

AUTOMOTIVE: STRATEGIC DEVELOPMENTS IN GKN DRIVELINE AND RECOVERY UNDERWAY IN POWDER METALLURGY.

Automotive financial highlights

Automotive sales of £2,950 million were £106 million (4%) above 2001. The net favourable effect of acquisitions and divestments was £40 million while the adverse impact of currency translation (related mainly to the US dollar, Brazilian real and Japanese yen) was £51 million. Excluding these factors sales rose by £117 million.

Operating profit before goodwill amortisation and exceptional items was £197 million compared with £187 million in 2001, an increase of £10 million (5%). The net impact of currency, acquisitions and divestments was negligible.

Operating profit after goodwill amortisation and exceptional items was £139 million (2001 – £129 million).

Market background

The year began with great uncertainty for the world's major automotive markets. Expectations of weaker demand in North America were confounded by continued consumer demand for new cars and light trucks. This trend prevailed for most of the year supported by incentive programmes, particularly by the 'Big Three' US domestic manufacturers. Total 2002 North American output of light vehicles was 16.4 million – a 6% increase on 2001.

In contrast, weaker demand in Western Europe was largely in line with expectations and at 16.5 million vehicles, production was 1.8% down on 2001. However, there were wide variations across the major European markets. Output in the UK and France showed an increase over 2001, Spanish production was relatively flat but output was down in Germany and in Italy.

Competitive pressures within the automotive industry continued to intensify. Vehicle manufacturers extended their product offerings and the use of pricing and financial incentives became a routine marketing tool. This obviously translates into continuing competitive pressure within the supply chain.

Western Europe is GKN's largest automotive market and the variation in demand across major national markets within the region caused operational imbalances, particularly within the European operations of GKN Driveline, formerly the Automotive Driveline Division. While some German driveline plants were operating at or near maximum capacity to support customers' programmes, the Group's Italian operations were affected by the downturn in the Italian market and well publicised problems at Fiat. Actions have already been initiated to adjust capacity to meet anticipated 2003 demand levels.

Driveline Sales £1,826 million (2001 – £1,781 million)

For GKN Driveline 2002 was a year of significant strategic activity which saw a continued enlargement of the Group's presence within

Below: Driver's view of the Nissan March. GKN technology has a significant impact on the 'driving experience' of vehicles using the Group's components and systems. Technology from GKN and its partner TFS is at the heart of the revolutionary, four-wheel drive (FWD) variant of the March launched in 2002. When the driver of this sub-compact wants to move from front-wheel drive to four-wheel drive, electrical power is delivered to the rear wheels. The system is called 'e-FWD' and uses CVJ sideshafts from GKN and a FWD control unit from TFS which manages the electrical drive system. Refinement, stability and safety are all influenced by a vehicle's driveline system.

Sales 2002 £m	By origin	By market
Europe	1,547	1,446
Americas	1,035	1,073
Rest of the World	368	431
Total	2,950	2,950

Japan and a related drive to develop a leading position within the growing market for advanced torque management devices. GKN is already the world leader in constant velocity jointed driveline components and torque management is a closely related systems application. A specialist Torque Systems Group was established within GKN Driveline to expand its presence in this area.

In March the Group acquired a 33.3% stake in Tochigi Fuji Sangyo (TFS), a leading Japanese supplier of advanced automotive driveline devices. This was acquired from Nissan and other major shareholders for £29 million. GKN also obtained the option to acquire further shares to bring its potential holding in TFS to 50.4%. TFS and GKN Driveline have been partners for 16 years in a viscous coupling joint venture in Japan and enjoy an excellent working relationship. TFS employs more than 2,000 people in Japan and elsewhere in Asia Pacific and in the US. The Japanese automotive industry leads the world in torque management technology and TFS is one of the leaders in the field.

Since 1999 GKN Driveline has built a major presence in Japan through a manufacturing joint venture with Toyoda Machine Works, a member of the Toyota Keiretsu, and through the acquisition of Nissan's driveline manufacturing operation at Tochigi. This penetration of the world's third largest automotive market is built on successful and long established relationships with the major Japanese vehicle manufacturers who account for almost 30% of world light vehicle output.

During the year GKN Driveline increased its 51% shareholding in GKN Driveshafts (India) Ltd to 96.4% for a total consideration of £5 million. This follows a number of transactions in recent years which has seen GKN Driveline acquire control of joint venture businesses in the world's emerging markets. These markets, albeit from a relatively small base, are experiencing growth rates higher than those in the mature markets of North America, Western Europe and Japan. GKN Driveline has been successful in building a strong presence in emerging markets. In Asia Pacific, excluding Japan and Korea, GKN's share of the market for constant velocity jointed sideshafts is 60% and in Latin America it is 79%. This compares with an overall 42% share of the global market.

Powder Metallurgy Sales £632 million (2001 – £612 million)

For GKN's Powder Metallurgy businesses – GKN Sinter Metals and Hoeganaes – 2001 was a year of considerable difficulty after a period of positive performance. During 2002 however there has been a significant recovery in profitability.

Management action has involved the closure of a number of plants in the US and a cost reduction programme at Lichfield in the UK. Hoeganaes has overcome the start-up problems associated with

its new plant in Gallatin, Tennessee in the US and is now operating well. GKN Sinter Metals' European plants performed strongly and there was encouraging progress in the recovery within US operations. Steady progress is now anticipated as management works hard to bring all of its plants closer to the level of its best performers.

In April GKN Sinter Metals took 100% ownership of the former joint venture company, Mahindra Sintered Products Ltd (India) for a consideration of £9 million. The new subsidiary, GKN Sinter Metals Ltd, is now India's largest producer of powder metal components. The transaction is a key step in GKN Sinter Metals' Asian strategy and aligns closely with GKN's Group-wide determination to serve its customers on a global basis.

OffHighway and AutoComponents Sales £492 million (2001 – £451 million)

GKN has a number of smaller automotive businesses largely focused on the market for agricultural and construction equipment and on automotive structural components. There were signs in early 2002 of a recovery in the US off-highway market following increased government subsidies to farmers but this was short-lived. However, GKN OffHighway Systems was able to take advantage of a slightly stronger European market and once more confirmed its ability to generate cash and deliver profits in challenging conditions.

As a result of a customer's decision to relocate tractor assembly operations out of the UK, GKN announced the closure of its cab systems business based at Telford in the UK. The closure is scheduled for mid-2003 and will result in approximately 150 redundancies. The closure costs are included in the 2002 results.

During 2002 the supply of the chassis for an important Land Rover model was threatened when a supplier went into receivership. GKN's AutoComponents business, which is a long established supplier to Land Rover, was able to assume control of the insolvent supplier's manufacturing operation in Wolverhampton in the UK and successfully secured the chassis supply contract. Land Rover has also awarded the contract to produce the chassis frame for a mid-sized platform to a partnership between GKN and Dana of the US which will use a new metal forming technology.

Emitec

Emitec, the 50:50 joint venture with Siemens VDO, held US sales at the same level as 2001 but sales in Europe declined slightly due to the weaker market and higher sales of diesel engined cars which are subject to less stringent emission legislation. The new Test and Development Centre in Thuringia in Germany continues the development of new cell structures and higher cell densities to meet increasing customer requirements.

Some automotive awards received in 2002

VW Group award for exceptional performance (GKN German Driveline Operations)

Fiat Auto Qualitas Award. GM Certificado de Merito. State of Rio Grande Quality and Productivity Award (GKN do Brasil Ltda)

Ford Silver World Excellence Award for Quality and Delivery Performance (Shanghai GKN Drive Shaft Co Ltd)

Renault Charte Qualité du Delai for delivery performance (GKN Sheepbridge Stokes Ltd)

Toyota Certificate of Recognition for Cost Management Achievement (GKN AutoStructures Ltd)

Honda Best Quality Award for Quality and Delivery. Toyota Best Quality Performance Award (GKN Driveshafts (Thailand) Co Ltd)

