



## PRIME MINISTER

ROVER GROUP (RG)

1 In advance of our meeting with Graham Day on 20 November I should report on where the current privatisation initiatives stand, the financial issues relating to the sale of Bus and Trucks which we need to consider now; and preliminary thinking on options for ARG.

PRIVATISATION: GENERAL PROGRESSUnipart

2 We announced in July that RG had reached agreement in principle to sell to a management buy out supported by Charterhouse Bank. RG are aiming for contract completion before the end of the year. Receipts at completion will be about £30m with a possible further £20m in deferred consideration according to future performance.

Istel

3 RG have pressed ahead quickly in seeking bidders for Istel. Expressions of interest have been received from Geisco, a subsidiary of GE of the United States, Olivetti and a management buy out team. These are being evaluated, with the aim of disposal before the end of the year. Sale proceeds may be of the order of £30m.

JRA (Jaguar Rover Australia)

4 RG have announced agreement in principle to sell 80% of JRA to a consortium including local management, Australian investors and Jaguar. Sale proceeds are expected to be roughly £20m.

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#### Land Rover Ltd

5 Although still profitable, Land Rover's current financial performance is disappointing. Graham Day will review at the end of 1987 prospects for privatisation in the light of the Range Rover launch in the United States. This is in line with the position I outlined to the House in the spring following the ending of the GM talks on Land Rover.

#### Freight Rover

6 DAF have expressed interest in including Freight Rover in a deal on Trucks (see below). I understand from Graham Day that DAF would probably continue operations on the present site in Birmingham. If there is no deal with DAF, Graham Day will explore other options for privatising Freight Rover, including sale with Land Rover. Either under DAF or RG management there is some possibility that Freight Rover might supply vans to Bedford.

#### LEYLAND BUS

7 We announced in July that RG had reached agreement in principle to sell to a management buy out. Discussions are still continuing between the Rover Group and the management buy out and progress is being made. We cannot seek to force the pace too hard but I hope it will soon become clear whether all the outstanding questions can be resolved. Cash receipts to RG would be negligible, and the company would have to be sold debt free but we should have released the tax payer from supporting this severely loss making business.

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## LEYLAND TRUCKS

8 Paccar have confirmed their intention to put in firm proposals in December. Their interest is confined to Trucks. If Paccar decide to make a bid, Cummins may support them with an equity participation.

9 Discussions with DAF have been broadened to include Freight Rover. Graham Day tells me that DAF may insist on the creation of a combined DAF/Leyland Trucks company at least as an interim step before flotation in 2-3 years time. I have made it clear to him that if it is at all negotiable we would strongly prefer an early disposal of 100% of Trucks. A recommendation to the RG and DAF boards on the possibility of a deal is expected in December.

10 Graham Day may wish to recommend at the end of the year which Truck deal he wishes to pursue. With either company he believes, it would be possible to reach Heads of Agreement by February.

11 However, given the uncertainties surrounding these two proposals, Graham Day is preparing a radical restructuring plan for Leyland Trucks under present ownership. This would be likely to involve retrenchment to assembly-only within Leyland and piecemeal disposal of certain facilities.

12 Under any option substantial rationalisation would occur. Serious job losses would be unavoidable. Manufacturing plans are not certain at this stage but:



- a) DAF would probably
- continue the plant at Leyland in Lancashire, but reduce manning;
  - continue the Freight Rover operation in Birmingham;
  - move Scammell production from Watford to Leyland;
  - perhaps close the Albion axle plant in Scotland
- b) Paccar would probably
- reduce the Leyland plant to an assembly only operation;
  - close peripheral activities within Leyland Trucks including Scammell, Albion and engine manufacture;
  - initiate consequential rationalisation in the component industry.
- c) RG would themselves in an internal rationalisation retrench onto the Leyland site;
- but close the engine and founding operations at Leyland;
  - close Scammell;
  - retain or sell Albion.

Under any of these option at least 2000 jobs would be likely to go within Leyland Trucks. Under Paccar, and the RG restructuring plans perhaps as many jobs again would go in the component industry. Under any option a substantial part of this shake out would occur in 1987.

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FUNDING

13 On the assumption that we are able to dispose of Truck and Bus, we need urgently to decide how to tackle the large historical debts in these companies and the restructuring costs which the potential purchasers will insist should be for RG's account. Debt in Truck and Bus is now forecast to reach about £470m by the end of 1986. Cash outflow on Trucks in 1987 before a deal can be concluded and rationalisation costs on Truck and Bus could add another £120m-£180m. Total costs could reach £600m - £650m, or higher depending on how quickly the disposals are effected and the precise terms of each deal.

14 We agreed on 1 July that we would need to put in equity to prevent this legacy falling on the residual Group, so the question is over what timescale should we act. Given the Chancellor's concerns about avoiding public expenditure costs in 1987/88 I am convinced that the right course is to write off the historical debt and rationalisation costs in Truck and Bus in 1986/87. I believe this is the only course which makes commercial sense for RG, which would otherwise be left to stagger on through 1987 and early 1988 carrying this huge burden of debt. Graham Day will himself wish to emphasise to you just how fragile confidence in the company now is. And I am even more certain that this is the only course which makes sense in political terms, if we are to avoid the accusation that we are just leaving the company to endure a slow but visible death as 1987 progresses.

15 I have discussed the options set out in attachment A on the timing of Government decisions and announcements on dealing with these historical debts with Nigel Lawson. Nigel feels strongly that ways should be found of deferring this

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expenditure until 1988/89 (Option 3). I have reflected carefully on whether this might be possible. Theoretically it would be feasible to leave the debt and restructuring costs within RG and, for presentational reasons, move the debt within the Group so that it does not appear on Austin Rover's balance sheet. The debt might be serviced from additional borrowings on the back of Varley-Marshall. A public reassurance could be given at the time a Trucks deal is announced of the Government's intention to act on the debt once EC clearance was obtained and we might then play for time by stage-managing a lengthy examination by the Commission. This might achieve Nigel's objective of pushing all the expenditure into 1988/89.

16 Frankly, however, I do not believe this course would be commercially or politically realistic. The background is that:-

- by February RG will need to announce an Extraordinary General Meeting to relax the borrowing restrictions in the Articles of Association. At the same time, the Board and auditors will need formally to comment on the adequacy of the Group's working capital in a circular to shareholders related to the sale of Leyland Bus and approval of the 1986 accounts. These events will focus attention on the financial position of Rover Group.
- by February also we shall be under intense pressure to announce the results of our consideration of the Corporate Plan. After months of uncertainty public and customer confidence in the Group is already fragile and if we are to restore the position our statement will need to be decisive and carry conviction.

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- Nigel's option would probably require us to defer an announcement of a Trucks deal until the early Summer to enable the ploy with the Commission to work. I fear this is excessively optimistic. Reports of a possible sale of Trucks to DAF or Paccar/Cummins are already circulating within the industry and (as with the GM and Ford talks) the Opposition - sooner rather than later - will make this public and exploit it. If we are not to be caught on the back foot, the earliest possible substantive statement will be necessary.

17 As these events come together, I do not believe it will be sufficient response to say that the Government will eventually act on the debts but only after formal clearance by the Commission - which we would have to acknowledge might be a lengthy process. There would inevitably be speculation that, in allowing a massive debt to rest on an already weak balance sheet, the Government is playing for time before a post-Election run-down of Austin Rover; and, if we failed to carry conviction, the commercial credibility of Austin Rover and its products would decline further and customer confidence could collapse. Even if in these circumstances the banks were willing to continue support for ARG (and it is an open question whether they would be willing to do so without formal guarantees) we must take fully into account the position of Graham Day and his Board. An extremely delicate situation would arise if they were to reach a considered view that, without Government funding of the debt, it would be very difficult for the company to continue trading through 1987.

18 I would therefore strongly recommend that in February we should aim to make a positive and comprehensive announcement covering:

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- an agreed Corporate Plan
- disposal of Leyland Trucks
- an equity injection before the end of this financial year.

19 I would not pretend this will be easy to achieve. Leaving aside consideration of the Corporate Plan, it would be essential for Graham Day to pursue negotiations on Trucks to the point where a Heads of Agreement with the potential purchaser can be announced; and we should ourselves need to reach an understanding with the EC Commission enabling us at least to make a loan to Rover Group (to be converted into equity if and when formal clearance is obtained) and this will not be straightforward. Nevertheless it is the option I strongly believe we should pursue.

#### ARG

20 ARG's current trading performance is very poor with domestic market share in October at 14.1%. Day believes customer and dealer confidence is very fragile. It is clear that radical solutions need to be found for this business but until we are in a position to reach decisions and make announcements in this sensitive political area, we shall need to tread very carefully lest confidence declines further.

21 Graham Day will wish to give you a first indication of this thinking on the options which may be open to us. These seem likely to divide into a possible strengthening of the relationship with Honda and finding a complementary strategy, possibly with other partners, for the rest of the business.

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At this stage, I do not believe that we will be able to do more than give first reactions, consider the timing envisaged for any decisions and public announcements, and give some preliminary thought to political handling. What I think Graham Day can legitimately expect from us is an indication of any areas we would not wish him to explore at the moment.

22 Any radical option of ARG, as on the commercial vehicle businesses, is likely to raise questions, sooner or later, about the need to improve the balance sheet if this proves necessary to secure commitment from potential purchasers for all or part of the business. From my discussions with Graham Day I believe it is yet too early to address this question. Ideas about ARG are still evolving. But it may be necessary to begin to look at these questions if we decide to encourage Graham Day to go into detailed discussions with potential partners in the next few months.

#### PUBLIC PRESENTATION OF GOVERNMENT POLICY ON RG

23 I suggest that we should also take the opportunity to discuss with Graham Day how best to handle public presentation of Government policy on RG. On Trucks I fear that concern in the component industry will translate into press speculation and well directed Opposition questions before too long. We must be prepared to meet this. My inclination is to favour a robust statement underlining that radical solutions are needed if the truck industry is to survive in the UK and Graham Day has our full support in exploring all options. The sticking point may be pressure to name the commercial parties to whom RG are talking. While Graham Day strongly supports the view that we must keep the initiative, he may find it difficult at this stage to persuade DAF and Paccar that they might be named if pressure

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is intense. We cannot know how soon speculation may mount. If we reached agreement that RG should go forward into detailed price negotiations with one company we would then be better placed to make a firm statement. But there can be no certainty that we shall not be pressed earlier. We need to consider urgently with Graham Day just how full a statement we could seek to make if pressed.

24 On cars, equally, there is press speculation about plans to sell at least a minority holding in ARG to Honda. We shall need to decide how to handle this in the light of what Graham Day has to tell us. We may also need to consider what the Government might say to steady confidence in ARG's future. I know Graham Day believes a Government Statement of support would be helpful, though we should need to ensure that options for the future were not prejudiced.

#### CONCLUSION

25 There is a great deal of ground to cover with Graham Day. I suggest it may be helpful to focus on the key questions set out in attachment B.

26 I am copying this minute and attachments to Nigel Lawson.

PAUL CHANNON

November 1986

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## OPTION 1: FINANCIAL SUPPORT TO RG IN 1986/87

Summary

The payment of equity (or a loan for conversion into equity) during 1986/87. Amount sufficient to write off residual debt of Bus and Trucks. Possible announcement of acceptance of Corporate Plan.

Timing of decisions

Decision in principle November 1986

Decision to talk to DGIV November

Timing of public announcement

In Parliament during February 1987 before issue of Class 1 Circular and notice of EGM (for which latest possible date is 5 March).

Timing of actionEquity route:

EGM to amend Articles and reopen powers to take equity by 27 March 1987 at latest.

EC clearance for equity by end March 1987 at latest.

Equity injection by April 3 1987 at latest

Loan route:

EGM to amend Articles March 1987.

Loan under Industry Act by April 3 1987.

AGM to include power to take equity June 1987.

Conversion of loan to equity Summer 1987.

PROS

- Government acting in considered way on basis of Corporate Plan
- Bus sale should be completed and chance of reaching "Heads of Agreement" on Truck
- With proper groundwork, some degree of confidence in Commission decisions.

CONS

- Still a risk that Commission would decide to oppose
- Trucks deal might still founder in final stages
- Very limited scope for indicating future of ARG





SECRET

OPTION 2: GOVERNMENT FINANCIAL SUPPORT TO ROVER GROUP  
FOLLOWING EACH MAJOR DISPOSAL/RATIONALISATION

Summary

Payment of equity to write off Bus debts in 1986/87. Tackle Trucks debt in 1987/88 after Commission approval. February 1987 announcement refers to Bus specifically, makes general statement about the provision of equity for financial reconstruction, perhaps related to announcement of acceptance of Corporate Plan.

Timing of decisions

Decision in principle November 1986.  
Decision on amount for Bus December 1986.  
Decision on amount for Trucks March 1987 (?)  
Decision to explain strategy to DGIV December 1986 (?)

Timing of public announcement

In Parliament during February 1987

Timing of action

EGM to amend Articles and reopen powers to take equity by March 1987.  
EC clearance for first tranche of equity by end March 1987.  
Equity injection for Bus by April 3 1987.  
EC clearance for second tranche of equity Summer 1987.  
Equity injection for Trucks Summer 1987.

PROS

- No risks taken on Commission approval of Trucks deal
- Shows that privatisation programme will not progressively leave behind a debt-ridden unmanageable rump.

CONS

- PES impact of Trucks in 1987/8
- Very limited scope for indicating future of Trucks and ARG in February statement.
- Weakens ability to produce "counterpart" to the Commission drawing on rationalisation across commercial vehicle and bus sectors.
- Commission consideration of Bus might still drag on into 1987/8
- Sequential treatment of Bus and Truck debt popularly perceived as "more and more money" for Rover Group.





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OPTION 3: GOVERNMENT FINANCIAL SUPPORT TO  
ROVER GROUP IN 1988/89

Summary

Announcement of intention to write off Bus debt, making general statement about the provision of equity for financial reconstruction. Indicate publicly that this is subject to EC Commission approval. Delay equity injection until 1988/89

Timing of decisions

Decision in principle November 1986  
Decision on EC strategy January 1987 (?)  
Decision on amount mid-1987 (?)

Timing of public announcements

In Parliament during February 1987

Timing of actions

EGM to amend Articles by March 1987  
Confidential discussions with DGIV spring/summer 1987.  
AGM to reopen powers to take equity June 1987 (?) or June 1988 (?)  
EC approval 1988/89  
Injection of equity 1988/89

PROS

- PES advantages
- Perhaps possible to combine handling of Bus/Trucks with re-structuring of ARG and possible Land Rover privatisation.

CONS

- Increasing Parliamentary pressure, focussed by EGM, on funding problem. Government judged to be marking time until post-Election run-down of Austin Rover
- Government delay publicly attributed to need for EC approval of UK plans
- Significant risk that saddling ARG with a mountain of debt/perceived Government indecision will lead to collapse of confidence in ARG
- Treasury palliatives (eg Government meeting interest costs) would lead to major difficulties with the Commission and would be unconvincing to the domestic audience
- Possible that RG Board would refuse to go forward on these terms
- Banks may demand re-assurance beyond Varley-Marshall eg formal guarantees.





QUESTIONS ON RG TO DISCUSS WITH GRAHAM DAY

Bus and Trucks

- 1 When does Graham Day believe these disposals will be concluded?
- 2 When can the full costs involved be accurately determined?
- 3 Subject to EC Commission clearance, when should the Government take action on the historic debt and rationalisation costs?
- 4 When can a full Government statement be made?
- 5 What should RG and the Government say if speculation mounts in the next few weeks?

*Middle - 2nd  
Feb*

ARG

- 6 Options and timing for privatisation (do we want to rule any out at this stage)

HONDA

- 7 - Day's impressions of their long term intention in Europe and towards ARG
  - a) - development of Honda's Swindon site?
  - b) - a substantial equity stake in ARG? With rights to increase it?
  - c) - or only on specific production facilities?
  - d) - what is the timing? of shareholding or next joint venture.
  - e) - implications for ARG's financial position eg would Honda insist on an improvement in ARG's balance sheet before investing?
  - f) - what funding decisions would be needed and when?

PUBLIC STATEMENTS

- 8 What could the Government say on ARG to steady confidence and discourage speculation? - but without giving the promise of more unlimited finance.

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*Middle*

*January*