

SUBJECT
cc master

SECRET AND PERSONAL



file 25
cc Prof Griffiths

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary

20 November 1986

Dear Timothy

ROVER GROUP

The Prime Minister this afternoon met Mr. Graham Day, Chairman of Rover Group, with the Chancellor of the Exchequer, your Secretary of State and Mr. Giles Shaw (Minister of State, Home Office). Mr. George Guise, No. 10 Policy Unit, was also present.

Mr. Day said there was a great need to increase confidence in the company. Three disposals were on track and were likely to produce £80-90 million. Capital spending had been reduced by about £65 million. A good wage settlement had been achieved, for about three quarters of employees, which had introduced worthwhile incentives.

Continuing, Mr. Day said that the sale of Leyland Bus was in a fragile state. The position on Leyland Trucks was much as at the previous meeting with the Prime Minister. The sale, whether to DAF or PACCAR, was likely to come to a head around the turn of the year. The PACCAR deal would be the cleaner of the two. However, the deal with DAF would preserve more jobs and would retain for the UK a role in European truck building. The combined truck company would be in the first rank of truck builders. The proposal was that Freight Rover, Leyland Truck and DAF should be amalgamated into a new company in which RG might have a 25-30 per cent share of the equity. It would be late 1988 or early 1989 before such a joint company could be floated. DAF would not require RG to hold a continuing minority interest. They might agree to a placement of shares with institutions before flotation, but this was, on balance,

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unlikely. It would not be feasible for the new company to carry existing RG debt: debt which would be brought to the company by DAF would take gearing to the limits. A deal with DAF offered the advantage that RG would not have to fund model development for Freight Rover. DAF would retain the plant at Washbrook Heath. A link with DAF had already been forged through the provision next year by Freight Rover of 2,000 units for DAF. Plans were being prepared against the possibility that both deals might fail. Mr. Day noted that the award by MOD of contracts for DROPS and four-wheel drive four-ton trucks would make an immense difference to the successful company. It would tide Leyland Trucks through a very lean period. The Prime Minister said that the position on these contracts would need to be investigated. (I should be grateful if you could establish the position on these contracts with MOD before the meeting which is to be held next week - see below.)

On Land Rover Mr. Day said the Range Rover would be launched in the US in March. The traditional Land Rover business was falling away and a new vehicle below the level of the Range Rover was being developed. It would be possible in due course to consider a flotation, a trade sale or possibly a management buy out, but this was some way off: the earliest date would be 1988. If the deal with DAF on Leyland Trucks and Freight Rover combined were to fall through, Freight Rover might then be joined with Land Rover.

On Austin Rover, Mr. Day said employment had quietly been reduced by 8 per cent during the past five or six months. Capital expenditure and fixed costs had been reduced and further reductions were in prospect. The company faced at least 25 per per cent excess capacity. A number of possibilities for increasing throughput were in prospect. Mr. Day then outlined the projects described in his background note. He rated the probability of the projects coming to fruition in the order Honda, MG Roadster, Chrysler-Lotus and finally Chrysler.

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Mr. Day said his aim was to reduce the number of car platforms from seven to two. Production of the Mini would now continue until 1991. A replacement for the Metro had been postponed and the existing car would be re-engined with K series engines. If the Honda relationship was maintained the YY car would replace the Maestro and the Rover 200. The remaining cars in the range might be the MG Roadster and the Rover 800. The overall intention was to restrict the range of cars and to move up market. Austin Rover might eventually become like Volvo. The volume of car production might drop from the present 450,000 to around 300,000 with the difference being made up by production for other companies.

Mr. Day then described the possible shareholding to be taken by Honda. There was a three month window for discussions with Honda about this. Honda would probably at first take no more than a 19 per cent shareholding in Austin Rover since any higher level would involve consolidating Austin Rover into their balance sheet. The investment would be paid for by a contribution towards the capital costs for the joint project YY. There would need to be conditions and understandings to satisfy both sides. Honda were concerned that in the event of another company acquiring Austin Rover the Government should not then prevent them from developing their greenfield site at Swindon. This concern, however, appeared to stem from a misunderstanding about the relationship between Government and industry in this country. Both the Government and Honda would also probably wish to secure understandings about future increases in the Honda shareholding. If Austin Rover were making an operating profit in 1988 and Honda had by then taken a shareholding, it might be possible to sell further shares to employees, to existing shareholders and to institutions. Mr. Day noted finally that a decision on the capital injection of £550 million for Austin Rover mentioned in his note would be required by February because the company's borrowing limits would be reached then. The figure of £550 million did not take account of any group disposals.

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Many of the points made by Mr. Day were in answer to questions and these need not be separately recorded. In discussion of the possible Honda shareholding, it was argued that this could tie the Government's hands: no other company would be interested in buying Austin Rover while it was so dependent on Honda. On the other hand, no other partnership was in prospect. The reaction to Honda taking a majority stake could not easily be predicted.

After further discussion, agreement was reached on the following points:

- (i) it could well be necessary to make a statement during December about the sale of Leyland Bus and the possibility of deals with DAF or PACCAR. Mr. Day should prepare DAF and PACCAR for this possibility;
- (ii) debt should be written off in 1986-7 rather than 1987-8 or 1988-9. However, any announcement of this would need to be made after publication of the 1987 Public Expenditure White paper: to announce changes in the public expenditure figures between the Autumn Statement and the PEWP would be damaging;
- (iii) if the Leyland Bus sale were to be completed and an announcement made before publication of the PEWP it might be feasible for the debt to be retained by Rover Group, provided the banks could be re-assured that the debt position would be resolved before too long; a Treasury official might need to help re-assure the banks about this. It would not be possible to handle the much larger debt related to Leyland Trucks and Freight Rover in this way;

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- (iv) the European Commission were unlikely to cause difficulties over writing off the debt relating to Leyland Bus; discussions over debt relating to Leyland Trucks and Freight Rover were likely to be more protracted: these would need to begin soon if the write offs were to be made in 1986-7;
- (v) a cash injection for Austin Rover would be needed, but the scale and options for this should be further studied and discussed in the context of the Corporate Plan.

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Bringing the meeting to a close, the Prime Minister said that a meeting of the smaller group should be held next week. (This is likely to be arranged for Wednesday.) A meeting of MISC 126 could well be needed thereafter. DTI and Treasury officials should prepare a paper to be handed round at the meeting of the smaller group which would set out the position reached on Leyland Bus, the possible deals with DAF and PACCAR and the possibility of Honda taking an equity stake. The endorsement of the group would be sought for continuing the discussions with DAF and PACCAR with priority for DAF, and the group should be invited to consider the principle of Honda taking an equity stake. The paper should set out possible options for the size and form of a Honda stake, and indicate conditions which might be attached. But it should make clear that no decisions could be taken on these aspects until more was known of Honda's own preferences and intentions. The later meeting of MISC 126 would be invited to consider the DAF and PACCAR proposals, but not at this stage the possible Honda deal. Separately, DTI and Treasury officials should prepare a detailed note on the timetable and options for handling the statements which might be needed in the coming few months, the debt write offs and discussions with the European Commission. This would be discussed between the Prime Minister, the Chancellor of the Exchequer and Mr. Channon. Any statement by Mr. Channon would provide an opportunity to help restore confidence in the future of Austin Rover and there might be

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other opportunities. DTI should prepare a form of words which might be used to this end.

I am copying this letter to Alex Allan (H.M. Treasury).

Yours,
David.

DAVID NORGROVE

Timothy Walker, Esq.,
Department of Trade and Industry.