

## CHAIRMAN'S STATEMENT

### Performance

GKN achieved a number of successes in 2004 – some of them in the face of powerful headwinds.

The successful disposal of our 50% stake in AgustaWestland realised substantial value for the Group and its shareholders and will allow us to increase and accelerate the level of investment in our wholly-owned businesses. To provide a more immediate return to shareholders from this transaction we initiated a buyback of shares into treasury of up to £100 million.

During 2004 we increased our Automotive revenues in largely flat markets. This hard won achievement was, however, frustrated by an unprecedented rise in raw material prices, particularly steel.

Our continuing Aerospace businesses increased sales revenues over the previous year and built a strong pipeline of future business thanks to new, competitive technologies.

Meanwhile, recognition of our pension obligations resulted in a charge of £38 million (2003 – £23 million) to our profit and loss account in respect of the UK pension fund deficit. We also used proceeds from the AgustaWestland transaction to make an additional £100 million contribution towards this deficit.

However, as this annual report shows, GKN has taken robust operational measures to alleviate the impact of these headwinds, as well as the effect of adverse currency movements, and we have taken important steps in the long-term strategic development of the Group.

### Results

Pre-tax profits for the year before goodwill amortisation and exceptional items were £221 million (2003 – £246 million) and earnings per share on the same basis were 21.3p (2003 – 22.8p). Net funds at the end of the year were £65 million compared with debt of £793 million at the end of 2003. Interest cover was 5.7 times (2003 – 5.4). On a statutory basis profit before tax was £629 million (2003 – £173 million) reflecting the exceptional net credit which arose largely from the divestment of the Group's share of AgustaWestland offset by restructuring and impairment charges.

### Dividend

Subject to prevailing economic conditions the Board is committed to a progressive dividend policy and recommends that a final dividend of 8.0p be paid on 10 May 2005 bringing the total for the year to 11.9p (2003 – 11.6p). The dividend of 11.9p is covered 1.8 times by earnings before goodwill amortisation and exceptional items (2003 – 2.0 times).

### The Board

I was honoured to become Chairman of GKN in May following the retirement of Sir David Lees. During my nine years on the Board of GKN I have come to respect the Group's inherent strength. This is due in no small measure to David's distinguished leadership over many years.

Our Board continues to evolve. Klaus Murmann retired in May as a non-executive Director, a position he had held since 1995. In June Dick Etches and Neal Keating left the service of the Group. Dick had been Human Resources Director and Neal, Managing Director Aerospace Services. We thank each of them for their contribution. In December



Roy Brown, Chairman (left) with Kevin Smith, Chief Executive

John Sheldrick, Group Finance Director of Johnson Matthey plc, joined as a non-executive Director bringing considerable financial experience.

### Corporate social responsibility

GKN has been active for more than 150 years in what is now commonly termed 'social responsibility' but our best practice continues to develop. This issue is reviewed regularly by the Board and in 2004 we established an executive sub-committee on governance and risk which has completed an unprecedented survey of our global social responsibility behaviour and practice in more than 100 locations. The results will be used to refine and improve the way we interact with our employees, customers, suppliers and communities.

### The future

The year 2004 was a difficult one for the Group and the outlook promises another demanding year in 2005. However, we have considerable strengths and market leadership positions and the Board is confident that GKN will continue to deliver long-term shareholder value.

Roy Brown

23 February 2005

## CHIEF EXECUTIVE'S STATEMENT

### Transforming GKN

The strategic development of GKN gathered pace in 2004.

The disposal of our share of AgustaWestland transformed our balance sheet, taking control of Tochigi Fuji Sangyo of Japan accelerated our move into higher-value automotive systems, we set in train a global plan to deploy more production assets in high-growth, low-cost economies and we won positions on the world's major new aircraft programmes.

### The AgustaWestland effect

When we announced the agreement to sell our 50% stake in AgustaWestland to Finmeccanica, we described the £1.063 billion consideration, which represents 1.2 times AgustaWestland's 2003 sales, as 'the right price at the right time'. GKN secured a strong contribution from helicopters over the 10 years since the acquisition of Westland Group plc and the price realised for our shareholding gave full recognition to the potential of that business.

The balance sheet strength we have secured will provide the resources necessary for the next stages of development of our wholly-owned Automotive and Aerospace businesses.

### High-growth, low-cost economies

GKN has an enviable record of penetrating new global markets. Economic expansion in the emerging economies provides a major opportunity, particularly as we are able to build on an existing presence – GKN has been in China for 16 years, India for almost a century and Brazil for 32 years. We are also established in Poland and Slovenia.

South America, Asia Pacific and Eastern Europe now account for 26% of global light vehicle production. These markets are forecast to grow at almost four times the rate of those in North America, Western Europe and Japan. They also offer a low cost base to enhance our competitiveness. In 2004 we announced our intention to migrate 20% of our CVJ production to these low-cost, high-growth economies so that by 2007 more than 50% of our production will take place there. We expect the benefits to be substantial. We are also pursuing the restructuring of our North American Powder Metallurgy operations to return the business to an adequate level of profitability.

### The creation of technology

Four years ago GKN identified the emerging demand for a new generation of automotive driveline components to manage the efficient distribution of power and torque in increasingly powerful vehicles. Since then we have built a world-leading portfolio of mechanical and electronic products. 2004 saw new vehicles come to market with innovative GKN products and systems including the Cadillac SRX/STS and Land Rover Discovery. We also won positions on important new vehicles still under development.

There has also been a strong focus on aerospace technology, particularly in composite structures which offer significant strength and weight benefits. In 2004 we achieved a number of firsts. These included the first production components from new composite manufacturing processes for the Airbus A380 and the Lockheed Martin F-35 Joint Strike Fighter. We won the order for the world's first composite primary wing structures for a large aircraft, the Airbus A400M military airlifter, and the Boeing 787 will fly with the world's first all-composite engine containment casing from GKN on the General Electric GEnx turbofan.

Our ability to produce complex composite structures has attracted funding from the UK Department of Trade & Industry and South East Development Agency, who are helping establish GKN's Advanced Composite Facility in the UK. The facility will be operational this year and will accelerate our progress in pioneering aerospace composite applications. We value the Government's support.

The operating and financial review on pages 21 to 30 details the significant challenges we faced during the year from rising raw material and energy costs. The creditable results we achieved in 2004 owe much to the skill, commitment, dedication and innovation of GKN people around the globe. My thanks go to them all.

### Outlook

In Automotive the major European and North American markets are forecast to remain relatively static in 2005. Growth in the developing markets is expected to continue, although at a slightly lower level than 2004. Overall, global automotive demand is anticipated to maintain its steady 2-3% annual growth. In Aerospace prospects are improving, with rising civil aircraft production and a robust US military market. Our OffHighway markets overall look set to show modest growth with steady US demand and a slight increase in Europe.

Against this background we expect our Automotive businesses to improve underlying sales and operating performance although high worldwide raw material prices, particularly for steel, present a challenge to 2005 Automotive profitability. Renegotiated annual supply contracts will add some £30 million to costs in 2005. In addition we are exposed to fluctuations in the scrap steel price which is surcharged in the industry. In the first quarter this surcharge will have some impact on costs, although if scrap were to stay at the current somewhat reduced price levels, little further impact would be felt in the rest of the year.

We continue to negotiate for recovery of this cost increase with our customers and are having some success, although the full quantum of recovery will not be known for several months. Our focus on productivity improvement will continue.

In Aerospace trading is expected to continue to improve in 2005 and OffHighway's performance should also show progress.

The benefits of our leading technology, new products and strong presence in emerging markets, combined with the benefits of the restructuring activities underway, leave the Group's continuing businesses well positioned for growth.

In addition, the transformation of the Group which started in 2004 will continue in 2005. The £1 billion sale proceeds from AgustaWestland have significantly strengthened the balance sheet and provide a solid platform for accelerated growth in profits and earnings from their new, re-based levels. The Group is well placed to take advantage of opportunities in all its markets and looks to the future with confidence.



Kevin Smith  
23 February 2005