

Consolidated Income Statement

For the year ended 31 December 2007

	Notes 1	2007 £m	2006 Restated £m
Sales	2	3,869	3,634
<i>Trading profit</i>		277	251
<i>Restructuring and impairment charges</i>		(31)	(74)
<i>Amortisation of non-operating intangible assets arising on business combinations</i>		(8)	(3)
<i>Profits and losses on sale or closures of businesses</i>		(7)	(4)
<i>Changes in fair value of derivative financial instruments</i>		(10)	33
Operating profit	3	221	203
Share of post-tax earnings of joint ventures	12	24	17
Interest payable		(62)	(57)
Interest receivable		19	23
Other net financing charges		(3)	(4)
Net financing costs	4	(46)	(38)
Profit before taxation		199	182
Taxation	5	(1)	(5)
Profit after taxation for the year		198	177
Profit attributable to minority interests		2	—
Profit attributable to equity shareholders		196	177
		198	177
Earnings per share — p	6		
Basic		27.9	25.0
Diluted		27.8	24.9
Dividends per share — p	7		
Interim dividend per share		4.3	4.1
Final dividend per share		9.2	8.7

All activities in 2007 and 2006 were from continuing operations.

Consolidated Statement of Recognised Income and Expense

For the year ended 31 December 2007

	2007 £m	2006 £m
>		
Currency variations	66	(124)
Derivative financial instruments:		
Transactional hedging	—	1
Translational hedging	(28)	43
Actuarial gains on post-employment obligations including tax:		
Subsidiaries	140	40
Joint ventures	1	—
Deferred tax on other items	(8)	—
Net profits/(losses) not recognised in the income statement	171	(40)
Profit for the year	198	177
Total recognised income for the year	369	137
Total recognised income for the year attributable to:		
Equity shareholders	365	138
Minority interests	4	(1)
	369	137

Consolidated Balance Sheet

At 31 December 2007

	Notes 1	2007 £m	2006 Restated £m
Assets			
Non-current assets			
Intangible assets — goodwill	10	280	244
— other	10	136	112
Property, plant and equipment	11	1,462	1,354
Investments in joint ventures	12	100	83
Other receivables and investments including loans to joint ventures	13	22	24
Deferred tax assets	22	56	114
		2,056	1,931
Current assets			
Inventories	14	552	470
Trade and other receivables	15	571	520
Current tax assets	17	2	—
Derivative financial instruments	20	25	32
Cash and cash equivalents	18	282	342
		1,432	1,364
Total assets		3,488	3,295
Liabilities			
Current liabilities			
Borrowings	18	(92)	(39)
Derivative financial instruments	20	(30)	(11)
Trade and other payables	16	(837)	(743)
Current tax liabilities	17	(104)	(93)
Provisions	21	(45)	(66)
		(1,108)	(952)
Non-current liabilities			
Borrowings	18	(696)	(729)
Deferred tax liabilities	22	(75)	(63)
Trade and other payables	16	(31)	(29)
Provisions	21	(51)	(53)
Post-employment obligations	27	(331)	(561)
		(1,184)	(1,435)
Total liabilities		(2,292)	(2,387)
Net assets		1,196	908
Shareholders' equity			
Ordinary share capital	23	372	371
Share premium account		29	25
Retained earnings		834	589
Other reserves		(58)	(93)
Total shareholders' equity	24	1,177	892
Minority interests — equity	24	19	16
Total equity		1,196	908

The financial statements on pages 70 to 114 were approved by the Board of Directors and authorised for issue on 27 February 2008. They were signed on its behalf by:

Roy Brown, Sir Kevin Smith, Bill Seeger, Directors

Consolidated Cash Flow Statement

For the year ended 31 December 2007



	Notes	2007 £m	2006 £m
Cash flows from operating activities			
Cash generated from operations	26	299	117
Interest received		16	25
Interest paid		(60)	(58)
Tax paid		(28)	(31)
Dividends received from joint ventures		13	7
		240	60
Cash flows from investing activities			
Purchase of property, plant and equipment and intangible assets		(192)	(230)
Proceeds from sale of property, plant and equipment		21	13
Acquisition of subsidiaries (net of cash acquired)		(71)	(126)
Proceeds from sale of subsidiaries and businesses (net of cash disposed)		—	13
Investment loans and capital contributions		7	1
		(235)	(329)
Cash flows from financing activities			
Net proceeds from issue of ordinary share capital	23	5	3
Purchase of treasury shares	23	—	(40)
Net proceeds from borrowing facilities		13	48
Finance lease payments		(1)	(1)
Repayment of borrowings		(17)	(14)
Dividends paid to shareholders	7	(91)	(88)
Dividends paid to minority interests		(1)	(1)
		(92)	(93)
Currency variations on cash and cash equivalents		9	(7)
Movement in cash and cash equivalents		(78)	(369)
Cash and cash equivalents at 1 January		328	697
Cash and cash equivalents at 31 December	26	250	328

All cash flows arise from continuing operations. Cash inflows from government capital grants of £nil (2006 – £3 million) have been offset against purchases of property, plant and equipment and intangible assets.

For the purposes of presenting the cash flow statement the components of cash and cash equivalents are offset. A reconciliation between the cash flow statement and balance sheet presentation is shown in note 26.

Notes to the Financial Statements

1 Accounting policies and presentation

The Group's key accounting policies are summarised below.

Basis of preparation and consolidation

The Group consolidated financial statements are for the 12 months ended 31 December 2007. These consolidated financial statements have been prepared in accordance with the Companies Act 1985 as applicable to companies reporting under IFRS and with those IFRS standards and IFRIC interpretations issued and effective and endorsed by the European Union as at the time of preparing these statements.

The Group consolidated financial statements incorporate the financial statements of the Company and its subsidiaries (together 'the Group') and the Group's share of the results and equity of its joint ventures.

Subsidiaries are entities over which, either directly or indirectly, the Company has control through the power to govern financial operating policies so as to obtain benefit from their activities. This power is generally accompanied by a shareholding of more than 50% of the voting rights. The results of subsidiaries acquired or sold during the year are included in the Group's results from the date of acquisition or up to the date of disposal. All business combinations are accounted for by the purchase method.

Joint ventures are entities in which the Group has a long term interest and exercises joint control with its partners over their financial and operating policies. In all cases voting rights are 50% or lower. Investments in joint ventures are accounted for by the equity method. The Group's share of equity includes goodwill arising on acquisition.

In a single case the Company indirectly owns 100% of the voting share capital of an entity but is precluded from exercising either control or joint control by a contractual agreement with the United States Department of Defense. In accordance with IAS 27 this entity has been excluded from the consolidation and treated as an investment. Further details are contained in note 13.

Intra-group transactions and balances and any unrealised gains and losses arising from intra-group transactions, together with those with joint ventures, are eliminated.

The profit or loss on discontinued operations comprises the trading results up to the date of disposal or discontinuance and the profit or loss on the disposal or closure where businesses are sold or closed by the date on which the financial statements are approved. A discontinued operation is a business or businesses that have either been disposed of or closed or satisfies the criteria to be classified as held for sale and that represents either a material line of business within the Group or within one of its reported segments or a primary geographical area of operation. Where businesses fall to be treated as discontinued in the current year the comparative data is reclassified to reflect those businesses as discontinued.

Minority interests represent the portion of shareholders' earnings and equity attributable to third party shareholders not belonging to the Group.

Presentation of the income statement

IFRS is not prescriptive as to the format of the income statement. The format used by the Group, in arriving at the results of continuing operations, in these financial statements is explained below.

Sales shown in the income statement are those of continuing subsidiary companies only.

Operating profit is the pre-finance profit of continuing subsidiary companies and, in order to achieve consistency and comparability between reporting periods, is analysed to show separately the results of normal trading performance and individually significant charges and credits. Such items arise because of their size or nature and, in 2007, comprise:

- › charges relating to the Group's strategic restructuring programme announced in 2004,
- › the impact of the annual goodwill impairment review,
- › asset impairment and restructuring charges which arise from events which are significant to any reportable segment,
- › amortisation of the fair value of non-operating intangible assets arising on business combinations,
- › profits or losses on businesses sold or closed which do not meet the definition of discontinued operations or which the Group views as capital rather than revenue in nature, and
- › changes in the fair value of derivative financial instruments between the opening and closing balance sheets.

The Group's post-tax share of joint venture profits is shown as a separate component of profit before tax.

Net finance costs are analysed to show separately interest payable, interest receivable and the net of interest payable on post-employment obligations and the expected return on pension scheme assets.

Restatement of 2006 comparatives for presentation purposes

The 2006 trading profit of the Group has been reanalysed in respect of the results of GKN Sheepbridge Stokes, the UK cylinder liner business which formed a significant component of the Other Automotive segment. The closure of this operation was announced in January 2007. Trading has ceased during the year, and its trading results are shown as a separate component of operating profit within the caption 'Profits and losses on sale or closures of businesses'. Sales of the business in the year were £22 million (2006 – £27 million) and are included in total Group sales.

In the segmental analysis (note 2), comparative figures for the Driveline and OffHighway segments have been restated by equal and opposite amounts in respect of two businesses formerly reported in Driveline, the customer and the product base of which has become increasingly focused on off-highway applications.

Finalisation of fair value adjustments in respect of the 2006 acquisitions of Stellex Aerostructures, Rockford Powertrain and Liuzhou Steel Rim Factory (Liuzhou) were made in the year. As required under IFRS 3, amendments to provisional fair values have been shown as a prior period restatement. As a consequence, and only in respect of Liuzhou, intangible fixed assets have been restated to recognise non-operating intangible assets arising on business combinations of £1 million with an equal reduction in the value of goodwill.

The impact of the presentational changes noted above on the previously reported 2006 figures is set out below:

	As previously reported	Restated
Trading profit (£m)	242	251
Operating profit (£m)	203	203
Profit after taxation for the year (£m)	177	177
Basic earnings per share (p)	25.0	25.0
Adjusted earnings per share (p)	28.8	30.1
Net assets (£m)	908	908
Retained earnings (£m)	589	589

Foreign currencies

Subsidiaries, joint ventures and associates account in the currency of their primary economic environment of operation, determined having regard to the currency which mainly influences sales revenue and input costs. Transactions of subsidiaries are translated at exchange rates approximating to the rate ruling on the date of the transaction except in the case of material transactions where actual spot rate may be used if it more accurately reflects the underlying substance of the transaction. Where practicable, transactions involving foreign currencies are protected by forward contracts. Assets and liabilities in foreign currencies are translated at the exchange rates ruling at the balance sheet date.

The Group's presentational currency is sterling. On consolidation, results and cash flows of foreign subsidiaries and joint ventures are translated to sterling at average exchange rates. Their assets and liabilities are translated at the exchange rates ruling at the balance sheet date.

Profits and losses on the realisation of currency net investments include the accumulated net exchange differences that have arisen on the retranslation of the currency net investments since 1 January 2004 up to the date of realisation.

Derivative financial instruments

The Group does not trade in derivative financial instruments. Derivative financial instruments including forward foreign exchange contracts are used by the Group to manage its exposure to (i) changes in the fair value of recognised assets and liabilities, (ii) risk associated with the variability in cash flows in relation to both recognised assets or liabilities or forecast transactions and (iii) changes in the value of the Group's net investment in overseas operations. All derivative financial instruments are measured at the balance sheet date at their fair value.

Where derivative financial instruments are not designated as or not determined to be effective hedges, any gain or loss on the remeasurement of the fair value of the instrument at the balance sheet date is taken to the income statement.

Where derivative financial instruments are held as and are effective as cash flow hedges against the fair value changes in recognised assets and liabilities, remeasurement gains and losses on the instrument are matched against the remeasurement gain or loss on the recognised asset and liability in the income statement.

Remeasurement gains and losses on derivative financial instruments held as net investment hedges are recognised in equity via the statement of recognised income and expense until the instrument and the underlying hedged investment are sold, when the profit or loss arising is recognised in the income statement.

Any derivative financial instruments no longer designated as effective hedges are restated at market value and any gains or losses are taken directly to the income statement.

Derivatives embedded in non-derivative host contracts are recognised at their fair value when the nature, characteristics and risks of the derivative are not closely related to the host contract. Gains and losses arising on the remeasurement of these embedded derivatives at each balance sheet date are taken to the income statement.

Other financial instruments

Borrowings are measured at their amortised cost unless they are matched by an associated effective hedging financial instrument in which case they are stated at their fair value.

Cash and cash equivalents comprise cash on hand and demand deposits and overdrafts together with highly liquid investments of less than three months maturity. Unless an enforceable right of set-off exists and there is an intention to net settle, the components of cash and cash equivalents are reflected on a gross basis in the balance sheet.

The carrying value of other financial assets and liabilities, including short term receivables and payables, are stated at amortised cost less any impairment provision unless the impact of the time value of money is considered to be material.

Notes to the Financial Statements

continued

1 Accounting policies and presentation *continued*

Sales and revenue recognition

Revenue from the sales of goods and services is measured at the fair value of the consideration receivable which generally equates to the invoiced amount, excluding sales taxes and net of allowances for returns, early settlement discounts and rebates.

Invoices for goods are raised when the risks and rewards of ownership have passed which, dependent upon contractual terms, may be at the point of dispatch, acceptance by the customer or, in Aerospace, certification by the customer. Invoices for services are raised on the basis of hours worked or the achievement of contractual deliverables which have been agreed by the customer.

Revenue is recognised in the income statement when it can be reliably measured and its collectability is reasonably assured.

Royalty and licence income is recognised on an accruals basis in accordance with relevant agreements and included within sales.

Intangible assets

All intangible assets, excluding goodwill arising on a business combination, are stated at cost (fair value on initial recognition) and subsequently carried at their amortised cost or fair value less any provision for impairment.

Research and development costs

Research expenditure is written off as incurred.

Where development expenditure results in new or substantially improved products or processes and it is probable that recovery will take place, it is capitalised and amortised on a straight line basis over the product's life up to a maximum of 7 years in Automotive and 15 years in Aerospace starting from the date on which serial production commences. Costs are capitalised as intangible assets unless physical assets, such as tooling, exist when they are classified as property, plant and equipment.

Computer software costs

Where computer software is not integral to an item of property, plant or equipment its costs are capitalised and categorised as intangible assets. Amortisation is provided on a straight line basis over its economic useful life which is in the range of 3–5 years.

Acquired non-operating intangible assets — business combinations

Non-operating intangible assets that are acquired as a result of a business combination including but not limited to customer contracts and relationships, order backlog, patents and know-how, proprietary technology, brand names and trademarks, other intellectual property rights, and agreements not to compete that can be separately measured at fair value on a reliable basis, are separately recognised on acquisition at their fair value. Amortisation is charged on a straight line basis to the income statement over their expected useful lives which are:

	Years
Brands/trademarks	30–50
Intellectual property rights	5–10
Customer contracts and relationships	2–15
Proprietary technology and know-how	7–10
Agreements not to compete	3

Goodwill — business combinations

Goodwill arising on consolidation consists of the excess of the fair value of the consideration over the fair value of the identifiable intangible and tangible assets net of the fair value of the liabilities including contingencies of businesses acquired at the date of acquisition. Goodwill in respect of business combinations of subsidiaries is recognised as an intangible asset. Goodwill arising on the acquisition of a joint venture or associated undertaking is included in the carrying value of the investment.

Where negative goodwill arises, following reassessment of fair values, it is credited to the income statement in the period in which the acquisition is made.

Goodwill is carried at cost less any recognised impairment losses that arise from the annual assessment of its carrying value. To the extent that the carrying value exceeds the value in use, determined from estimated discounted future net cash flows or recoverable amount, goodwill is written down to the value in use and an impairment charge is recognised in the income statement.

Impairment of non-current assets

All non-current assets are tested for impairment when events occur or circumstances indicate that their carrying values might be impaired. Goodwill, capitalised development costs and acquired non-operating intangibles are subject to annual impairment reviews and assessments. Impairments arising are charged to the income statement.

Property, plant and equipment

Cost

Property, plant and equipment are stated at cost or deemed cost less accumulated depreciation and impairment charges. Cost comprises the purchase price plus costs directly incurred in bringing the asset into use but excludes interest.

Where freehold and long leasehold properties were carried at a valuation at 23 March 2000, these values have been retained as book values and therefore deemed cost at the date of the IFRS transition.

Where assets are in the course of construction at the balance sheet date they are classified as capital work in progress. Transfers are made to other asset categories when they are available for use.

Depreciation

Depreciation is not provided on freehold land or capital work in progress. In the case of all other categories of asset, depreciation is provided on a straight line basis over the course of the financial year.

Depreciation is applied to specific classes of asset so as to reduce them to their residual values over their estimated useful lives, which are reviewed annually.

The range of main rates of depreciation used are:

	Years
Freehold buildings	Up to 50
Steel powder production plant	18
General plant, machinery, fixtures and fittings	6–15
Computers	3–5
Commercial vehicles and cars	4–5

Leasehold properties are amortised by equal annual instalments over the period of the lease or 50 years, whichever is the shorter.

Leased assets

Where fixed assets are financed by leasing arrangements which give rights approximating to ownership, the assets are treated as if they had been purchased and the capital element of the leasing commitment is shown as obligations under finance leases. The rentals payable are apportioned between interest, which is charged to the income statement, and capital which reduces the outstanding obligation. Operating lease rentals are charged to the income statement as incurred over the lease term.

Inventories

Inventories are valued on a FIFO or weighted average cost basis at the lower of cost and estimated net realisable value, due allowance being made for obsolete or slow moving items. Cost includes raw materials, direct labour, other direct costs and the relevant proportion of works overheads assuming normal levels of activity.

Taxation

Current and deferred tax are recognised in the income statement unless they relate to items recognised directly in equity when the related tax is also recognised in equity.

Full provision is made for deferred tax on all temporary timing differences resulting from the difference between the carrying value of an asset or liability in the consolidated financial statements and its tax base. The amount of deferred tax reflects the expected manner of realisation or settlement of the carrying amount of the assets and liabilities using tax rates enacted or substantively enacted at the balance sheet date.

Deferred tax assets are reviewed at each balance sheet date and are only recognised to the extent that it is probable that they will be recovered against future taxable profits.

Deferred tax is recognised on the unremitted profits of joint ventures. No deferred tax is recognised on the unremitted profits of overseas branches and subsidiaries except to the extent that it is probable that such earnings will be remitted to the parent in the foreseeable future.

Pensions and post-employment benefits

The Group's pension arrangements comprise various defined benefit and defined contribution schemes throughout the world. In the UK and in certain overseas companies pension arrangements are made through externally funded defined benefit schemes, the contributions to which are based on the advice of independent actuaries or in accordance with the rules of the schemes. In other overseas companies funds are retained within the business to provide for retirement obligations.

The Group also operates a number of defined contribution and defined benefit arrangements which provide certain employees with defined post-employment healthcare benefits.

The Group accounts for all post-employment defined benefit schemes through full recognition of the schemes' surpluses or deficits on the balance sheet at the end of each year. Actuarial gains and losses are included in the statement of recognised income and expense. Current and past service costs, curtailments and settlements are recognised within operating profit. Returns on scheme assets and interest on obligations are recognised as a component of other net financing charges.

For defined contribution arrangements the cost charged to the income statement represents the Group's contributions to the relevant schemes in the period in which they fall due.

Notes to the Financial Statements

continued

1 Accounting policies and presentation *continued*

Share-based payments

Share-based incentive arrangements are provided to employees under the Group's share option, incentive and other share award schemes. Share options granted to employees and share-based arrangements put in place since 7 November 2002 are valued at the date of grant or award using an appropriate option pricing model and are charged to operating profit over the performance or vesting period of the scheme. The annual charge is modified to take account of shares forfeited by employees who leave during the performance or vesting period and, in the case of non-market related performance conditions, where it becomes unlikely the option will vest.

Government grants

Grants receivable from governments or similar bodies are credited to the balance sheet in the period in which the conditions relating to the grant are met. Where they relate to specific assets they are amortised on a straight line basis over the same period as the asset is depreciated. Where they relate to revenue expenditure and/or non-asset criteria they are taken to the income statement to match the period in which the expenditure is incurred and criteria met.

Treasury shares

GKN shares which have been purchased and not cancelled are held as treasury shares and deducted from shareholders' equity.

Dividends

The annual final dividend is not provided for until approved at the Annual General Meeting whilst interim dividends are charged in the period they are paid.

Standards, amendments to standards and interpretations issued and applied

During the year ended 31 December 2007 the Group adopted the following standards, amendments to standards and interpretations.

IFRS 7 'Financial Instruments: Disclosures' and the amendment to IAS 1 'Presentation of Financial Statements' regarding capital disclosures. IFRS 7 introduces new and revised disclosures for financial instruments and for risks associated with financial instruments. As a disclosure based standard there have been no changes in either accounting policies or the primary financial statements.

The following standards and interpretations had no material impact on the Group's results, assets or liabilities or were not relevant:

IFRS 4 'Insurance contracts'.

IFRIC 7 'Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies'.

IFRIC 8 'Scope of IFRS 2'.

IFRIC 9 'Reassessment of Embedded Derivatives'.

Standards, amendments to standards and interpretations issued but not yet applied

IFRS 8 'Operating Segments' was issued in November 2006 and is required to be implemented from 1 January 2009. It requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the Chief Executive to allocate resources to the segments and to assess their performance, and supersedes IAS 14 'Segment Reporting'. The effect of this standard on Group disclosures has not been determined at this stage.

The following amendments to standards and interpretations are unlikely to have a material impact on the Group's results, assets or liabilities or are not relevant:

IAS 23 (Amendment) 'Borrowing Costs'.

IFRIC 11 'IFRS 2 — Group and treasury share transactions'.

IFRIC 12 'Service concession arrangements'.

IFRIC 13 'Customer loyalty programmes'.

IFRIC 14 'IAS 19 — the limit on a defined benefit asset, minimum funding requirements and their interaction'.

Significant judgements, key assumptions and estimates

The Group's significant accounting policies are set out above. The preparation of financial statements, in conformity with IFRS, requires the use of estimates, subjective judgement and assumptions that may affect the amounts of assets and liabilities at the balance sheet date and reported profit and earnings for the year. The Directors base these estimates, judgements and assumptions on a combination of past experience, professional expert advice and other evidence that is relevant to the particular circumstance.

The accounting policies where the Directors consider the more complex estimates, judgements and assumptions have to be made are those in respect of acquired non-operating intangible assets — business combinations (note 25), post-employment obligations (note 27), derivative financial instruments (notes 3e and 20), taxation (notes 5 and 22) and impairment of non-current assets (notes 10 and 11). The details of the principal estimates, judgements and assumptions made are set out in the related notes as identified.

2 Segmental analysis

The Group is managed by type of business. Segmental information is provided having regard to the nature of the goods and services provided and the markets served.

Primary reporting format — business segments

For the year ended 31 December 2007	Notes	Automotive					Corporate and unallocated £m	Total £m
		Driveline £m	Other Automotive £m	Powder Metallurgy £m	OffHighway £m	Aerospace £m		
Sales		1,922	109	602	416	820	—	3,869
EBITDA		227	2	58	39	112	(10)	428
Depreciation and impairment charges		(75)	(5)	(28)	(10)	(24)	—	(142)
Amortisation of intangible assets		(3)	—	(1)	—	(5)	—	(9)
Trading profit/(loss)	3a	149	(3)	29	29	83	(10)	277
Restructuring	3b	(19)	—	(14)	—	—	—	(33)
Other impairments	3b	—	2	—	—	—	—	2
Amortisation of business combination non-operating intangibles	3c	(1)	—	—	(2)	(5)	—	(8)
Profits and losses on sale or closures of businesses	3d	—	(7)	—	—	—	—	(7)
Changes in fair value of derivative financial instruments	3e	(1)	(1)	(1)	(2)	(5)	—	(10)
Operating profit/(loss)		128	(9)	14	25	73	(10)	221
Share of post-tax earnings of joint ventures		14	10	—	—	—	—	24
Segment assets								
Goodwill		65	—	24	38	153	—	280
Investments in joint ventures		71	28	—	1	—	—	100
Derivative financial instruments		6	—	—	—	19	—	25
Operating assets		1,280	56	531	251	620	5	2,743
Other unallocated assets:								
Cash and cash equivalents		—	—	—	—	—	282	282
Current tax assets		—	—	—	—	—	2	2
Deferred tax assets		—	—	—	—	—	56	56
Total assets		1,422	84	555	290	792	345	3,488
Segment liabilities								
Derivative financial instruments		(1)	(1)	(1)	(1)	(9)	(17)	(30)
Operating liabilities:								
Post-employment obligations		(208)	(7)	(23)	(45)	(32)	(16)	(331)
Other		(446)	(21)	(122)	(115)	(209)	(51)	(964)
Other unallocated liabilities:								
Borrowings		—	—	—	—	—	(788)	(788)
Current tax liabilities		—	—	—	—	—	(104)	(104)
Deferred tax liabilities		—	—	—	—	—	(75)	(75)
Total liabilities		(655)	(29)	(146)	(161)	(250)	(1,051)	(2,292)
Other segment items								
Capital expenditure								
Property, plant and equipment		94	2	38	11	28	1	174
Intangible assets		3	—	—	1	16	—	20
Other non-cash expenses (share-based payments)		2	—	1	—	1	2	6

All business segments shown above are continuing. EBITDA is earnings before interest, tax, depreciation and amortisation.

Notes to the Financial Statements

continued

2 Segmental analysis *continued*

Primary reporting format – business segments

For the year ended 31 December 2006 (restated)	Notes	Automotive		Powder Metallurgy £m	OffHighway £m	Aerospace £m	Corporate and unallocated £m	Total £m
		Driveline £m	Other Automotive £m					
Sales		1,884	120	582	353	695	—	3,634
EBITDA		215	4	60	34	95	(12)	396
Depreciation and impairment charges		(74)	(5)	(28)	(9)	(21)	—	(137)
Amortisation of intangible assets		(3)	—	(1)	—	(4)	—	(8)
Trading profit	3a	138	(1)	31	25	70	(12)	251
Restructuring	3b	(37)	—	(24)	—	—	(2)	(63)
Other impairments	3b	(11)	—	—	—	—	—	(11)
Amortisation of business combination non-operating intangibles	3c	(1)	—	—	(1)	(1)	—	(3)
Profits and losses on sale or closures of businesses	3d	5	(9)	—	—	—	—	(4)
Changes in fair value of derivative financial instruments	3e	11	—	(1)	2	21	—	33
Operating profit/(loss)		105	(10)	6	26	90	(14)	203
Share of post-tax earnings of joint ventures		12	5	—	—	—	—	17
Segment assets								
Goodwill		62	—	24	34	124	—	244
Investments in joint ventures		61	21	—	1	—	—	83
Derivative financial instruments		7	—	—	1	24	—	32
Operating assets		1,164	59	496	223	532	6	2,480
Other unallocated assets:								
Cash and cash equivalents		—	—	—	—	—	342	342
Deferred tax assets		—	—	—	—	—	114	114
Total assets		1,294	80	520	259	680	462	3,295
Segment liabilities								
Derivative financial instruments		(1)	—	—	—	(8)	(2)	(11)
Operating liabilities:								
Post-employment obligations		(340)	(25)	(33)	(52)	(102)	(9)	(561)
Other		(445)	(35)	(115)	(92)	(160)	(44)	(891)
Other unallocated liabilities:								
Borrowings		—	—	—	—	—	(768)	(768)
Current tax liabilities		—	—	—	—	—	(93)	(93)
Deferred tax liabilities		—	—	—	—	—	(63)	(63)
Total liabilities		(786)	(60)	(148)	(144)	(270)	(979)	(2,387)
Other segment items								
Capital expenditure:								
Property, plant and equipment		96	7	49	12	30	—	194
Intangible assets		3	—	1	2	27	—	33
Other non-cash expenses (share-based payments)		2	—	1	—	1	1	5

All business segments shown above are continuing.

Intra-group sales, which are priced on an 'arm's length' basis between segments and regions are not significant. The analyses of operating profit by business includes an allocation, based on their nature, of costs incurred centrally in the United Kingdom, United States of America, China and Germany. Unallocated costs represent corporate expenses. Segment assets and liabilities comprise all non-current and current items as per the balance sheet but exclude taxation, borrowings and cash and cash equivalents. Cash and cash equivalents and borrowings are not allocated to specific segments as these resources are managed centrally and no business in any segment has sufficient autonomy to manage these resources. Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one year.

Restatement of comparative data

- i) Double Universal Joint business transfer: With effect from 1 January 2007 the Group's Double Universal Joint activities in Italy and Uruguay have been managed within our OffHighway segment having previously been included within Driveline. Segmental analyses presented in this note represent the current period structure. Previously reported analyses have been restated.
- ii) Cessation of UK cylinder liner manufacturing operation: In January 2007 the Group announced its intention to cease manufacturing at its UK cylinder liner operation. This operation constitutes a major proportion of the Group's Other Automotive segment. The losses of this business have been reanalysed from trading profit to profits and losses on sale or closures of businesses.
- iii) Finalisation of provisional fair value adjustment in respect of an OffHighway acquisition in 2006. See note 25.

The impact of these restatements is shown as follows:

	Driveline		Other Automotive		OffHighway	
	As previously reported £m	Restated £m	As previously reported £m	Restated £m	As previously reported £m	Restated £m
For the year ended 31 December 2006						
Sales	1,906	1,884	120	120	331	353
Trading profit/(loss)	140	138	(10)	(1)	23	25
Operating profit/(loss)	107	105	(10)	(10)	24	26
Total assets	1,310	1,294	80	80	243	259
Total liabilities	(796)	(786)	(60)	(60)	(134)	(144)

Secondary reporting format — by geographical region

	Sales by destination		Segment assets		Capital expenditure	
	2007 £m	2006 £m	2007 £m	2006 £m	2007 £m	2006 £m
Continuing operations						
Europe	1,773	1,664	1,411	1,307	87	112
Americas	1,595	1,512	1,315	1,153	75	83
Rest of the World	501	458	417	373	32	32
Corporate and unallocated	—	—	345	462	—	—
	3,869	3,634	3,488	3,295	194	227

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3 Operating profit

The analysis of the components of operating profit is shown below:

(a) Trading profit

	2007	2006
	£m	Restated £m
Sales by subsidiaries (note (i))	3,869	3,634
Less: UK cylinder liner manufacturing operation	(22)	(27)
	3,847	3,607
Operating costs and other income		
Change in stocks of finished goods and work in progress	12	6
Raw materials and consumables	(1,415)	(1,314)
Unwind of fair value inventory adjustments arising on business combinations (note (ii))	(1)	(1)
Staff costs (note 8)	(1,100)	(1,096)
Reorganisation costs (note (iii)):		
Redundancy and other amounts	(4)	—
Impairment of plant and equipment	(1)	—
Depreciation and impairment of property, plant and equipment:		
Depreciation of owned assets	(140)	(136)
Depreciation of assets under finance leases	(1)	(1)
Impairment of plant and equipment	—	—
Amortisation of intangible assets	(9)	(8)
Operating lease rentals payable:		
Plant and equipment	(12)	(14)
Property	(20)	(20)
Impairment of trade receivables	(3)	(3)
Amortisation of government grants	2	3
Net exchange differences on foreign currency transactions	(1)	2
Other costs (note (v))	(877)	(774)
	(3,570)	(3,356)
Trading profit	277	251

(i) Sales by subsidiaries includes sales of goods £3,797 million (2006 – £3,565 million), sales of services £69 million (2006 – £66 million) and royalty income £3 million (2006 – £3 million).

(ii) IFRS 3 'Business Combinations' requires inventory recognised on business combinations to be fair valued. Generally this requires uplifting inventory from its historical purchase or manufactured cost to current market values being current replacement cost for raw materials and consumables and adjusted selling price for work in progress and finished goods. This fair value adjustment recognised on acquisition is charged to the income statement as this inventory is sold.

(iii) Reorganisation costs shown above reflect ongoing actions in the ordinary course of business to reduce costs, improve productivity and rationalise facilities in continuing operations. Costs incurred include redundancy and related post-employment obligation charges, asset write-downs and impairments and other revenues and expenditures directly attributable to the reorganisation actions. Headcount realignment activity continued at a cost of £3 million (2006 – £4 million). Rationalisation of a UK facility continued at a cost of £2 million, including a £1 million plant and equipment impairment charge (2006 – £4 million net surplus including land disposal surpluses amounting to £5 million).

(iv) Research and development expenditure in subsidiaries was £81 million (2006 – £75 million).

(v) Including property surpluses of £4 million (2006 – £1 million).

(vi) Auditors' remuneration

The analysis of auditors' remuneration is as follows:

	2007 £m	2006 £m
Fees payable to PricewaterhouseCoopers LLP for the Company's annual financial statements	0.6	0.5
Fees payable to PricewaterhouseCoopers LLP and their associates for other services to the Group:		
– Audit of the Company's subsidiaries pursuant to legislation	2.8	2.8
Total audit fees	3.4	3.3
– Other services pursuant to legislation	0.1	0.1
– Tax services	0.5	0.6
– Corporate finance transaction services	–	0.1
– Other services	0.1	0.1
Total non-audit fees	0.7	0.9
Fees payable to PricewaterhouseCoopers LLP and their associates in respect of associated pension schemes		
– Audit	–	–
– Other services	–	–
	–	–
Total fees payable to PricewaterhouseCoopers LLP and their associates	4.1	4.2

All fees payable to PricewaterhouseCoopers LLP, the Company's auditors, include amounts in respect of expenses. All fees payable to PricewaterhouseCoopers LLP have been charged to the income statement except for those in relation to associated pension schemes, which are borne by the respective schemes, and fees amounting to £nil (2006 – £0.1 million) which have been capitalised as they relate to the Group's assessment of its acquisitions and are therefore a directly attributable acquisition expense.

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3 Operating profit *continued***(b) Restructuring and impairment charges**

	2007			2006		
	Restructuring £m	Other impairments £m	Total £m	Restructuring £m	Other impairments £m	Total £m
Restructuring and impairment charges						
Goodwill impairment	—	—	—	—	(11)	(11)
Tangible fixed asset impairments/reversals	7	2	9	(1)	—	(1)
Other asset write-downs	(1)	—	(1)	(1)	—	(1)
	6	2	8	(2)	(11)	(13)
Redundancy costs including post-employment curtailments	(16)	—	(16)	(35)	—	(35)
Other reorganisation costs including property surplus	(23)	—	(23)	(26)	—	(26)
	(33)	2	(31)	(63)	(11)	(74)

Restructuring

During 2007 the Group continued to deploy its strategic restructuring programme, first announced in March 2004, that involves the migration of Driveline production capacity from high cost to low cost/high growth economies, actions in support of the recovery in Powder Metallurgy and the realignment and reduction of production capacity, overhead and infrastructure costs in other areas of the business. Charges recognised in the year in respect of this programme amount to £33 million (2006 – £63 million) which comprises amounts in respect of asset impairments of £6 million credit (2006 – £2 million charge), redundancy costs, including pension past service charges, credits and curtailments of £16 million (2006 – £35 million) and other reorganisation costs of £23 million (2006 – £26 million). Pension past service charges, credits and curtailments amount to a £4 million charge in 2007 (2006 – £3 million). An analysis by segment and description of the charges is set out below:

	2007				2006 Total £m
	Impairments £m	Redundancy £m	Reorganisation £m	Total £m	
Driveline	5	(14)	(10)	(19)	(37)
Powder Metallurgy	1	(2)	(13)	(14)	(24)
Corporate	—	—	—	—	(2)
	6	(16)	(23)	(33)	(63)

Redundancy costs provided for represent charges for contractual severance and other employee related exit benefits and post-employment augmentations and curtailments. Reorganisation costs include charges for onerous lease, property and other contracts, incremental costs borne by the Group as a consequence of dedicated restructuring and transition teams and equipment relocation costs attributable to the transfer of equipment between closing facilities and continuing operations and incremental premium freight and product homologation costs. The impairment reversal in Powder Metallurgy arises from the redeployment of previously impaired plant into cash generative alternative use elsewhere in the relevant division. In Driveline the net impairment relates to the write-downs for plant deemed to be irrecoverable via future use (£3 million) being offset by a reversal (£8 million) in a specific cash generating unit where business recovery has been sufficient to support reinstatement of the asset.

Restructuring actions undertaken in the year included the closure of a North American Powder Metallurgy production facility, the continuation of the strategic fixed headcount reduction programme in Driveline and the ongoing reductions in operations in Driveline plants and four Powder Metallurgy facilities. A net £2 million surplus has arisen on the disposal of a UK Powder Metallurgy facility that became surplus to operational requirements as a consequence of the restructuring.

In 2006 restructuring charges arose primarily in respect of the announced closure and/or downsizings of four Driveline facilities, Driveline strategic fixed headcount reductions and the announced closure of three Powder Metallurgy manufacturing facilities.

Cash outflow in respect of 2007 and earlier periods' strategic restructuring actions amounted to £44 million (2006 – £57 million). The disposal of the surplus property noted above generated a net £4 million cash inflow.

Other impairments

The £2 million impairment reversal recognised in 2007 arose in relation to the Group's UK cylinder liner manufacturing operation. The business disposed of land and buildings and plant and machinery at a value greater than the theoretical net book value of the assets had they not been impaired, consequently, a proportion of the previously recognised impairment has been reversed. The 2006 full year goodwill impairment arose in Driveline.

(c) Amortisation of non-operating intangible assets arising on business combinations

In establishing the fair value of assets and liabilities arising on business combinations the Group identifies the fair values attributable to intangible assets. The intangible assets recognised include operating intangibles, predominantly computer software, and non-operating intangibles being the value in respect of brands and trademarks, intellectual property rights, customer contracts and relationships and proprietary technology rights and know-how. All intangibles recognised on business combinations are amortised over the expected useful economic lives. Details of the lives used are set out in the Group's accounting policies and note 10 to these financial statements.

The amortisation of non-operating intangible assets is separately identified as a component of operating profit on the face of the income statement. The analysis below sets out the amortisation charge in the year by category of non-operating intangible asset.

	2007 £m	2006 £m
Brands/trademarks	—	—
Proprietary technology rights and know-how	2	1
Other intellectual property rights	1	1
Customer contracts and relationships and agreements not to compete	5	1
	8	3

(d) Profits and losses on sale or closures of businesses

	2007 £m	2006 Restated £m
Profits and losses on closure of businesses:		
Trading losses of the UK cylinder liner manufacturing operation	(7)	(9)
Profits and losses on sale of businesses:		
Fujiwa China	—	5
	(7)	(4)

On 2 March 2006 final approval was received from the Taiwanese authorities to transfer the Group's 60% shareholding in Fujiwa to its business partner, Lioho Corporation. At this point the Group's control of and active participation in the Fujiwa business ceased. The net cash inflow arising on disposal is set out below:

	2006 £m
Net assets disposed	19
Minority interests	(8)
Cumulative translation adjustment	(1)
Surplus arising on disposal	5
Consideration receivable net of attributable expenses	15

In the period from 1 January 2006 to disposal Fujiwa contributed £5 million to Group sales, £1 million to Group trading profit and £nil to cash generated from operations.

(e) Changes in fair value of derivative financial instruments

IAS 39 requires derivative financial instruments to be valued at the balance sheet date and any difference between that value and the intrinsic value of the instrument to be reflected in the balance sheet as an asset or liability. Any subsequent change in value is reflected in the income statement unless hedge accounting is achieved. Such movements do not affect cash flow or the economic substance of the underlying transaction. In 2007 and 2006 the Group used transactional hedge accounting in a limited number of instances. As a consequence, and to assist year on year comparison, the change in value continues to be identified as a separate element of operating profit. Details of the charges and credits to 2007 operating profit are set out in note 20.

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4 Net financing costs

	2007 £m	2006 £m
Interest payable and fee expense:		
Short term bank and other borrowings	(7)	(3)
Loans repayable within five years	(29)	(5)
Loans repayable after five years	(25)	(48)
Finance leases	(1)	(1)
	(62)	(57)
Interest receivable:		
Short term investments, loans and deposits	19	23
	19	23
Other net financing charges:		
Expected return on pension scheme assets	146	136
Interest on post-employment obligations	(149)	(140)
	(3)	(4)
Net financing costs	(46)	(38)

5 Taxation

	2007 £m	2006 £m
Analysis of charge in year		
Current tax:		
Current year	38	38
Utilisation of previously unrecognised tax losses and other assets	(9)	(2)
Adjustments in respect of prior years	3	(3)
Net movement on provisions for uncertain tax positions	4	(15)
	36	18
Deferred tax:		
Origination and reversal of temporary differences (excluding post-employment obligations)	12	15
Tax in respect of post-employment obligations	(3)	(6)
Tax on change in fair value of derivative financial instruments	—	2
Utilisation of previously unrecognised tax losses and other assets	(7)	(7)
Other changes in unrecognised deferred tax assets	(28)	(21)
Changes in tax rates	(8)	—
Adjustments in respect of prior years	(1)	4
	(35)	(13)
Total tax charge for the year	1	5
Overseas tax included above	18	15
Tax in respect of restructuring and impairment charges included in total charge for the year		
Current tax	(7)	(6)
Deferred tax	2	(8)
	(5)	(14)

The Group is required to estimate the income tax due in each of the jurisdictions in which it operates. This requires an estimation of the current tax liability together with an assessment of the temporary differences which arise as a consequence of different accounting and tax treatments. These temporary differences result in deferred tax assets or liabilities which are measured using substantively enacted tax rates expected to apply when the temporary differences reverse. Recognition of deferred tax assets, and hence credits to the income statement, are based on forecast future taxable income and therefore involves judgement regarding the future financial performance of particular legal entities or tax groups in which the deferred tax assets are recognised.

The Group is subject to many different tax jurisdictions and tax rules as a consequence of its geographic spread. It is therefore subject to tax audits and tax reviews, which by their nature are often complex and can require several years to conclude. Management judgement is therefore required to determine the total provision for income tax. Amounts set aside and released in any period are based on management judgement and interpretation of country specific tax law and the likelihood of crystallisation and settlement. Tax benefits are not recognised unless it is probable that the tax positions are sustainable. However, as amounts set aside in any period could differ from actual tax liabilities incurred, adjustments are required in subsequent periods which may have a material impact on the Group's income statement and/or cash tax payment. Payments in respect of tax liabilities for an accounting period comprise payments on account and payments on the final resolution of open items with tax authorities and, as a result, there can be substantial differences between the charge in the income statement and tax cash payments. Interest on provisions for uncertain tax positions is, where relevant, provided for in the tax charge.

Details of the effective tax rate for the Group and the underlying events and transactions affecting this and the tax charge are given in the business review on page 15.

Tax on items included in equity	2007		2006	
	£m		£m	
Deferred tax on post-employment obligations	84		67	
Deferred tax on non-qualifying assets	6		—	
Deferred tax on foreign exchange provisions	2		—	

Tax reconciliation	2007		2006	
	£m	%	£m	%
Profit before tax	199		182	
Less: Share of post-tax earnings of joint ventures	(24)		(17)	
Profit before tax excluding joint ventures	175		165	
Tax calculated at 30% standard UK corporate tax rate	53	30%	49	30%
Differences between UK and overseas corporate tax rates	5	2%	7	4%
Non-deductible and non-taxable items	(8)	(4%)	(1)	(1%)
Utilisation of previously unrecognised tax losses and other assets	(16)	(9%)	(9)	(5%)
Other changes in unrecognised deferred tax assets	(28)	(16%)	(21)	(13%)
Changes in tax rates	(8)	(4%)	—	—
Deferred tax (credit)/charge in respect of post-employment obligations	(3)	(1%)	(6)	(4%)
Current year tax (credit)/charge on ordinary activities	(5)	(2%)	19	11%
Net movement on provision for uncertain tax positions	4	2%	(15)	(9%)
Adjustments in respect of prior years	2	1%	1	1%
Total tax charge for the year	1	1%	5	3%

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6 Earnings per share

Basic earnings per share

Basic earnings per share are calculated by dividing the profit attributable to equity shareholders by the weighted average number of ordinary shares in issue during the period, excluding ordinary shares purchased by the Company and held as treasury shares.

Diluted earnings per share

Diluted earnings per share are calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. The Company has only one category of dilutive potential ordinary shares; share options.

The calculation is performed for the share options to determine the number of shares that could have been acquired at fair value (determined as the average market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

Earnings per share are computed as follows:

	2007			2006		
	Earnings £m	Weighted average number of shares m	Earnings per share p	Earnings £m	Weighted average number of shares m	Earnings per share p
Total Company						
Basic eps:						
Profit attributable to ordinary shareholders	196	703.4	27.9	177	708.8	25.0
Dilutive securities:						
Dilutive potential ordinary shares	—	2.9	(0.1)	—	2.1	(0.1)
Diluted eps	196	706.3	27.8	177	710.9	24.9

Adjusted earnings per share — total Company

Earnings per share before restructuring and impairment charges, amortisation of non-operating intangibles arising on business combinations, profits and losses on sale or closures of businesses and the changes in fair value of derivative financial instruments, which the Directors consider gives a useful additional indicator of underlying performance, is calculated on earnings for the year adjusted as follows:

	2007		2006 (restated)	
	£m	p	£m	p
Profit attributable to equity shareholders	196	27.9	177	25.0
Charges/(credits) included in operating profit:				
Restructuring and impairment charges	31	4.4	74	10.5
Amortisation of non-operating intangibles on business combinations	8	1.1	3	0.4
Profits and losses on sale or closures of businesses	7	1.0	4	0.6
Changes in fair value of derivative financial instruments	10	1.4	(33)	(4.7)
Taxation on charges/(credits) included in operating profit	(5)	(0.7)	(12)	(1.7)
Adjusted earnings attributable to equity shareholders	247	35.1	213	30.1
Diluted adjusted earnings per share attributable to equity shareholders		35.0		30.0

7 Dividends

	2007 £m	2006 £m
Equity dividends paid in the year		
Previous year final: 8.7p (2006 – 8.2p) per share	61	59
Current year interim: 4.3p (2006 – 4.1p) per share	30	29

In addition, the Directors are proposing a final dividend in respect of the financial year ended 31 December 2007 of 9.2p per share, at a cost of £65 million. It will be paid on 14 May 2008 to shareholders who are on the register of members at close of business on 25 April 2008.

8 Employees including Directors

Employee benefit expense for the Group during the year	2007 £m	2006 £m
Wages and salaries	930	917
Social security costs	147	142
Post-employment costs	28	47
Equity-settled share-based payments	6	5
	1,111	1,111

Amounts included above relating to the UK cylinder liner manufacturing operation are wages and salaries £9 million (2006 – £13 million), post-employment costs £1 million (2006 – £1 million) and social security costs £1 million (2006 – £1 million).

Average monthly number of employees (including executive Directors)	2007 Number	2006 Number
By business		
Driveline	18,022	18,402
Other Automotive	1,506	1,645
Powder Metallurgy	6,959	6,940
OffHighway	3,815	2,760
Aerospace	7,241	6,190
Central	192	180
Total	37,735	36,117

Key management

The key management of the Group comprises GKN plc Board Directors and the members of the Group's Executive Committee during the year and their aggregate compensation is shown below. Details of Directors' remuneration are contained in the Directors' remuneration report on pages 57 to 68.

Key management compensation	2007 £m	2006 £m
Salaries and short term employee benefits	7.1	5.6
Post-employment benefits	1.2	1.1
Termination benefits	0.1	—
Share-based benefits	2.5	1.3
	10.9	8.0

Salaries and short term employee benefits comprises annual salary, benefits in kind and amounts accrued in respect of short term variable remuneration schemes. Details of the Directors' short term variable remuneration schemes are set out in the remuneration report. Other members of key management participate in schemes based on the achievement of profit and cash targets and which are payable in cash. The amount outstanding at 31 December 2007 in respect of annual short term variable remuneration was £3 million (2006 – £2 million). Post-employment benefits represent the charge to trading profit under IAS 19 attributable to key management arising in the year and the attributable cost of post-employment medical benefits. Termination benefits include redundancy, pension augmentations and ex gratia payments arising in connection with loss of office and termination of employment with the Group. Share-based payments represents the annual charge attributable to key management in respect of their participation in the Group's share-based remuneration arrangements; details of the nature of these arrangements are set out in note 9 and in the Directors' remuneration report. Total awards made or shares granted in the year to key management in respect of these arrangements were:

	2007		2006	
	Number of instruments 000s	Weighted average exercise price p	Number of instruments 000s	Weighted average exercise price p
Executive Options	349	380.30	642	334.05
Long Term Incentive Plan	499	—	892	—
Bonus Co-investment Plan	—	—	—	—
Profit Growth Incentive Plan	125	—	—	—

7,141 options were exercised by key management during the year (2006 – 8,056) at an average exercise price of 230p, whilst 2,992,479 options lapsed (2006 – 2,364,675).

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9 Share-based payments

The Group has granted options over shares to employees for a number of years under different schemes. Where grants were made after 7 November 2002 they have been accounted for as required by IFRS 2 'Share-based Payment'. As permitted by the transitional arrangements of that standard, awards made before that date have not been so accounted. All options have been valued at the date of grant by an independent third party using a Monte Carlo model which uses the same principle as a binomial model.

Details of awards made since 7 November 2002 are:

a) Employee Sharesave Scheme

In September 2003 the Company awarded options to UK employees under an approved Sharesave scheme the terms of which were that the employee entered into a regular savings commitment up to a maximum of £250 per month for a three year period. The cumulative savings were then used to acquire options over a number of shares at a 10% discount to market price at the date of grant. There were no performance conditions but, in general, the employee must remain in employment for the three year period. Inputs to the valuation model were: option price 229p, volatility 38%, expected dividend yield 4.3%, risk-free interest rate 4.49% and a term of 3.25 years. There have been no further awards since September 2003.

b) Executive Share Option Schemes (ESOS)

Awards were made to Directors and certain senior employees in March 2003 under the 2001 scheme and in September 2004, April 2005 and April 2006 under the 2004 scheme. In April 2007 awards were made to Directors under the 2004 scheme. Under both schemes options were granted with a fixed exercise price equal to the market price at the date of grant and subject to meeting performance conditions over a three year period. In the case of the 2001 scheme, the performance condition was based on earnings per share (EPS) growth whilst under the 2004 scheme the condition is based on Total Shareholder Return (TSR) compared with that of comparator companies. Under the 2001 scheme only, where the performance condition is not satisfied in full after the first three years, retesting is carried out each year up to six years from the date of grant. Inputs to the valuation model were: option price 163p to 380.3p, volatility 31% to 38%, expected dividend yield 3.3% to 6.2%, risk-free interest rate 4.28% to 5.40% and expected terms of 6.4 years to 6.7 years.

c) Long Term Incentive Plans (LTIP)

Awards were made to Directors and certain senior employees in March 2003 under the 2001 scheme and in September 2004, April 2006 and April 2007 under the 2004 scheme. In April 2005 awards were made to Directors under the 2004 scheme. Under both schemes, options were granted subject to TSR performance over a three year period compared with a comparator group. There is no retest facility under either scheme. Inputs to the valuation model were: option price nil, volatility 23% to 39%, expected dividend yield 3.3% to 6.2%, risk-free interest rate 4.05% to 5.40% and a term of 3 years to 4 years 9.5 months.

d) Bonus Co-Investment Plan (BCIP)

Under the Bonus Co-Investment Plan, certain senior employees (excluding Directors) were entitled to use up to 10% of their gross short term annual bonus potential to purchase shares in the Company at market price. Provided they remain in employment for three years and the shares are retained for that period the Company matches those shares. For shares purchased by employees in 2004 the match was on a two for one basis and in 2005 was two and a half for one. In addition, in 2005 there was a further one for one match if certain profit targets are achieved. All shares under the scheme are purchased in the open market. Inputs to the valuation model were: option price nil, volatility, where applicable, 37%, expected dividend yield 4.9% to 5.4%, risk-free interest rate, where applicable, 4.94% and a term of 3 years.

e) Profit Growth Incentive Plan (PGIP)

Awards were made in April 2007 under the PGIP to certain senior employees (excluding Directors). Any benefit under the PGIP will be deliverable dependent upon the extent to which profit growth targets are satisfied by the Group over a three year performance period; the Group's reported profit for the year prior to the year of award forms the baseline for this performance measure. The PGIP is a cash-based incentive plan. However, for certain very senior employees the benefit is deliverable in shares; the number of shares given below will be released following the performance period if the minimum targeted profit growth is achieved. A maximum of twice the amount of shares listed below will be released on achievement of the maximum profit target, with one and a half times the number being released for interim performance. No shares will be released and the awards will lapse if the minimum profit target is not achieved. Release is also conditional upon the satisfaction of a personal shareholding requirement. Any awards deliverable under the PGIP will be satisfied from GKN ordinary shares already in issue.

The expected volatility is based on historical volatility over a period commensurate with the term of the awards. The risk-free interest rate is the rate obtainable from government securities over the expected life of the equity incentive.

Further details of the ESOS, LTIP, BCIP and PGIP schemes are given in the Directors' remuneration report on pages 57 to 68.

Shares granted under each award were:

Scheme	Date of grant	Number of shares 000s	Contractual life of options years
Employee Sharesave	18/09/2003	1,880	3
Executive Options	19/03/2003	7,735	10
	16/09/2004	5,550	10
	05/04/2005	4,203	10
	11/04/2006	2,705	10
	02/04/2007	349	10
Long Term Incentive Plan	19/03/2003	1,158	3
	19/03/2003	2,545	10
	16/09/2004	1,133	3
	16/09/2004	2,006	10
	05/04/2005	613	10
	11/04/2006	850	3
	11/04/2006	1,883	10
Bonus Co-Investment Plan	10/08/2004	675	3
	21/04/2005	1,151	3
Profit Growth Incentive Plan	02/04/2007	333	3

A reconciliation of option movements over the year to 31 December 2007 is shown below:

	2007		2006	
	Number 000s	Weighted average exercise price p	Number 000s	Weighted average exercise price p
Outstanding at 1 January	24,378	235.35	25,204	224.87
Granted	349	380.30	2,609	334.05
Forfeited	(10,428)	223.78	(2,388)	234.87
Exercised	(2,186)	223.99	(1,047)	230.24
Outstanding at 31 December	12,113	251.53	24,378	235.35
Exercisable at 31 December	213	231.45	303	229.00

For options outstanding at 31 December the range of exercise prices and weighted average contractual life is shown in the following table:

Range of exercise price	2007		2006	
	Number of shares 000s	Contractual weighted average remaining life years	Number of shares 000s	Contractual weighted average remaining life years
130p–180p	3,855	5.208	6,051	6.208
215p–230p	650	1.409	7,146	5.146
240p–260p	3,140	7.250	5,901	6.700
261p–280p	7	—	120	1.000
300p–385p	4,461	6.745	5,160	7.189

The weighted average share price during the period for options exercised over the year was 356.2p (2006 – 296.0p). The total charge for the year relating to share-based payment plans was £6 million (2006 – £5 million), all of which related to equity-settled share-based payment transactions. After deferred tax, the total charge was £6 million (2006 – £5 million).

Liabilities in respect of share-based payments were not material at either 31 December 2007 or 31 December 2006. There were no vested rights to cash or other assets at either 31 December 2007 or 31 December 2006.

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10 Intangible assets

	2007			2006 (restated — see note 25)		
	Goodwill £m	Other intangible assets £m	Total £m	Goodwill £m	Other intangible assets £m	Total £m
Cost						
At 1 January	571	210	781	600	144	744
Subsidiaries acquired	30	21	51	38	45	83
Capital expenditure	—	20	20	—	33	33
Disposals	—	(4)	(4)	—	(4)	(4)
Currency variations	5	1	6	(67)	(8)	(75)
At 31 December	606	248	854	571	210	781
Accumulated amortisation and impairment						
At 1 January	327	98	425	359	90	449
Charge for the year (note 3a)	—	9	9	—	8	8
Charge for the year (note 3c)	—	8	8	—	3	3
Impairment losses (note 3b)	—	—	—	11	—	11
Disposals	—	(4)	(4)	—	—	—
Currency variations	(1)	1	—	(43)	(3)	(46)
At 31 December	326	112	438	327	98	425
Net book amount at 31 December	280	136	416	244	112	356

The following useful lives have been determined for Other intangible assets:

	Years
Operating intangibles	
Computer software	3–5
Non-recurring (design and development) costs in Aerospace businesses	3–15
Non-operating intangibles	
Brands/trademarks	30–50
Intellectual property rights arising from business combinations	5–10
Customer contracts and relationships	2–15
Proprietary technology and know-how	7–10
Agreements not to compete	3

The net book value of Other intangible assets includes non-recurring costs (consisting of design and development) on major aerospace contracts of £61 million (2006 – £50 million), computer software £17 million (2006 – £17 million), intellectual property rights arising from business combinations of £1 million (2006 – £3 million), brands/trademarks £3 million (2006 – £3 million), customer contracts and relationships £38 million (2006 (restated) – £31 million), proprietary technology and know-how £13 million (2006 – £7 million) and agreements not to compete £1 million (2006 – £nil). Intangible assets acquired in relation to production order backlog are included within customer contracts and relationships. No individual Other intangible asset is material to the Group.

Computer software under finance leases amounts to £2 million (2006 – £1 million).

All non-operating intangibles are recognised when they are controlled through contractual or other legal rights or are separable from the remainder of the business and other tangible assets and their fair value can be reliably measured. Details of the intangible assets considered and arising on the current year business combinations are set out in note 25 to these financial statements.

Impairment

An impairment test is a comparison of the carrying value of the assets of a business or cash generating unit (CGU) to their recoverable amount. Where the recoverable amount is less than the carrying value, an impairment results. During the year, all goodwill was tested for impairment, with no impairment charges resulting.

For the purposes of carrying out impairment tests, the Group's total goodwill has been allocated to a number of CGUs and each of these CGUs has been separately assessed and tested. The allocation of goodwill by business segment is set out in note 2. The size of a CGU varies but is never larger than a primary or secondary reportable segment. In some cases, the CGU is an individual subsidiary or operation. The only amount of goodwill allocated to an individual CGU which is significant to the total Group goodwill is that attributable to a US Aerospace business of £67 million (2006 – £68 million).

All of the recoverable amounts were measured based on value in use except for current year acquisitions where market values have been used. Detailed forecasts for the next five years have been used in the majority of impairment tests except where a longer term more detailed forecast is available and appropriate. These forecasts are based on approved annual budgets and represent a best estimate of future performance.

A number of key assumptions have been made as a basis for the impairment tests. In each case, these key assumptions have been made by management reflecting past experience and are consistent with relevant external sources of information and these are set out below. Where a reasonably possible change to an assumption would lead to an impairment, a sensitivity analysis has been provided which quantifies the amount of change required for an impairment to result.

Discount rates

A relative risk adjustment (or 'beta') has been applied to discount rates to reflect the risk inherent in specific CGUs. In determining the risk adjusted discount rate, management have applied an adjustment for risk of such companies relative to all other sectors on average, determined using an average of the betas of comparable listed companies.

Except for operations in India, where a rate of 16.0% has been factored into impairment models, the risk adjusted pre-tax discount range of rates set out below have been used for impairment testing. The range of rates reflects the mix of currencies within CGUs within the segments.

Driveline: 8.25%–13.0%

Powder Metallurgy: 9.75%–12.25%

OffHighway: 11.0%–12.25%

Aerospace: 9.75%–11.50%

Long term growth rates

To forecast beyond the five years covered by detailed forecasts, a long term average growth rate has been used. In each case, this is not greater than the published Oxford Economic Forecast average growth rate in gross domestic product for the next five year period in the territory or territories where the CGU is primarily based. This results in a range of real growth rates from 2.1% (2006 – 2.4%) for Japan to 7.7% (2006 – 7.9%) for India, with most other countries between 2.0% and 4.0% in both years. Nominal growth rates used in the calculations ranged from 2.7% to 13.4%.

Goodwill sensitivity analysis

In order to gauge sensitivity to likely and potential changes in discount rates and long term growth rates the impact of a 1% increase and/or decrease in each rate in isolation was reviewed. In no instance does such a change result in an impairment in segmental goodwill balances.

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10 Intangible assets *continued*

Driveline

In determining the recoverable amount of Driveline CGUs, it is necessary to make a series of assumptions to estimate future cash flows. The main assumptions include discount rates, long term growth rates, future sales prices and volumes (with reference to specific customer relationships and product lines), a realistic estimate of new business, the cost structure of each CGU and the ability to realise benefits from annual productivity improvements. Assumptions have also been made regarding input costs, including steel prices. It is not considered that a reasonably possible change in any of these assumptions would generate a different impairment test outcome to the one included in this annual report.

Aerospace

In addition to the discount rate and long term growth rate, the key assumptions used to determine the recoverable amount of Aerospace CGUs were specific volumes on certain US military and civil programmes, the achievement of forecast selling prices, the cost structure of each CGU and the ability to realise planned productivity improvements. It is not considered that a reasonably possible change in any of these assumptions would generate a different impairment test outcome to the one included in this annual report.

Other segments

For the remaining impairment tests, key assumptions related to sales volumes and prices, raw material input costs and achieving benefits from annual productivity improvements.

11 Property, plant and equipment

	2007				2006			
	Land and buildings £m	Other tangible assets £m	Capital work in progress £m	Total £m	Land and buildings £m	Other tangible assets £m	Capital work in progress £m	Total £m
Cost								
At 1 January	505	2,567	85	3,157	515	2,642	108	3,265
Subsidiaries acquired	3	16	—	19	4	22	1	27
Capital expenditure	6	92	76	174	14	106	74	194
Disposals	(18)	(74)	—	(92)	(1)	(125)	—	(126)
Transfers	5	55	(60)	—	8	82	(90)	—
Currency variations	20	117	4	141	(35)	(160)	(8)	(203)
At 31 December	521	2,773	105	3,399	505	2,567	85	3,157
Accumulated depreciation and impairment								
At 1 January	111	1,692	—	1,803	108	1,793	—	1,901
Charge for the year	11	130	—	141	13	124	—	137
Disposals	(10)	(69)	—	(79)	—	(121)	—	(121)
Impairments — charged to trading profit (note 3a)	—	1	—	1	—	—	—	—
Impairments/reversals — other (note 3b)	(1)	(8)	—	(9)	—	1	—	1
Currency variations	4	76	—	80	(10)	(105)	—	(115)
At 31 December	115	1,822	—	1,937	111	1,692	—	1,803
Net book amount at 31 December	406	951	105	1,462	394	875	85	1,354
Owned assets	399	950	105	1,454	386	874	85	1,345
Assets under finance leases	7	1	—	8	8	1	—	9
Net book amount at 31 December	406	951	105	1,462	394	875	85	1,354

12 Investments in joint ventures

	2007 £m	2006 £m
At 1 January	83	81
Share of profits retained	11	10
Actuarial gain on post-employment obligations, including deferred tax	1	—
Currency variations	5	(8)
At 31 December	100	83
Group share of net assets		
Non-current assets	70	60
Current assets	91	81
Current liabilities	(50)	(42)
Non-current liabilities	(11)	(16)
	100	83

The joint ventures have no significant contingent liabilities to which the Group is exposed and nor has the Group any significant contingent liabilities in relation to its interest in the joint ventures other than bank guarantees set out in note 28. The share of capital commitments of the joint ventures are shown in note 30.

	2007 £m	2006 £m
Group share of results of joint ventures		
Sales	253	208
Operating costs and other income	(221)	(187)
Net financing costs	—	(1)
Profit before taxation	32	20
Taxation	(8)	(3)
Share of post-tax earnings	24	17

The segmental analysis of the Group's share of joint venture sales and trading profit is set out below:

	2007		2006	
	Sales £m	Trading profit £m	Sales £m	Trading profit £m
Driveline	130	17	113	13
Other Automotive	120	15	92	8
OffHighway	3	—	3	—
	253	32	208	21

13 Other receivables and investments including loans to joint ventures

	2007 £m	2006 £m
Loans to joint ventures	—	7
Other investments	—	—
Trade and other receivables	22	17
	22	24

Other investments mainly comprise the Group's net investment in GKN Aerospace Services Structures Corp. which is an entity in which the Group has, since 2003, had a 100% share in the equity of the entity. This corporation operates under a proxy agreement with the United States Department of Defense developing high technology, classified products for the Joint Strike Fighter. The agreement currently places significant restrictions on the Group's management and control of the business for the life of the contract so that, in accordance with IAS 27, it has been excluded from the consolidation and treated as an investment. The investment, which is fully provided, is stated at cost less provision for diminution. At 31 December 2007, the excluded net liabilities were £5 million (2006 – £4 million) and the operating loss for the year then ended was £1 million (2006 – £1 million). During the year, the Group provided engineering and design services to GKN Aerospace Services Structures Corp. which amounted to £nil (2006 – less than £1 million).

Other receivables includes amounts recoverable in respect of employee deferred compensation arrangements and amounts recoverable from fiscal authorities. Financial assets within the scope of IFRS 7 included within trade and other receivables amount to £9 million (2006 – £7 million).

Loans to joint ventures are at variable interest rates. The fair value of the loans at 31 December 2007 was £nil (2006 – £7 million).

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14 Inventories

	2007 £m	2006 £m
Raw materials	264	211
Work in progress	176	151
Finished goods	112	108
	552	470

Inventories of £51 million (2006 – £55 million) are carried at net realisable value. The amount of any write-down of inventory recognised as an expense in the period was £2 million (2006 – £1 million).

15 Trade and other receivables

	2007 £m	2006 £m
Trade receivables	509	457
Amounts owed by joint ventures	10	8
Other receivables	38	39
Prepayments	14	16
	571	520
Provisions for doubtful debts against trade receivables:		
At 1 January	(5)	(4)
Charge for the year:		
Additions	(3)	(3)
Unused amounts reversed	1	1
Amounts used	1	1
At 31 December	(6)	(5)
Ageing analysis of trade receivables and amounts owed by joint ventures past due but not impaired:		
Up to 30 days overdue	40	39
31–60 days overdue	11	8
61–90 days overdue	4	3
More than 90 days overdue	7	4

Trade receivables of £12 million (2006 – £11 million) are subject to provisions for doubtful debts. Other receivables includes £19 million (2006 – £23 million) of financial assets within the scope of IFRS 7.

16 Trade and other payables

	2007		2006 restated ¹	
	Current £m	Non-current £m	Current £m	Non-current £m
Trade and other payables	602	1	544	1
Amounts owed to joint ventures	2	—	2	—
Accrued interest	26	—	26	—
Payroll taxes, indirect taxes and audit fees	36	2	26	1
Amounts due to employees	119	22	106	17
Government grants	1	5	2	5
Customer advances and deferred income	51	1	37	5
	837	31	743	29

Note 1: Restated following adoption of IFRS 7.

Non-current amounts due to employees includes amounts payable in respect of employee deferred compensation arrangements in the United States of America. Non-current trade and other payables fall due within 2 years.

17 Current tax

	2007 £m	2006 £m
Assets		
United Kingdom	2	—
Liabilities		
Overseas	(104)	(93)

18 Net borrowings

a) Analysis of net borrowings

	Notes	Current	Non-current			Total £m	Total £m
		Within one year £m	One to two years £m	Two to five years £m	More than five years £m		
2007							
Other borrowings:							
£350 million 6 ³ / ₄ % 2019 unsecured bond	i	—	—	—	(346)	(346)	(346)
£325 million 7% 2012 unsecured bond	i	—	—	(325)	—	(325)	(325)
£30 million 12 ³ / ₈ % 2008 Westland Group plc debenture	i	(30)	—	—	—	—	(30)
Other secured US\$ denominated loan		(1)	(1)	(6)	(1)	(8)	(9)
Other long term borrowings		(2)	(4)	(2)	—	(6)	(8)
Finance lease obligations	iii	(1)	(1)	(2)	(8)	(11)	(12)
Unsecured bank loans and overdrafts		(32)	—	—	—	—	(32)
Other short term bank borrowings		(26)	—	—	—	—	(26)
Borrowings		(92)	(6)	(335)	(355)	(696)	(788)
Bank balances and cash		135	—	—	—	—	135
Short term bank deposits	ii	147	—	—	—	—	147
Cash and cash equivalents	iv	282	—	—	—	—	282
Net borrowings		190	(6)	(335)	(355)	(696)	(506)
2006							
Other borrowings:							
£350 million 6 ³ / ₄ % 2019 unsecured bond	i	—	—	—	(346)	(346)	(346)
£325 million 7% 2012 unsecured bond	i	—	—	—	(325)	(325)	(325)
£30 million 12 ³ / ₈ % 2008 Westland Group plc debenture	i	—	(30)	—	—	(30)	(30)
Other secured US\$ denominated loan		(1)	(1)	(7)	(1)	(9)	(10)
Other long term borrowings		—	(4)	(3)	—	(7)	(7)
Finance lease obligations	iii	(1)	(1)	(2)	(9)	(12)	(13)
Unsecured bank loans and overdrafts		(14)	—	—	—	—	(14)
Other short term bank borrowings		(23)	—	—	—	—	(23)
Borrowings		(39)	(36)	(12)	(681)	(729)	(768)
Bank balances and cash		154	—	—	—	—	154
Short term bank deposits	ii	188	—	—	—	—	188
Cash and cash equivalents	iv	342	—	—	—	—	342
Net borrowings		303	(36)	(12)	(681)	(729)	(426)

Other borrowings include: Unsecured £350 million (2006 – £350 million) 6³/₄% bond maturing in 2019 less unamortised issue costs of £4 million (2006 – £4 million), unsecured £325 million (2006 – £325 million) 7% bond maturing in 2012 less unamortised issue costs of £nil (2006 – £nil) and secured term loans of £39 million (2006 – £40 million). These secured term loans include £30 million (2006 – £30 million) debenture stocks of Westland Group plc, which are secured by a floating charge on the undertaking and net assets including financial assets of £88 million (2006 – £100 million) of that company and certain of its subsidiaries and guaranteed by GKN Holdings plc, and £9 million (2006 – £10 million) secured by way of a fixed and floating charge on certain Aerospace fixed assets.

Notes

- i) Denotes borrowings at fixed rates of interest until maturity. All other borrowings and cash and cash equivalents are at variable interest rates.
- ii) The average interest rate on short term bank deposits was 5.48% (2006 – 5.16%). These deposits had an average maturity from 31 December 2007 of 2 days (2006 – 4 days).
- iii) Finance lease obligations gross of finance charges fall due as follows; £2 million within one year (2006 – £3 million), £8 million in one to five years (2006 – £8 million) and £12 million in more than five years (2006 – £12 million).
- iv) £18 million (2006 – £25 million) of the Group's cash and cash equivalents are held by the Group's captive insurance company. In the normal course of events these funds are held by the captive insurance company to maintain solvency requirements and as collateral for Letters of Credit issued to the Group's principal external insurance providers. These funds, therefore, are not circulated within the Group on demand.

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18 Net borrowings *continued*

b) Fair values of borrowings and cash and cash equivalents

	2007		2006	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Other borrowings	(718)	(736)	(718)	(752)
Finance lease obligations	(12)	(12)	(13)	(13)
Unsecured bank loans, overdrafts and other short term bank borrowings	(58)	(58)	(37)	(37)
Bank balances and cash	135	135	154	154
Short term bank deposits	147	147	188	188
	(506)	(524)	(426)	(460)

The following methods and assumptions were used in estimating fair values for financial instruments:

Unsecured bank loans, overdrafts, other short term bank borrowings, bank balances and cash and short term bank deposits approximate to book value due to their short maturities. For other borrowings and finance lease obligations carrying fixed rates of interest, the repayments which the Group is committed to make have been discounted at the relevant interest rates applicable at 31 December 2007. Bonds included within other borrowings have been valued using quoted closing market value.

19 Financial risk management

The Group's activities give rise to a number of financial risks: market risk, credit risk and liquidity risk. Market risk includes foreign exchange risk, cash flow and fair value interest rate risk and commodity price risk. The Group has in place risk management policies that seek to limit the adverse effects on the financial performance. Derivative financial instruments, mainly forward foreign exchange contracts, are used to hedge risk exposure that arise in the ordinary course of business.

Risk management policies have been set by the Board and are implemented by the central Treasury Department that receives regular reports from all the operating companies to enable prompt identification of financial risks so that appropriate actions may be taken. The Treasury Department has a policy and procedures manual that sets out specific guidelines to manage foreign exchange risks, interest rate risk, financial credit risk and liquidity risk and the use of financial instruments to manage these. These disclosures should be read in conjunction with the financing and risk commentary in the business review on pages 36 to 39.

a) Foreign exchange risk

The Group has transactional currency exposures arising from sales or purchases by operating subsidiaries in currencies other than the subsidiaries' functional currency. These exposures are forecast on a quarterly basis by operating companies and are reported to the central Treasury Department. Under the Group's foreign exchange policy, such exposures are hedged on a reducing percentage basis over a number of forecast time horizons.

The Group has a significant investment in overseas operations. As a result, the sterling value of the Group's balance sheet can be affected by movements in exchange rates. The Group's policy is to mitigate the effect of these translational currency exposures for major currencies (US dollar, euro and yen) by hedging 70% to 90% of the net investment in overseas operations with borrowings denominated in their functional currencies, except where significant adverse interest differentials or other factors would render the cost of such hedging activity uneconomic. This is achieved by borrowing either directly or indirectly through the use of rolling annual forward foreign exchange contracts.

The main impact of foreign exchange risk on the Group's results arises from the translation into sterling of the results of operations outside of the UK. The Group's largest exposures are the euro and the US dollar where a 1% movement in the average rate impacts trading profit of subsidiaries and joint ventures by £1.6 million and £0.7 million respectively.

Regarding financial instruments, the main operating profit (changes in fair value of derivative financial instruments) exposure arises from changes in the US dollar and euro for derivative financial instruments held at fair value through profit and loss and the main exposure on equity arises from changes in the euro, US dollar and yen for derivative financial instruments designated as net investment hedges.

A 1% strengthening of sterling against the currency rates indicated would have the following impact:

	2007 £m	2006 £m
Income statement:		
US dollar	3	4
Euro	—	—
Equity:		
Euro	3	3
US dollar	3	3
Yen	1	1

The sensitivity analysis has been prepared by reperforming the calculations used to determine the balance sheet values adjusted for the changes in the individual currency rates indicated with all other cross currency rates remaining constant.

Analysis of amounts included in the balance sheet by currency

	2007			2006		
	Borrowings £m	Cash and cash equivalents £m	Total £m	Borrowings £m	Cash and cash equivalents £m	Total £m
Sterling	(702)	152	(550)	(703)	197	(506)
US dollar	(36)	10	(26)	(28)	18	(10)
Euro	(12)	41	29	(4)	52	48
Others	(38)	79	41	(33)	75	42
	(788)	282	(506)	(768)	342	(426)

b) Interest rate risk

The Group is exposed to fair value interest rate risk on fixed rate borrowings and cash flow interest rate risk on variable rate net borrowings/funds. The Group's policy is to optimise interest cost in reported earnings and reduce volatility in the debt related element of the Group's cost of capital. This policy is achieved by maintaining a target range of fixed and floating rate debt for discrete annual periods, over a defined time horizon. The Group's normal policy is to require interest rates to be fixed for 30% to 70% of the level of underlying borrowings forecast to arise over a 12 month horizon. However, this policy was suspended in December 2004 as it was deemed inappropriate given the absence of floating rate bank debt following the receipt of the sale proceeds of GKN's share in AgustaWestland. At 31 December 2007 89% (2006 – 91%) of the Group's gross borrowings were subject to fixed interest rates.

As at 31 December 2007 £147 million (2006 – £188 million) was on deposit with various banks and in money market funds, of which £145 million (2006 – £163 million) was on deposit in the UK. A 1% change in interest rates would have a £1 million impact on net interest. This sensitivity impact has been prepared by determining average floating interest rates and flexing these against average floating rate deposits and borrowings by major currency area over the course of the year.

c) Credit risk

The Group is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments. In terms of substance, and consistent with the related balance sheet presentation, the Group considers it has two types of credit risk; operational and financial. Operational credit risk relates to non-performance by customers in respect of trade receivables and by suppliers in respect of other receivables. Financial credit risk relates to non-performance by banks and similar institutions in respect of cash and deposits and financial contracts, including forward foreign currency contracts.

Operational

As tier one suppliers to automotive, off-highway and aerospace original equipment manufacturers the Group may have substantial amounts outstanding with a single customer at any one time. The credit profiles of such original equipment manufacturers are available from credit rating agencies. The failure of any such customer to honour its debts could materially impact the Group's results. However, there are many advantages in these relationships. In certain parts of the Group, mainly Industrial Distribution Services within Driveline and OffHighway there are a greater proportion of amounts receivable from small and medium sized customers.

Credit risk and customer relationships are managed at a number of levels within the Group. At a subsidiary level documented credit control reviews are required to be held at least every month. The scope of these reviews includes amounts overdue and credit limits. At a divisional level debtor ratios, overdue accounts and overall performance is reviewed regularly. Provisions for doubtful debts are determined at these levels based upon the customer's ability to pay and other factors in the Group's relationship with the customer. As at 31 December 2007 41% (2006 – 44%) of trade receivables arose from 10 customers.

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19 Financial risk management *continued*

The amount of trade receivables outstanding at the year end does not represent the maximum exposure to operational credit risk due to the normal patterns of supply and payment over the course of a year. Based on management information collected as at month ends the maximum level of trade receivables at any one point during the year was £650 million (2006 – £611 million).

Financial

Credit risk is mitigated by the Group's policy of only selecting counterparties with a strong investment graded long term credit rating, normally at least AA– or equivalent, and assigning financial limits to individual counterparties.

The maximum exposure with a single bank for deposits is £25 million (2006 – £40 million), whilst the maximum mark to market exposure for forward foreign currency contracts at 31 December 2007 to a single bank was £3 million (2006 – £6 million). The amounts on deposit at year end represent the Group's maximum exposure to financial credit risk with Group indebtedness varying over the course of a year in line with normal financing and trading patterns.

d) Capital risk management

The Group's objectives when managing capital are to safeguard the ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain a capital structure which optimises the cost of capital.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce borrowings.

The Group monitors capital on the basis of the ratio of Gross borrowings to EBITDA.

The Group seeks to operate at an EBITDA to Gross borrowings ratio of 2.5 times or less and the ratios at 31 December 2007 and 2006 were as follows:

	2007 £m	2006 £m
Gross borrowings	788	768
EBITDA	428	396
Gross borrowings to EBITDA ratio	1.8 times	1.9 times

e) Liquidity risk

The Group is exposed to liquidity risk as part of its normal financing and trading cycle at times when peak borrowings are required. Borrowings normally peak in May and September following dividend and bond coupon payments. The Group's policies are to ensure that sufficient liquidity is available to meet obligations when they fall due and to maintain sufficient flexibility in order to fund investment and acquisition objectives. Liquidity needs are assessed through short and long term forecasts. Committed bank facilities of £350 million expire in July 2010 and were undrawn at the year end (2006 – £350 million expiring in July 2010 and undrawn at the year end). Committed facilities are provided through ten banks.

Maturity analysis of borrowings and derivative financial instrument liabilities

	Within one year £m	One to two years £m	Two to five years £m	More than five years £m	Total £m
2007					
Borrowings (note 18)	(92)	(6)	(335)	(355)	(788)
Contractual interest payments and finance lease charges	(50)	(47)	(128)	(169)	(394)
Derivative financial instruments liabilities – receipts	883	16	23	18	940
Derivative financial instruments liabilities – payments	(894)	(17)	(23)	(18)	(952)
	(153)	(54)	(463)	(524)	(1,194)
2006					
Borrowings (note 18)	(39)	(36)	(12)	(681)	(768)
Contractual interest payments and finance lease charges	(52)	(52)	(142)	(202)	(448)
Derivative financial instruments liabilities – receipts	601	5	2	3	611
Derivative financial instruments liabilities – payments	(602)	(5)	(2)	(3)	(612)
	(92)	(88)	(154)	(883)	(1,217)

There is no significant difference in the contractual undiscounted value of other financial liabilities from the amounts stated in the balance sheet and balance sheet notes.

f) Commodity price risk

The Group is exposed to changes in commodity prices, particularly of metals, which has a significant impact on input costs and the overall financial results. The Group seeks to mitigate this exposure in a variety of ways including medium term price agreements, surcharges and advance purchasing. In rare circumstances and only in respect of certain specified risks, the Group uses derivative commodity hedging instruments. The impact of such financial instruments in respect of the overall commodity price risk is not material.

g) Categories of financial assets and financial liabilities

	Loans and receivables £m	Amortised cost £m	Held for trading		Derivatives used for hedging £m	Total £m
			Financial assets £m	Financial liabilities £m		
2007						
Other receivables and investments including						
Loans to joint ventures	9	—	—	—	—	9
Trade and other receivables	538	—	—	—	—	538
Derivative financial instruments	—	—	24	(13)	(16)	(5)
Cash and cash equivalents	282	—	—	—	—	282
Borrowings	—	(788)	—	—	—	(788)
Trade and other payables	—	(631)	—	—	—	(631)
Provisions	—	(1)	—	—	—	(1)
	829	(1,420)	24	(13)	(16)	(596)
2006						
Other receivables and investments including						
Loans to joint ventures	14	—	—	—	—	14
Trade and other receivables	488	—	—	—	—	488
Derivative financial instruments	—	—	30	(9)	—	21
Cash and cash equivalents	342	—	—	—	—	342
Borrowings	—	(768)	—	—	—	(768)
Trade and other payables	—	(573)	—	—	—	(573)
Provisions	—	(2)	—	—	—	(2)
	844	(1,343)	30	(9)	—	(478)

20 Derivative financial instruments

Amounts included in operating profit comprise:

	2007 £m	2006 £m
Forward currency and commodity contracts	(10)	38
Embedded derivatives	—	(5)
	(10)	33

Amounts included in the balance sheet comprise:

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Forward currency and commodity contracts — not hedge accounted	23	(7)	28	(2)
Forward currency contracts — hedge accounted	1	—	1	—
Embedded derivatives	1	(6)	2	(7)
Net investment hedges	—	(17)	1	(2)
	25	(30)	32	(11)

The amounts in respect of embedded derivatives primarily represent the movement between 1 January 2007 and 31 December 2007 or date of maturity in the value of the embedded derivatives in commercial contracts between European Aerospace subsidiaries and customers and suppliers outside the USA which are denominated in US dollars.

Forward foreign exchange contracts, commodity contracts and embedded derivatives are marked to market using published prices, with forward foreign exchange contracts and commodity contracts being settled on a net basis.

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20 Derivative financial instruments *continued*

Hedge accounting

Cash flow hedges

The Group manages exposure to foreign currency fluctuations on outstanding purchase and sale agreements using forward foreign currency contracts. In 2007 the Group adopted transactional foreign exchange hedge accounting in a limited number of contracts. The value of forward foreign exchange contracts subject to hedge accounting was £1 million asset (2006 – £1 million asset). The net cash flows and profit impact will occur during 2008 (2006 – during 2007). A £1 million gain was recognised in equity during the year (2006 – £1 million gain). An accumulated gain of £1 million was removed from equity during the year and included in the income statement as a £1 million gain in Cost of Sales. Cash flow hedging was 100% effective during 2007 and 2006.

Net investment hedging

See note 19. Net investment hedging was 100% effective during 2007 and 2006.

21 Provisions

	Restructuring £m	Warranty £m	Legal and environmental £m	Other £m	Total £m
At 1 January 2007	34	14	36	35	119
Subsidiaries acquired and sold	—	—	—	9	9
Charge for the year:					
Additions	37	6	2	8	53
Unused amounts reversed	—	(3)	(7)	(7)	(17)
Amounts used	(44)	(5)	(10)	(12)	(71)
Currency variations	1	1	—	1	3
At 31 December 2007	28	13	21	34	96
Due within one year	22	7	8	8	45
Due in more than one year	6	6	13	26	51
	28	13	21	34	96

Restructuring

Restructuring provisions outstanding at 31 December 2007 relate primarily to the estimated future cash outflows in respect of redundancies and onerous contracts (predominantly leases) arising from the Group's strategic restructuring programme, details of the charges in respect of which are included in note 3. Amounts are only set aside when irrevocable commitments exist at the balance sheet date and these invariably reflect actual or constructive contractual arrangements which indicate the amount and most likely timing of flows.

Warranty

Provisions set aside for warranty exposures either relate to amounts provided systematically based on historical experience under contractual warranty obligations attaching to the supply of goods or specific provisions created in respect of individual customer issues undergoing commercial resolution and negotiation. In the event of a claim, settlement will be negotiated with the customer based on supply of replacement products and compensation for the customer's associated costs. Amounts set aside represent management's best estimate of the likely settlement and the timing of any resolution with the relevant customer.

Legal and environmental

Legal provisions amounting to £5 million (2006 – £8 million) relate to management estimates of amounts required to settle or remove litigation actions that have arisen in the normal course of business. Further details are not provided to avoid the potential of seriously prejudicing the Group's stance in law. Amounts unused and reversed only arise when the matter is formally settled or when a material change in the litigation action occurs where legal advice confirms lower amounts need to be retained to cover the exposure.

As a consequence of primarily legacy activities, a small number of sites in the Group are subject to environmental remediation actions, which in all cases are either agreed formally with relevant local and national authorities and agencies or represent management's view of the likely outcome having taken appropriate expert advice and following consultation with appropriate authorities and agencies. Amounts charged and carried reflect the current best estimates of the likely cost of remediation and inherent timings.

Other

Other provisions include amounts set aside in terms of insurance provisions held within the Group's captive insurance company £8 million (2006 – £10 million), provisions held in respect of onerous loss making contracts £11 million (2006 – £9 million), and long service non-pension and other employee related obligations arising primarily in the Group's continental European subsidiaries £15 million (2006 – £12 million). Insurance provisions and charges are established in accordance with external insurance and actuarial advice. The onerous loss making contract provisions relate to specific non-cancellable contractual commitments where it is anticipated that unavoidable net operating losses will arise.

Vacant leasehold property provisions included in Restructuring and Other provisions above amount to £1 million (2006 – £2 million).

22 Deferred tax

Deferred tax is calculated in full on temporary differences under the liability method.

Amounts recognised on the balance sheet	2007 £m	2006 £m
Deferred tax assets	56	114
Deferred tax liabilities	(75)	(63)
	(19)	51

Movement on deferred tax	2007 £m	2006 £m
At 1 January	51	112
Subsidiaries acquired and sold	(8)	(7)
(Charge)/credit for the year:		
Income statement	35	13
Equity	(92)	(67)
Currency variations	(5)	—
At 31 December	(19)	51

The movements in deferred tax assets and liabilities (prior to the offsetting of balances within the same jurisdiction as permitted by IAS 12) during the period are shown below:

Deferred tax assets	Pensions £m	Tax losses £m	Other £m	Total £m
At 1 January 2007	102	20	28	150
Credited to income statement	3	27	45	75
Charged to equity	(84)	—	—	(84)
Other movements	—	—	(6)	(6)
Currency variations	—	—	2	2
At 31 December 2007	21	47	69	137

Deferred tax liabilities	Accelerated tax depreciation £m	Other £m	Total £m
At 1 January 2007	(94)	(5)	(99)
Charged to income statement	(31)	(9)	(40)
Charged to equity	(6)	(2)	(8)
Subsidiaries acquired	(2)	(6)	(8)
Other movements	—	6	6
Currency variations	(7)	—	(7)
At 31 December 2007	(140)	(16)	(156)

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22 Deferred tax continued

Unrecognised deferred tax assets

Deferred tax assets have not been recognised in relation to certain taxable losses and other temporary differences on the basis that their future economic benefit is uncertain. The gross and tax values of these unrecognised assets together with any expiry dates where relevant are shown below. The tax value of the assets has been calculated using tax rates enacted or substantially enacted at the balance sheet date.

	2007			2006		
	Tax value £m	Gross £m	Expiry period	Tax value £m	Gross £m	Expiry period
Tax losses — with expiry: national	186	532	2019 to 2027	160	451	2019 to 2026
Tax losses — with expiry: local	40	813	2008 to 2027	48	877	2007 to 2026
Tax losses — without expiry	118	402		112	355	
Other temporary differences	32	113		50	163	
Unrecognised deferred tax assets	376	1,860		370	1,846	

Included above are tax losses of £677 million with a tax value of £109 million (2006 – £732 million with a tax value of £111 million) that are severely restricted for future use and management, based on the Group's current profile, believes they are unlikely to be utilised in the foreseeable future.

Deferred tax assets totalling £35 million (2006 – £82 million) have been recognised relating to territories where tax losses have been incurred in the year. It is anticipated that future profitability arising from restructuring and other actions will result in their realisation.

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries except where the distribution of such profits is planned. If the earnings were remitted in full, tax of £25 million (2006 – £25 million) would be payable.

The UK Government announced the gradual abolition of industrial building allowances in the 2007 Budget. Since this change had not been substantively enacted at the balance sheet date, its effect is not included in the calculation of deferred tax as at 31 December 2007. The impact of this change on the Group's future tax rate is anticipated to be insignificant.

23 Share capital

	Authorised		Allotted, called up and fully paid	
	2007 £m	2006 £m	2007 £m	2006 £m
Ordinary shares of 50p each	450	450	372	371

	Number 000s	Number 000s	Number 000s	Number 000s
Ordinary shares of 50p each				
At 1 January	900,000	900,000	741,513	740,466
Shares issued under the share option schemes	—	—	2,186	1,047
At 31 December	900,000	900,000	743,699	741,513

At the last Annual General Meeting, shareholder authority was obtained for the Company to purchase up to a maximum of 70.3 million of its own ordinary shares (representing 10% of the issued share capital of the Company on 31 December 2006) for a period ending on the earlier of the next Annual General Meeting or 3 August 2008, provided that certain conditions (relating to the purchase price) are met. The Notice of Annual General Meeting proposes that shareholders approve a resolution updating and renewing this authority. Shares in the Company may also be purchased by the GKN Employee's Share Ownership Plan (ESOP) Trust.

At 31 December 2007 there were 38,659,142 ordinary shares of 50p each (nominal value £19.3 million (2006 – £19.3 million)) held as treasury shares. No shares were purchased in the open market during the year. In 2006 13,439,142 shares were purchased at a cost of £40 million including expenses. These shares, which represented 5.2% (2006 – 5.2%) of the called up share capital at the end of the year, have not been cancelled but are held as treasury shares and represent a deduction from shareholders' equity.

During the year shares issued under the share option schemes generated £5 million (2006 – £3 million).

24 Changes in shareholders' equity

	Share capital £m	Share premium £m	Retained earnings £m	Exchange reserve £m	Other reserves Hedging reserve £m	Other reserves £m	Equity interest £m	Minority interests — equity £m	Total equity £m
At 1 January 2006	370	23	493	26	1	(38)	875	26	901
Purchase of treasury shares	—	—	(40)	—	—	—	(40)	—	(40)
Share issues	1	2	—	—	—	—	3	—	3
Transfer from income statement	—	—	177	—	—	—	177	—	177
Minority interests in subsidiary disposed	—	—	—	—	—	—	—	(8)	(8)
Actuarial gains and losses arising on post-employment obligations, including tax	—	—	40	—	—	—	40	—	40
Share-based payments	—	—	5	—	—	—	5	—	5
Transfers	—	—	2	—	—	(2)	—	—	—
Dividends	—	—	(88)	—	—	—	(88)	(1)	(89)
Accumulated currency variations realised on sale of business	—	—	—	(1)	—	—	(1)	—	(1)
Currency variations	—	—	—	(123)	—	—	(123)	(1)	(124)
Derivative financial instruments:									
Translational hedging	—	—	—	—	43	—	43	—	43
Transactional hedging	—	—	—	—	1	—	1	—	1
At 31 December 2006	371	25	589	(98)	45	(40)	892	16	908
Share issues	1	4	—	—	—	—	5	—	5
Transfer from income statement	—	—	196	—	—	—	196	2	198
Actuarial gains and losses arising on post-employment obligations, including tax	—	—	141	—	—	—	141	—	141
Deferred tax on other items	—	—	(8)	—	—	—	(8)	—	(8)
Share-based payments	—	—	6	—	—	—	6	—	6
Transfers	—	—	1	—	—	(1)	—	—	—
Dividends	—	—	(91)	—	—	—	(91)	(1)	(92)
Currency variations	—	—	—	64	—	—	64	2	66
Derivative financial instruments:									
Translational hedging	—	—	—	—	(28)	—	(28)	—	(28)
Transactional hedging	—	—	—	—	—	—	—	—	—
At 31 December 2007	372	29	834	(34)	17	(41)	1,177	19	1,196

Retained earnings include the accumulated profits and losses arising from the consolidated income statement and certain items from the statement of recognised income and expense attributable to equity shareholders less distributions to shareholders and the cost, £100 million (2006 – £100 million), of the Company's shares held in treasury. Also included within the retained earnings balance is goodwill written off directly to equity and accumulated net currency variations on overseas net assets and hedging instruments under legacy GAAP and the impact of the adoption of IFRS.

Other reserves include the UK GAAP revaluation reserve, accumulated adjustments in respect of piecemeal acquisitions and other accumulated reserves where distribution has been restricted due to legal or fiscal requirements. The accumulated debit balance includes the impact of the demerger transaction of Industrial Services in 2001.

The exchange reserve and the hedging reserve represent the accumulated net currency variations on overseas net assets and hedging instruments.

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25 Acquisitions

2007 Acquisitions

On 29 June 2007, the Group completed the acquisition of the Teleflex Aerospace Manufacturing Group (TAMG) of Teleflex Inc, in a mixed trade and asset and legal entity deal, for a fair value consideration of £68 million. The businesses acquired provide manufacturing and engineering services from operations in the US, Mexico, France and the UK.

The acquisition has been accounted for by the purchase method of accounting. Fair values on the acquisition remain provisional as the review of acquired operations and assets remains ongoing.

	Carrying values pre-acquisition £m	Fair value adjustments £m	Fair values £m
Intangible fixed assets	—	21	21
Property, plant and equipment	14	5	19
Inventories	12	(1)	11
Trade and other receivables	15	—	15
Trade and other payables	(10)	(1)	(11)
Provisions — post-employment obligations	—	—	—
— other	—	(9)	(9)
Deferred tax liabilities	(2)	(6)	(8)
Cash and cash equivalents	—	—	—
	29	9	38
Goodwill			30
Total fair value of consideration			68
Consideration satisfied by:			
Cash			67
Directly attributable costs			1
			68

Valuation of non-operating intangibles — methodology

The fair value exercise carried out in conjunction with a third party expert on the acquisition of TAMG considered the existence of the following recognisable intangibles attributable to the business: in-process research & development (IPRD), non-compete covenants, marketing agreements, distributor relationships, trade names, leasehold interests, software, proprietary technology and customer relationships/contracts.

No significant IPRD or marketing agreements were identified and accordingly no fair value was ascribed. TAMG transacts most of its business directly with aerospace prime engine manufacturers, any revenue applicable to distributors is included within the customer relationship calculation. No trade names were acquired in the transaction.

As part of the transaction the vendor covenanted not to compete on the products and processes of the business acquired for a period of three years. Although the vendor still operates in the aerospace business it has retained no activities of a similar nature to those it disposed of. The costs of recreating the specific technology and processes it disposed of would be significant. A fair value of £1 million was identified for the covenant not to compete.

TAMG is a recognised market leader in the manufacture of complex engine components for the aerospace industry, thus giving the Group further positions on a range of established engine programmes. The business has a range of both cold section products that are complementary to the Group's existing engine case and fan blade activities and hot section core activities in blisks, compressor airfoils and guide vanes. TAMG has manufacturing and technological expertise in electrochemical machining (ECM), forging, multi axis milling and conventional milling. These capabilities are based on developed ECM proprietary technology and milling know-how. The proprietary technology and know-how has been valued using a relief from royalty methodology. The cash flow forecasts supporting this valuation reflect the future sales to be generated in conjunction with the technology. The fair value attributed to proprietary technology represents the theoretical costs avoided by TAMG from not having to pay a licence fee for the technology. The royalty rate used in the valuation was 3.0% for ECM and 2.0% for milling, which was based on a review of licence agreements for comparable technologies in similar industrial segments. An after tax discount rate of 12.0% was applied to the forecast cash flows, a rate that reflects the higher inherent risk of intangible cash flows compared to the weighted average cost of capital of the TAMG acquisition.

The intangible assets inherent in TAMG's customer relationships/contracts were valued using an excess earnings method. This methodology places a value on the intangible as a function of (a) management's estimate of the attrition rate on the expected cash flows arising from the contracts and forecast cash flows likely to accrue to TAMG from its customer base; (b) expected cash flows arising from the intangibles; (c) discount rate reflective of the risks inherent in the flows; and (d) an asset charge attributable to operating assets needed to generate the cash flows. The cash flows attributable to customer relationships include an annual attrition rate of 5.0% to reflect expected decay in future revenues. An after tax discount rate of 14.0% was applied to the forecast cash flows.

TAMG's primary operations and centre of management are based in the US. The valuation of all intangibles reflects the tax benefit of amortisation, which in the context of TAMG has meant a benefit assessed with reference to US tax laws. According to US tax law an intangible may be rateably amortised over 15 years regardless of its actual useful life, as such, there is a tax benefit to an acquirer and hence values attributable to the intangible assets have been recognised. This value amounts to £3 million across all the intangibles recognised.

The fair value of customer relationships/contracts recognised was £13 million and the fair value of ECM and milling know-how was £7 million.

Fair value adjustments on tangible fixed assets represent a net uplift on plant and equipment to fair values following an external third party appraisal. The uplift primarily represents the restoration of asset values fully depreciated by TAMG. TAMG operates from owned and leased facilities. At leased facilities the rentals are reflective of current market values and hence no fair value is attributable to TAMG's interest in these leases. Inventories acquired were assessed for scrap and obsolete items before being fair valued. Inventories acquired have been fair valued at current replacement cost for raw materials and selling price, adjusted for costs of disposal and a selling margin, for finished goods and work-in-progress. The value of the fair value inventory uplift was £1 million, the adjustment for scrap and obsolete items was £2 million. Provisions includes amounts in respect of onerous contracts. Three contracts with two customers have been identified where the unavoidable costs of meeting the obligations under long term agreements exceeds the economic inflow they generate. In assessing these contracts dedicated fixed assets have been impaired upon acquisition. Two of the contracts identified are at an early stage and reflect the impact of contractually committed price downs. Unavoidable costs include direct labour and material and a reasonable proportion of manufacturing overhead. Also included are the unavoidable costs of purchasing fixed assets dedicated to these contracts and required as future volumes increase.

The goodwill arising on the acquisition of TAMG is attributable to the anticipated future operating synergies from the combination with the Group's existing US Engine Products business, the value of the embedded workforce, the value of a significant manufacturer in the US engine component market and the ownership and control of a leading business in an industry with substantial barriers to entry.

TAMG contributed £38 million to sales and £4 million to the Group's trading profit for the period between the date of acquisition and the balance sheet date. If the acquisition of TAMG had been completed on the first day of the financial year, Group sales for the year would have increased by £72 million and Group trading profit would have increased by £6 million. TAMG was acquired debt and cash free.

In the post-acquisition period TAMG contributed £4 million to cash generated from operations and absorbed £1 million in investing activities.

Prior year acquisitions

Finalisation of fair value adjustments in respect of the 2006 acquisitions of Stellex Aerostructures, Rockford Powertrain and Liuzhou Steel Rim Factory (Liuzhou) were made in the year. As required under IFRS 3, amendments to provisional fair values have been shown as a prior period restatement. As a consequence, and only in respect of Liuzhou, intangible fixed assets have been restated to recognise non-operating intangible assets arising on business combinations of £1 million with an equal reduction in the value of goodwill.

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26 Cash flow reconciliations

	2007 £m	2006 £m
Cash generated from operations		
Operating profit	221	203
Adjustments for:		
Profits and losses on sale of businesses	—	(5)
Amortisation of non-operating intangible assets arising on business combinations	8	3
Changes in fair value of derivative financial instruments	10	(33)
Tangible fixed asset impairment/reversals	(9)	1
Impairment of goodwill	—	11
Depreciation and amortisation	151	145
Amortisation of capital grants	(2)	(3)
Net profits on sale of fixed assets	(8)	(3)
Charge for share-based payments	6	5
Movement in post-employment obligations	(29)	(204)
Changes in working capital and provisions	(49)	(3)
	299	117
Movement in net debt		
Net movement in cash and cash equivalents	(78)	(369)
Net movement in borrowings	4	(36)
Currency variations on borrowings	(7)	34
Finance leases	1	1
Subsidiaries acquired and sold	—	9
Movement in year	(80)	(361)
Net debt at beginning of year	(426)	(65)
Net debt at end of year	(506)	(426)
Reconciliation of cash and cash equivalents		
Cash and cash equivalents per balance sheet at 31 December	282	342
Bank overdrafts included within 'current liabilities — borrowings' (note 18)	(32)	(14)
Cash and cash equivalents per cash flow at 31 December	250	328

27 Post-employment obligations

Post-employment obligations as at the year end comprise:		2007 £m	2006 £m
Pensions	— funded	(24)	(217)
	— unfunded	(260)	(268)
Medical	— funded	(9)	(28)
	— unfunded	(38)	(48)
		(331)	(561)

Pensions and medical — funded

The Group's pension arrangements comprise various defined benefit and defined contribution schemes throughout the world. A number of retirement plans are operated which provide certain employees with post-employment medical benefits.

Pensions

In the UK, pension arrangements are made through an externally funded defined benefit scheme. In the USA and the Rest of the World there are a number of externally funded defined benefit schemes while in certain companies in Europe funds are retained within the business to provide for post-employment obligations.

(a) Defined benefit schemes — measurement and assumptions

Independent actuarial valuations of all major defined benefit scheme assets and liabilities were carried out at 31 December 2007. The present value of the defined benefit obligation, the related current service cost and the past service cost were measured using the projected unit credit method.

Key assumptions were:

	UK %	Americas %	Europe %	ROW %
2007				
Rate of increase in pensionable salaries	4.3	3.5	2.50	2.0
Rate of increase in payment and deferred pensions	3.4	2.0	1.75	n/a
Discount rate	5.9	6.4	5.60	2.3
Inflation assumption	3.3	2.5	1.75	1.0
Rate of increases in medical costs:				
initial/long term	8.0/4.5	9.0/5.0	n/a	n/a
2006				
Rate of increase in pensionable salaries	4.1	3.5	2.50	2.0
Rate of increase in payment and deferred pensions	3.2	2.0	1.75	n/a
Discount rate	5.1	5.9	4.70	2.5
Inflation assumption	3.1	2.5	1.75	1.0
Rate of increases in medical costs:				
initial/long term	8.0/4.5	10.0/5.0	n/a	n/a

The underlying mortality assumptions for the major schemes are as follows:

United Kingdom

Such is the size and profile of the UK scheme that data on the scheme's mortality experience is collected and reviewed annually. At the recent annual review the age adjustment to PA92 (year of birth) was strengthened by 0.5 to 2.5 years to reflect actual scheme experience. Mortality assumptions were strengthened further by moving to medium cohort projections. The key current year mortality assumptions for the scheme are that a male aged 65 lives for a further 19.8 years, whilst a male aged 40 is expected to live a further 21 years after retiring at 65. The impact of this change in assumptions has increased liabilities by £75 million.

Overseas

In the USA, CL2007 tables were adopted in 2007 whilst in Germany the RT2005-G tables were again used. In the USA the longevity assumption for a male aged 65 is that he lives a further 18.8 years whilst in Germany for a further 17.7 years. The longevity assumption for a US male currently aged 40 is that he also lives for a further 18.8 years once attaining 65 years, with the German equivalent assumption being 17.7 years. These assumptions are based solely on the prescribed tables not on actual GKN experience.

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27 Post-employment obligations *continued***Assumption sensitivity analysis**

The impact of a one percentage point movement in the primary assumptions on the defined benefit net obligations as at 31 December 2007 is set out below:

	UK £m	Americas £m	Europe £m	ROW £m
Discount rate +1%	282	32	31	3
Discount rate -1%	(346)	(40)	(39)	(3)
Rate of inflation +1%	(200)	—	(25)	—
Rate of inflation -1%	180	—	22	—
Rate of increase in medical costs +1%	(1)	(1)	n/a	n/a
Rate of increase in medical costs -1%	1	1	n/a	n/a

A one percentage point increase in the assumption on healthcare benefits would increase the total service and interest cost by £nil (2006 – £1 million) and the liability by £2 million (2006 – £11 million). A one percentage point decrease in the assumption on healthcare benefits would reduce liabilities by £2 million (2006 – £9 million).

(b) Defined benefit schemes – reporting

The amounts recognised in the income statement are:

	2007			2006	
	Employee benefit expense £m	Redundancy and other employment amounts £m	Restructuring and impairment charges £m	Total £m	Total £m
Included within operating profit					
Current service cost	(32)	—	—	(32)	(38)
Past service cost	12	(1)	(4)	7	(2)
Settlement/curtailments	2	—	—	2	(3)
	(18)	(1)	(4)	(23)	(43)
Included within net financing costs					
Expected return on pension scheme assets				146	136
Interest on post-employment obligations				(149)	(140)
				(3)	(4)

The past service credit of £7 million within operating profit (2006 – £2 million charge) includes a £12 million credit from the impact of changes to retiree medical benefits in the USA, partly offset by a past service charge of £5 million (2006 – £2 million charge), £4 million of which is within Restructuring and impairment charges (2006 – £nil) primarily from further downsizing of a UK business in the Automotive portfolio. The 2007 settlement/curtailments credit arises from changes in pension regulations in Italy.

The amounts recognised in respect of funded obligations in the balance sheet are:

	2007				2006	
	UK £m	Americas £m	Europe £m	ROW £m	Total £m	Total £m
Present value of funded obligations	(2,251)	(244)	(13)	(20)	(2,528)	(2,660)
Fair value of plan assets	2,248	212	21	14	2,495	2,415
Net obligation recognised in the balance sheet	(3)	(32)	8	(6)	(33)	(245)

The contributions expected to be paid by the Group during 2008 to the UK schemes is £12 million and to overseas schemes £26 million.

Cumulative actuarial gains and losses recognised in equity are as follows:

	2007 £m	2006 £m
At 1 January	17	(90)
Net actuarial gains in year	225	107
At 31 December	242	17

Movement in schemes' obligations (funded and unfunded) during the year

	UK £m	Americas £m	Europe £m	ROW £m	Total £m
At 1 January 2007	(2,375)	(301)	(277)	(23)	(2,976)
Subsidiaries acquired	—	—	—	—	—
Current service cost	(16)	(8)	(6)	(2)	(32)
Interest	(119)	(17)	(13)	—	(149)
Contributions by participants	(11)	—	—	—	(11)
Actuarial gains and losses	141	28	36	—	205
Benefits paid	121	13	13	2	149
Past service cost	(5)	12	—	—	7
Curtailments	—	—	2	—	2
Currency variations	—	3	(23)	(1)	(21)
At 31 December 2007	(2,264)	(270)	(268)	(24)	(2,826)
At 1 January 2006	(2,381)	(316)	(284)	(23)	(3,004)
Subsidiaries acquired	—	(23)	—	—	(23)
Current service cost	(18)	(10)	(8)	(2)	(38)
Interest	(111)	(17)	(12)	—	(140)
Contributions by participants	(11)	(1)	—	—	(12)
Actuarial gains and losses	35	13	12	(2)	58
Benefits paid	116	11	13	2	142
Past service cost	(1)	—	(1)	—	(2)
Curtailments — subsidiaries sold	(4)	1	—	—	(3)
Currency variations	—	41	3	2	46
At 31 December 2006	(2,375)	(301)	(277)	(23)	(2,976)

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27 Post-employment obligations *continued***Movement in schemes' assets during the year**

	UK £m	Americas £m	Europe £m	ROW £m	Total £m
At 1 January 2007	2,187	196	19	13	2,415
Subsidiaries acquired	—	—	—	—	—
Expected return on assets	131	14	1	—	146
Actuarial gains and losses	21	—	(1)	(1)	19
Contributions by Group	19	15	1	2	37
Contributions by participants	11	—	—	—	11
Benefits paid	(121)	(11)	(1)	(1)	(134)
Currency variations	—	(2)	2	1	1
At 31 December 2007	2,248	212	21	14	2,495
At 1 January 2006	1,915	170	20	14	2,119
Subsidiaries acquired	—	19	—	—	19
Expected return on assets	122	13	1	—	136
Actuarial gains and losses	35	15	(1)	—	49
Contributions by Group	220	13	—	2	235
Contributions by participants	11	—	—	—	11
Benefits paid	(116)	(10)	(1)	(2)	(129)
Currency variations	—	(24)	—	(1)	(25)
At 31 December 2006	2,187	196	19	13	2,415

The defined benefit obligation is analysed between funded and unfunded schemes as follows:

	2007 £m	2006 £m
Funded	(2,528)	(2,660)
Unfunded	(298)	(316)
	(2,826)	(2,976)

The fair value of the assets in the schemes and the expected rates of return were:

	UK		Americas		Europe		ROW	
	Long term rate of return expected %	Value £m	Long term rate of return expected %	Value £m	Long term rate of return expected %	Value £m	Long term rate of return expected %	Value £m
At 31 December 2007								
Equities	8.0	1,114	8.5	142	—	—	6.2	8
Bonds	5.1	810	5.5	57	—	—	1.3	4
Property	6.7	102	—	—	—	—	—	—
Cash/short term mandate	5.7	190	4.7	13	—	—	1.0	1
Other assets	5.8	32	—	—	5.1	21	0.9	1
		2,248		212		21		14
At 31 December 2006								
Equities	7.5	1,093	8.5	134	—	—	7.2	7
Bonds	4.9	687	5.0	53	—	—	2.0	4
Property	6.8	109	—	—	—	—	—	—
Cash/short term mandate	5.1	265	3.8	9	—	—	—	—
Other assets	5.1	33	—	—	5.0	19	1.3	2
		2,187		196		19		13

The expected return on plan assets is a blended average of projected long term returns for the various asset classes. Equity returns are developed based on the selection of the equity risk premium above the risk-free rate which is measured in accordance with the yield on government bonds. Bond returns are selected by reference to the yields on government and corporate debt as appropriate to the plan's holdings of these instruments; all other asset classes' returns are determined by reference to current experience.

The actual return on plan assets was £165 million (2006 – £185 million).

History of experience gains and losses

	UK	Americas	Europe	ROW
2007				
Experience adjustments arising on scheme assets:				
Amount — £m	21	—	(1)	(1)
Percentage of scheme assets	0.9%	—	(4.8%)	(7.1%)
Experience gains and losses on scheme liabilities:				
Amount — £m	141	28	36	—
Percentage of the present value of scheme liabilities	6.2%	10.4%	13.4%	—
Present value of scheme liabilities — £m	(2,264)	(270)	(268)	(24)
Fair value of scheme assets — £m	2,248	212	21	14
Deficit — £m	(16)	(58)	(247)	(10)
2006				
Experience adjustments arising on scheme assets:				
Amount — £m	35	15	(1)	—
Percentage of scheme assets	1.6%	7.6%	(4.5%)	—
Experience gains and losses on scheme liabilities:				
Amount — £m	35	13	12	(2)
Percentage of the present value of scheme liabilities	1.5%	4.3%	4.3%	(11.2%)
Present value of scheme liabilities — £m	(2,375)	(301)	(277)	(23)
Fair value of scheme assets — £m	2,187	196	19	13
Deficit — £m	(188)	(105)	(258)	(10)
2005				
Experience adjustments arising on scheme assets:				
Amount — £m	187	(1)	1	2
Percentage of scheme assets	9.7%	(0.7%)	5.0%	14.7%
Experience gains and losses on scheme liabilities:				
Amount — £m	(192)	(10)	(29)	(1)
Percentage of the present value of scheme liabilities	(8.1%)	(3.2%)	(10.2%)	(3.1%)
Present value of scheme liabilities — £m	(2,381)	(316)	(284)	(23)
Fair value of scheme assets — £m	1,915	170	20	14
Deficit — £m	(466)	(146)	(264)	(9)
2004				
Experience adjustments arising on scheme assets:				
Amount — £m	68	4	(1)	(3)
Percentage of scheme assets	4.0%	3.1%	(7.3%)	(17.6%)
Experience gains and losses on scheme liabilities:				
Amount — £m	(95)	(6)	(13)	1
Percentage of the present value of scheme liabilities	(4.4%)	(2.1%)	(5.0%)	1.2%
Present value of scheme liabilities — £m	(2,152)	(262)	(260)	(41)
Fair value of scheme assets — £m	1,697	128	19	17
Deficit — £m	(455)	(134)	(241)	(24)

(c) Defined contribution schemes

The Group operates a number of defined contribution schemes outside the United Kingdom. The charge to the income statement in the year was £10 million (2006 – £9 million).

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28 Contingent assets and liabilities

The Group is involved in an arbitration with Finmeccanica SpA, the acquirer of the Group's joint venture share in AgustaWestland, over the potential release of the £35 million set aside in escrow as deferred consideration on the disposal. An amount receivable will only be recognised on conclusion of the arbitration.

At 31 December 2007 the Group had contingent liabilities in respect of bank and other guarantees amounting to £7 million (2006 – £5 million). In the case of certain businesses, performance bonds and customer finance obligations have been entered into in the normal course of business.

29 Operating lease commitments

	2007		2006	
	Property £m	Vehicles, plant and equipment £m	Property £m	Vehicles, plant and equipment £m
Minimum lease payments under non-cancellable operating leases				
Within one year	19	11	19	10
Later than one year and less than five years	50	19	47	18
After five years	43	1	41	2
	112	31	107	30

30 Capital expenditure

Contracts placed against capital expenditure sanctioned at 31 December 2007 so far as not provided by subsidiaries amounted to £47 million (2006 – £38 million) and the Group's share not provided by joint ventures amounted to £1 million (2006 – £2 million).

31 Related party transactions

In the ordinary course of business, sales and purchases of goods take place between subsidiaries and joint venture companies priced on an 'arm's length' basis. Sales of product by subsidiaries to joint ventures in 2007 totalled £70 million (2006 – £69 million). The amount due at the year end in respect of such sales was £8 million (2006 – £8 million) (see note 15). Purchases by subsidiaries from joint ventures in 2007 totalled £10 million (2006 – £8 million). The amount due at the year end in respect of such purchases was £2 million (2006 – £2 million) (see note 16).

At 31 December 2007 a Group subsidiary had £nil receivable (2006 – £7 million receivable) by a joint venture in respect of a loan, bearing interest at EURIBOR plus 1% (see note 13). In addition, a Group subsidiary had £2 million receivable (2006 – £nil) from a joint venture in respect of a short term financing facility bearing interest at LIBOR plus 1% (see note 15).