



Public Accounts Committee  
**The Welsh Government's funding  
of Kancoat Ltd**

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February 2017



**National Assembly for Wales**  
Public Accounts Committee

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# Public Accounts Committee

The Committee was established on 22 June 2016 to carry out the functions set out in Standing Orders 18.2 and 18.3 and consider any other matter that relates to the economy, efficiency and effectiveness with which resources are employed in the discharge of public functions in Wales.

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## Current Committee membership:



**Nick Ramsay AM (Chair)**  
Welsh Conservative  
Monmouth



**Neil McEvoy AM**  
Plaid Cymru  
South Wales Central



**Mohammad Asghar AM**  
Welsh Conservative  
South Wales East



**Neil Hamilton AM**  
UKIP Wales  
Mid and West Wales



**Mike Hedges AM**  
Welsh Labour  
Swansea East



**Rhianon Passmore AM**  
Welsh Labour  
Islwyn



**Lee Waters AM**  
Welsh Labour  
Llanelli



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## Chair's Foreword

The Auditor General for Wales published a report on the Welsh Government's funding of Kancoat Ltd. This was a metal-coil-coating company which received financial support worth £3.4 million from the Welsh Government. The Company went into administration in September 2014, and Welsh Government losses to date are at least £1.5 million and rising.

The Committee chose to undertake further work on the Auditor General's report, given our concerns that many of the issues identified in the report appear to have some parity with other failed businesses in receipt of Welsh Government funding.

On hearing the evidence from this inquiry, the Committee have serious concerns about whether the initial decision to invest should have been made, given the substantial uncertainties around the company and the commercial viability of the project proposed.

A key theme emerging through the evidence we heard was around the lack of clarity and transparency around the Welsh Government's decision making processes. Our evidence suggests that the Welsh Government has made a number of decisions around business finance, such as expanding the definitions of sectors and the conditions for providing repayable or non-repayable repayable financing, that have not been well documented nor communicated clearly.

We note that investment in Kancoat Ltd was made against a backdrop of the global economic crisis that began in 2008, and this appears to have been a major factor in the Welsh Government's decision making process. Inevitably, an economic downturn will impact on the support available for businesses and the decisions made in this economic environment will be more challenging and potentially more risky than during more buoyant times. However, we believe these factors should not cloud judgement to the extent that it results in poor decision making based on inadequate supporting evidence.

In this report we make a series of recommendations which aim to tighten procedures and improve the framework for decision making, in order to minimise the risk of questionable decisions being made again.

We welcome the Auditor General undertaking a broader value-for-money examination of the Welsh Government's approach to business finance during 2017, as the Committee has raised concern over some actions taken by the Welsh Government to support Welsh Business. This is such a vital area to ensure the future prosperity of Wales that we want to ensure it is administered to best effect.

## Recommendations

**Recommendation 1.** The Committee recommends the Welsh Government clarifies the definition of 'advanced materials and manufacturing' and the intention that this is to be considered as one sector. This clarification should be clear in defining as to what specifically is included in 'advanced materials and manufacturing'. .....Page 11

**Recommendation 2.** The Committee recommends that the Welsh Government keep clear records of decisions around the awarding of financing outside of established definitions. This will ensure that there are no questions of inconsistent treatment in the decision making process from those companies outside of the traditional definition that have not received support..... Page 11

**Recommendation 3.** To ensure sufficient clarity, the Committee recommends that the Welsh Government amend the terminology for the finance they provide from 'non-repayable repayable' to something which more accurately describes what is being offered. .... Page 13

**Recommendation 4.** The Committee recommends that the Welsh Government develop and publish clearer guidelines as to when non-repayable repayable business finance will be offered and when repayable business finance will be offered. We suggest that the Auditor General may wish to return to this issue in his future work on business support. .... Page 13

**Recommendation 5.** The Committee recommends that the Welsh Government clarifies the distinction between actual repayable business finance (interest free) and commercial loans..... Page 13

**Recommendation 6.** The Committee recommends that the Welsh Government produces updated robust risk identification and mitigation guidance, which reflects the lessons learnt from this inquiry. This guidance should ensure that decision makers have a more robust framework from which to work and therefore give due consideration to risk. We would expect both risk identification and the adequacy of any proposed mitigation to be significant elements in the Auditor General's future work on Business Finance..... Page 14

- Recommendation 7.** The Committee recommends that the First Minister ensures the Ministerial Code requires the consideration of perceived conflict of interests and that the outcome of such consideration is formally fully documented. ....Page 17
- Recommendation 8.** The Committee recommends that decisions to go against the advice of the due diligence report should be clearly documented in project documentation. This is not to say that it should be followed in all instances, but that evidence of full consideration including a market analysis, and the reasons for decisions should be recorded to ensure that the value of due diligence is maintained. ....Page 19
- Recommendation 9.** The Committee recommends that, when handling requests for the provision of additional financial support to companies, the Welsh Government should build in a more robust 'pause and reflect' stage to its due diligence, consideration and approval processes. .... Page 19
- Recommendation 10.** The Committee recommends that Welsh Government guidance for investments explicitly states that up to date and independent professional valuations of any assets offered as collateral security are obtained prior to any finance being agreed..... Page 21
- Recommendation 11.** We recommend that the Welsh Government inform the Committee about the outcome of any negotiations for the site, and the impact this has on the final sum lost as a result of the Kancoat investment and should include the cost of any remediation works. .... Page 22

# 01. Introduction

1. The Auditor General for Wales (Auditor General) published a report on 14 July 2016, examining the Welsh Government's funding of Kancoat Ltd (Kancoat). The report sets out a factual account of the key matters relating to the Welsh Government's financial support package for this company. It presents these matters in the wider context of the Welsh Government's approach to supporting businesses in Wales, but with a particular focus on the financial packages available to the 'Advanced Materials and Manufacturing' sector in Wales.

2. This was the first time that the Auditor General has reported formally on a 'facts only' basis, meaning that the Auditor General did not 'form evaluative conclusions' or 'make specific recommendations'. The report instead sets out the facts for the Public Accounts Committee (the Committee) to consider. This is an approach which has also been adopted recently by the National Audit Office for some of its reporting. The Committee considered the report at its meeting on 19 September 2016 and undertook an evidence session on 14 November 2016, with the relevant Welsh Government Additional Accounting Officer and other officials.

## Background to the Auditor General's examination of the Welsh Government's support for Kancoat

3. Kancoat was a limited company set up in early 2012 to take over the operation of an aluminium-coil-coating production line at the Alcoa site on the Waunarlyydd estate in Swansea. The Kancoat line processed pre-lacquered steel and tinsplate strip for the manufacture of can components. These components, known as can stock, include ring pulls, aerosol caps and can ends.

4. The Welsh Government provided Kancoat with a funding package for acquiring a coil-coating line and the operating the line totalling £3.4 million. Despite this, the business venture failed and the company went into administration in September 2014.

5. Following this failure, the Auditor General received correspondence raising questions about the:

- Value for money of the financial support package that the Welsh Government had made available to Kancoat; and
- The transparency of Kancoat's relationship with another company called Coilcolor Ltd (Coilcolor).

6. At the request of the Wales Audit Office, the Welsh Government's Internal Audit Service considered these matters as part of its review of Welsh Government compliance with its own policies and procedures in supporting Kancoat. The Internal Audit Service concluded that although the Welsh Government had complied with its policies and procedures, in so far as these were relevant, it needed to introduce additional procedures to address commercial loans and property transactions used in the Kancoat support package.

7. The Auditor General decided to undertake an external audit review of the Kancoat case as there were some issues noted in the Internal Audit Service working papers regarding the management of risk by the sponsors of the project within the Welsh Government's Economy, Skills and Natural Resources Group. Furthermore, there had been a number of other instances when companies in receipt of Welsh Government financial support had gone into administration.

**8.** Since the Auditor General’s decision to report on Kancoat, there have been a number of other cases reported in the media about the Welsh Government’s approach to business finance, such as the company Oysterworld. As a result, the Auditor General has indicated to the Committee that he is considering undertaking a broader value-for-money examination of the Welsh Government’s approach to business finance during 2017. The scope and timetable for that wider review is yet to be confirmed but we understand that it would consider, in broader terms, the arrangements for the governance and management of business support programmes and evidence of value for money. We recognise that the review is unlikely to examine any individual case in the same level of detail as Kancoat. The Committee fully endorses this approach, and through this report we have made reference to areas which we believe would benefit from consideration as part of this review.<sup>1</sup>

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<sup>1</sup> Auditor General for Wales, The Welsh Government's funding of Kancoat Ltd, July 2016

## 02. Welsh Government Business Finance

9. Between 2012-13 and 2014-15, the Welsh Government figures state it provided some £266 million of financing to businesses operating within the eight business sectors, outlined below in paragraph 10. The Auditor General’s report describes three types of support package available to businesses in the advanced materials and manufacturing sector each of which was relevant to Kancoat:

- Repayable Business Finance;
- Commercial loans; and
- Property solutions - head leases.

### Definition of Sectors

10. The Welsh Government’s Economy, Skills and Natural Resources Group operate eight sector teams providing financial and non-financial support to businesses. These sectors are:

- Energy and Environment;
- Construction;
- Creative Industries;
- Advanced Materials and Manufacturing;
- Financial and Professional services;
- Information and Communications Technologies;
- Life Sciences; and
- Tourism.

11. Kancoat was classified as being within, and received Welsh Government support as part of, the ‘advanced materials and manufacturing’ sector. The Committee queried with officials the definition of this sector, and whether it was intended to support ‘advanced materials and manufacturing’ as a singular classification, since the nature of the planned work of Kancoat, putting paint/colour coating onto steel and aluminium, does not itself seem classifiable as ‘advanced materials’. James Price, Deputy Permanent Secretary, Economy, Skills and Natural Resources Group, Welsh Government, confirmed that it was considered to be one sector<sup>2</sup> and that he thought Kancoat would be classified as such because:

“When the financial crisis hit, there was a review of what was in sectors and what wasn’t in sectors, and I think it’s fair to say that the boundary of a number of sectors was widened quite significantly to include a wider definition. So, some people would say that that type of basic metal processing shouldn’t be advanced materials. Other people at the time would have argued, ‘Yes, it should’. And probably, the reasons that would have been put forward for why it should—I don’t know; I’d have to check the record—would have been down to

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<sup>2</sup> Record of Proceedings (RoP), 14 November 2016, paragraph 28

the kit that was being used, the capital intensive nature of the activity, and so on.”<sup>3</sup>

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**12.** The Government subsequently wrote to the Committee to explain how the processes relevant to Kancoat’s operation and production aligned with processes classified as being relevant to the advanced materials and manufacturing sector. The explanation provided set out “the SIC codes 2003 and 2007, which are generally associated and aligned to Advanced Materials and Manufacturing Sector”,<sup>4</sup> however it is unclear what these actually refer to, and they do little to add clarity to the reference above from James Price ‘that the boundary of a number of sectors was widened quite significantly to include a wider definition’.

**13.** While the Committee understands the need to make the sectors as wide as possible, to offer support to a large number of businesses, particularly given the global financial crisis, we are concerned that the Welsh Government was unable to provide us with reasoning for, or a record of, the deviation from the initial definition. We advise the Government that it would be prudent to keep a record of such a decision in order to ensure that there are no questions of inconsistent treatment in the decision making process from those companies outside of the traditional definition that have not received support.

**Recommendation 1.** The Committee recommends the Welsh Government clarifies the definition of ‘advanced materials and manufacturing’ and the intention that this is to be considered as one sector. This clarification should be clear in defining as to what specifically is included in ‘advanced materials and manufacturing’.

**Recommendation 2.** The Committee recommends that the Welsh Government keep clear records of decisions around the awarding of financing outside of established definitions. This will ensure that there are no questions of inconsistent treatment in the decision making process from those companies outside of the traditional definition that have not received support.

## **Repayable Business Finance**

**14.** The Auditor General’s report set out that of the £166 million Repayable Business Finance made available to businesses between April 2012 and March 2015, £154 million (93%) was in fact made available on a non-repayable basis, including £778,000 for Kancoat.<sup>5</sup>

**15.** The Welsh Government document ‘Economic Renewal: A new Direction’,<sup>6</sup> which was published in July 2010, sets out the discretionary support to businesses. Repayable Business Finance is provided as a grant and the level of support is negotiable but must always be within State Aid ceilings and no more than necessary to enable the project to go ahead. The Auditor General’s report cites an explanation from Welsh Government officials that:

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“...Repayable Business Finance can be deemed non-repayable in either of the following circumstances:

a) A mobile project, which would include inward investment. Mobile projects

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<sup>3</sup> RoP, 14 November 2016, paragraph 32

<sup>4</sup> Written Evidence, PAC(5)-12-16 PTN4, 12 December 2016

<sup>5</sup> Auditor General for Wales report on examination of the Welsh Government's support for Kancoat, July 2016

<sup>6</sup> [Economic Renewal: a new direction, Welsh Government, July 2010](#)

only become repayable if key targets are not met, for example: the number and quality of jobs, longevity of project, etc.

b) With Ministerial approval and in ‘exceptional circumstances’, it is possible for the scheme to be offered on a non-repayable basis. An example of this was during the delivery of the Wales Economic Growth Fund, under which approval was given for Repayable Business Finance applications to be considered on a non-repayable basis.”<sup>7</sup>

**16.** The Committee explored what the Welsh Government actually meant by the term ‘non-repayable repayable finance’. James Price explained:

“It’s actually very simple: repayable business finance is a grant that you have to pay back, typically without interest. Non-repayable repayable business finance is a grant.”<sup>8</sup>

**17.** He added that the ‘Economic Renewal: A new Direction’ was amended to include non-repayable repayable finance because:

“When the policy was rolled out in the period of the financial crash, it was concluded that that didn’t work, so it was amended. It was amended in a time-limited way, because people always thought that we would go back to try and offer non-repayable finance. But, in the view of the decision makers, which would be the politicians—and I think they’re right—we haven’t yet reached a time when the economy is good enough to remove grants from the system.”<sup>9</sup>

**18.** The Committee questioned the reasoning for the change of direction and whether there was a fair and transparent means of determining whether business finance was repayable or non-repayable. Regarding how the decision was made on what terms the finance was offered, James Price explained that there were two strands set out in the economic renewal policy – mobile projects and:

“There was then a further category that was on an exceptional basis. Now, when the credit crunch happened, Ministers signed off a series of exceptional bases, which was the Welsh economic growth fund, if anyone can remember that so-called WEGF. I think there were three rounds of WEGF, which delivered grant to a significant number of smaller businesses. That was all signed off as an exceptional basis, so it simply went out as grant, and then every business is told what the rules are and that they can make a case on an exceptional basis for it to be non-repayable. The test for us being that we need to provide the minimum necessary for a project to go ahead, and so the investment panel or the Welsh Industrial Development Advisory Board will scrutinise the project to test whether that is the case.”<sup>10</sup>

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<sup>7</sup> Auditor General for Wales report on examination of the Welsh Government's support for Kancoat, paragraph 1.11, July 2016

<sup>8</sup> RoP, 14 November 2016, paragraph 96

<sup>9</sup> RoP, 14 November 2016, paragraph 108

<sup>10</sup> RoP, 14 November 2016, paragraph 115

**19.** Despite this explanation, the Committee remains concerned that there does not appear to be a clear approach set out in deciding whether to offer finance on a repayable or non-repayable basis to applicant companies.

**20.** Furthermore, it is also unclear how the Welsh Government distinguishes between a grant and a loan. The explanation for repayable business finance appears to be what would be considered generally as an interest free loan. The criteria for these decisions seem to be somewhat weak and ad hoc. It appears to the Committee that the Welsh Government are currently unable to articulate clear reasons for their decisions on the types of funding support offered to companies, leaving them open to questions and potential legal challenges about consistency and fairness of treatment.

**Recommendation 3.** To ensure sufficient clarity, the Committee recommends that the Welsh Government amend the terminology for the finance they provide from ‘non-repayable repayable’ to something which more accurately describes what is being offered.

**Recommendation 4.** The Committee recommends that the Welsh Government develop and publish clearer guidelines as to when non-repayable repayable business finance will be offered and when repayable business finance will be offered. We suggest that the Auditor General may wish to return to this issue in his future work on business support.

**Recommendation 5.** The Committee recommends that the Welsh Government clarifies the distinction between actual repayable business finance (interest free) and commercial loans.

### **The Welsh Government’s risk management when supporting businesses**

**21.** The Committee raised a number of queries with the Welsh Government about the risks identified for the Kancoat investment during the evidence session, and the Welsh Government agreed to write to the Committee with further information on the risks and the mitigation taken. In correspondence, the Welsh Government set out 11 risks which were assessed and mitigated against during the appraisal process:

1. Failure to achieve viable level of orders;
2. Failure to obtain the right people;
3. Failure of Products supplied to customers;
4. Failure of Products supplied as incoming stock;
5. Failure of process equipment;
6. Extended prequalification trials;
7. Failure to supply to customers on time;
8. Loss of key personnel;
9. Under achievement of production targets;
10. Energy price rises; and
11. Insured risks.<sup>11</sup>

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<sup>11</sup> Written Evidence, PAC(5)-12-16 PTN4, 12 December 2016

**22.** Having considered the list, the Committee were concerned to see that Kancoat's initial reliance on a single supplier of steel coil was not identified as a risk by the Welsh Government during the appraisal process. The company's difficulties with a single supplier appear to have been a significant factor in the further loan provided in 2014, shortly before Kancoat went into administration. The Auditor General's report states:

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“Unforeseen difficulties with Kancoat's main UK supplier of steel coil meant that Kancoat considered it had no alternative other than to seek new suppliers in France and Korea. The consequent two-month lead time for the product led to delays in the receipt of income against the sales forecast in the business plan. In addition, both overseas suppliers demanded payment in advance. These two factors, taken together, created a significant cash-flow problem for Kancoat. Kancoat sought finance from other commercial sources, including an additional application to Finance Wales and the Enterprise Finance Guarantee scheme – a UK Government lending scheme intended to help smaller viable businesses who may be struggling to secure finance, by facilitating bank loans of between £1,000 and £1 million – but was unsuccessful.”<sup>12</sup>

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**23.** Despite undertaking to provide information on the mitigation as part of their initial follow up correspondence, the response received from the Welsh Government was very vague, prompting the Committee to write again to establish the actions taken by the Government to mitigate the risk. The follow up response was still lacking in certain detail.

**24.** The Committee does not consider the response from the Welsh Government to provide sufficient clarity on the mitigation for the risks, in particular risks two, five, eight and nine set out in paragraph 21 above. It is difficult to make a judgement on and have confidence in the decisions around risk management, without this clarity. Furthermore, despite the response from Welsh Government that “the Kancoat Business Plan was not dependent on a single supplier”<sup>13</sup> the omission of the reliance of limited suppliers of materials from the list of identified risks appears to be a substantial oversight, and one which may have had an impact on the outcome of this funding application. The Committee expects to see a much more considered approach to risk identification and mitigation for future applications.

**Recommendation 6.** The Committee recommends that the Welsh Government produces updated robust risk identification and mitigation guidance, which reflects the lessons learnt from this inquiry. This guidance should ensure that decision makers have a more robust framework from which to work and therefore give due consideration to risk. We would expect both risk identification and the adequacy of any proposed mitigation to be significant elements in the Auditor General's future work on Business Finance.

**25.** The Auditor General's report sets out a number of changes in policies and procedures that have been introduced by the Welsh Government in light of the Kancoat case. The Welsh Government also provided an update on the 'lessons learned' to the Committee.<sup>14</sup>

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<sup>12</sup> Auditor General for Wales report on examination of the Welsh Government's support for Kancoat, paragraph 3.46, July 2016

<sup>13</sup> Written Evidence, PAC(5)-03-17 PTN2, 23 January 2017

<sup>14</sup> Written Evidence, PAC(5)-03-16 P8, 19 September 2016

**26.** The Committee explored with the Welsh Government whether the experience with Kancoat (and other failed business ventures) has led it to re-evaluate its appetite for taking risks in this area. In response to this, James Price said:

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“... I think that’s another very fair question and one that kind of goes to the heart of the whole issue here, actually, and the heart of the whole issue of Government being involved in economic development. So, the rationale, widely accepted across the economic development world, even if you look at the development of less-developed-countries literature, will say that Government’s involvement should be as a lender of last resort. ‘A lender of last resort’ implies that you should finance things that the private sector won’t finance. Financing things that the private sector won’t finance implies taking risks that the private sector won’t take, which implies things are going to fail.”<sup>15</sup>

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**27.** The Committee agrees with this assertion from James Price, that the Welsh Government should be only financing projects that are too risky for the private sector. However, the oral and written evidence received during this inquiry did little to allay our concerns that there is a lack of coherence in the Welsh Government’s approach to lending. In the instance of Kancoat, there were a substantial number of risks which, when considered altogether, should have been of concern to the Welsh Government.

### **Relationships between Welsh Government and Kancoat Officials**

**28.** The Auditor General’s report notes that the Director of Kancoat reported being unhappy about the Welsh Government’s handling of the company’s application for financial support, on the basis that inconsistent messages were given about the amount of funding that could be made available. The Committee explored this relationship, and whether there was any pressure on Welsh Government officials to increase the funding from the Company. James Price said:

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“... I am almost certain that pressure would have been put on officials and possibly on the Minister by the company, and I am equally certain that that is what happens in most instances of companies looking for finance. And frankly, if I was working for a company that was looking for finance, I’d probably do the same thing, as in, I would try to get as much out of the Government as possible, and our job is to assess whether it’s worth giving the company anything and to make it the minimum necessary. So, I suspect that the company did; I don’t know for sure that the company did, but I suspect they did. It’s annoying, if you’re working within Government, but I don’t think there’s anything wrong with it, and our systems and processes do not allow for that to have any influence on staff.”<sup>16</sup>

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**29.** Welsh Government officials told the Auditor General, and confirmed again to the Committee, that the increase in subsequent funding from £500,000 to £788,000 was because the company’s

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<sup>15</sup> RoP, 14 November 2016, paragraph 189

<sup>16</sup> RoP, 14 November 2016, paragraph 192

circumstances had changed, and therefore this increase had nothing to do with the representations being made by Kancoat's director.<sup>17</sup>

**30.** The Committee also questioned officials about the role of the then Minister for Economy, Science and Transport (Edwina Hart) who was responsible for decisions regarding the awarding of the lease and repayable business finance. This was particularly pertinent as the location of the coil coating line, although not in her constituency, was less than one mile from her constituency border.

**31.** Following the publication of the Auditor General's report, there has been criticism in the media of the former Minister's involvement with Kancoat. A former Chair of the UK's Committee on Standards in Public Life, Sir Alistair Graham, has suggested this involvement to be "a potential conflict of interest, or a perception of a conflict of interest, between her role as an assembly member and her role as a Minister".<sup>18</sup>

**32.** The Committee asked the witnesses whether there was a conflict of interest or a perception of a conflict of interest. James Price told the Committee that this would not have been possible due to the Ministerial Code and the processes and procedures in place which would not allow for any undue influence. The Ministerial Code, which is overseen by the First Minister, prohibits the involvement of individual Welsh Ministers in decisions within their own constituencies. In all other cases however, any decision to recuse themselves from involvement is a matter of individual Ministerial judgement. He added:

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"In this instance, because the investment was outside the Minister's constituency area, that process wasn't adopted because there was deemed not to be a conflict of interest."<sup>19</sup>

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**33.** James Price expressed concern about this being interpreted as a conflict of interest based on the proximity to the Minister's constituency because:

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"I don't think there was any blurring of understanding in this case, because the test was simply: is it in the constituency area, or not? This is a matter for Ministers, rather than officials, so I don't want to get too drawn on this, but what I would say is, if we started to try to get into those areas of grey, how do you define when something is a conflict and when something isn't a conflict, particularly with the travel-to-work areas that we have in Wales? You could be locking out most Assembly Members, for instance, in south-east Wales from any investment anywhere in south-east Wales, if we were to adopt a different approach to it, and I suspect we'd get ourselves into more difficulty. But I can understand what motivates the question."<sup>20</sup>

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**34.** While the Committee did not see any evidence of undue influence from the then Minister, we do believe that the potential for a perceived conflict of interest should have been identified and considered in the making of this decision. This is particularly important given the broader approach to

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<sup>17</sup> Auditor General for Wales report on examination of the Welsh Government's support for Kancoat, paragraph 3.25, July 2016

<sup>18</sup> [BBC Wales news article](#), 24 August 2016, last accessed 1 February 2017

<sup>19</sup> RoP, 14 November 2016, paragraph 21

<sup>20</sup> RoP, 14 November 2016, paragraph 23

defining the sector, and how to award the financing which the Welsh Government adopted to address the financial crisis

**Recommendation 7.** The Committee recommends that the First Minister ensures the Ministerial Code requires the consideration of perceived conflict of interests and that the outcome of such consideration is formally fully documented.

## 03. Kancoat Business Model

### The Decision to Invest in Kancoat

#### Previous Business Failures at the coil coating line

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**35.** Kancoat was due to operate from a site with an existing coil-coating line. The line was originally in use by Alcoa Manufacturing (GB) Ltd (Alcoa), the owners of the Waunarlwydd site. With the support of a £350,000 grant from the Welsh Government, a company called Falcon Steel Ltd negotiated a lease for use of part of the site with Alcoa in 2009. However, Falcon Steel Ltd was unable to make a commercial success of the line and transferred both the lease and ownership of the line to Falcon Holdings UK Ltd in 2010. Both companies went into administration in 2011. A major obstacle to the site was that the owner Alcoa Ltd, placed a standing prohibition on the processing of aluminium on the site until 1 January 2018. This meant that only steel or other substrates such as tinplate could be processed by the existing machinery on the line until that date.

**36.** The Committee questioned Welsh Government officials why the decision was taken to support this business given the previous failures that had occurred on two occasions and the condition of the aluminium industry in South Wales.

#### The Business Case

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**37.** In addition to concerns about the viability of the business, given the previous failures at the coil coating line there were a number of concerns about the business case. The report from the Welsh Government's own due diligence officer concluded that:

“...with the exception of Coilcolor Ltd [Welsh Government] have no financial information as to the financial or otherwise standings of the other two shareholders. Building Products Offshore Fze would appear to be the name of a UAE business, however, internet searches do not find an entity of this name, we do not have a CV for [the Kancoat Managing Director].”<sup>21</sup>

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**38.** Furthermore, an updated due diligence review that was prepared in February 2013, following Kancoat increasing their request to increase their request for finance, concluded that:

“The business plan appears weak and inconsistent. The inherent risks associated with Kancoat as a start-up remain. The replacement of the Coilcolor Group and the loss of their participation and guarantee leave the risks identified as essentially unmitigated. The proposal involves the WG taking on a significant landlord risk in addition. The project was identified as high risk in the initial assessment. The revised proposal and developments surrounding this have increased the level of risk rather than mitigated it.”<sup>22</sup>

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**39.** The Committee questioned the officials on their justification for the investment, given the concerns raised by the due diligence reviewer. Mick McGuire, Director, Sectors and Business, Welsh Government, explained that the due diligence advice was taken in the round alongside other information, so for example:

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<sup>21</sup> Auditor General for Wales report on examination of the Welsh Government's support for Kancoat, July 2016

<sup>22</sup> Auditor General for Wales report on examination of the Welsh Government's support for Kancoat, July 2016

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“... in the absence of a CV, we asked the sector to go and get the evidence of the experience of the senior partners and to share that back with the panel, which was shared. I think there was something like 60 years of experience in coating tinplate, aluminium and steel in the three senior practitioners. In terms of the projections, those projections get reworked, and that’s what this pile of 1,000 pages is.”<sup>23</sup>

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**40.** Despite the assurances from the Welsh Government about the process and thoroughness of the decision making, the Committee remains unconvinced that, given the number and extent of concerns highlighted by the due diligence, that the Government should have made even its initial investment in the company.

**Recommendation 8.** The Committee recommends that decisions to go against the advice of the due diligence report should be clearly documented in project documentation. This is not to say that it should be followed in all instances, but that evidence of full consideration including a market analysis, and the reasons for decisions should be recorded to ensure that the value of due diligence is maintained.

### **Kancoat’s trading difficulties and the need for more Welsh Government money to keep it afloat**

**41.** Kancoat had only one main supplier of steel coil who was based in the UK. However this supplier experienced unforeseen difficulties in early 2014 and consequentially, Kancoat had to seek alternative suppliers of steel from abroad (France and Korea). These difficulties arose just some six months after the Welsh Government had provided substantial support (£778,000 non-repayable repayable finance, and a £0.8 million loan) to enable Kancoat to purchase and operate the coil coating line.

**42.** Kancoat made an application for an additional loan of £500,000 which they projected without this additional funding they would be unable to purchase raw materials in order to meet its order book and would cease trading. This second loan was agreed and advanced on 14 February 2014.

**43.** The Committee are concerned that the Welsh Government appears to have continued to invest funding into Kancoat, and had the sense of the Government ‘pouring good money after bad’ once the decision had been made to invest. There appears to be little consideration of whether this was the best approach or if the Welsh Government should have cut their losses at any point, rather than continuing to invest. Although the Committee appreciate that businesses need a reasonably quick decision on financing, we do not think that this should mean that further applications are not subject to a period of proper consideration about whether the investment still merits the risk.

**Recommendation 9.** The Committee recommends that, when handling requests for the provision of additional financial support to companies, the Welsh Government should build in a more robust ‘pause and reflect’ stage to its due diligence, consideration and approval processes.

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<sup>23</sup> RoP, 14 November 2016, paragraph 178

## Welsh Government Losses

**44.** The Auditor General’s report contains an estimated potential loss to the public purse of £1.5 million, although it notes that the final figure could be significantly different depending on a number of factors. The Committee is concerned that the final figure could be higher than this initial estimate, and the sections below outline some areas where this will be the case.<sup>24</sup>

### The valuation of the Coil Coating Line

**45.** During the decision process of whether to support the purchase of the line by Kancoat in the summer of 2013, Welsh Government officials opted to rely on an asset valuation that had been obtained by Coilcolor Limited in 2011, rather than obtaining its own independent up to date valuation. Furthermore, officials did not follow the advice of the Welsh Government’s ‘due diligence’ reviewer that an independent valuation should be obtained. James Price said:

“...the investment panel, if they were here now—would say to you, because they said to me, that they believed there was sufficient headroom in the valuation—which was done by GVA Grimley Ltd, I think, Mick, which is a well-regarded valuation agency, and there was a further valuation done a year later for a set of different people, again to proper standards, which again saw £2 million more than we needed to get back.”<sup>25</sup>

**46.** However, he also stated that he thought an independent valuation should have been obtained<sup>26</sup> and that part of the reason for this was:

“And the reason why I would want one for me—this is not necessarily a very good—. It doesn’t maybe paint me in a very good light, but valuation companies will have public indemnity insurance, but the public indemnity insurance can only be called on by the people whom they’re acting for. So, if someone got something very wrong for me and I had paid them to do it, then we could sue their insurance company for it.”<sup>27</sup>

**47.** Given the importance placed on the asset value of the coil coating line as collateral security when deciding whether or not to provide financial support to Kancoat, the Committee were surprised that the Welsh Government did not obtain an up to date independent valuation and that they decided not to follow the advice of the due diligence officer on this. It was unclear to the Committee that the civil servants involved in this decision possessed the necessary professional skills to make judgements on valuations. The Committee are concerned that this is not the first instance where independent valuations should have been obtained, although a different and much wider issue, the issue of obtaining appropriate valuations was a significant feature within the failures in the Regeneration Investment Fund for Wales. It is essential that up to date and independent valuations are obtained and the Committee would expect this to be included in the requirements for any future investments where asset security is being proposed as a safeguard for public funds.

<sup>24</sup> Auditor General for Wales report on examination of the Welsh Government’s support for Kancoat, July 2016

<sup>25</sup> RoP, 14 November 2016, paragraph 206

<sup>26</sup> RoP, 14 November 2016, paragraph 206

<sup>27</sup> RoP, 14 November 2016, paragraph 210

**Recommendation 10.** The Committee recommends that Welsh Government guidance for investments explicitly states that up to date and independent professional valuations of any assets offered as collateral security are obtained prior to any finance being agreed.

**48.** The Auditor General’s report states that a worst case scenario would be the disposal of the coating line machinery essentially for its scrap value, which could yield proceeds of some £1.25 million.<sup>28</sup> In terms of the negotiation, James Price explained that there are two elements:

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“One is the state of the line. So, it has deteriorated slightly from when it was being used. And the second is there was a piecemeal valuation in there in terms of scrap. The price of scrap metal has been all over the place, and this was one thing we discussed last week, actually. My view is that, provided we’re not leasing the land any longer, if it had to go for scrap we shouldn’t immediately offload it if scrap is very low at the minute, and we should wait until we can get the best value for it. But the lesson has been learned, and we would take an independent valuation.”<sup>29</sup>

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**49.** However, the Committee are concerned that this £1.25 million figure is based on a valuation that is some five years old, and that the price of steel has reduced substantially since that time. It is therefore possible that the current scrap value could be significantly lower than this.

#### **Further costs associated with the disposal of the coating line**

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**50.** As part of its head-lease agreement with Alcoa, the Welsh Government agreed to become liable to meet unquantified site remediation costs at the ‘appropriate time’. The Committee asked for clarification on this, and James Price explained:

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“...I think this will be, primarily, two things. It will be, firstly, if we have to strip out the line and make good, and, secondly, there’s a dividing wall, I believe, that was put up within the unit. I’ve never been to the unit, but I believe there’s a dividing wall—a concrete block wall, quite a big concrete block wall—that’s been put up. That needs to be taken out and made good.”<sup>30</sup>

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**51.** The Committee understands that these costs will only be clear once the site has been disposed of, and will be dependent on the intention of the next occupant for the site. We expect the Welsh Government to update us on this matter once negotiations for the site are concluded.

#### **Future prospects for the coating line and the industrial site more widely**

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**52.** The Auditor General’s report set out that at the time of its publication, in July 2016, there had not been any bids for the steel coating line. It also states that Alcoa has put the whole of the Waunarlwydd site up for sale.<sup>31</sup> The Committee asked officials for an update on the level of interest there had been into the future development of the coil coating line since Kancoat went into administration in 2014. James Price said that the Welsh Government was holding discussions, but

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<sup>28</sup> Auditor General for Wales report on examination of the Welsh Government’s support for Kancoat, paragraph 3.59 July 2016

<sup>29</sup> RoP, 14 November 2016, paragraph 214

<sup>30</sup> RoP, 14 November 2016, paragraph 217

<sup>31</sup> Auditor General for Wales report on examination of the Welsh Government’s support for Kancoat, paragraph 3.55, July 2016

could not provide any more information at the moment as “negotiations are ongoing and commercially sensitive”.<sup>32</sup>

**53.** The Committee considers these negotiations to be an important consideration in the final cost to the public purse, and as such believe that the Welsh Government should inform us of the outcome of these negotiations.

**Recommendation 11.** We recommend that the Welsh Government inform the Committee about the outcome of any negotiations for the site, and the impact this has on the final sum lost as a result of the Kancoat investment and should include the cost of any remediation works.

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<sup>32</sup> RoP, 14 November 2016, paragraph 220

## Annex - Witnesses

The following witnesses provided oral evidence to the Committee on the date noted below. A transcript of the oral evidence session can be viewed in full at: <http://senedd.assembly.wales/mgIssueHistoryHome.aspx?IId=15048>

| <b>Date</b>      | <b>Name and Organisation</b>   |
|------------------|--|
| 14 November 2016 | James Price, Welsh Government<br>Mick McGuire, Welsh Government<br>Simon Jones, Welsh Government |