



GKN – A global engineering company

In August 2001 the demerger of our Industrial Services businesses and their subsequent merger with Brambles Industries Limited was completed. For the first time for at least three decades GKN's business now entirely comprises engineering activities and, given its international spread, the description of GKN as a global engineering company is exactly correct. 2002 has been the first full year when this has been the appropriate description and the results, as described below, are certainly an encouraging start for the Company as it embarks on the next phase in its development.

Results

Pre-tax profits for the year were £267 million (2001 – £245 million) and earnings per share were also higher at 25.2p (2001 – 24.0p). Cash inflow from operating activities was £367 million (2001 – £452 million) but with expenditure on capital projects and acquisitions below that of the previous year, net debt at £834 million was £51 million lower than at the end of 2001. Interest cover improved to 6.6 times (2001 – 5.0 times).

The Chief Executive in his review refers to the diverse range of challenges that faced the management team in 2002. To have delivered results at the top end of market expectations and well ahead of what both we and the market expected at the start of last year is a creditable achievement.

Dividend

In my statement in last year's annual report I said that the Board expected to pursue a progressive dividend policy subject always to prevailing economic conditions. That policy remains unchanged and, although the global economic outlook is uncertain, the Board has recommended that the dividend for 2002 should be increased from 11.0p last year (on a pro forma basis) to 11.3p thus maintaining its value in real terms.

The Board

Marcus Beresford, who became a Director in 1992, retired at the end of 2002. He was appointed Chief Executive in August 2001 following the demerger of the Industrial Services businesses and has performed a valuable role in the repositioning of GKN. The Board is most grateful to him for his significant contribution to the Company both in his earlier and more recent roles.

Marcus has been succeeded as Chief Executive by Kevin Smith, who became a Director in 1999. Kevin was formerly Managing Director of GKN Aerospace and has been succeeded in that position by Neal Keating who joined the Board last August from Rockwell Collins in the US.

Sir John Parker retired from the Board as a non-executive Director in May 2002 having been appointed in 1993. As an independent non-executive Director, John has made a major contribution to the Board for which he fully deserves the thanks of his colleagues. In his

place Sir Ian Gibson was appointed to the Board as a non-executive Director in June 2002. Ian is a former Senior Vice President of Nissan Motor Company Japan and brings to the Board considerable international automotive experience.

Life President

The death of Lord Brookes in July 2002 at the age of 93 is recorded with sadness. He joined the Board of GKN in 1953 and was Chairman from 1965 until his retirement in 1974 when he became Life President.

Social responsibility

The Social Responsibility Review on pages 26 to 33 of the annual report sets out our approach to sustainable development covering the range of issues that are embraced by this heading. Pages 31 and 32 cover the management of health and safety and set out some performance figures which continue to show improvement. Subsequent pages address environmental issues. The performance graphs here show a mixed pattern of success although the narrative offers some explanations for what may appear to be a lack of progress in some areas. Continuous improvement of environmental management is an important issue for the Board and one particularly encouraging statistic is the accreditation in 2002 of 50 sites to ISO 14001, 30 more than in 2001.

Post-retirement benefits

In common with a number of long established UK companies, GKN's UK pension scheme has a large number of members, 54,000 out of 60,000, who are no longer in service. As described in the Financial Review on page 39, based on FRS 17 (the accounting standard currently scheduled to come into force in January 2005) the UK pension scheme had a gross deficit at the end of 2002 of £551 million. After taking into account overseas post-retirement schemes, deferred taxation and net liabilities already provided for on the balance sheet, the overall reduction in shareholders' equity at the end of 2002 would have been £527 million compared with £169 million at the end of 2001.

This adverse movement reflects the significant fall in world stock markets in the last year together with the reduction in the discount rate used to calculate the liabilities of the various schemes. As is well known, the FRS 17 valuation reflects the position as at one date and does not take account of the long-term nature of post-retirement benefit schemes. As a result there can be considerable volatility from year to year in the deficit and surplus figures.

Post-retirement benefit scheme deficits are obviously a matter of concern to shareholders and can be a cause of considerable anxiety to pension scheme members. It is therefore worth stating that the Board fully recognises its responsibilities to those members and in 2003 plans to increase its contribution to the UK pension scheme to not less than £50 million. This is some 50% higher than the contribution for 2002 and more than double the figure for 2001.

Corporate governance

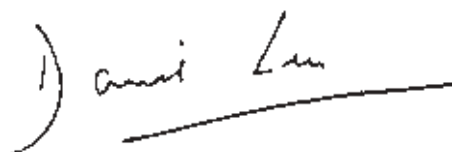
The Board has practised high standards of corporate governance for many years and fully recognises its importance. Pages 78 to 89 of the annual report, which include a report on Directors' remuneration, describe GKN's approach to this subject. The Combined Code on Corporate Governance is to be significantly amended following the reports by Derek Higgs on the role and effectiveness of non-executive directors and Sir Robert Smith on audit committees. Both these reports require detailed consideration by the Board which is now taking place.

However, the Board believes that certain of the recommendations of the Higgs Report should be reconsidered. Representations have therefore been made to the Financial Reporting Council who have responsibility for issuing the revised Combined Code in its final form. The essence of those representations is to emphasise the point that, while an increase in prescription will almost certainly involve increased cost, it will not necessarily guarantee higher standards of corporate governance. It is too easy to be compliant in terms of the letter of the law but to be non-compliant in terms of its spirit. High standards of corporate governance can only be guaranteed if, in particular, the Chairman and the non-executive Directors see that as an important objective, which is the case in GKN.

The future

GKN is one of only three companies that is a survivor of the original FT 30 Share Index, first put together in the early 1930s. That survival has been possible because of the Company's ability to reinvent itself to meet the challenges of new markets, new products, and new competition. To some extent 2002 was the start of a further phase in GKN's development, the foundations for which at this time look very firm.

More immediately, the prospect of war in Iraq and heightened political uncertainty in other parts of the world are making economic forecasts even more difficult than usual. This leads to the risk that business planning time horizons become increasingly short term. For GKN the need to control costs and manage cash is as important today as it has ever been, although this is complementary rather than an alternative to the focus on longer-term strategy and the enhancement of shareholder value. That remains the top priority for the Board.



Sir David Lees 28 February 2003