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P 02193
PRIME MINISTER

Unipart & Leyland Bus
MISC 126(86)

CONCLUSIONS

1. You will wish the Group to reach conclusions on
 - a. the terms negotiated for the sale of Unipart to a consortium organised by Charterhouse Merchant Bank;
 - b. policy on the sale of Leyland Bus; and
 - c. the terms of an announcement by the Secretary of State for Trade and Industry before the Recess.
2. You will wish to arrange for the outcome of the Group's discussion to be reported to Cabinet on 24 July but it does not appear necessary to put it on the agenda as a specific item.

BACKGROUND

3. MISC 126 agreed in the spring that negotiations for the privatisation of Unipart should be carried forward, and that bids should be sought for Leyland Bus. The Trade and Industry Secretary's paper* reports progress on these matters; work is continuing on the possible sale of Leyland Trucks, but this has not yet come to fruition, while the new Chairman of the Rover Group (RG) is reviewing the strategic future of the cars business and the relationship with Honda.

Unipart

4. The terms of the sale are that RG would receive £27 million up front for 75 per cent of the company, retaining the final 25 per cent. In addition they would receive a share of the profits


* to be circulated later this evening.


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up to 1990 which could amount to £15 million, together with a further payment of £6 million when the company is successfully floated. The argument for RG's retention of a substantial stake in Unipart is that they need to be seen to have a strong interest in the success of Unipart as a separate company. Separation of Unipart from RG will increase the Company's prospects of diversifying away from Austin Rover, while the retained RG shareholding recognises the continuing links between the two companies. In response to criticism that parts operations are profitable, and are retained in-house by other car manufacturers, the defence can be made that RG will share substantially in Unipart's profits in the years immediately ahead, as well as receiving 25 per cent of any dividends, and will benefit further when the Company is successfully floated. Subject to detailed negotiations about the precise terms of the further payments, it appears that satisfactory arrangements have been made for the privatisation of Unipart.

Leyland Bus

5. Three bidders have expressed interest: A management buy-out (MBO) team, with banking support; Aveling Barford (AB), previously a loss-making BL subsidiary which now profitably manufactures construction equipment; and the Laird Group. Privatisation of Leyland Bus will inevitably involve substantial redundancies, the costs of which RG will have to meet; overall, it is likely to lead to some modest net cash outflow. The Laird Group's bid is the lowest, and the redundancy and rationalisation bill the largest; Department of Trade and Industry officials consider that Laird have accepted that they will not be chosen. The other two bids are broadly competitive in financial terms, but the RG Board seem most unlikely to be willing to recommend the AB bid, given the difficulties they are still having in negotiations with that Company arising from the earlier sale; money is still owed to them, and they will be very reluctant to have further dealings with AB's current owners, a Hong Kong trust


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controlled by a Singaporean. The MBO bid had the disadvantage that a significant part of the money was to have been provided, at least on a temporary basis, by a company controlled by the Greater Manchester Passenger Transport Executive; it now appears that Bankers Trust is ready to replace the finance previously expected both from the Manchester source and from the British Linen Bank. Provided there is no element of 'municipalisation' it appears that the MBO bid will prove the best option; it is likely to be acceptable to the RG Board, and it would leave the business in the hands of a relatively new team who nevertheless understand the difficulties it faces. AB, by contrast, know nothing about the market for buses. Under the terms of the MBO bid, RG would receive £12 million, but RG would have to bear redundancy and rationalisation costs of £19 million.

6. Disposal of Leyland Bus is much less advanced than that of Unipart. However, it would be desirable to make progress with it as soon as possible, during the Parliamentary Recess. Mr Channon's proposal is, therefore, to announce now the MBO's status as successful bidder, subject to contract, which would enable the arrangements for the disposal to be completed during the Recess.

RG Longer Term Strategy

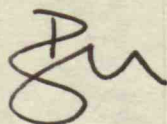
7. The present discussion should clear the way for the disposal of the relatively minor Unipart and Bus businesses. Meanwhile the new Chairman of RG, Mr Graham Day, is reviewing the future of the main businesses - cars, landrover and trucks. It is not yet certain whether it will be possible to sell the trucks business; and the future of that business will depend also on decisions taken by General Motors about the future of their Bedford trucks operation. Until the future of trucks is clearer, it will not be possible for RG to reach firm conclusions about the Company's financial structure, and the crystallisation of those elements of RG's Government guaranteed debts which are attributable to the

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Bus and Trucks businesses. Sooner or later disposal of the bus business is likely to require the write-off of £100 million of debt; but there is no need for any immediate action on this, since RG have sufficient funds remaining from the sale of Jaguar to cover immediate cash outflows. Very careful thought will need to be given to the arrangements for debt write-offs, given the EC restrictions on State Aids and the difficulties the cars business would face if all RG's available funds were drained away to meet part of the write-off costs on the commercial vehicle businesses.

HANDLING

8. You will wish to invite the Secretary of State for Trade and Industry to introduce the discussion of his paper. Thereafter the Chancellor of the Exchequer will wish to comment from the Treasury standpoint. The proposals now on the table do not have employment implications in the West Midlands comparable with those which could arise on the Land Rover and Cars businesses, but you will wish to invite the members of the Group to consider the local political implications (in Cumbria and Suffolk) of the inevitable bus rationalisation. The Lord President of the Council, the Chancellor of the Duchy of Lancaster and the Chief Whip will all wish to contribute on these aspects, as may other members of the Group.



J B UNWIN
Cabinet Office
22 July 1986

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