

Chief Executive's report



“GKN has seen many changes in the last four years. A potent combination of enduring values and a dynamic global outlook is driving the Group forward to new levels of achievement.”

The advantage of global leadership

During 2000, the strategic leadership which GKN has achieved in key global sectors allowed us to deliver a robust performance in the face of softening market conditions in the latter part of the year. Sales were up by 10% and earnings per share before goodwill amortisation and exceptional items were up by 4% to 54.5p.

Our strategic leadership positions, supported by our technology, our ability to move swiftly to seize opportunities, and the determination and talents of our people, also saw us take a further series of strategic initiatives. These will extend our global reach and enlarge our presence in those sectors which will drive our continued growth.

Strong Automotive performance

Our two largest automotive businesses – Automotive Driveline Division (ADD) and Powder Metallurgy – are the global leaders in their sectors and both businesses delivered significant sales growth in 2000.

ADD continues to take full advantage of three growth drivers: an increasing demand for advanced driveline systems, outsourcing by original equipment manufacturers and opportunities in emerging markets. As a result, it has grown its world market share of constant velocity jointed (CVJ) halfshafts from 37% in 1999 to 41% at the end of 2000.

In the US, where there was a significant downturn in vehicle production at the end of 2000, ADD succeeded in growing both sales and profits. This was as a

result of a number of new contract wins which were launched into production and the increasing consumer demand for four wheel drive vehicles. ADD's driveline systems and products are a key element in these vehicles.

In Germany, although the domestic market fell in 2000, vehicle exporters such as VW, Audi and BMW achieved considerable success in the US, due in part to the weakness of the euro against the US dollar. ADD is a significant supplier to the above three manufacturers and consequently enjoyed a strong performance in Germany.

In the rest of Europe, ADD did not escape the effects of depressed UK automotive production in 2000 but was able to outperform the market in France thanks to its presence on some

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of the country’s best selling models. GKN experienced high growth in the developing regions of Latin America and in Asia-Pacific where ADD has established a strong presence.

Three important transactions were completed in 2000 for ADD. In February we finalised a wide-ranging agreement with Dana of the US which included the formation of a driveline systems joint venture and asset swaps which increased our global presence in CVJ halfshafts. In September we concluded the acquisition of the General Motors’ Opel driveline facility at Kaiserslautern in Germany and in November we concluded a similar agreement to acquire Nissan’s driveline operation at Tochigi in Japan. The Nissan transaction is of high strategic importance as it provides us with our first driveline manufacturing operation in Japan.

Our confidence in the growth potential of powder metallurgy remains high. While we enjoyed strong growth in Europe, the downturn in the US automotive market had a significant effect on the business’ performance in the last quarter of the year. Powder metal sales to the US automotive industry are focused on the ‘big three’ domestic manufacturers – General Motors, Ford and DaimlerChrysler –

which have been most affected by the US downturn.

Hoeganaes, which is North America’s largest producer of metal powder, became part of the Group following the Interlake acquisition in early 1999. In 2000, it completed a US\$100 million investment to increase manufacturing capacity by 30%. Hoeganaes was similarly impacted by the downturn in the US automotive market and also by a threefold increase in the price of natural gas, a key material in metal powder production.

In four years GKN has moved rapidly and decisively to build the world’s leading powder metallurgy business. From a small manufacturing operation in 1996 with sales of approximately US\$100 million to today’s world leader with sales approaching US\$1,000 million, the business is now more than three times larger than our nearest competitor. We are also the only sizeable company to possess both material and component technologies.

The agricultural and off-highway equipment market continues to experience a depressed level of demand which has prevailed for the past three years. However, once more a determined effort by our management team has

lifted market share which has translated into improved sales over 1999.

One of the emerging stars of our automotive business is Emitec, a joint venture with Siemens, which produces emission control components. During 2000, Emitec experienced exceptional growth of 73% in operating profit.

Continued growth in Industrial Services

Industrial Services is one of our highest growth business areas, led by CHEP, the world’s pioneer and leader in pallet and container pooling. CHEP is a dynamic logistics and distribution business which continued to achieve double digit global growth in 2000. Following its breakthrough in 1999 with Wal*Mart, the world’s largest retailer, which advocates the use of CHEP’s pallet pooling system to its suppliers, CHEP achieved a similar success with The Home Depot.

The Home Depot is the world’s largest home improvement retailer and has asked its suppliers to ship products to the company’s 1,000 stores and distribution centres using CHEP pallets. The Home Depot regards CHEP’s system of pallet recycling as more environmentally sound than conventional pallet usage. CHEP management continues to devote considerable energy to the

Chief Executive's report continued

successful implementation of both the Wal*Mart and The Home Depot programmes.

CHEP grew strongly in North America for the tenth consecutive year and, while sales in Europe increased, a number of factors such as Y2K stockbuilding in 1999 and transport disruption had an adverse impact.

CLEANAWAY has continued to grow in the UK and Germany both organically and through acquisition of a number of waste management businesses in both countries.

Strategic initiatives in Aerospace

Our strategy in the aerospace industry is focused on prime contractorship in helicopters and international tier one supplier status in the design, engineering, manufacture and sub-assembly of components and systems for civil and military aircraft. We have now successfully completed two major strategic initiatives which have positioned our aerospace businesses for the future – in February 2001 GKN and Finmeccanica of Italy completed the merger of our respective helicopter businesses, GKN Westland Helicopters and Agusta, and in January 2001 we acquired a major structural fabrication business from Boeing in the US.

The AgustaWestland joint venture is now fully operational. With a combined order book of more than £5.4 billion and combined revenues of £1.4 billion, the new company is a powerful force in the world helicopter industry.

In 2000, GKN Westland Helicopters continued to increase output. A total of 47 aircraft, including kits, were delivered during the year. This compares with 25 deliveries, including kits, in 1999. Such a rapid increase in output is a considerable achievement by the entire team at Yeovil.

Our aerospace structures business, which is now renamed GKN Aerospace Services, experienced a difficult year. A combination of customer delays on existing programmes such as the C130J and C27J and the start-up of a number of new programmes such as the AS900 business/regional propulsion system led to manufacturing inefficiencies, particularly at the Cowes site on the Isle of Wight. In October, the business launched a radical restructuring programme impacting operations in Europe and the US as it focused its operations on fewer but more flexible operational sites. These now include the former Boeing Military Aircraft fabrication assembly business in St Louis, USA.

We believe that the consolidation which has taken place among the world's aerospace prime contractors will generate considerable additional structures outsourcing and act as a catalyst for equivalent consolidation within the highly fragmented supply chain. Only in this way will higher levels of efficiency be driven through the industry. Through its automotive businesses, GKN has considerable experience and success as a global first tier supplier. Our strategic intent is to combine that knowledge with the experience of the former GKN Westland Aerospace to build GKN Aerospace Services into a major global independent first tier supplier in the aerospace sector.

GKN people working together

During the past four years the GKN organisation has moved decisively towards a more integrated approach as we learn how to share talent, experience and knowledge across business and geographical boundaries.

Our change programme, which we call 'The Way Forward', continued in 2000 with a fourth series of workshops for more than 500 managers which focuses on team working and personal leadership.

Our Innovation and Learning programme, designed to unlock the

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latent creativity and imagination within the Group, has been spectacularly successful in generating product and business ideas – more than 650 since its launch in 1999.

At the heart of the innovation process is a proprietary, web-based system which has attracted considerable interest from other companies looking to develop innovation within their own businesses.

As a result of a cross-business task force on procurement, we have taken purchasing specialists from across the Group and established a new centrally-based procurement unit. Using web-based technology and centralised purchasing of indirect materials, it is expected to drive down costs by a significant margin within the short term.

New levels of achievement

GKN has seen many changes in the last four years.

Our powder metallurgy business is now ten times bigger than it was at the end of 1996 and our industrial services businesses are now three times as big. GKN Westland Helicopters has become part of AgustaWestland which is the second largest helicopter company in the world. GKN Aerospace Services has more than doubled its size and is now

being transformed into one of the few global first tier suppliers in the industry.

We are now more global than before. In four years we have trebled the size of our activities in the Americas, principally in the US. The Americas now represent more than 31% of total Group sales compared to only 15% in 1996. We have established a manufacturing presence in Japan and various of our businesses have entered new markets such as Poland, Korea, Norway, Hong Kong, Greece, Thailand, Finland and Denmark.

There is now an increasingly open and dynamic culture at work within the Group. Teamworking happens spontaneously as people come together to achieve common goals within demanding timescales. Entrepreneurship is increasing as people feel more confident about using their initiative and managing risk.

Underpinning these new virtues are the values which never change within GKN – integrity, dedication, attention to detail and an unrelenting focus on performance. It is this potent combination of enduring values and a dynamic global outlook which is driving GKN forward to new levels of achievement, despite short-term difficulties in some of our major markets.

Outlook

The outlook for the first half of 2001 will be heavily influenced by the North American automotive market. If vehicle production continues at its present level, which is some 20% lower than the same period of last year, the impact on our Automotive business in North America will be significant. Additionally the worsening conditions in the agricultural sector in Europe are adversely affecting the performance of our OffHighway business.

In the second half, North American automotive production is predicted to stabilise and we should benefit from cost reduction measures already taken. The European automotive markets are forecast to remain firm and our businesses in the emerging economies should advance further. GKN Aerospace Services should yield benefits from restructuring and Industrial Services should continue to grow. These factors lead to a more optimistic view for the second half year.



Sir C K Chow
6 March 2001