



2002 financial highlights

Sales for the year of £4.5 billion were 3% higher than the comparable figure for 2001. The negative impact of currency translation was £62 million and the net favourable impact of acquisitions and divestments was £50 million.

Operating profit before goodwill amortisation and exceptional items was 3% higher at £315 million after charging GKN's £11 million share of redundancy and reorganisation costs in AgustaWestland. The net impact of currency translation, acquisitions and divestments was insignificant.

Operating profit after goodwill amortisation and exceptional items was £230 million (2001 – £161 million).

Operating cash flow after capital expenditure and fixed asset disposals was again strong at £174 million (2001 – £210 million).

Net debt reduced to £834 million at the end of 2002 from £885 million a year earlier. Interest was covered 6.6 times (2001 – 5.0 times).

Divisional operating results are discussed in the Operating Review on pages 22 to 25. Overall Group performance is summarised in the Financial Review on pages 36 to 39.

Achievement

An uncertain outlook and variations in market conditions made 2002 a difficult year. Nonetheless, as our performance demonstrates, this was a year of hard won achievement in uncertain times.

That achievement was built on the combination of strengths which gives GKN a distinctive, competitive advantage. We are world leaders with strong market positions in our key products and technologies. We operate on a truly global basis across the Americas, Europe, Asia Pacific and Japan and our customer base includes all of the world's leading automotive and aerospace companies.

GKN businesses received more than 20 awards from those customers in 2002 for achievement in areas such as quality and productivity. This recognises the individual efforts and teamwork of the men and women who work for GKN. Meeting customer expectations is their minimum level of performance – their goal is to exceed those expectations. This is how we deliver sustainable performance and how we create value for our shareholders.

During 2002 the GKN team responded effectively to a diverse range of challenges.

Automotive

In Western Europe – our largest automotive market – overall car and light vehicle output fell by 2.1% and there were wide variations in customer demand. Some of our driveline plants in Germany were operating at the upper extent of their capacity to meet strong export



Left: Constant velocity jointed passenger car siveshaft produced by GKN Driveline.
Right: Jet engine thrust reverser component produced by GKN Aerospace Services.

sales by customers but our Italian operations were impacted by the problems experienced by Fiat. This led to imbalances across our European driveline plants with a consequent effect on operations.

North American car and light vehicle output rose by 6%. Again, the increase in the overall market masked a mixed performance by manufacturers which led to variations in customer demand across our North American automotive businesses.

A strategic priority was to continue our recovery actions within Powder Metallurgy. During 2002 the business has shown significant improvement. Hoeganaes, our metal powder production company, continued to bring the new Gallatin plant in Tennessee, USA, up to full production and it is operating well. GKN Sinter Metals, our powder metal component manufacturer, is achieving strong performance in Europe and recovery is underway in the US.

Looking ahead, our Powder Metallurgy research and development is aimed at increasing the size and density of components which could significantly enlarge the market for powder metal components. Our confidence in the potential of Powder Metallurgy remains high.

The early promise of an upturn in the market for agricultural equipment was short-lived and, following a customer's decision to relocate tractor production out of the UK, we initiated the closure of our small UK-based cab systems business. In AutoComponents we were pleased to support Land Rover by taking over chassis production for a key model after a supplier went into receivership.

Aerospace

In Aerospace we completed the restructuring initiated in 2001 to bring our business into line with the depressed conditions prevailing in the civil aerospace market. The impact of this restructuring fell most heavily on our European plants which have a larger exposure to civil aerospace than our US operations. The environment for the civil structures business remains difficult and it may be some years before the next cyclical upturn in demand for civil airliners. Meanwhile we have won business on all of the Airbus range and are part of the technology team working with Boeing on their next generation civil aircraft. We are therefore well positioned to take advantage of the recovery when it comes.

By contrast, demand for military aircraft is growing as the US and Western Europe bring new fixed and rotary wing aircraft into service. The combined market for fighters and helicopters is forecast to increase by 50% to \$30 billion during the period 2003 to 2007. This represents a significant opportunity for our aerospace businesses.

AgustaWestland delivered another good performance in 2002 thanks to a £4.7 billion order book. In early 2002 AgustaWestland consolidated its UK operations on its Yeovil site in Somerset. The

consolidation, which incurred redundancy and reorganisation costs of £22 million, was in response to the completion of UK contracts for the EH101 helicopter. GKN's share of the costs was £11 million which was charged to operating profit in the first half of 2002.

Approximately 80% of our overall aerospace revenues derive from the defence sector. In 2002 this mitigated the effects of the civil downturn and will be a powerful advantage for the future.

Strategic development

Alongside our intense focus on the operational management of the business we also advanced the strategic development of the Group.

GKN Driveline is leveraging its leadership in constant velocity jointed and torque systems components to build a strong presence in the market for electronic torque management systems which enhance vehicle traction, stability and safety. The acquisition of a stake in Tochigi Fuji Sangyo, a leading Japanese torque management specialist, along with the option to take control was a step forward in this process. GKN has a growing presence in Japan and places great importance on its close relationships with Japanese manufacturers. We see the combined markets of Asia Pacific as an area of strategic growth. A particular feature of the region is the strong growth in vehicle output in China where GKN has been present for 15 years.

GKN Aerospace Services has developed rapidly as an international first tier supplier of composite and high performance alloy structures. Boeing's outsourcing of its St Louis structures plant to GKN had a transformational impact which has helped the Group forge a productive relationship with the world's largest aerospace company and has given us a presence on all of the new US military aircraft programmes. We will continue to remain alert to other outsourcing opportunities which add value. Technology lies at the heart of Aerospace Services' strategy and we have achieved considerable advances in new composite materials which deliver performance within the military market or cost and weight advantages for the civil sector. Today GKN is the world's largest independent supplier of composites.

The greatest single aerospace opportunity which emerged in 2002 was access to the US military helicopter market which is the world's largest. AgustaWestland and Lockheed Martin have agreed to jointly produce and market a US version of the EH101 for four programmes with a combined requirement of 200 aircraft over the next 10 years. In Japan the EH101 is sole contender for the first stage of a Japanese Self Defence Force helicopter acquisition programme.

People

I assumed the role of Chief Executive on 1 January 2003, succeeding Marcus Beresford who had led GKN since the demerger of our Industrial Services businesses. Under his leadership GKN moved

forward decisively and successfully as a global group focused on automotive and aerospace. Our achievements in 2002 are due in no small part to Marcus' strength as a leader and his support as a colleague.

At GKN we are determined to build the Group by capitalising on our technology and market positions. One of our other great strengths is the spirit and enterprise of our people. It has long been my belief that people look for more than a livelihood when they come to work. Much has already been done to make working for GKN a rewarding and interesting experience. We will continue to find new ways of developing and stimulating the men and women who work in our research and development centres, in our manufacturing plants, in our sales teams and in all of the other functions which support and help drive forward this great company.

Outlook

The outlook for the major automotive markets remains uncertain. Some weakening is anticipated compared with 2002, particularly in the first half, but currently there are no indications of a substantial reduction in demand, notwithstanding anxieties about conflict in the Middle East.

The outlook for aerospace has more clarity, but with significant contrasts in the prospects for civil and military. Civil markets look certain to remain depressed until 2004 and beyond, while demand for military aircraft, which accounts for some 80% of our aerospace sales, is likely to grow.

With increasingly competitive markets, pricing pressure from customers and additional pension costs, it is certain that 2003 will be another challenging year. However, continuing benefit should be seen from the ongoing recovery in Powder Metallurgy and the specific actions we have already taken to reduce costs across the Group.

Our businesses are clearly focused with leading market positions and considerable underlying strength. This, together with the strategic initiatives we are pursuing, gives GKN a solid foundation for future growth.



Kevin Smith 28 February 2003

