

Chairman's statement



Strategic progress

GKN's performance in 2006 confirms that the Group is making significant progress in implementing its strategy which is focused on the achievement of long-term growth and enhanced shareholder value.

Driveshaft manufacturing capacity continues to be transferred to the high growth economies of Asia Pacific, South America and Eastern Europe. Whilst we have had production facilities in Japan and China for some 20 years and have achieved significant market penetration in these countries, the scale of the current re-alignment of the Group's manufacturing assets will take full advantage of the new world order in automotive production.

Our Aerospace business, which now represents 29% of subsidiaries' trading profit, increased sales in 2006 by 11% and profits by 30%, achieving a trading margin of 10%. Stellex Aerostructures, acquired during the year, will increase our exposure to the US civil aircraft market.

We have also transformed the contribution which Powder Metallurgy is making to the Group. Our Sinter Metals business in North America returned to profitability in 2006 and further progress can now be expected. We also made bolt-on acquisitions in OffHighway including a wheels business in China.

I am pleased to report that the Group produced a satisfactory improvement in profitability and earnings despite high energy and raw material costs and difficult conditions in some of our markets.

We made a £200 million payment to the UK pension scheme during the year and, although a deficit remains, we feel confident that this issue is now substantially behind us.

Results

Profit before tax on a management basis was £221 million compared with £204 million in 2005. Earnings per share on the same basis rose to 28.8p (2005 – 22.3p) helped by a lower tax rate. Net debt rose to £426 million at the year end (2005 – £65 million) due to the cost of acquisitions, restructuring charges, further share buybacks and the contribution to the UK pension scheme.

Dividend

The Board remains committed to a progressive dividend policy, subject always to prevailing economic conditions. We recommend that a final dividend of 8.7p be paid on 9 May 2007 bringing the total dividend for the year to 12.8p (2005 – 12.2p). The proposed dividend is covered 2.3 times by earnings on a management basis (2005 – 1.8 times).

The Board

On 1 January 2006 Sir Ian Gibson succeeded Baroness Hogg as Senior Independent Director. Sarah retired from the Board at the Annual General Meeting on 12 May after more than nine years' service. We thank her for her extremely valuable contribution during that time.

On behalf of the Board, I am delighted to be able to congratulate Kevin Smith on the Knighthood conferred upon him in the 2007 New Year Honours. This recognises Kevin's contribution to British industry and is richly deserved.

Corporate responsibility

Last year I reported that we would be introducing the GKN Code which is common to all parts of the Group and sets out a clear and unambiguous framework of conduct and behaviour. During 2006 we executed a major communications exercise in 25 languages to make our entire global workforce aware of the obligations which the Code demands of the Group and its individual employees.

To further support our Values, and in particular our commitment to make a positive contribution to the communities in which we operate, we have launched an exciting initiative which aims to raise funds across the Group in 2007 for charitable purposes in our local communities and in Africa. The initiative is known as GKN Mission Everest and involves sponsorship of the first flight over Mount Everest by powered paraglider. Further information is available in the corporate responsibility review in this report and at www.gknmissioneverest.com.

Against the background of global concern over the impact of climate change, GKN strives continuously to improve its environmental performance. As well as preserving scarce resources and reducing levels of waste and emissions from our manufacturing processes, this includes the development of lighter weight components which contribute to greater fuel efficiency for both automotive vehicles and aircraft. Through our joint venture, Emitec, we also assist vehicle manufacturers to achieve ever more stringent emission standards through the production of advanced metal substrates for catalytic converters and diesel particulate filters.

The future

Enhancing shareholder value remains paramount in the development and execution of our strategy. Having almost completed the most significant restructuring programme of recent years we now look forward to a period of profitable growth.

A handwritten signature in black ink, appearing to read 'Roy D. Brown'. The signature is fluid and cursive.

Roy Brown Chairman

Chief Executive's statement



Improving profitability

GKN is in good shape. The strategic actions we have taken to better position the business for sustained growth are now contributing strongly to improving profitability.

Aerospace had another excellent year, increasing sales by 11% and profits by 30% and achieved the double digit margins we have promised. Substantial new business was secured across a range of programmes, growing our order book for both defence and civil customers. The market outlook continues to be positive in both sectors.

Overall Automotive profits also improved slightly despite well publicised turbulence in our major markets. A significant downturn in US production and a particularly weak third quarter demand in Western Europe combined to significantly challenge the skills of GKN plant management in both markets.

Our Driveline Driveshafts business found conditions particularly difficult and profits were down as a result. The foundations of the business remain solid and with our restructuring programme completing in 2007, we are confident of achieving improved performance in the coming year.

Powder Metallurgy performed strongly, returning our US business to profitability and improving margins in Europe. We also continued to grow revenues in Asia Pacific and Latin America, creating a business with a better geographic and customer mix. Powder Metallurgy is now well set for a sustained period of growth.

OffHighway markets have been mixed, with Europe remaining stable, US construction equipment demand strong and the US agricultural market being somewhat soft. Helped by the acquisition in the US of Rockford Powertrain, OffHighway also increased profits during the year. Its acquisition of a wheels manufacturing operation in Luizhou in China now positions OffHighway as a global leader in the wheels sector and the business is now well positioned to make a growing contribution to GKN's future.

In Aerospace the acquisition of Stellex Aerostructures created a leading position in the high growth area of titanium structures manufacture.

Restructuring for growth

The strategic restructuring programme we embarked on two years ago is now moving to a close with the final announcements on site reorganisation and closure in Driveline and Sinter Metals having been made and the actions commenced in 2007.

In addition, in the light of further deterioration in UK market conditions, we took the decision to close our UK manufacturing facility for cylinder liners and this was announced in January 2007. Liner production will take place solely in China with some machining and finishing in North America.

The successful completion of the Group restructuring plan is a major plank of our strategy to position GKN for accelerated growth. Our team are executing this most difficult of leadership challenges with great skill and sensitivity, creating a very strong foundation for the future – I am grateful to them.

It is the promise of that future which is now exciting the GKN team.

Technology and people

Our technology programme is producing new market leading products from all parts of the Group. The world's first composite primary wing structure, developed at our Cowes site, is now assembled into the first A400M development aircraft at Airbus; our Alabama facility will deliver the world's first production standard large commercial engine fan case manufactured in composite materials to General Electric early next year for their new GE9x engine; in Automotive, GKN's market leading new power control system product will enter the market on a new premium vehicle during 2008; and in Powder Metallurgy, OffHighway and Emitec market leading, innovative new designs are securing GKN's future prosperity.

The pace of development of GKN businesses in serving high growth emerging markets has also increased. Nine GKN businesses employing around 3,500 people now

Our performance in 2006 shows GKN making excellent progress with strong results and major milestones achieved which will help secure sustainable growth.

We have entered 2007 with our four major businesses – Driveline, Powder Metallurgy, OffHighway and Aerospace – in great shape and all well positioned to drive growth.

serve the Chinese domestic automotive and off-highway markets. Two new factories in India will double our employment there and significant expansion is taking place in Brazil, Mexico and Eastern Europe.

Our Lean Enterprise programme has taken hold right across the Group, securing a strong continuous improvement culture in all parts of GKN.

Strong order books, increasing market shares and new technology products have positioned all GKN's major businesses for growth. More importantly our fantastic team of people continue to develop, grow and excel – it is a privilege to lead them.

My family and I were immensely proud and excited that I and GKN should be recognised by the award of a Knighthood in Her Majesty The Queen's New Year Honours. I would like to thank the entire GKN team for the wonderful support they have given me since I joined the Group in 1999. This honour is recognition of the hard work and dedication of that team and they should all take pride in it.

Outlook

The outlook for our major markets is positive, despite some uncertainty around the strength of North American automotive demand.

Forecasts for the global automotive market remain mixed with overall growth in 2007 production projected at 3% to 4%. Within this, Western European output is forecast to be broadly unchanged and North American demand is also expected to be at a similar level to 2006, although slightly down in the first half. Good growth is expected in emerging markets including China and India, which represent a growing percentage of the Group's sales.

OffHighway demand in North America is slightly down on last year although sentiment appears to be improving; European markets and the mining and heavy construction sectors generally are expected to be good.

Aerospace markets in all sectors are expected to remain strong.

Raw material input costs remain volatile, but the Group is not expecting them to make a major impact on 2007 performance compared to 2006.

Against this background, in 2007 the Group expects to see further improvement in its Automotive businesses and continuing growth in OffHighway and Aerospace. Driveline will benefit from the successful restructuring programme which should allow it to recover much of the ground lost in 2006. Powder Metallurgy and Aerospace should see good top line growth helped by a strong backlog of booked business. Performance in our retained Other Automotive businesses should also improve. The acquisitions made in 2006 are integrating well and will also contribute to revenue and profit growth in 2007.

Overall, we expect the Group to see another year of good progress, with the high level of business wins in 2006 supplemented by further bolt-on acquisitions giving us confidence for this year and beyond.



Sir Kevin Smith Chief Executive