

GKN's strategy, which is focused on technology, our global customers and tight cash management, will continue to serve us well.

Results

The year 2003 was not an easy one for the Group with declines in our major automotive markets exacerbated by continuous downward pressure on prices and weaker demand in civil aerospace. Nevertheless the results for 2003 were at the top end of market expectations and thanks are due to all our people in GKN responsible for this performance.

Pre-tax profits for the year before goodwill amortisation and impairment and exceptional items were £246 million (2002 – £267 million) and earnings per share were 22.8p (2002 – 25.2p). Cash inflow from operating activities was £287 million (2002 – £361 million) and net debt at £793 million was £41 million lower than at the end of 2002. Interest cover was 5.4 times (2002 – 6.6 times).

Dividend

Subject to prevailing economic conditions the Board is committed to a progressive dividend policy. The Board therefore recommends that a final dividend of 7.8p should be paid on 21 May 2004 bringing the total for the year to 11.6p (2002 – 11.3p). The dividend of 11.6p is covered 2.0 times by earnings before goodwill amortisation and impairment and exceptional items (2002 – 2.2 times).

Post-retirement benefits

Last year we reported that the UK pension scheme, which has 60,000 members with 90% no longer in service, had a gross deficit of £551 million. This figure was based on FRS 17, the accounting standard that was then due to come into force on 1 January 2005. At the end of 2003, on the same basis the gross deficit was similar at £549 million.

The Board fully recognises its responsibilities to pension scheme members irrespective of whether they are current or former employees. It therefore accepts that the substantial costs involved in funding the UK pension fund deficit have to be charged against profits. The figures below set out the impact on pre-tax profits before goodwill amortisation and impairment and exceptional items for the last three years.

	Pre-tax profits as defined above £m	UK pension fund deficit charge £m	Pre-tax profits before UK pension fund deficit charge £m
2001 (pro forma)	245	–	245
2002	267	6	273
2003	246	23	269

In 2004 the UK pension fund deficit charge is expected to be £39 million.

Social responsibility

We firmly believe that a positive attitude to social responsibility is a *sine qua non* of a successful company. Reference has already been made to our attitude to post-retirement benefits but the quest for continuous improvement in the management of health, safety and environmental issues is an important goal for the Board which regularly reviews performance. Pages 38 to 41 of this annual report set out our achievements in the last year and they make encouraging reading. Our two main measures of safety, namely the accident frequency rate and the accident severity rate, show 2003 to be the best ever year for the Group with a significant improvement over 2002. Our environmental performance in 2003 also shows an improvement with waste generation and both energy and water consumption in relation to sales all lower than a year ago. Further progress was made in terms of ISO 14001 accreditation which has now been achieved in 59 plants compared with 50 in 2002.

The Board

The last 12 months has seen a number of actual and prospective changes to the Board. More than two years ago we announced that I would be stepping down as Chairman at the AGM in May 2004 and a year ago under the leadership of Sarah Hogg we set in train a rigorous process to select my successor in which external advisers played a part. Roy Brown was duly selected and an announcement to that effect was made in November of last year. Roy joined the Board in 1996 as a non-executive Director and has accumulated considerable experience of GKN. The Board has made a wise choice and on a personal basis I wish Roy every success.

On 1 December 2003 Sarah Hogg, who also joined the Board in 1996, was appointed Deputy Chairman and Senior Independent Director. Sarah brings extensive expertise to this role. She has given me, as Chairman, considerable support and will undoubtedly do the same for my successor.

Sir Christopher Meyer and Helmut Mamsch both joined the Board as non-executive Directors in 2003 and their different international experience will add value in our boardroom. Christopher was the British Ambassador in Washington from 1997 until 2003 and prior to that from 1994 to 1996 he was Chief Press Secretary to the Prime Minister. He is very well acquainted with both the British and American political and business scene. Helmut was formerly a Management Board member of VEBA AG (now E.ON AG). He serves as a Supervisory Board member and a non-executive Director on a number of other German and UK company Boards.

Klaus Murmann retires as a non-executive Director at the AGM in May. Klaus joined the Board in 1995 and has brought to it a wealth of international business knowledge. He has given generously of his time for which his colleagues are most appreciative.

Corporate governance

A year ago the report by Sir Derek Higgs on the role and effectiveness of non-executive Directors had been published but the Combined Code on Corporate Governance had not then been revised. When the revised Combined Code finally emerged it reflected some of the main representations made by GKN and other companies and although the revised Code only comes into effect for UK listed companies for reporting years beginning on or after 1 November 2003 (2004 in the case of GKN) we are substantially compliant with its requirements. Pages 74 to 79 of this report address the positioning of GKN with regard to the new Combined Code.

It is worth commenting that five years ago three pages in the annual report were devoted to corporate governance. In this report, and in smaller print, six pages are devoted to the subject. Does this suggest in any way that standards of corporate governance in GKN are twice as high now as they were then? Emphatically the answer is no. The Board of GKN has maintained high standards of corporate governance for a long time and quantity of information should not be confused with quality of execution. Of course if shareholders require increasing amounts of information on corporate governance it is incumbent upon the Board to provide it but at a time when regulation has become a growth industry of its own it is perhaps worth reflecting on two points neither of which is new. Firstly, that the provision of more and more information almost certainly incurs actual and opportunity costs for both the provider and the recipient. It can therefore only be justified if it creates real value. Secondly, strong adherence to the spirit of corporate governance is infinitely more important than apparent compliance with its law.

The future

Twenty years ago, in 1984, the FTSE 100 Index was launched at which point the industrial manufacturing sector accounted for 28 of the 100 constituent companies. Today there are only 41 companies who are still in the FTSE 100 Index who were part of the original 100 of which only six are in the industrial manufacturing sector. GKN is one of them.

So how has GKN managed to keep its place in the premier league? The answer almost certainly lies in the successful pursuit of a strategy that places at its leading edge the importance of managing within the core competences of its executive team, the development of technology, the establishment of a focused global company serving global customers and the tight management of cash. That strategy has served us well for many years and will continue to do so.

Sixteen annual reports ago I ended my first Chairman's statement with a paragraph which said: "Looking further ahead, we have a clear strategy in place, a management team well capable of executing it, and an international spread of manufacturing and service businesses that give us a sound base for further growth." That paragraph is equally appropriate as an ending to my last Chairman's statement for I am as optimistic today about the future prospects for GKN as I was then.



Sir David Lees
27 February 2004

