

E(DL)(79)11

16 July 1979

COPY NO 41

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

SUB-COMMITTEE ON DISPOSAL OF PUBLIC SECTOR ASSETS

BRITISH SHIPBUILDERS: SALE TO THE PRIVATE SECTOR

Memorandum by the Secretary of State for Industry

1 The Manifesto said that we would "offer to sell back to private ownership the recently nationalised aerospace and shipbuilding concerns, giving their employees the opportunity to purchase shares". This paper discusses the various methods I have considered for implementing this commitment in relation to British Shipbuilders (BS) and whether we should proceed with legislation this session. I am putting forward my proposals for British Aerospace in a separate paper (E(DL)(79)8).

2 British Shipbuilders as a whole and its merchant shipbuilding and shiprepair activities are currently loss-makers. A severe contraction of the industry is inevitable and in the short-term will require very large Government subsidies. In these circumstances I see no prospect of selling shares in a company created to carry on the whole of BS's business, and virtually none of doing so in any individual merchant shipbuilding or mixed yard. However, five subsidiaries are profitable: the three specialist warshipbuilders, Vickers, Vosper Thornycroft and Yarrow, and two small companies engaged principally on naval work, Hall Russell and Brooke Marine. The first three have firm orders from Government (although their long-term prosperity depends on winning export orders as well); the two small shipbuilders need new orders. Details of each company are annexed. Apart from those, the only possibilities seem to be Vosper Shiprepair, which the former owners might take back with the warshipbuilding activity, but at a price reflecting current losses; the shiprepair facilities at Falmouth which BS have largely closed down; and possibly some other shiprepair assets.

3 I have therefore reviewed the only substantial realistic prospects which we have, namely the sale of part or all of the equity of the five profitable companies. I am anxious to make progress here if possible, to meet our Manifesto commitment. But even this restricted disposal raises important and difficult issues, which are set out below.

Financial Issues

4 Legislation would be needed to effect sales of these companies or of shares in them. This could not be passed until sometime in 1980, and the sale would have to wait until the accounts of 1979-80 were available, probably not before July. The total value of the five companies might be between £60 million and £80 million. However, this estimate is subject to great uncertainty. It is based on a price/earnings ratio derived from average ratios in similar companies

or sectors of industry, and takes account of interest that these companies might have earned - but did not in fact earn - if their cash balances had been invested rather than simply made use of by BS. It assumes that BS's forecasts for these yards will be met, and takes no account of the extent to which potential proceeds from the sale of these companies are likely to be depressed by the industrial disruption caused by the inevitable contraction of the merchant shipbuilding industry. Yarrow, because of its position on the Clyde, is particularly likely to suffer from this.

5 The receipts we might receive from sale of the companies are offset by the immediate adverse financial consequences that their sale would have for BS and hence for the Government. BS's losses on merchant shipbuilding have not had to be fully financed by the Exchequer because the cash balances in the major warship builders have been available to finance BS as a whole. BS estimate that the total cash balance of the five warship builders will comprise £134 million in December 1979. Retained profits have not been taken account of in the valuation of the companies since they could be correctly extracted by BS, but BS state that £86 million of payments in advance of work done would in any case need to be repaid by BS to the companies concerned. I have taken full account of this in the valuation of the companies. But, despite this, and even before making allowances for the likely depressing effect of disruption in the industry, I think it unlikely that we could obtain as much as £86 million for the sale of these yards. On this basis, therefore, sale of the companies will increase rather than reduce the PSBR. In the longer term, the direct financial effect of the sale on BS would be negligible. The loss of profits per annum would be marginally more than the capital expenditure, which is currently running at around £20 million per annum.

6 A second adverse financial consequence arises from the risk that announcement of a proposal to sell off the warship builders would exacerbate the industrial action which is likely to arise from further contraction. This may involve a reduction in employment of up to half, with 16,000 redundancies in merchant shipping alone. Contraction will be particularly fierce on the Tyne, the Mersey, and - above all - the Clyde. Relations between Government and the industry will inevitably be highly charged. Soundings of senior industrialists - particularly in Scotland - confirm that any announcement of our intention to dispose of the only profitable parts of the industry would make matters much worse. I have dealt already with the effect on the warship builders themselves. But the main risk of added disruption is likely to fall on the yards remaining in BS's control. The consequences could be increased requirements for finance for BS because of delays in completing work. Three month's slippage on all orders is estimated to cost some £50 million.

7 A further financial complication is that compensation has not yet been agreed for any of the five companies. In many cases, however, the most likely purchasers of the companies are their previous owners, who will clearly not be in a position to buy until the compensation terms are settled. Indeed some of the interest expressed in the companies by their former owners has been based on the hope that they would not be asked to pay significantly more than they might receive in compensation. This would fall far short of the £60-£80 millions I have indicated in para 4 above; in my Department's view, compensation for the companies may total only £25m, but arbitration could result in a higher figure. The situation is complex (see Annex B). But if, as is probable, arbitration is required the compensation terms may

well not be settled until well into 1980, and possibly not until 1981. And, irrespective of who the potential purchasers may be, it will prove difficult to settle a price until the final compensation is known.

Political Issues

8 I recognise the force of our Manifesto commitment. Not to take immediate action would provoke reaction from many supporters; some of the former owners of shipyards, who may be hoping that they can re-acquire their former companies on favourable terms, would be disappointed. And I accept that if we do not act now, it may be more difficult to find a suitable opportunity later. Former owners may lose interest, and it could be difficult later to give priority to the legislation. But equally I recognise how hard it will be to justify selling off the only profitable parts of BS, at a time when the industry is being subject to painful cuts, and in the face of hostile reaction from both the national trade unions and the BS Board. Such an action could not be justified in terms of PSBR reduction, for the reasons set out in para 5: and much would no doubt be made by our opponents of the extent to which the profitable parts being returned to private ownership made their money mainly from Government contracts.

9 I am also conscious of the danger that an attempt to act now on shipbuilding may hinder our chances of making rapid progress with aerospace - where the prospects look somewhat better, and the financial gains greater. A Bill confined to aerospace will inevitably be controversial, but not exceedingly, and should be both coherent and relatively short. By contrast, a Bill dealing with both aerospace and shipbuilding is likely to prove unwieldy (since different approaches may well be adopted towards the two industries), and to attract all the hostility that the contraction of shipbuilding will occasion. More positively, I believe it should be possible to represent immediate action confined to aerospace as a mark of our determination to make progress quickly where there is real prospect of doing so.

Strategic issues

10 The Ministry of Defence would, I understand, be perfectly content with denationalisation if it could be accomplished without disruption, and they recognise that it could bring more competition between the three yards. However, the consequences of industrial disruption could be very serious: and as I have said, this seems very likely at Yarrow if denationalisation legislation is undertaken at the same time as closures of merchant yards in the vicinity.

11 BS argue that hiving-off the warshipbuilders could adversely affect their exports, since a coordinated effort would be more difficult. This argument has limited force.

Options for disposal

12 In the light of these issues, I have reviewed a wide range of options, set out below:

- a) Separate sale of all three specialist warshipbuilders in their entirety.

The warshipbuilders should be viable in private ownership and they would be subject to commercial disciplines so far as this is

possible where their main business is to supply essential equipment to the Government. However, all the disadvantages discussed above would be present in their most serious form. Opposition to the Government's policies would be at its most intense, and the net financial effect at least in the short-term would be a loss to the Exchequer;

- b) Sales of shares in all three specialist yards separately or together but with BS (or Government) retaining a holding.

This option would be worse financially, since the £86 million in advance payments should still have to be repaid by BS, and we should receive less for the sale of shares. Opposition to the Government's proposals would be less strong, but possibly sufficient to ensure disruption. On the other hand, the de-nationalisation threat would have less weight. The benefit in terms of exposing the businesses to commercial pressures would depend on the extent of the BS ownership and any conditions attached. In any case sale on this basis might not be feasible since the former owners would probably only be interested in 100 per cent ownership. The legislative provisions involved would be different from those proposed for British Aerospace, and the two would sit uncomfortably in the same Bill;

- c) Sale of one or two yards only, either wholly or in part.

Vospers is the most attractive to investors and the furthest removed from the rest of the industry. However, it would be difficult to defend selling one or two warshipbuilders only when the other owners would also like their yards back, at the right price. Moreover, this solution would be little better financially, at least in the short term, since most of the loans to BS in the form of advance payments comes from Vospers. The former owners might well be reluctant to buy in these circumstances, since they would fear that their competitors who remained in BS would be given preference in placing Government contracts;

- d) Sale of Hall Russell and Brooke Marine.

The proceeds of these sales would be so small that it would not be worth while legislating for these alone. I have asked the Chief Executive of BS to consider whether they would be willing to sell these two yards. This would of course be welcome, but it would only be a very modest gesture.

Conclusion

13 None of the options that has been considered offers a means of escaping the adverse financial and industrial effects of disposal which I have set out above; all, with the possible exception of voluntary action by BS on the two small mixed yards, run the risk of slowing the passage of the aerospace Bill, and of making Parliament the focal point for industrial and political reaction against the rundown of shipbuilding. I regard the risk of not being able to introduce the legislation later as a lesser evil than these adverse consequences. I would, however, wish to consider the possibility of legislation on British Shipbuilders in the next session. I therefore propose confining the measures in this session to aerospace alone. I would intend to present this to our supporters as a policy of acting rapidly where action is likely to prove fruitful, and to

make clear that we should return to the denationalisation of British Shipbuilders, when we have a more definite idea of its size, structure and prospects, and when the market picks up. We could also apply to it the benefits of our experience acquired during the denationalisation of aerospace. I therefore seek agreement that:

- i action on denationalisation of BS should be deferred, with the possible exception of any voluntary sales that BS may be willing to undertake; and
- ii the legislation to be introduced this year to introduce private sector finance into British Aerospace should make no provision to enable us to compel BS to sell off the warshipbuilders.

K J
16 July 1979

1. PROFITS

(Before tax and extraordinary items)

	£'000		
	1977-78 (Actual)	1978-79 (Actual) ¹	1979-80 (Forecast)
Vickers	4,896 ¹	9,025	12,535
Vosper	4,519 ¹	10,700	9,430
Yarrow	1,789 ¹	3,099	3,826
Brooke Marine	935	1,721	1,523
Hall Russell	554	160	516
		<u>24,705</u>	<u>27,830</u>

1 Subject to audit

2 9 months to 31 March 1978

2. ORDERS

Vickers

MOD: 4 nuclear submarines
1 anti submarine cruiser
1 type 42 destroyer

Prospective ordering pattern

Nuclear submarine every 12/15 months
Type 42 destroyer every 18 months to 1983
Type 43 destroyer every 2 years from 1983
Conventional submarine 1982
(first of class)

Vospers

MOD: 3 Type 42 destroyers
3 Mine Counter Measures Vessels (MCMV's)

Prospective ordering pattern

Type 42 destroyer every 18 months to 1980
Type 22 frigate every 18 months from 1980
MCMV every year

EXPORT: 6 Fast Patrol craft for Egypt
Refit of 6 Patrol craft for Egypt. 2 to be carried
out here and 4 kits to be supplied.

Yarrow

MOD: 5 Type 22 frigates
2 MCMV's

Prospective ordering pattern

Type 22 frigate
MCMV

every year
every 9 months

EXPORT: 2 support vessels for Iran. 4 were originally ordered and later cancelled but it is now expected that they will take two. Purchasers for the other two are being sought.

Brooke Marine

EXPORT: 6 Fast Patrol craft for Middle Eastern country
1 42m Patrol craft for Australia

Hall Russell

MOD: 4 torpedo recovery vessels
2 offshore patrol vessels

3. EMPLOYMENT

Vickers	13,900 (including 5,000 in engineering)
Vosper	4,700
Yarrow	5,500
Brooke Marine	870
Hall Russell	890 (including 140 in engineering)

The link with compensation for nationalisation

- 1 A link between compensation for nationalisation and plans for denationalisation arises only if it is assumed either that the former owners are to be offered the opportunity to reacquire their former subsidiaries, or that they are to be given some form of preferential treatment as applicants for shares in a general offer for sale.
- 2 The sale price for the companies must represent their worth at the time of sale if objections to denationalisation are to be minimised. There is no logical connection between the sale price (early 1980s) and the compensation value (1973/74). Nevertheless the former owners are unlikely to be willing to reacquire their former subsidiaries until compensation is settled and even then may be reluctant to pay more for the reacquisition than they received in compensation. This reaction is reinforced by the severe effect which nationalisation has had on the earnings and financial position of the former owners.
- 3 Compensation has not yet been settled for any of the five companies with which this paper is principally concerned. The Department's negotiating position is being reviewed. Because the former owners were dissatisfied by the statutory terms, and most have reflected this in their claims for compensation, it appears likely that they will have recourse to arbitration even if the Department's offers are increased as a result of the review. The outcome of arbitration is unlikely to be known until well through 1980 and possibly not until 1981. On the Department's view, the compensation value of the five companies is around £25 million; a higher total value could result from arbitration.
- 4 Compensation for the five companies is the average of national Stock Exchange quotations for their shares in the six months September 1973-February 1974. The Act also provides that, where a vesting business formed a substantial part of a group whose holding company had a Stock Exchange listing, the quotations of that company are a relevant factor in valuing the subsidiary. This applies to Vosper and Yarrow, whose former owners have protested the most strongly about the compensation offered; they regard the market capitalisation in 1973-74 as an unsatisfactory basis because of the subsequent growth of profits.