

CABINET - SUBJECTS FOR CONSIDERATION, 25 MARCH 2002 11:00 AM

Not Relevant

107 **DIT110/210/006PT3** **Mitsubishi Motors Australia Limited (MMAL)**
CS

APPROVED

Premier & Cabinet Minister.

Not Relevant

CABINET COVER SHEET

- 1 **TITLE:** Mitsubishi Motors Australia Limited (MMAL)
- 2 **MINISTERS:** Deputy Premier
Treasurer
Minister for Industry, Investment and Trade
- 3 **PURPOSE:** Approve a financial assistance package to MMAL to assist in securing the future of the South Australian manufacturing operations.
- 4 **RESOURCES REQUIRED FOR IMPLEMENTATION:** An additional \$15 million to be added to the existing allocation of \$20 million.
- COSTS** This financial year: \$15 million
- The additional \$15 million is to be sourced from existing Department of Industry and Trade allocations. The impact of this on the Department's activities will be addressed in a future submission.
- 5 **RELATIONSHIP TO GOVERNMENT POLICY:** Consistent with Government policy aimed at securing the existing economic and employment base of the State, and creating opportunities for employment growth.
- 6 **CONSULTATION:** There has been consultation with DTF on this matter. The Industries Development Committee of Parliament has not been reformed yet. The Industries Development Cabinet Committee has not yet been convened.
- 7 **URGENCY:** High, as detailed in Cabinet Submission.
- 8 **RECOMMENDATIONS:** It is recommended that Cabinet:
- 8.1 Approve the addition of \$15 million to the Mitsubishi loan package approved by Cabinet on 29th Jan 2001, subject to

- Mitsubishi confirming the establishment of the global centre of engineering and design excellence in South Australia.
- 8.2 Approve the funds being sourced from existing DIT IIAF allocations.
 - 8.3 Agree to the changed implementation date in the existing contract for parent company sign-off on the post 2005 model development to 31st May 2002.
 - 8.4 Agree to the secondment of Mr Bob Manning from DIT to Mitsubishi for a further 12 months



Kevin Foley MP
DEPUTY PREMIER
TREASURER
MINISTER FOR INDUSTRY, INVESTMENT AND TRADE

25 / 3 / 2002

TO: PREMIER FOR CABINET

RE: MITSUBISHI MOTORS AUSTRALIA LIMITED (MMAL)

1. PROPOSAL

1.1 That Cabinet approve an increase in the total South Australian Government loan assistance package for MMAL from \$20 million to \$35 million.

1.2 That the existing contract with MMAL be amended to include the additional assistance and change the date by which the Company must obtain corporate approval for the development of the new model from the end of February 2002 to the 31st of May 2002.

1.3 That Cabinet agree to the request by MMAL for the continuation of the secondment of a Department of Industry and Trade (DIT) staff member for a further twelve months.

2. BACKGROUND

2.1 DIT identified serious concerns about the future of the local manufacturing operations of MMAL in 1998, and this led to the State Government establishing the Automotive Task Force under the Chairmanship of former MMAL chief Graham Spurling. The Task Force made a number of recommendations, including the provision of State Government financial incentives to MMAL if they undertook the necessary business planning work to convince their parent company that they did deserve a place in the global stable of Mitsubishi brands.

2.2 It is important to note that Mitsubishi Motors Corporation (MMC), the parent company, have themselves been under considerable financial stress, accumulating debts of some \$26 billion, and making decisions to close plants and retrench employees. The Daimler Chrysler Corporation has acquired a controlling stake in MMC.

2.3 MMAL sales in 1999 totalled some \$2B of which \$884M was contributed by the locally produced MAGNA/VERADA, the balance coming from CBU's (completely built up imports), and parts and accessories. Some \$318M of sales came from exports, comprised of \$273M complete vehicles and \$45M from componentry.

2.4 MMAL has a 2 shift production capacity of some 130,000 units PA, but in 1999 produced 34,700. Production peaked in 1997 at 59,275 with an overall market share of 10.4%, albeit with only 4.6% accounted for by local production. Production in 2001 was 43 800 units.

2.5 The automotive industry is of critical economic importance to South Australia. The two automotive manufacturers directly employ over 7,000 people and support a further 14,000 indirect jobs. The industry contributes around \$1.6 billion in Gross State Product, accounts for over 14% of the State's manufacturing sector and around 50% of the State's merchandise exports.

2.6 Two independent sets of economic modelling have been conducted, and DTF have also conducted their own modelling, on the potential impacts of the closure of MMAL's local manufacturing operations on the South Australian economy. Closure would lead to the loss of 3000 direct jobs, and between 5000 and 7000 other jobs in South Australia. This would lead to an increase in the South Australian unemployment rate of an additional 1.4%. The ten-year time frame of the models suggests this unemployment impost would not reduce over the following decade.

2.7 In addition to the employment impact, MMAL accounts for between \$515 and \$550 million of annual GSP, which would be lost if the operation closed. The closure of the manufacturing operations would have an adverse effect on almost every sector of the South Australian economy.

2.8 If the new model development program is approved and the 60 000 plus annual sales target achieved after 2005, up to 1000 direct additional jobs at MMAL could be created in the State. The annual difference in the community's welfare as a result of the investment proceeding, as opposed to operations closing (as measured by NPV consumption) is over \$2 billion.

2.9 Discussions are underway between MMAL and MMC about Australia becoming the global development centre for excellence in research and engineering for luxury vehicle development within the MMC group. The initial submission from Australia has been well received by the parent and MMAL are optimistic that this proposal will be supported. This facility would see up to 150 engineers employed on new model development. These jobs would be in addition to the production line jobs.

2.10 After a retrenchment program in June 1999 MMAL employment (as at November 2000) stood as follows:-

Tonsley Park Plant	2137
Technical, Admin etc	507
Lonsdale	<u>771</u>
Total South Australia	3415
Interstate Regional Offices	<u>91</u>
Total:	<u>3506</u>

This figure has remained relatively constant since then.

2.11 Despite this retrenchment program, MMAL recorded a large financial loss in 2000. The acceptance of the current vehicle in the market place was below what was required for MMAL to be viable in the long term.

2.12 In January 2001 Cabinet agreed to an assistance package for MMAL of \$20 million. The package was aimed at convincing local MMAL management that their local manufacturing operations could in fact be saved if they could demonstrate to their corporate parent the merits of doing so. There was a strong suspicion in Government circles at the time that MMC had already made a decision to close the Australian manufacturing operations. The object of State Government intervention was to convince local management that they had an opportunity to reverse that decision. A copy of the recommendations approved by Cabinet on the 29th January 2001 is attached at Appendix 1.

2.13 This assistance package imposed a number of obligations on MMAL regarding the development of a business plan to produce a new model in South Australia in the period post 2005. \$500 000 of the assistance package could be utilised in developing this plan, and the balance of the funds could be accessed to assist with implementation of the business plan. A performance hurdle relating to the agreed value of production in 2005/06 using industry standard figures to calculate this information was put in the contract. If the agreed production value target is reached, then \$10 million of the assistance package converts into a grant.

2.14 During 2001 MMAL undertook a comprehensive manufacturing capability review and business planning process. Part of this process identified a place for MMAL within the global MMC structure, as the only source of a new long wheel base luxury platform. This luxury platform forms an integral part of the MMAL business plan for the development of a post 2005 vehicle.

2.15 In October 2001 MMAL presented their business plan to MMC and later that year received approval to proceed with the new vehicle development, provided that the Daimler/Chrysler/Mitsubishi Product Car Committee gave them the go ahead after their February 2002 meeting, and provided the project could be funded without further recourse to their parent company.

2.16 The business plan was provided to the Government in accordance with requirements of the assistance package, and to receive the balance of the assistance MMAL is required to implement the business plan. The current plan for the development and production of the new model requires investment of \$976 million. This would lead to the production of 65 000 vehicles per year, approximately half for export and half for the domestic market.

2.17 The MMAL business plan as presented to their parent had made allowance for the receipt of \$145 million through the Federal Government Strategic Investment Coordination (SIC) Process, but had not included the SA Government assistance package within their funding requirements.

2.18 The Australian automotive industry had requested the Federal Government to bring forward their proposed review of post 2005 industry assistance arrangements, so as to provide certainty for the automotive industry in relation to future investment

decisions. The Commonwealth decided that the MMAL application for SIC funding did not meet the requirements of that process, and would instead be considered as part of the response to the post 2005 review, likely to be given by the Federal Government in the third quarter of 2002.

2.19 The automotive industry is characterised by very long lead times, and this timing was not suitable to MMAL. If the Federal Government insisted on adhering to this proposal, it would in all likelihood have seen MMAL implement their decision to close their Australian manufacturing operations.

2.20 A delegation of senior DIT staff met with their counterparts from the Department of Industry, Tourism and Resources in early February 2002, and shortly afterwards, the Commonwealth advised MMAL they would decouple the assistance request and the industry review.

2.21 Accepting the reality of the lack of Federal enthusiasm to provide support to MMAL, the company reviewed its funding requirements. The CEO of MMAL is prepared to recommend to MMC that the project be approved subject to total government funding of \$70 million. With the existing SA Government offer of \$20 million, this meant the ask on the Commonwealth was reduced to \$50 million. Determining the minimum Cash Flow Return on Investment (CFROI) that MMC will accept for this project arrived at the \$70 million figure. Government contributions of \$70 million will take the CFROI to over 20%, which is near normal industry standards, but below MMC's normal benchmark of 34%.

2.22 A meeting with the Federal Industry Minister was held early in March, and it was made clear to the SA Government and MMAL that the Federal contribution would be capped at \$20 million. This figure appeared to be matching the SA contribution.

2.23 The current SA assistance package of \$20 million is insufficient to secure the Commonwealth support necessary to secure this deal. The magnitude of the impact from failure to secure MMAL's future is so high that further consideration of support is warranted. By increasing the total State contribution to \$35 million, it is anticipated that the Commonwealth will provide matching funds.

2.24 The timing issue is very important for MMAL. The window of opportunity for them to provide a long wheel base left hand drive luxury vehicle to the United States is very tight. Even with the current MMAL development schedule, the new model would not be available for export until early 2006. The North American arm of MMC are very keen to protect market share, and have already expressed concerns about the period of time (6 months) when they will not have the new luxury model available. If the new development proceeds, Australia will be the sole global source of the long wheel base luxury variant in both left and right hand drive and this provides the opportunity for sustained activity on a longer term basis at MMAL.

2.25 If MMAL cannot guarantee self-funding to their parent, then they may not receive approval to move to final design and engineering of this car. Even small delays in gaining that approval will further increase the time when a luxury variant cannot be supplied to the United States market. There will come a point when the

North American Mitsubishi organisation will say enough is enough, and seek to source their luxury vehicle elsewhere.

2.26 Conversely, there are considerable grounds for optimism if the new model development goes ahead. It will require market acceptance of the vehicle in the domestic market, but a modest level of acceptance will see MMAL reach its production targets. This would lead to the employment of up to 1 000 additional staff at MMAL, with the consequential flow on effects meaning the total employment impact (according to the Allen model) for the State economy is some 2850 jobs. A summary of the Allen report is at Appendix 2.

2.27 The MMAL business planning process has been assisted by the secondment of the Director, Special Projects with the Strategic Initiatives Group of DIT, Mr Bob Manning, to work with MMAL. That secondment is due to expire in April 2002, and MMAL have requested that it be extended for a further 12 months.

2.28 The existing contract relating to the \$20 million loan required MMAL to have received full approval from MMC by the end of February 2002. Because of funding uncertainty by the Federal Government, that has not occurred, and MMAL have requested the date be extended to the 31st of May 2002.

3. DISCUSSION

3.1 The Australian automotive industry is unlikely to ever compete internationally in terms of scale with manufacturers in other parts of the world. However, the industry does have a reputation for its quality design skills, and the exceptional flexibility of its vehicle assembly plants. It is these skills that have allowed the industry to develop a significant export market in recent years, and that offer scope to save MMAL's local manufacturing operations.

3.2 A major facelift for the existing Magna/Verada range is planned for 2003, with an expectation that this face-lifted vehicle will allow the company to retain market share until the new post 2005 model is released. If the final go ahead is not given by MMC for the post 2005 development, MMC may require an immediate exit from local manufacturing operations. This could see the plants close prior to the end of the year. MMAL does face Australian exit costs of some \$600 million, so the option of continuing manufacturing is not out of the question even without additional support, but it has been put clearly to both the Prime Minister and former Premier that manufacturing will cease without the appropriate level of government support.

3.3 The existing agreement with MMAL contains a number of significant performance hurdles for the Company. If the Company is achieving an annual build of 60 000 units with 70% local content within five years of the first draw down, \$10 million of the loan funds will convert to a grant. It is proposed that the additional SA loan funds and the Federal Government funding be tied to the establishment of the research and development centre discussed in para 2.9.

3.3.1 Economic, financial and budget implications

The allocation of an additional \$15 million to Mitsubishi from existing DIT IIAF allocations severely inhibits the Department's ability to pursue its investment attraction charter. This issue will be addressed in a future Cabinet Submission.

3.3.2 State development, social, environmental and other impacts

Clearly there are significant State Development and social impacts if Mitsubishi cease local manufacturing. DTF have conducted their own modelling on the impact that such an outcome would have on the State budget. Modelling performed by Allen Consulting, using the Monash model, suggests that over the ten-year period of the modelling, there would be a 1.4% adverse impact on the unemployment rate in SA. That is, the State economy would not recover from the impact within ten years.

The social implications of the loss of over 3 000 direct jobs plus many more indirect jobs from the southern suburbs would be overwhelming. Governments have struggled to attract major industries to the south at the same rate as residential development has occurred. It is likely that such an event would create a significant air of despondency in the State economy that, based on previous experience, would take years from which to recover.

3.3.3 Staffing implications

Part of the original agreement with MMAL saw the secondment of Mr Bob Manning from DIT to MMAL for a period of 12 months. Mr Manning has a great deal of experience in manufacturing engineering processes, and formerly headed the engineering division of the South Australian Centre for Manufacturing.

MMAL have requested that Mr Manning's secondment be extended for a further twelve months. Mr Manning is a contracted employee of DIT. His secondment will be at a cost to the Department of approximately \$126,500, but this figure is already included in the Department staffing budget.

3.3.4 Consultation

The Department of Treasury and Finance have been extensively consulted on this proposal.

4. RECOMMENDATIONS

It is recommended that Cabinet:

- 4.1 Approve the addition of \$15 million to the Mitsubishi loan package approved by Cabinet on 29th Jan 2001, subject to Mitsubishi confirming the

establishment of the global centre of engineering and design excellence in South Australia.

- 4.2 Approve the funds being sourced from existing DIT IAF allocations.
- 4.3 Agree to the changed implementation date in the existing contract for parent company sign-off on the post 2005 model development to the 31st of May 2002.
- 4.4 Agree to the secondment of Mr Bob Manning from DIT to Mitsubishi for a further 12 months.

In Cabinet

25 MAR 2002

Kevin Foley MP
DEPUTY PREMIER
TREASURER
MINISTER FOR INDUSTRY, INVESTMENT AND TRADE

APPROVED

 PREMIER

25/3/2002

Appendix:

- 1. Recommendations from Cabinet Approval 29th Jan 2001
- 2. Economic Modelling Allen Consulting
- 3. Economic Modelling Barry Burgan from Economic Research Consultants