Bus

2 Three bids are on the table:

(i) Aveling Barford (AB); previously a loss-making BL subsidiary, AB now profitably manufactures construction equipment. It is effectively controlled by a Singaporean through a Hong Kong registered trust.

(ii) Laird; the Laird Group has many different operations including railbuses and buses. They plan to merge one RG plant with Metro Cammell Weymann, their bus subsidiary.

(iii) A Management Buyout Group (MBO); mostly BL Bus Management with part of its funding and 29.9 per cent of the equity provided by a company effectively controlled by the municipal Greater Manchester Passenger Transport Executive (GMPTE). Potential support is also likely from Lancashire

JF4ADE

999-49

SECRET

Enterprises Limited - another rate dependent body which expressed earlier interest in Land Rover - and the trade union controlled Unity Trust.

3 The RG Board seem set to recommend the MBO bid. Although the AB and MBO bids are financially comparable there are many uncertainties surrounding AB's plans and their lack of experience in the high risk bus market. In financial terms the Laird bid is a poor third particularly as RG would have to bear the rationalisation costs of the much higher level of redundancies (2,000 compared with 1,250 or less - resulting from Laird's plans to close RG's Workington and Lowestoft plants) and it is almost certain in any case that, unless it were the only bid, the Director General of Fair Trading would advise a reference to the Monopolies and Mergers Commission which it would be difficult for me to ignore.

4 A Board recommendation in favour of the MBO bid would command much political, trade union and employee support. The big disadvantage of the MBO offer is that on one possible interpretation of the funding it could be presented by hostile observers as municipalisation rather than privatisation. This is based on the argument that of the £13m total funding £8m is to be provided by the British Linen Bank, but secured on the assets of the Parts business, so that of the remaining £5m risk money all but £210,000 is provided by the Manchester PTE. The more positive, alternative view is that the PTE will provide only 29.9 per cent of the equity and under 40 per cent of the total loan finance.

5 We can take a final view when we have heard formally from the RG Board and have advice from our merchant bankers,

JF4ADE

Barings. However, despite the difficulties, I believe that subject to the views of colleagues we should be ready to ~~supply~~ support the recommendations of the RG Board and go for the MBO. The political cost of shelving our privatisation plans - and the financial cost of continuing Government involvement in a business which is forecast to lose money after tax until the end of the decade - would be heavy. In the announcement I propose before the Recess I would therefore say that the MBO is the preferred bidder that, whilst further work is needed before a deal can be completed, the other bids will for the moment remain on the table.

Unipart

6 The RG Board have now made a clear recommendation in favour of disposing of 75 per cent of Unipart to a consortium led by Charterhouse Japhet. On privatisation RG will on
Why? hold the remaining 25 per cent of the shares: their commercial interests and right to appoint directors to the Unipart Board will be protected by a shareholders' agreement.

7 The consideration in the offer is partly dependent on profitability in the coming years and the achievement of flotation. It values 100 per cent of Unipart at £30-56m and removes current short-term external borrowings. For 75 per cent of Unipart, RG get £31-41m (net present value). RG's initial proceeds will be £27m with up to £15m more dependent on profits and £5m (plus 9 per cent up to 1990) on flotation. In addition, £30m ARG-branded inventory will not be transferred to Unipart.

8 I believe the proposals represent a satisfactory outcome to our efforts to privatise this part of RG and

should be finalised as quickly as possible. It will no doubt be claimed that the plan lacks industrial logic - most car manufacturers maintain their own (profitable) spares operations - or that the sale is mistimed and better proceeds might be expected later. We have a good defence against these views. There may also be interest in the arrangements for management/workforce participation where the initial management interest will be 10 per cent with a performance - dependent option to obtain another 5 per cent from the institutions. Profit-sharing share issues to employees are also intended (in neither case are full details yet available). Some may well argue that it is unacceptable that there is no free or profit-sharing allocation to the workforce (unlike to the management): we can point out that this is not a business with Jaguar-style profitabilty but that, once a good profitability is achieved, the workforce contribution will naturally be recognized.

9 Subject to views of colleagues I intend to announce the acceptance in principle, of the Charterhouse Japhet proposals probably at the same time as my statement on Leyland Bus.

Austin Rover

10 ARG is currently forecasting a full year 1986 loss before tax of £89.3m - more than twice last year's level. Their UK market share is also at its lowest level (16.3 per cent) for several years although there has been a significant improvement in their penetration of the European market. The need for urgent action therefore remains but the scope for such action is limited with Honda offering the only real prospect.

£6p-

11 Honda's President has expressed interest in principle in deepening their collaboration with Austin Rover and in considering taking a minority shareholding in ARG. Graham Day believes that an eventual material equity stake by Honda offers the best route forward towards the eventual privatisation of ARG. He is gloomy about any alternative but, under the right conditions, considers that Honda's involvement might attract institutional money and, with evenutual workforce participation, allow for progressive privatisation.

12 In my talks with Graham Day I have underlined the political sensitivities of Honda taking even a small minority stake in ARG. However he emphasized, rightly in my view, the need to establish precisely what Honda's intentions in Europe are given that Honda remain free to go it alone in Europe - perhaps by developing their Swindon site. Indeed under their existing collaboration with Honda, ARG's sales will become increasingly dependent on the jointly produced vehicles (from some 19 per cent of sales to over 50 per cent by end-1989).

13 I propose to tell Graham Day that he should go ahead with a further round of talks with Honda on a clearly exploratory basis. In doing so I shall ask him to make clear that, while the Government does not at present exclude the possibility of a modest minority stake, it has no intention of endorsing arrangements which could lend to eventual Honda control of ARG as a whole. In the light of these contacts we shall then need to consider whether to pursue the Honda route under which ARG's fortunes - and those of Honda in Europe - would become inextricably linked.

JF4ADE

SECRET

Leyland Trucks

14 RG have had further contacts with Paccar and with DAF and these will continue in parallel. Exploratory talks with GM/Bedford, no longer a potential purchaser, are also planned to explore collaborative possibilities.

(i) Paccar

Paccar remain interested in a straight acquisition of Leyland Trucks involving their Foden subsidiary and perhaps the UK independent, ERF. It will probably not be until early September before Paccar's intentions become clear.

(ii) DAF

Van Doorne 37

Govt.

Stich Thier 25

DAF have told RG that they have no interest in a tripartite arrangement involving GM (partly, I believe, because of DAF's fear of involvement with a corporation the size of GM and partly because they perceive that GM have no long-term interest in the European truck industry). DAF are however interested in a separate deal with RG and in particular the possibility of a DAF acquisition of Leyland Trucks. The consideration would be in the form of shares in the DAF company in which RG would thus, at least temporarily, maintain a minority holding. However it would be proposed that RG should have the opportunity to divest this holding in the planned flotation of the DAF company, which is anticipated will be in 2/3 years.

Unlike the deal with Paccar, the retention by RG of a minority holding in DAF would prevent a "clean" privatisation. However, an agreement with DAF would in any case be necessary on their manufacturing and sourcing intentions for Leyland and a temporary RG holding in DAF (accompanied by Board representation) could be helpful

JF4ADE

999-49

presentationally and substantively in protecting UK interests.

(iii) Bedford

There are now strong indications that GM are moving steadily to a decision to close the Bedford truck operation, though the timing and phasing of this is unclear. GM have indicated interest to RG (and no doubt to others) in discussing arrangements whereby Leyland would take over certain elements of the Beford business (but none of the Bedford facilities). GM have particularly in mind the Bedford military vehicle business with MOD - which might in the future be supplied from Leyland plants - and the possibility that Leyland might manufacture Bedford-badged vehicles to maintain truck supplies to dealers holding joint Vauxhall/Bedford franchises.

The additional volumes Leyland would gain from such arrangements are obvious. But Graham Day feels that exploration of the possibilities is in any case necessary as a "defensive" measure against the possibility that any gap left by Bedford might be met from imported competition.

Any deal with Bedford would be "free standing" as it would enhance the attractions of Leyland Truck for both DAF and Paccar as potential purchasers. But care would be needed over the timing and presentation of any agreement so that it would be seen as a consequence of a GM decision to close Bedford and not criticised by opponents as a nationalisation of parts of Bedford. However, much would depend on the form of any deal (it might for example be possible to proceed by contractual means rather than by the acquisition of physical assets or shares) and presentation of any deal might be easier if it took place on or after an announcement of

SECRET

Bedford's closure, especially if it was seen to forestall an alternative GM deal with an importer.

15 I propose to ask Graham Day to continue with his exploratory discussions with Paccar, DAF and GM/Bedford in the areas mentioned above and to keep me closely informed on progress.

16 As you suggested, I am copying this minute to Nigel Lawson.

John Mogg

pp PAUL CHANNON
15 July 1986

(Agreed by the Secretary of State and signed in his absence)

DEPARTMENT OF TRADE AND INDUSTRY

JF4ADE

999-49