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Dame Meg Hillier MP
Chair of the Public Accounts Committee
Sent electronically

Dear Ms Hillier,

I am writing to inform you that the Ministry of Defence (MOD) has today launched an offer to the shareholders of Sheffield Forgemasters International Limited (SFIL). The major shareholders have agreed that the MOD will acquire the entire share capital of the company allowing it to come into Government ownership at a cost of around £2.5million. The MOD will take on and refinance the existing indebtedness of the Group which is currently around £18 million. The MOD would then undertake a major capital investment programme of up to £400 million over the next 10 years, to secure the supply of critical components into major MOD programmes.

SFIL has unique capabilities making it an essential supplier to the MOD. It is the only UK based manufacturer with the skills and capability to produce the large scale high-integrity castings and forgings from specialist steels that are required for defence programmes. However, the current state of the company's critical plant, machinery and infrastructure is poor, and, in some cases, it is significantly past its end of life point, introducing significant risk to product delivery. Without intervention Defence programmes would be exposed to significant delivery delay risk.

SFIL is in significant financial distress and, again, without this intervention its financial viability beyond 2021 would be severely at risk. It is privately-owned by current and former employees and they cannot inject the capital needed to support this investment programme. The level of capital investment required also makes the business unattractive to third party buyers or lenders. Without MOD support, SFIL is expected to be unable to repay its lending facility at the end of this year and would enter into an insolvency event.

The Department, working with SFIL and with support from external advisors, has evaluated and scrutinised the level of capital investment needed to secure the defence supply. The proposed recapitalisation is the minimum level of investment required to bring the risk of delay to an acceptable level. This intervention is significantly less costly than the alternatives and secures the company's defence output for the long-term future.

The Department has not taken this action lightly. Full Government ownership is regarded as the best and only viable route to achieve appropriate levels of control and influence over the investment from Her Majesty's Government (HMG). Other forms of Government Ownership, including preference and golden shares, do not provide HMG with the levers of control and levels of transparency required for an investment of this magnitude. A Government Owned, Contractor Operated option was considered but was not regarded as feasible to implement ahead of when SFIL was expected to enter administration in late 2021. Buying the company out of insolvency was also considered but carries greater risk and is potentially costlier than the consensual sale agreed with shareholders.

Once the transaction is complete, full governance and sponsorship arrangements will be implemented, including a specific sponsorship team and additional board representation to oversee the MOD's objectives for the company. As part of these arrangements, there will be regular reporting to and monitoring by SFIL including specific arrangements focused on the recapitalisation programme to ensure sufficient oversight and scrutiny of MOD funding. We are now focused on working with all parties to secure SFIL's future success, and ensure the supply of key defence components, with the aim of eventually returning the business to the private sector.

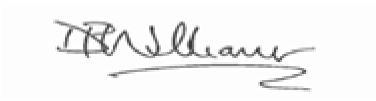
I am confident that this proposal satisfies the Accounting Officer tests as set out in Managing Public Money. This project is proceeding under the powers of the Industrial Development Act, 1982, and use of the powers has been agreed by HMT Ministers. As part of the process we have consulted the Industrial Development Advisory Board (IDAB) for independent 'commercial' advice who have concluded that: "*The Board recognises the strategic need for MOD to take control of Sheffield Forgemasters' defence outputs but can't support the proposal on a commercial basis."* Having consulted the Department for Business, Energy and Industrial Strategy, the Treasury Officer of Accounts, and legal colleagues, and gained CST approval for the IDA route; I am satisfied as Accounting Officer that this intervention can proceed, given that the IDAB's perspective is limited to its 'commercial' remit, looking for a commercial return rather than broader value for money. This intervention is being made for policy and security reasons, not for a commercial return, and I am satisfied this approach is the best value for money option, given the strategic need for the company's components, the lack of alternative suppliers available, and the significant and greater cost to Government if we did not intervene.

Ministers have also taken into account that placing this specialist manufacturing company on a secure financial footing has the added benefit of maintaining the key specialist skills at SFIL, and securing future employment at the plant which currently employs around 600 people in South Yorkshire. Under Government ownership we will be able to ensure that SFIL also delivers fully against the Government's levelling up agenda, supporting high quality training and employment at the forefront of science and technology in the Defence sector.

Finally, I know that Ministers would want me to emphasise that there was no discourtesy meant to the Committee or wider House by making this announcement during the summer recess. This has been necessitated by the complicated legal timelines relating to this intervention. A written ministerial statement will be laid in parliament at the earliest opportunity.

I am happy to follow up with further information if you would find that helpful. I am copying this letter to Gareth Davies, Comptroller and Auditor General, and the Treasury Officer of Accounts.

Yours sincerely,



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