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GKN's results in 2003, delivered in some difficult markets, confirm our long-standing reputation for consistently high levels of operational and financial management as well as our success in building strong positions in automotive and aerospace markets.

Our principal challenge in 2003 was declining light vehicle production in North America, Western Europe and Japan and depressed conditions in civil aerospace.

However, we were able to take full advantage of the growth in automotive output in emerging markets and the continued strength of military aerospace programmes. Our Driveline business and AgustaWestland both delivered strong performances at the top end of our expectations.

We have also been successful in winning substantial new business from our global customer base and there was strong order intake across the entire Group. In Automotive, Driveline won more than 70% of all available new constant velocity joint (CVJ) programmes, Sinter Metals won US\$150 million of new orders and in Aerospace our technology has won us positions on all the important new aircraft under development in Europe and the US.

Underlying profit before tax, goodwill amortisation and impairment and exceptional items, was down on last year. The 8% reduction was largely caused by increased UK pension deficit charges of £17 million, without which we would have been close to last year.

GKN's recognition of its pension fund obligations saw the Group contribute £44 million of cash in 2003 towards the deficit alone. In spite of that our cash performance was encouraging. Despite increased pension contributions we have reduced net debt for the second successive year.

Developments in 2003

GKN Driveline has positioned itself to take advantage of the growth in emerging markets. Through a strategic programme of investment and partnership it has established market positions in Asia Pacific and Latin America which are considerably in excess of its 42% global market share in CVJ products.

Our long-term presence in China and India – where vehicle output grew by 37% and 26% respectively in 2003 – has allowed us to take full advantage of the economic expansion in these markets.

Meanwhile GKN Aerospace Services, through a series of targeted outsourcing agreements and acquisitions, has grown to become a key supplier of aircraft structures and components to virtually all of the USA's frontline military aircraft.

There were a number of significant developments in 2003:

- › following the acquisition of Pilkington Aerospace, GKN Aerospace Services became the world's No. 1 supplier of transparencies to the military market and No. 2 supplier to the civil market;
- › the Japan Defence Agency selected the AgustaWestland EH101 for an initial requirement for 14 aircraft. This is a major breakthrough into a market dominated for more than 40 years by US aircraft;
- › GKN Driveline completed two new joint ventures in Thailand with Toyoda Machine Works (TMW) of Japan to supply driveshafts for a new vehicle to be produced by Toyota in the region. GKN has well-established relationships with TMW and Toyota;
- › Hoeganaes, GKN's metal powder production business, established its first full manufacturing base in Europe when it acquired Ductil Iron Powder of Romania; and
- › GKN completed the sale of its 29% stake in Alvis plc to BAE Systems for £73 million in cash. This transaction, which marked GKN's exit from the armoured vehicle business was well received by investors.

Accelerating the development of technology

The leadership team which is now taking GKN forward believes in the strategic potential of our technology. During 2003 a team of senior engineering executives from across the Group identified product and process technologies which have the greatest potential to expand our available markets.

This accelerated development of our technology is focused primarily on the performance and packaging of torque systems and geared components, the achievement of significantly higher levels of density and surface finishing on a wider range of powder metal parts and the application of highly automated processes to the production of composite aircraft structures. On pages 12 to 15 we look in some detail at how technology is shaping the future of our Automotive and Aerospace activities.

Other measures of performance

Ultimately our performance is judged on financial and commercial criteria and our ability to deliver value to our shareholders. But there are other measures which we also value.

The well-being and safety at work of GKN people is of paramount concern. Safety is measured on the basis of accident frequency, accident severity and serious injuries incurred. During the last five years all three measures have reduced by between one third and

one half. GKN's performance compares well with industry averages in the UK, Germany and the US but our ultimate goal is to create a working environment with zero preventable accidents. On pages 38 and 39 we look in more detail at our performance in this critical area.

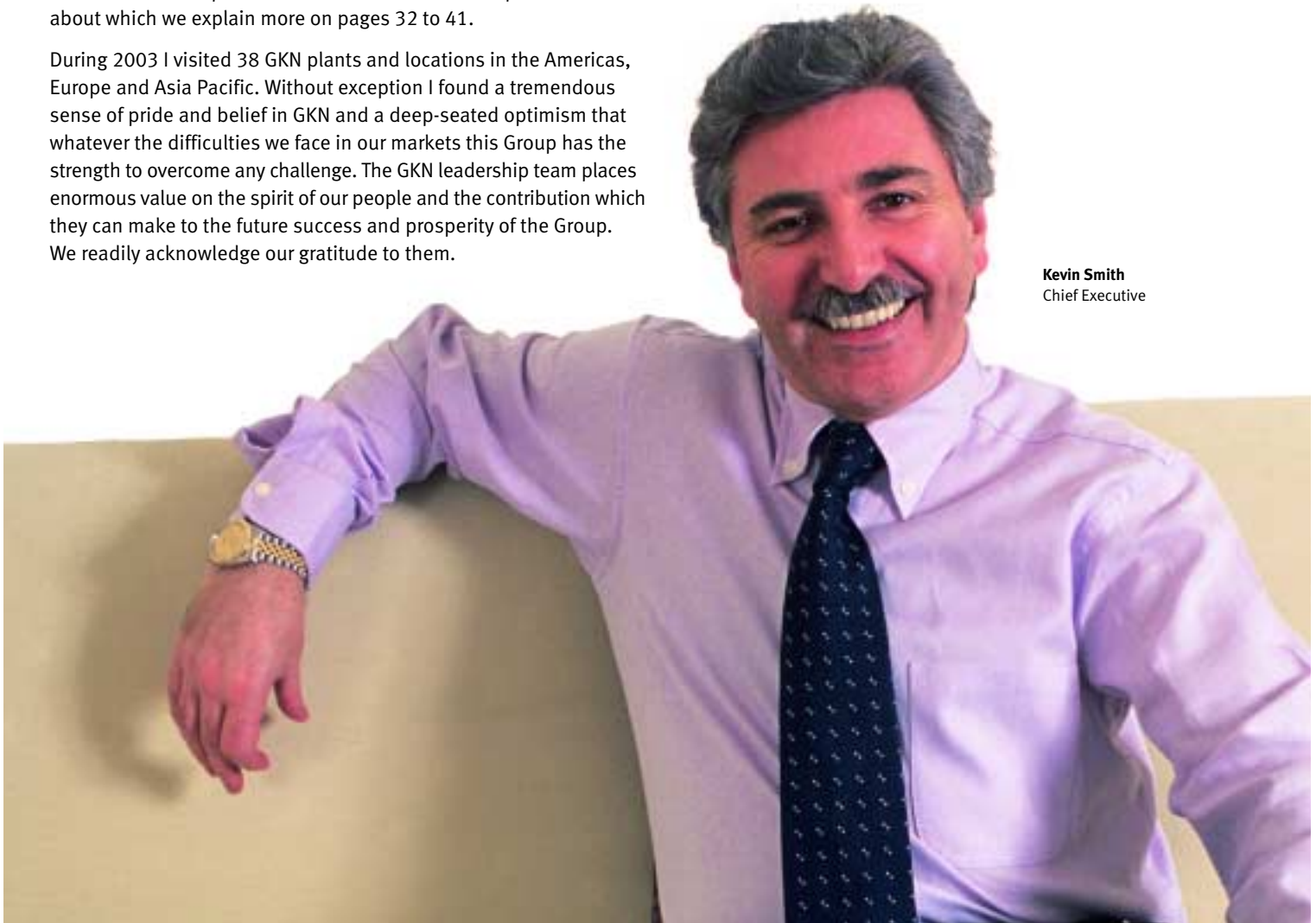
During the last 12 months many of our businesses have again received a number of awards from customers for our performance in areas such as quality, delivery, service and technology demonstrating GKN's ranking as a world-class supplier. During 2003 GKN Driveline received its second Global Contribution Award from Toyota – the only non-Japanese supplier to have ever done so. DaimlerChrysler selected GKN Driveline and GKN Sinter Metals to jointly share its Global Power Train Supplier Award and GKN Driveline received a global award from General Motors for continuous improvement. There were also further awards from Mazda, Honda and Nissan.

Throughout the year thousands of GKN people once more gave freely of their time to support their local communities and we take pride in personal thanks from individuals and in more formal civic recognition of our contribution.

GKN people have always been conscious that they are expected not only to deliver short-term performance but to build a business which can be sustained by future generations. We see no conflict between our commercial imperatives and our wider social responsibilities about which we explain more on pages 32 to 41.

During 2003 I visited 38 GKN plants and locations in the Americas, Europe and Asia Pacific. Without exception I found a tremendous sense of pride and belief in GKN and a deep-seated optimism that whatever the difficulties we face in our markets this Group has the strength to overcome any challenge. The GKN leadership team places enormous value on the spirit of our people and the contribution which they can make to the future success and prosperity of the Group. We readily acknowledge our gratitude to them.

Kevin Smith
Chief Executive



Automotive

Global light vehicle production is expected to grow at slightly above its historical rate over the next five years. We expect production to increase at a compound annual rate of about 3.3% between 2003 and 2008. Over that period, the largest economies of Western Europe, North America and Japan will account for a relatively small proportion of that growth in light vehicle production. Most of the growth will come from the developing economies of South America, Eastern Europe and Asia Pacific.

GKN Driveline is well positioned to serve its customers in these fast-growing regions. The division has long-standing and strong relationships with all the key Japanese vehicle manufacturers, relationships which began through support of Japanese transplant operations in North America and Western Europe and have now been extended to include operations in Japan itself. In 2003, Driveline's share of the Japanese market for CVJs reached 17.5% – up sharply from only 3.3% five years ago.

GKN Driveline is operating in a global market which is becoming increasingly competitive and subject to pricing pressure as vehicle manufacturers (VMs) look to suppliers to reduce prices while improving technology, service and quality. While the number and variety of cars offered for sale has increased, the consolidation of VMs has created larger and more effective purchasing groups which leverage their scale and scope. We estimate that the top six VM groups now account for more than 75% of global vehicle production.

The issues which we face in Powder Metallurgy are more challenging in the short term.

Hoeganaes continues to perform well and in 2003, as referred to earlier, acquired a powder production plant in Romania – its first production facility in Europe. This will enhance our competitive position in Europe and broaden our international production base.

In Europe GKN Sinter Metals has a track record of good performance and continued new programme wins will sustain future growth. In 2003 the restructuring of our UK Sinter Metals operations was completed and work began on a new central European research and technology centre which is due for completion in 2004.

In the US GKN Sinter Metals has a high exposure to the North American automotive market which saw vehicle output fall by 3.5% in 2003. The impact of this market weakness was exacerbated for GKN Sinter Metals by a combined 6% decline in output by its three largest customers.

Recovery actions in the US enabled us to win new programmes for 2006 and beyond with an annual sales value of US\$80 million. The business has been able to improve operating efficiency but more remains to be done and the market weakness we encountered has impaired our ability to deliver an improved financial performance. We continue to be confident that the powder metallurgy sector offers significant opportunities for growth as VMs capitalise on the lower cost production processes for sintered components to substitute them for cast or forged components and as our technology creates new market opportunities for sintered components.

Our smaller automotive businesses faced mixed conditions. OffHighway Systems saw sales fall but by less than the overall decline in the agricultural and construction equipment market. This continues to be a robust business which has proved its ability time and again to weather difficult market conditions. In the UK our AutoStructures business successfully completed pre-production work on the chassis for a new Land Rover model. Emitec continued to grow in Europe but this was offset by reduced sales in the US.

Aerospace

Within the aerospace sector GKN operates as an international first tier supplier through its wholly-owned business GKN Aerospace Services and as a prime contractor and systems integrator through AgustaWestland, a 50:50 joint venture with Finmeccanica of Italy.

Defence contracts account for approximately 80% of our overall Aerospace revenues. This is not only a particular advantage at a time when the civil aircraft market is in the grip of a protracted downturn but also offers long-term advantages. Military procurement programmes are not closely linked to the cyclicity of the civil economy and offer predictable, long-term revenue streams. Military work on current US programmes is worth an estimated US\$6 billion to GKN Aerospace Services. AgustaWestland, at the end of 2003, had a £4.4 billion forward order book following a £1.2 billion order intake during the year from its worldwide customers.

Our successful management of the outsourcing by Boeing Integrated Defense Systems (IDS) of its military aircraft structures business in St Louis, Missouri was enhanced by applying our previous experience within GKN Driveline. As a result of our performance, Boeing IDS awarded GKN life-of-programme contracts on the F-15, F/A-18 and C-17 worth more than US\$850 million.

AgustaWestland continued to perform strongly in 2003 making a substantial contribution to our results. At the heart of AgustaWestland is the EH101, the most modern medium-lift helicopter in the world. It is this aircraft which has taken us into the Japanese defence market following the selection of 14 EH101 aircraft by the Japan Defence Agency and there is the potential for further orders. This is a significant breakthrough for Japan had previously acquired its major front line helicopters from the US. Other countries in Asia Pacific could well be influenced by Japan's selection of the EH101.

In the US there is an opportunity for a US variant of the EH101, spread across five programmes, for a total of 360 new helicopters. AgustaWestland has teamed with Lockheed Martin as US prime contractor and Bell Helicopters as the US air vehicle manufacturer.

AgustaWestland's performance to date has met all our expectations and it has the scale of operations and the product range to compete very effectively in all its markets.

Shaping up for the future – a new direction for Driveline

GKN Driveline has been a consistently high-performing business. During 2003 and early 2004, we undertook a full review of our current Driveline manufacturing and business footprint to assess its future suitability for our key global markets. As a result of this strategic review we have now decided to embark on a

programme of reorganisation which we are confident will provide a platform to significantly improve the quality of earnings in our core Driveline business and position us well to serve the future needs of our customers.

Our major markets of Western Europe and North America have provided little overall market growth in recent years with intense competition amongst manufacturers putting increased pressure on pricing and productivity. In contrast, the emerging markets in South America, Asia and Eastern Europe are providing strong growth in automotive production and we have continued to successfully build our presence in all three regions, which also offer potential to provide much lower cost sources of supply.

To take advantage of this opportunity we have developed a global manufacturing strategy for our CVJ business which today represents 75% of our Driveline sales. Over the next three years we will migrate about 20% of our global production from high cost to low cost economies so that by 2007 over 50% of our CVJ manufacture will be sourced from low cost locations. This will require a significant realignment of our manufacturing network.

Detailed plans are being prepared to deploy this strategy and will be announced in due course. We expect that the exceptional cash costs of restructuring in Driveline will average around £35 million per year over the next three years, with additional non-cash costs being likely in 2004. Total exceptional costs, which should not exceed £150 million, will be finalised as the detailed plans are approved. Any additional capital expenditure required should not increase the Group's overall level of expenditure above the normal level of 110-120% of depreciation.

Although there will be little benefit from this strategy in 2004, by 2007 we estimate full year profit benefits from completion of this exceptional restructuring to be in the region of £40 million a year.

Supporting US Sinter Metals' recovery, realigning our cost base

Although our success in winning new orders in US Sinter Metals should lead to a resumption of growth in 2006, this recovery is at an early stage. We intend to support recovery and underpin its base by further reducing costs and focusing activities on our areas of technological advantage. Additional restructuring is therefore expected in 2004. Detailed plans are being developed and will be announced in due course.

In addition, across the Group as a whole we intend to realign overhead expenditure to better reflect the future shape of our business and reduce costs.

The cash costs of restructuring US Sinter Metals and realigning our cost base across the Group are expected to total some £30-£40 million, falling largely in the next 12 months. The impact of these actions on the carrying value of related assets will be revisited as the detailed plans are developed.

In summary, by investing in reshaping Driveline, by supporting US Sinter Metals' recovery and by realigning our cost base, we will build a stronger business in a world which still offers excellent opportunities for growth. The measures outlined above will leave

GKN well positioned to take full advantage of these opportunities. In total we estimate the exceptional cash cost of restructuring over the next three years to be some £140 million, with some £90 million likely to be charged to operating profit in 2004, together with any non-cash write-offs required as the detailed plans are developed. Our initial scenario planning indicates that such charges might be in the region of £60-£80 million, broadly shared equally between the two projects. The cash flow impact in 2004 should be some £50 million. Benefits in 2004 will be small, but will rise incrementally to an estimated £60 million a year by 2007 giving an overall cash payback of just over three years. The maximum cumulative cash outlay is likely to peak at around £80 million in 2005, well within the funding capacity of the Group.

Outlook

In contrast to the declines of recent years there is now a more positive outlook for our major markets. Automotive production is forecast to increase slightly in North America whilst in Europe volumes are expected to be level or marginally ahead of 2003. Continuing strong demand is expected in most of Asia Pacific. In aerospace, military demand looks set to remain strong with civil demand at its cyclical low.

However, competitive pressures in all our markets are expected to remain intense, exacerbated by increasing pressure from rising world raw material prices. The Group's global footprint means that the proportion of sales exported from one currency region to another is relatively small but the fall in the US dollar will affect approximately £150 million of exports from Europe to the US as the hedging cover now in place is at lower average rates than in 2003.

Against that background, the Group expects to make further improvements in its underlying operational performance although the overall result will be impacted by the charge relating to UK pension deficit costs increasing from £23 million to £40 million, as previously indicated.

Looking further ahead, GKN will continue to focus on its core strengths: technology, exceptional customer service and performance and, with the benefits of the strategic initiatives outlined above, the Group will continue to move forward with confidence.



Kevin Smith
27 February 2004