

Chief Executive's Report

COMPETE TO WIN – INNOVATE TO GROW

Leadership, the determination to win and the power of innovation are all part of GKN's competitive advantage. These virtues are playing a prominent role in the way we work at GKN and they made a strong contribution to our performance in 1999.

1999 was a successful year for GKN with pre-exceptional profits both before and after tax at record levels. Earnings per share before goodwill amortisation and exceptional items increased by 14% to 52.4p on sales which increased by 25%.

The Group was presented with a number of challenges and opportunities in 1999. The successful integration of acquired businesses was a management imperative across the Group as was the negotiation of far-reaching agreements on joint ventures and new partnerships.

Automotive Driveline Division achieved strong growth in demand in North America but was negatively impacted by an unfavourable model mix in Europe in the first half of 1999. The European model mix situation improved in the second half and the Division made good progress in the year as a whole.

Technology, new products and acquisitions continued to propel the growth of our powder metallurgy business, but to be the largest is not enough – we also aim to be the global leader in innovation and in the quality of the products and services we offer to our customers.

Our OffHighway business managed the impact of a downturn in its farm equipment market in such a way that the business remained profitable and succeeded in gaining market share.

In Industrial Services CHEP continued to grow very strongly. Although the autocrates agreement with DaimlerChrysler did not proceed as originally envisaged, CHEP achieved a major breakthrough with Wal*Mart, the world's largest retailer, which advocated CHEP's pallet pooling service to their US suppliers. The high growth momentum of CHEP continues to be supported by investment in pooling assets and systems to improve the quality and efficiency of its operations. In 1999 Industrial Services contributed a record 26% of overall Group profit.

Sales and operating profit grew by 59% and 39% respectively in our Aerospace business as a result of a large number of deliveries of Merlin and Lynx helicopters.

An important outcome of our continued growth is the increasingly global nature of our operations. Three years ago the Americas represented 13% of operating profit. Today they account for almost 23% of operating profit and 22% of our workforce. This planned increase in our exposure to a region which includes the world's largest and most dynamic economy (the US) is important to our growth momentum and the resultant geographic balance of our business.

The strong performance of GKN in a demanding business environment confirms the commitment of our people to the success of our growth strategy. Our performance also confirms our commitment to the creation of enduring shareholder value.

A YEAR OF CHALLENGE AND REWARD

In February the Group completed the £348 million (\$570 million) acquisition of The Interlake Corporation of the US. Interlake comprised three businesses, all of them leaders in their respective markets. The Hoeganaes Corporation is the largest powder metal producer in North

America. Chem-tronics Inc is a leading US producer of advanced and lightweight structural components for aerospace engines. Interlake Material Handling is the leader in the US market for pallet racking and dynamic storage and has a business in conveyor systems. All three businesses have integrated well and have contributed to our overall performance.

Automotive Driveline Division (ADD) employs 19,000 people in 31 manufacturing facilities worldwide and is the number one supplier of constant velocity jointed (CVJ) halfshafts to manufacturers of cars and light vehicles. It has a 37% share of the world market. During 1999 ADD took advantage of three growth drivers – advanced driveline systems, outsourcing by original equipment manufacturers and opportunities in emerging markets.

North American demand for light trucks and sports utility vehicles continues to be strong. More light truck and sports utility platforms are being converted to four wheel or all wheel drive as consumers demand higher levels of comfort and enjoyment. This trend requires increased numbers of CVJ halfshafts per vehicle as well as the introduction of CVJ propshafts. To support this trend, vehicle manufacturers are looking to suppliers to provide advanced systems solutions and during the last two years GKN has competed successfully for outsourced driveline system contracts from US auto manufacturers. As a result, we expect our North American driveline business to grow rapidly in the next three years.

In July we inaugurated a new factory in Poland. This low cost capacity provides greater flexibility in our manufacturing network and provides another Central and Eastern European supply base.

In August GKN entered into an agreement with Dana Corporation of the US to form a joint venture to design, engineer and market advanced driveline systems and to collaborate on the development of modular driveline assemblies containing CVJ technology. The transaction also involved a series of asset swaps in which GKN acquired Dana's CVJ interests thereby increasing our already strong global presence and Dana acquired our medium and heavy cardan jointed propshaft businesses in Europe. GKN and Dana also established a joint venture for the manufacture of light cardan jointed propshafts in Europe.

In December Opel AG (part of General Motors) announced that they will work with GKN to conclude an agreement for GKN to acquire the production assets of Opel's automotive driveline facility at Kaiserslautern in Germany. This facility produces approximately one million vehicle sets per annum for models which include the high volume Astra and Vectra.

During 1999 we took a majority shareholding in our driveline joint venture in Malaysia following similar moves in 1998 when we acquired control of operations in Slovenia, Republic of Korea and Thailand.

GKN has identified powder metallurgy as a growth opportunity. Powdered metal components are increasingly important to automotive manufacturers and demand is increasing by between 6-8% per annum. Three years ago the industry was highly fragmented with no company operating on a global basis. Since then we have brought together an internationally experienced management team which has actively led the consolidation of the industry through a series of acquisitions in the Americas, Europe and Africa.

Chief Executive's Report (continued)

Since 1996, when we had annual sales of approximately £65 million, we have seen the sales of our powder metallurgy business grow by some 700%. We are now the only global company in the sector and more than three times as large as our nearest competitor. Following the acquisition of Hoeganaes we are also the only sizeable company with material and component technologies. This gives us greater powers of innovation and the ability to increase the rate of growth in this market.

We were pleased when *Forbes*, the international business magazine, ranked GKN as one of the world's 400 best companies and number one automotive components supplier.

Our Industrial Services businesses recorded another year of major growth which has been underpinned by the continuing strength of CHEP. During 1999 CHEP recorded revenue growth of 16% in Europe and 36% in North America. A major success in 1999 has been Wal*Mart's advocacy of CHEP's pallet pooling system to their 17,000 US suppliers. This is a significant breakthrough and the long-term impact on the growth of CHEP will be very positive.

CHEP is also in the process of implementing a large number of initiatives to improve efficiency and sustain the next phase of its long-term growth. These include the implementation of a global IT platform, the management of intercontinental pallet movements, introducing the plastic pallet to the US, extending CHEP's service into Brazil and Argentina and consolidating the 170 North American depot network into 26 mega depots with full service capabilities.

This work and preparation for the use of CHEP's system by Wal*Mart's suppliers required considerable investment. While this investment has impacted profits during 1999 the long-term outlook for CHEP, as a pioneering global industrial services business, is stronger than ever.

CLEANAWAY management successfully integrated SKP, the German waste management business acquired in 1998, with their other German operations. CLEANAWAY Netherlands was disposed of at a premium to net assets following an assessment that it did not offer sufficiently attractive long-term growth prospects.

GKN Westland Helicopters has a £3 billion order book, increasing deliveries and a wide range of sales opportunities. The EH101 has proved to be a highly capable and competitive aircraft. Production of the British Army's Apache attack helicopter, for which GKN Westland is prime contractor, is on schedule with first deliveries in 2000. Meanwhile the Lynx continues to justify our faith and investment in this leading naval helicopter.

Negotiations with Finmeccanica of Italy to bring together GKN Westland Helicopters and Agusta into a 50:50 joint venture are at an advanced stage and at completion we will create one of the world's premier helicopter companies. The new enterprise will have a comprehensive portfolio of civil and military aircraft and a pipeline of new products and technology developments.

GKN Westland Aerospace has grown from a UK based business to an international supplier with operations in the US and Germany. The business is focused on the propulsion systems market, for which it supplies engine nacelles and components, and on large, integrated airframe assemblies and high technology niche products.

WORKING TOGETHER TO CREATE WEALTH

A key objective during the past three years has been to nurture a culture which supports our growth strategy and which is appropriate for an ambitious, global organisation. Our change programme, which we call 'The Way Forward', is designed to encourage everyone to move with greater confidence, more imagination and higher speed.

An important element of the programme has been a series of workshops involving 500 managers in developing new strategies, upgrading processes and finding solutions to business issues. The workshops are continuing with the emphasis on team working and personal leadership.

An early outcome of the programme was a decision to fuse two aerospace businesses with complementary skills in design services and training to form a new service sector business which was launched in March under the brand name *Engage*.

Other initiatives involve managers from different disciplines and businesses working together on innovation, learning, procurement, continuous improvement and acquisition integration. Our innovation and learning initiative is led by two executive Directors and encourages employees to generate ideas for new processes, products and business opportunities. More than 250 business ideas were submitted in 1999 and a significant number are under active evaluation.

Our procurement project has 21 commodity teams concentrated on a wide range of subjects from composites to capital items, from titanium to travel. These teams cover more than 60% of Group procurement and are building on significant savings which have already been achieved.

E-commerce is impacting the way business is conducted throughout GKN. There are a large number of initiatives to use electronic technology to improve communications with our customers, to reduce costs through better alignment of the supply chain and to improve the speed and efficiency of our own organisation. For example, our automotive and aerospace operations have launched internet based initiatives to share knowledge and engineering activities and more than 80% of CHEP's business in the US is administered via electronic data interchange.

Our competitive advantage comes from people and teams who innovate, learn from each other and turn ideas into action at high speed. More and more GKN people are finding ways to make a difference. I find their contribution to be a source of great pride and enormous encouragement. They are the true heroes of GKN.

OUTLOOK

As we move through 2000 we expect our investment throughout Industrial Services to deliver strong growth. While most market forecasts suggest that automotive production may moderate in 2000, our order book in the first quarter is strong. A significant recovery in the farm equipment market is not expected this year. Helicopter deliveries will increase further in 2000.

Our balance sheet is very robust and will continue to support our growth strategy.



Sir C K Chow

7 March 2000