

PRIME MINISTER

ROVER GROUP

Questions for decision are as follows:

On DAF:

(i) Must Leyland Trucks be sold debt free when DAF will be taking their own debt into the company?

The point here is that Leyland Trucks' assets will be absorbing cash over the next few years, whereas DAF assets will be generating cash.

(ii) Should DAF shareholders be pressed to convert some DAF debt into equity?

The result would be a stronger company and a conversion would help the political presentation in this country. But it should not be set as a condition for Graham Day.

(iii) Should the agreement include a provision to allow the Government to place its shares before flotation?

Yes.

You will want to note the position on discussions with the Commission.

Note also the slightly ominous sentence in paragraph 9 of Annex C that the need to fund investment in new products for Freight Rover may prove to be significant. ?

On Honda:

(iv) Should Honda be given an assurance that in the event of ARG being taken over by a third party Honda would be

welcome to develop their own assembly operation at Swindon?  
When?

It would be very difficult for the Government to refuse such an assurance. The real question is when it should be given. Mr. Day is clear that it must be given now.

You will also see that the Policy Unit are not convinced of the wisdom of allowing Honda to take an equity stake in ARG. They would prefer a joint venture. You could ask George Guise to speak to this.

*DW*

(DAVID NORGROVE)

15 December 1986

DCABPG

ROVER - MINISTERS' MEETING ON TUESDAY, 16 DECEMBER

1.0 Public Presentation of Sales of Bus and Truck/EEC Approvals

We have a united stance on taking the £650m of public funding for debt retirement in the 1986/87 period. Because of the vulnerability to leaks and delays which the EC Commission procedures expose, it is essential to have fall-back plans. Your request for a matrix of possibilities has been summarised in Annex A of the DTI paper. As to pre-empting leaks, the proposed announcement today will help without disclosing the amount of Government injection. However, it should not be very difficult for astute commentators to make some estimate of this.

As to delays, the critical path goes through achieving Heads of Agreement with DAF by end January leading to authorisation from the Commission for equity injection in February. If this timing is not met, officials have identified a rather messy fall-back position whereby Government 'with the Commission's connivance' would make a loan, which would be subsequently converted into equity following formal approval. Whether we use this alternative will not be clear until the end of January although a final mechanism is needed to be agreed by early February.

2.0 The Financial Structure of the DAF Joint Venture

The Chancellor asked whether debt could be transferred to the DAF joint venture company, and this is addressed in Annex C.

The essential point is that the assets which DAF put into the venture generate cash whereas the assets from Leyland absorb cash. Indeed, it was argued at the time of the GM proposals, that the Truck assets have a negative value (even without debt) because they lead to cash absorption for the next two years. Therefore, to ask Graham Day to renegotiate

so that Leyland Truck debt is taken into the joint venture or, alternatively, that less DAF debt is transferred into it or again that more equity should be put into it by DAF, is effectively to ask him to renegotiate the deal he has already stuck. He argues that this deal is vulnerable anyway and should not be jeopardised by trying to reopen fundamental issues.

The Chancellor's second question: whether the remaining minority shareholding in the joint venture could be sold by Rover forthwith raises issues both of politics and practicability. DAF are insisting that a minority shareholding (between a quarter and a third) remains with RG until it is profitable. This stake clearly has a near zero or negative value at the outset although it may achieve a positive value in three to four years time if forecast performance is achieved.

The practical question, therefore, is whether this shareholding could be transferred to British institutional shareholders before the company is floated. This could still be presented as a British commitment to the venture while absolving Rover Group of having to account any share of its losses. The predictions for the joint venture company are such that it is reasonable to try to offload the stake to British banking or institutional shareholders and, therefore, not to agree anything with DAF which would prevent this happening.

### 3.0 The Honda Relationship

The Rover Group must, in the eyes of the Japanese, have considerable assets in the production and marketing facilities which it owns within the EEC. The Japanese motor industry is under great pressure from the strength of the Yen, to service foreign markets from foreign points of manufacture. Honda already has manufacturing facilities in the United States. In the UK it has already purchased the Swindon site.

Rover's survival strategy is tied to the AR8 development in joint venture with the Japanese. There is a mood within Rover that this is the only alternative to a complete collapse of the company. Both sides are therefore playing for high stakes and the Honda/Rover collaboration would be better as a joint venture. Each side would put assets, including intangibles like market position and technical know-how, into a jointly owned company especially set up to exploit specific goals.

The offer of a shareholding in either ARG or RG itself may ultimately be needed in order to lock in the Japanese and this would then be presented politically as a vote of confidence in ARG. Nevertheless, it would be a significant coup for the Japanese to have got into the ARG boardroom for very little cost. In strategic terms this is exactly where they want to be. If the venture is a success in five years time they will have the power and inside information to prevent Rover facing them directly in the market place. There have recently been a number of published articles warning that the Japanese do precisely this. I, therefore, continue to advise that Graham Day's Japanese negotiator should try for a joint venture first with the equity position as a fall back offer.

The Swindon matter is quite different. HMG is both the controlling shareholder of Rover and the protagonist of the host country. It is perfectly reasonable for Honda to seek prior agreement that they should develop their own UK operation if the Rover Group, with whom they are joined, should fall into hostile hands. That central Government has neither formal powers nor the probable political inclination to prevent them from creating jobs, is not the key issue.

Honda are seeking an expression of sincerity that they are welcome as major long term participants in UK industry. Given that Rover's negotiators are appropriately tough on

commercial issues, it would be quite wrong to hold back assurance on Swindon as some sort of negotiating ploy. In my experience this would be exactly the wrong way to deal with the Japanese.

#### 4.0 Overall Conclusion

Rover has no real assets in Truck and the speediest exit should be pursued. By contrast, I suspect that poor morale about the overall car business has led Rover to defeatist thinking which is undervaluing the benefits which it has to offer to Honda.

#### 5.0 Summary and Key Points

1. There are risks of leaks and delays on the Truck disposal but the pitfalls are being thought out and planned for.
2. Leyland Truck debt cannot reasonably be transferred to the DAF joint venture company without fundamental renegotiation.
3. Rover should indicate that it may seek to place the minority shareholding with British institutions in advance of any flotation.
4. Day should be given every support to deliver the DAF deal by the end of January other than any continuing Rover liability to inject funds.
5. Rover should be told that the preferred route with Honda would be a joint venture for specific car models and that an ARG shareholding should only be offered if no progress can be made on that.
6. Swindon should be conceded forthwith in time for the December 18 negotiations.

GEORGE R J GUISE

