



PS/ Secretary of State for Trade and Industry

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**SECRET
PERSONAL**

1 December 1986

David Norgrove Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Dear David

ROVER GROUP : PAPER FOR MISC 126 AND STATEMENT

I attach a copy of the Misc paper which my Secretary of State will table tomorrow and a copy of the statement my Secretary of State proposes to make tomorrow. These have been cleared at official level with both the No 10 Policy Unit and Treasury.

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

Yours sincerely

TIMOTHY WALKER
Private Secretary

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BOARD OF TRADE
BICENTENARY

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MISC 126(86)8
2 December 1986

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BY NOON TOMORROW.
2/12/86

CABINET

MINISTERIAL GROUP ON LAND ROVER-LEYLAND

ROVER GROUP : FUTURE OF THE COMMERCIAL VEHICLE OPERATIONS

Note by the Secretary of State for Trade and Industry

Colleagues will be aware of the negotiations taking place with a management buy-out team on the sale of Leyland Bus. These are proceeding satisfactorily and the outcome should be known by the end of the year. Rover Group (RG) have also been reviewing alternative ways of securing a viable future for Leyland Trucks.

2 Leyland Trucks remains heavily loss-making. Following a 1985 loss after interest of £26.5m the estimated out-turn for 1986 on the same basis is £62.6m. Forecasts for 1987 show that the company will continue to make losses on this scale and thus represent a large cash drain for RG. Even allowing that Leyland should pick up additional market share following the Bedford closure, on any reasonable assumptions there is no early prospect of a return to profitability or of the company generating enough income to fund new models before the end of the decade.

3 It is against this background that the RG Chairman, Mr Graham Day has been exploring the possibilities for collaboration, merger or sale of the business. The two main options which have emerged are as follows:-

(i) DAF (Annex A)

DAF have expressed interest in Leyland Trucks and Freight Rover with whom they already have collaborative marketing agreements. The proposal under discussion would involve the formation of a combined DAF/Leyland Trucks/Freight Rover company as an interim step before flotation in 2-3 years time. Until flotation RG would retain a 25-30 per cent share of the equity in the joint company unless it should prove feasible to place this holding with institutions, a possibility which I am asking Mr Day to examine.

(ii) Paccar (Annex B)

Paccar, a US truck manufacturer and owners of the UK company, Foden, are interested in acquisition of Leyland Trucks only. If Paccar do bid, Cummins (a US engine manufacturer but with substantial UK operations) may support them with an equity participation. In addition to Foden, the UK independent truck company, ERF, might also be involved.

4 Both sets of talks are at an early stage. Mr Day hopes to be in a position to recommend which option to pursue before the end of the year and a conclusion to any subsequent negotiation might be expected in the first quarter of 1987. Against the possibility that neither of these deals should materialise, Mr Day is also preparing a fall-back restructuring plan for Leyland Trucks under present ownership. If Freight Rover were not included in any sale, that company would be retained by RG and prepared for later privatisation, perhaps alongside Land Rover.

5 Under any of the options substantial rationalisation would be needed and serious job losses would be unavoidable. The scope, location and timing of these are not certain at this stage but:

- (a) DAF would retain the Leyland assembly plant though the engine and foundry operations would be switched to DAF. The future of Freight Rover operation in Birmingham would be assured and DAF would also fund new model development there.

The Scammell plant at Watford would however probably close - with this work being transferred to the Leyland plant - but the Albion axle plant in Glasgow should be secure at least in the medium term.

- (b) Paccar plans are unclear but it is believed that they would reduce the Leyland operation to the assembly-only of vehicles from bought-in components. Peripheral activities including Scammell, Albion, and engine/foundry production at Leyland would almost certainly be closed. If ERF were involved, either the ERF or Foden plants at Sandbach could also be closed.
- (c) Under the RG fall-back option, restructuring within Leyland Trucks would be likely to follow closely the Paccar pattern.

Under the DAF proposals, at least 2,000 jobs would probably go within Leyland Trucks and there might be up to a further 1000 jobs at risk in the engine and components sector. Under Paccar and the RG 'retention' options a total of 4000 jobs might be at risk within Leyland as retrenchment there would be more severe, but the impact on the components sector could be less significant than under the DAF option. The bulk of these redundancies would either be implemented or become apparent in 1987.

6 Whilst for the moment Mr Day must clearly pursue both disposal options, a merger with DAF would be politically and industrially the better choice. DAF would offer a secure future for Freight Rover as well as Leyland Trucks; its truck product range is for the most part complementary to rather than competitive with that of Leyland (and it has no van range of its own); it would bring with it a good distribution network in Continental Europe where Leyland/Freight Rover is weak; and it would involve significantly less job losses within the UK. For these reasons I recommend that Mr Day should be asked to give priority to DAF even though this could require Rover Group temporarily to retain a minority holding in the proposed joint company.

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CMO UNTIL 31 MARCH 1987

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PUBLIC PRESENTATION

7 Public presentation of these issues requires care. We must show we have a clear plan, and we must retain the initiative. On Trucks, there is already growing speculation in the industry about the DAF and Paccar talks and this may very soon attract press comment and well directed questions in the House. We must be prepared to anticipate this and I therefore recommend that I make a pre-emptive statement on the future of Trucks today:-

- underlining that radical solutions are needed if the truck industry is to survive in the UK;
- making clear that Graham Day has our full support in exploring all options;
- acknowledging that he is currently exploring possibilities with DAF and with Paccar;
- promising that the House will be kept informed.

8 At the same time to reduce damaging speculation about ARG's future, I will also include a statement on the Government's commitment to ARG.

RECOMMENDATIONS

9 To summarise, I recommend:-

- (a) that Graham Day be asked to pursue both disposal options for Leyland Trucks, but giving priority to DAF and with the objective of concluding a deal in the first quarter of 1987;
- (b) that I make an oral statement in the House today;
- (c) that I consult colleagues again when the details of any deal are known.

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DEPARTMENT OF TRADE AND INDUSTRY
2 December 1986

SECRET
CMO UNTIL 31 MARCH 1987

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COMMERCIAL IN CONFIDENCE

ANNEX A

DAF TRUCKS B.V.

DAF, based at Eindhoven, manufactures around 14,000 trucks and buses per annum. Total employment is some 8,600 people of which 1,400 are employed at DAF's components plant in Belgium.

2. DAF holds 6.8 per cent of the total West European truck market predominantly in the heavier truck ranges - it has a 10 per cent share of the UK market for vehicles over 14½ tons. As DAF's strengths are in a limited product range, its growth opportunities are limited and the company might view a venture with Leyland as a means of developing a stronger and more broadly based position in Europe. DAF could use Leyland as a channel for the sale of heavy trucks in the UK market whilst looking to the UK operations as a source of light/medium trucks. The latter would represent an extension of the existing collaboration with Leyland under which DAF are to market on the Continent under a DAF badge the Leyland Road Runner light truck and Sherpa van with anticipated volumes of at least 2000 units in 1987 and rising thereafter.

3. Despite deep recession in European and overseas truck markets since the early 1980s, DAF has remained consistently profitable at the trading level and in only one year (1983) recorded a small loss after interest. In 1985 profit at the PBIT level was around £25m and net profit after interest was £6.4m.

COMMERCIAL IN CONFIDENCE

4. DAF's ownership is determined through a complex arrangement of direct holdings and trusts as set out below. In the event of all Dutch Government-related shares being voted together (which DAF assert is unlikely) this would still give the Dutch Government only 48.44 per cent of the votes.

Van Doorne Family Trust	37.5%
AMRO Bank*	14.06%
Dutch State Mines (wholly Government owned)	25.0%
GEM.DEELN/DAF Holding Company**	23.44%
	<hr/>
	100.0%

* Shares held in trust on behalf of International Harvester who retain the economic interest but have no voting rights.

** Ownership of this holding company is:

Van Doorne Family Trust	12%
Dutch State Mines	8%
DAF Trucks BV	31.66%
Dutch Investment Bank (50.3% Government owned)	48.34%
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	100.0%

COMMERCIAL IN CONFIDENCE

ANNEX B

PACCAR

Paccar, a US company specialising in the production of heavy trucks, has its headquarters in Washington. It employs around 12,000 and in 1985 recorded profits of \$104m on a total turnover of \$1,893m. The company holds a 0.5% share of the total US truck market and about 20% in heavy trucks alone.

2. Paccar acquired the UK specialist truck manufacturer, Foden, in 1980. Foden employs some 445 people at its plant at Sandbach, Cheshire and total production in 1985 was about 500 vehicles. Foden holds a UK market share of around 1% in its particular sector.

3. For Paccar, acquisition of Leyland Trucks would represent the US company's first substantial venture in Europe. As Paccar/Foden's strengths are in specialist heavy trucks (like Scammell) it would also involve a significant diversification of the product range into light/medium trucks.

4. In the US, Paccar's operations are based on the assembly-only of vehicles from bought-in components. Unlike most European manufacturers which have a high level of vertical integration, Paccar relies for all major components (engines, axles, transmissions) on separate deals with independent component suppliers. It is highly likely that a similar pattern of production would be introduced for Leyland.

COMMERCIAL IN CONFIDENCE

5. Cummins Engine Company, based at Columbus, Ohio, is a major world-wide supplier of diesel engines (and an important supplier to Paccar). Cummins has substantial operations in the UK centred on Darlington (1,100 employees), Shotts, Lanarkshire (900) and Daventry (500). Cummins supplies Leyland Trucks with B-series engines for Road Runner trucks and L10 engines for heavy goods vehicles.



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ROVER GROUP STATEMENT

With permission, Mr Speaker, I should like to make a statement on developments within certain Rover Group businesses.

On 24 July I informed the House that agreement in principle had been reached on the sale of Leyland Bus and of a majority holding in Unipart and I can report in both cases that detailed negotiations are proceeding satisfactorily. In reply to Questions on 5 November I also announced the disposal of majority interests in Jaguar-Rover-Australia and in Istel. The situation on Land Rover remains as I stated last April.

The Chairman of Rover Group has also been reviewing the options for Leyland trucks. This review has been taking place against the backdrop of continuing depressed demand, particularly in overseas markets, and severe over-capacity in Europe. Our objective is to achieve a secure future for the production of Leyland trucks. But it must be recognised that any option for the company - whether related to collaboration, merger, sale or indeed continuation under present ownership - will involve restructuring.

Talks are progressing with two companies.

The first is DAF. Hon Members will be aware that in October a limited but important collaboration on the marketing of Roadrunner trucks and Sherpa vans was announced. DAF and Rover Group are now in talks about the benefits that could arise from much more fundamental collaboration in the truck and van businesses.

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The second is Paccar, the parent company of Foden, who are considering the basis on which they might wish to make a bid for Leyland trucks.

Both sets of talks are at an early stage and, for the reasons I have already outlined, Mr Day has my full support in pursuing them; I thought it right to inform the House at this early stage and I shall of course keep the House in touch with developments. I am sure Hon Members will understand and accept that it would be prejudicial to the interests of those employed in these operations and in their suppliers for me to make any further detailed comment on the discussions at this stage.

Mr Day's review of the plans for all RG operating companies including Austin Rover will form the basis of the 1987 Corporate Plan now under preparation. After I have received it and given it careful consideration, I will announce the Government's response. In respect of Austin Rover, I should however like to take this opportunity to emphasise that I expect Mr Day's plan to set out a positive course for the continuation of the company as a major producer and leading exporter of cars made in Britain. I stress that the Government's aim is to secure the best possible future for Austin Rover, its suppliers and the motor industry generally in this country.

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