

## OffHighway



GKN OffHighway's acquisition of Rockford Powertrain in 2006 expanded the Group's presence in the US construction industry. Here Rockford's Steve Marshall (top), Tom Corcoran (below left) and Hermann Kampling stand beside a Caterpillar 988H wheel loader which uses Rockford driveshaft technology and GKN wheels.

# OffHighway: Growing presence

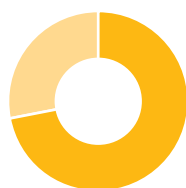
GKN is one of the world's leading suppliers to the agricultural and construction equipment industries. GKN OffHighway has a long established position in Europe and North America, has grown in Latin America, expanded into China and is extending its presence in the construction sector.

OffHighway sales by market



■ Agriculture - Europe 40%  
■ Agriculture - North America 15%  
■ Construction 29%  
■ Industrial Machinery 16%

OffHighway sales by region of origin



■ Europe 72%  
■ Americas 28%



All of the 550 strong workforce of Liuzhou Steel Rim Factory in Southern China joined with senior GKN executives to celebrate GKN OffHighway's acquisition of the business in 2006.

OffHighway designs and manufactures steel wheels and driveline systems for the global agricultural, construction and industrial machinery sectors. During 2006, approximately 55% of its sales were to the agricultural market, 29% to the construction equipment market and the balance to the industrial machinery market. The wheels operation accounts for over 50% of divisional revenue and has around a 30% market share in North America and 50% in Western Europe. In power take-off (PTO) shafts, which account for around 25% of sales, market shares are 29% and 50% in those regions.

Major customers include John Deere, Case New Holland and Caterpillar with a large percentage of sales going to a wide range of component users.

#### Agriculture

In Europe (40% of divisional sales), the overall agricultural machinery market in 2006 was essentially level with 2005, with German demand remaining strong and France showing the first signs of recovery.

In North America (15% of divisional sales) markets softened somewhat during the year as farm incomes fell as a consequence of lower government support and sharply higher input costs.

Industry forecasts for 2007 are for stable European demand across all product groups but some further reduction in North America driven by lower demand for tractors and combine harvesters. However, US commodity prices, in particular corn, are relatively strong and this may support demand.

#### Construction

The European construction machinery market remained solid throughout the year with no sign of any major changes in the short term.

In the US, demand for heavy construction equipment for mining and road building was strong throughout the year. In the light construction market, however, following a good first half, second half demand declined as a result of the reduction in the US house building programme. Looking to 2007, some further weakening appears possible in housing related equipment with level demand elsewhere.

#### Industrial machinery

This sector (16% of divisional sales) includes products for the material handling and other industries. Demand in 2006 was flat and the outlook for 2007 is for little or no change.

#### Input costs

The cost structure in OffHighway is similar to Automotive with the major costs being steel, energy and labour. In general, the business has been successful in mitigating fully the effect of

steel price increases during a period when end markets for both agricultural and construction equipment have been generally firm.

#### Divisional strategy

OffHighway's strategy is to achieve growth whilst at the same time reducing its dependence on the Western European agricultural market and increasing its exposure to the global construction market by:

- › new product development in existing businesses;
- › supporting original equipment manufacturers as they relocate production to emerging markets in Eastern Europe, Asia Pacific or South America; and
- › the acquisition of businesses in adjacent product areas or different regions.

#### 2006 Highlights

Sales in the year were £331 million compared with £310 million in 2005. There was a £2 million reduction from currency translation and a benefit of £25 million from 2005 and 2006 acquisitions. The small underlying decrease of £2 million (0.6%) mainly reflected the softer agricultural market conditions noted above.

Trading profit of £23 million was £3 million above 2005 with all of the improvement from acquisitions. The underlying result was £1 million below last year reflecting a modest increase in the wheels business on slightly higher sales, and a lower result in driveline systems which suffered more from decline in North American demand.

Margin in the year increased to 6.9% from 6.5% in 2005. Return on invested capital was 16% compared with 17% in 2005.

In line with its strategy, the division made a number of acquisitions during the year. The most significant of these was Rockford which was completed on 2 August. Rockford, which is US based, will give greater exposure to the world's construction markets. Other small European acquisitions were Cramer Kupplung (January), and Hytecomp (June). In November, as part of the strategy to expand our global footprint, Liuzhou Steel Rim Factory in China was acquired. In total, acquisitions in the year contributed £20 million of sales and are expected to generate revenue of approximately £50 million in 2007.

Capital expenditure on tangible fixed assets of £10 million (2005 - £10 million) was 1.3 times (2005 - 1.3 times) depreciation.

Top line growth is expected in 2007 from the full year impact of 2006 acquisitions, a number of business wins during the year and opportunities provided by greater exposure to the construction industry.