



Roy Brown Chairman (right) with
Kevin Smith Chief Executive

Chairman's statement

› Performance

During the past four years we have systematically evolved GKN into a highly focused and technology led engineering group with strong leadership positions in Automotive, OffHighway and Aerospace.

In 2005, through restructuring and investment, we accelerated our strategy to build a GKN which, while maintaining its focus, will be even more global than before. Today our production capacity is increasing in Mexico, Brazil, Poland, Slovenia, India and China where we are building on a strong presence established over a number of years.

Our businesses overall have made progress in both sales and trading profit. Despite flat production of light vehicles in North America and a slight decline in Western Europe – our two largest automotive markets – global light vehicle production increased by 3% as a result of growth in Brazil, India and China. However, we still had to deal with continued high input costs.

Whilst Automotive profits were down, the transformation of our Aerospace business allowed us to take advantage of both continuing strong defence expenditure and an upturn in the civil market which led to substantially higher Aerospace profits. OffHighway also showed continuing improvement.

Following receipt, some 15 months ago, of the proceeds of the sale of our 50% shareholding in AgustaWestland we have been examining acquisition opportunities rigorously. We have not set ourselves any arbitrary deadlines but will use our balance sheet strength when we find opportunities which we believe can deliver real, long-term shareholder value.

In common with other UK pension funds, GKN's UK scheme has been adversely impacted by declining real interest rates and increased longevity. While recognising the long-term nature of pension liabilities, we believe this deficit must be addressed and therefore are making an immediate contribution of £200 million into the scheme.

› Results

Post-tax earnings for the year before restructuring charges, profits on sale of businesses and changes in the fair value of derivative financial instruments were £163 million compared with £172 million in 2004 and earnings per share on the same basis were 22.1p compared with 23.1p in 2004. For continuing operations trading profit rose to £228 million from £214 million in 2004. Net debt at the end of the year was £65 million compared with net funds of £65 million at the end of 2004.

› Dividend

Subject to prevailing economic conditions the Board is committed to a progressive dividend policy and recommends that a final dividend of 8.2p be paid on 17 May 2006 bringing the total dividend for the year to 12.2p (2004 – 11.9p). The dividend is covered 1.8 times (2004 – 1.9 times) by earnings before the impact of restructuring and impairment charges, profits on the sale of businesses and changes in the fair value of derivative financial instruments.

› The Board

There were a number of changes in the composition of the Board. Following completion of nine years' service as a non-executive Director, Baroness Hogg ceased to be the Senior Independent Director with effect from 31 December 2005 and has been succeeded in that role by Sir Ian Gibson. Sarah continues as Deputy Chairman until her retirement from the Board at the AGM on 12 May 2006. Sir Peter Williams has taken over from Sarah as Chairman of the Remuneration Committee and John Sheldrick has succeeded Sir Peter as Chairman of the Audit Committee, both with effect from 1 January 2006.

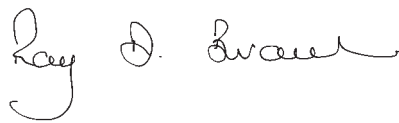
Richard Clowes, Group Managing Director Corporate Development, left the Group on 31 December 2005 and Ian Griffiths, Group Managing Director Automotive, resigned from the Group on 3 February 2006 to take up a senior external position. Both Richard and Ian served GKN over a considerable number of years and we thank each of them for their very valuable contribution.

› **Corporate social responsibility**

Last year I reported that we had carried out a global survey of our social responsibility behaviour and practice which would enable us to refine and improve the way we interact with employees, customers, suppliers and communities. As a result we are introducing The GKN Code which is supported by a number of policies, some of which are new and some of which are updates of existing policies. The Code is common to all parts of the Group and sets out a clear and unambiguous framework of conduct and behaviour.

› **The future**

GKN made good progress in 2005 in building a strong platform for the future. Our balance sheet remains strong and well able to support our growth ambitions.



Roy Brown
27 February 2006

Chief Executive's statement

› **A year of progress**

2005 has been an exciting year in the development of GKN and we made excellent progress across all of our major businesses. We achieved a solid financial performance and continued to deliver on the strategic actions which will re-establish the Group on a long-term growth path.

In a year of mixed automotive markets and escalating raw material and energy costs our Automotive businesses in total increased sales and produced a very respectable level of profits. Programme wins and successful new product launches confirmed Driveline's market and technology leadership and a soundly based improvement in Sinter Metals' performance underpinned our continued confidence in this sector. OffHighway increased both sales and market share and the proportion of its revenues derived from the global construction equipment market. The successful transformation of Aerospace is confirmed by our results and we further strengthened our position on the world's latest aircraft and engine programmes.

As a result of our new technologies, new programme wins and new investments, our progress in 2005 will make a major contribution to the future success of GKN.

› **Changing our global footprint**

In 2004 we informed shareholders of our plans to build on our long-established presence in high-growth, low-cost economies. By rebalancing our global manufacturing assets we will better exploit opportunities offered by the emerging, growth economies of Asia, Latin America and Eastern Europe. By 2008 our Driveline business plans to have approximately 50% of its constant velocity joint production capacity in these regions compared with 30% in 2003.

During 2005 we made rapid advances towards this goal. Taking full ownership of our joint venture in Mexico was an important step and we are investing to double our capacity there. Driveline is also increasing capacity in Brazil, Poland and Slovenia. Powder Metallurgy, Other Automotive and OffHighway have moved to establish new capacity in markets such as Brazil, India and China, all of which will be in place during 2006. Meanwhile we are implementing the closure of a number of Driveline and Powder Metallurgy plants in North America and Western Europe.

› **The contribution of technology**

Three years ago we stated that GKN was determined to become a technology led company. Our progress in achieving this ambition has been rapid.

In Driveline our engineers launched two new constant velocity joint technologies which are exciting the interest of vehicle manufacturers. These new technologies represent the first breakthrough in constant velocity joint design since the product was invented 70 years ago.

In 2005 we commissioned our Advanced Composite Facility on the Isle of Wight in the UK to accelerate the development of new material and process technologies for aerospace. We are grateful for funding support from the UK Department of Trade & Industry and the South East Development Agency. The Facility was opened by Alun Michael MP, Minister of State for Industry.

GKN's technology status in aerospace was confirmed by our selection by Northrop Grumman to join the team responsible for development and production of the X-47B unmanned combat aircraft. Prototype production work on this programme began in 2005. We also embarked on a major extension of our facility in Alabama, USA, to produce the world's first all-composite fan case for the new General Electric GENx jet engine for airliners such as the Boeing 787 and 747-8 and the Airbus A350.

› **Managing GKN**

As a result of the Board changes described by the Chairman we have enlarged the Executive Committee of the Board which now also includes the chief executives of our operating divisions – Driveline Driveshafts, Sinter Metals, Diversified Businesses Group, OffHighway and Aerospace. These changes to the Executive Committee were with effect from 1 January 2006. I am confident that through this team of experienced and talented executives we will be able to continue to drive forward our strategic development with maximum vigour.

Credit for our successes in 2005 is spread widely throughout the global GKN organisation. People at all levels have been challenged by the execution of our strategic plan and have shown exceptional skill and dedication. I thank them all for their contribution to what has been a memorable year of progress in the development of GKN.

› **Outlook**

There is a broadly stable outlook for major automotive markets whilst aerospace markets look set to remain strong.

In Automotive, industry forecasts for North American and Western European markets are for little change in production volumes, although there remains some risk of disruption to the former following recent supplier insolvencies. However, developing markets, especially in Asia Pacific, are expected to show continuing strong growth. Prices for steel and other automotive raw materials appear to have stabilised although energy costs are still showing some increase.

With its presence in emerging markets and strategic restructuring programme nearing completion, Driveline should have another solid year. Powder Metallurgy expects to show further recovery and growth. Results for our other smaller Automotive businesses will be impacted by redundancy costs.

OffHighway's agricultural markets softened slightly during 2005 but are expected to remain around current levels throughout 2006, with continuing strong demand in construction markets. We expect our business to continue to make good progress.

Aerospace markets will remain strong and we expect to continue to improve performance albeit at a lower rate of growth than the exceptional rate seen in 2005.

Interest costs on borrowings will rise in 2006 as increases in US interest rates will impact foreign currency borrowings by around £9 million.

Overall we expect to continue the progress seen last year into 2006, with the further benefits of restructuring together with the strength of our order book accelerating growth from 2007 onwards.



Kevin Smith
27 February 2006