Confidential

PRIME MINISTER 29 November 1985

BL PRIVATISATION - GM/LANDROVER-LEYLAND

GM's opening offer is just over £100m net of redundancy costs compared to an asset value of some £450m. This is not unrealistic (it is virtually what we predicted in September) but will still be difficult to justify publicly. DTI are hopeful of negotiating the price up to £220m using the rationalisation savings that can be achieved for Bedford Trucks, which like Leyland Trucks is losing some £50m p.a.

Although optimistic, this might be obtainable if HMG and BL can present a united and vigorous negotiating stance. But BL will not be cooperative unless they are assured that most of the residual debt remaining after the sale of these businesses is extinguished by a new equity injection from the Government. At worst BL would be looking for a £250m injection.

There is, of course, no justification for BL demanding any equity injection - all of the residual debt is the fruit of BL's mismanagement. Nor is there any financial case. The banks have been happy enough in the past to rely on the Varley Marshall assurances in lending BL money to fund its losses and pay interest on its borrowings. There is no reason for them to stop making such risk free profits now.

BL want an equity injection that will ensure that Austin Rover is not adversely affected by the residual debt left over after the GM sale. They calculate the requirement as a £140m equity injection if the £220m sale price is achieved, this being adjusted £ for £ for any shortfall. But any residual debt relates to the BL Group rather than ARG, and as ARG has not been and will not be financing that debt, there can be no true additional burden on ARG.

Even if the basic BL argument for an equity injection were accepted it certainly need not be £140m because this includes extinguishing £90m of Leyland Bus debt which does not form part of the sale to GM. The £140m injection also improves BL's debt/equity gearing ratio: if this were merely to be maintained at its existing ratio then only an £80m injection would be required.

Whilst we should press GM to increase their offer, even the present offer is acceptable: if the businesses are not sold then losses will continue and borrowings mount. The equity injection will score against PSBR but this is little to pay compared to the long term savings, and it really only amounts to relabelling BL's debt (but for which HMG are responsible) as HMG's debt.

Despite the total lack of justification, we believe some sweetener is essential to secure BL's commitment. The actual amount is for horse-trading. We recommend that BL should be told that HMG would, <u>in principle</u>, be prepared to:

i. maintain the overall BL gearing ratio, ie £80m injection assuming £220m proceeds;

ii. increase this to the DTI's proposed £140m, ie "ARG not worse off" when and only when the disposal of Leyland Bus and the other residual businesses has been completed;

iii. in both cases the existing cap on BL's borrowings would be reduced appropriately.

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