Business Review

This business review (which is incorporated by reference into the Directors' report) has been prepared to provide a fair review of the business of the Company and to describe the principal risks and uncertainties it faces. In doing so, it aims to provide a balanced and comprehensive analysis of the development and performance of the business of the Company during the 2008 financial year and the position of the Company at the end of the 2008 financial year, consistent with the size and complexity of its business. It has been prepared for the whole Group and therefore gives greater emphasis to those matters which are significant to GKN plc and its subsidiaries when viewed as a whole. The business review is addressed to and has been prepared for the members of the Company and it should not be relied upon by any other party or for any other purpose.

Group activities

GKN is a global engineering business serving mainly the automotive, industrial, off-highway and aerospace markets. The bulk of our sales are made to vehicle and aircraft manufacturers as well as, in Aerospace, to other major tier one suppliers. We operate in four different business areas:

Automotive

Automotive activities comprise GKN Driveline and Other Automotive companies which supply driveshafts, geared components, torque management devices, structural and engine components and substrates for catalytic converters, largely to vehicle manufacturers in the global car and light vehicle markets.

Powder Metallurgy

Powder Metallurgy produces powdered metal and sintered components for automotive and other industrial customers.

OffHighway

OffHighway mainly designs and manufactures steel wheels and driveline products for the agricultural, construction and mining, and industrial machinery markets.

Aerospace

Aerospace activities are concentrated on the production of airframe and engine structures, components and assemblies for both military and civil aerospace markets.

The Group has operations in over 30 countries with 36,500 employees in subsidiary companies and a further 3,500 in joint ventures.

Strategy and business objectives

The business review provides information on our performance in 2008, both financially and in terms of progress made against our objective and strategy as set out on the inside front cover of this report. We implement and monitor performance against our strategy through a number of key performance indicators and objectives, both financial and non-financial.

The global recession has interrupted our progress in achieving our goals, particularly against our key financial performance indicators; this is specifically evident in our Automotive and Powder Metallurgy businesses. Solid progress has been made, however, in Aerospace and OffHighway. Divisional information is given in the relevant section of this review.

Throughout the business review we give details of management's response to the deteriorating market conditions and in the section on Financing and Risk we note the additional risks created by the recession and how we are addressing these.

Key performance indicators

The principal key performance indicators and our performance against them in 2008 are shown below for the Group.

In defining financial indicators we use management sales and management trading profit as defined below as this better reflects the underlying performance of the Group and respective divisions.

Financial key performance indicators

1. Growth in Group earnings and dividends per share

We aim to achieve absolute growth in earnings per share each year (as measured on a management basis) and, recognising the nature and cyclicality of our major markets, have a longer term target of achieving average compound annual growth of at least 6%.

Our objective is to increase the dividend progressively in line with the long term trend in earnings, targeting a sustainable earnings to dividend cover ratio of between 2 and 2.5 times.

In 2008 the Group's management earnings per share declined by 11.3p (32%) to 23.8p after a 17% increase in 2007. This decline reflects both reduced profit levels in 2008 and the impact of a 2008 tax credit, the 2007 rate being a 3% charge. Using the cash tax rates (see pages 14 and 15) of 15% in 2008 and 17% in 2007, 2008 earnings per share would be 20.2p reducing the decline over 2007 to 10.2p (34%).

In response to prevailing market conditions the Board has decided not to pay a final dividend leaving the total dividend for the year at 4.5p. This dividend is covered 5.3 times (2007 – 2.6 times) by earnings on a management basis.

Measurement and reporting of performance

In this review, in addition to statutory measures of profit and loss, we have made reference to profits and earnings excluding the impact of:

- strategic restructuring and impairment charges of subsidiaries and joint ventures;
- amortisation of non-operating intangible assets arising on business combinations;
- profits and losses on the sale or closures of businesses;
- change in the value of derivative and other financial instruments; and
- profits and losses, after tax, arising on discontinued operations.

We believe results excluding the above items show more clearly the underlying trend in business performance.

Trading profit is defined as operating profit or loss before any of the above. In 2007 the Group closed its UK cylinder liner business, GKN Sheepbridge Stokes Ltd. 2007 sales include £22 million in respect of this business, whilst its 2007 trading performance, a loss of £7 million, is reported in 'profits and losses on sale or closures of businesses'.

In August 2008, negotiations in respect of the deferred consideration held in escrow on the AgustaWestland joint venture divestment were concluded. As a result the Group received a further £18 million in consideration, the after tax impact of which has been disclosed as a profit on discontinued operations, a treatment consistent with the original divestment.

Where appropriate, reference is also made to results excluding the impact of 2007 acquisitions as well as the impact of currency translation on the results of overseas operations.

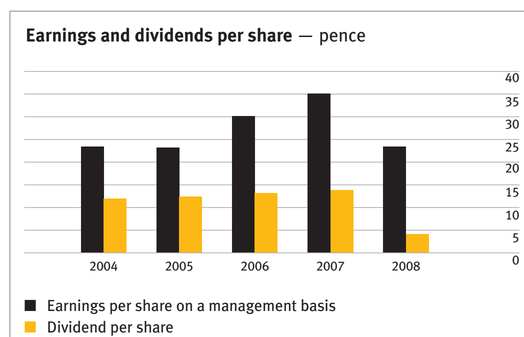
Exchange rates used for currencies most important to the Group's operations are:

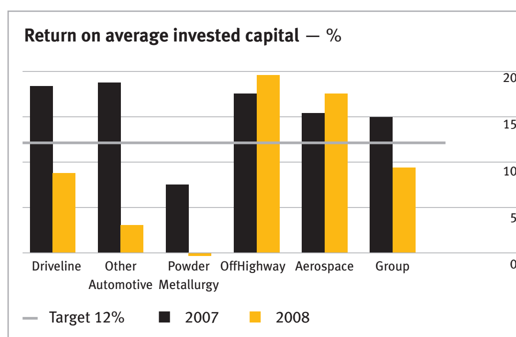
	Average		Year End	
	2008	2007	**2008**	2007
Euro	**1.26**	1.46	**1.03**	1.36
US dollar	**1.85**	2.00	**1.44**	1.99

The approximate impact on 2008 trading profit of subsidiaries and joint ventures of a 1% movement in the average rate would be euro — £1.2 million, US dollar — £0.8 million.

In our internal performance reporting we aggregate our share of sales and trading profits of joint ventures with those of subsidiaries. This is particularly important in assessing sales and profit performance in our Driveline and Other Automotive businesses where significant activity takes place in joint ventures. Reference to these combined figures is made, where appropriate, as 'management sales' and 'management trading profits'.

Business Review continued





2. Growth in sales and trading margins

We aim to achieve growth in sales at both a Group and divisional level in excess of that seen in our major markets both in absolute terms and on a like-for-like basis, i.e. excluding the effects of currency translation, acquisitions or divestments.

In 2008 sales of subsidiaries rose by 13% to £4,376 million. Joint ventures, the sales of which are not consolidated in the financial statements, declined by 5% to £241 million. Our total Group sales on a management basis increased by £495 million to £4,617 million (12%). Overall underlying sales remained flat with growth in both Aerospace and OffHighway, 10% and 17% respectively, being offset by declines in Automotive and Powder Metallurgy.

The Group's medium term trading margin targets are between 8% and 10% for Driveline and Powder Metallurgy, between 6% and 10% for Other Automotive, 7% to 10% in OffHighway and 10% or higher for the Aerospace division, giving an overall Group margin target of between 8% and 10%.

The Group trading margin for 2008 of 4.8% (2007 – 7.5%) was adversely affected by the sharp deterioration in automotive markets in the second half of the year. OffHighway and Aerospace margins were within their target ranges.

3. Return on average invested capital

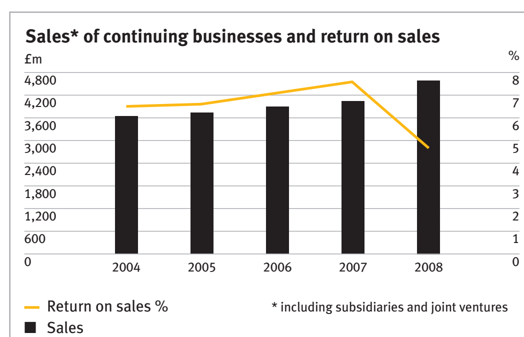
Return on average invested capital (ROIC) is defined as the ratio of management trading profit to average total net assets including the appropriate share of joint ventures and excluding current and deferred tax, cash, borrowings and post-employment obligations. We aim to achieve ROIC, at both a Group and divisional level, above the weighted average cost of capital of the Group.

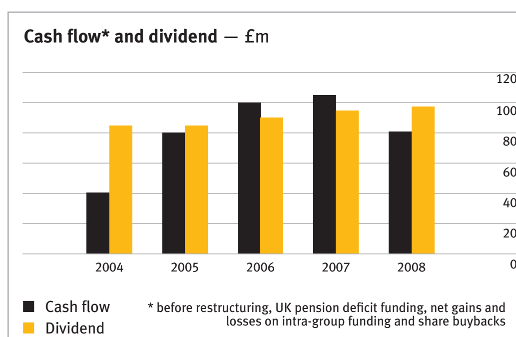
To ensure our goals are clearly understood across the Group, we use 12% as the pre-tax threshold for all our internal ROIC measures and target all divisions to meet or exceed that level. On a post-tax basis we estimate this to be close to the Group's long term weighted average cost of capital of between 8% and 9%.

For the Group as a whole ROIC fell to 9.4% in 2008 (2007 – 15.1%), although OffHighway and Aerospace achieved returns in excess of the threshold.

4. Group cash flow

The Group aims to generate sufficient cash flow each year to cover dividend payments and fund above sector organic growth. For these purposes cash flow is defined as after capital expenditure but before shareholder dividends, acquisitions, special contributions to the UK pension scheme, currency movements in overseas borrowings and the cash cost of strategic restructuring programmes.





Operating cash flow performance of £155 million (2007 – £141 million), including dividends from joint ventures of £24 million (2007 – £13 million), was ahead of the prior year. Group cash flow of £(10) million (2007 – £17 million) was below the Group's target.

Non-financial key performance indicators

The key non-financial indicators that we currently report relate to our health, safety and environmental performance and employee turnover.

1. Health and safety performance

Our goal is zero preventable accidents. We measure our progress against this goal by reference to accident frequency rate (AFR), which is the number of lost time accidents per 1,000 employees, and accident severity rate (ASR), which is the number of days/shifts lost due to accidents and occupational ill health per 1,000 employees.

Both the AFR and ASR demonstrate continuing performance improvement over the last five years with AFR falling from 6.2 in 2004 to 2.5 in 2008 and ASR falling from 176 in 2004 to 75 in 2008 (see charts on page 47). We continue to benchmark our AFR performance externally and against this measure we have again significantly outperformed industry averages in the UK, Germany and the US and our performance compares favourably with that of our peer companies in the UK and the US where comparative data is available.

2. Environmental performance

Our focus remains on the key performance indicators of energy consumption and associated carbon dioxide (CO_2) emissions, waste generation and recycled waste, and water usage. Given the diverse range of business processes across the Group, performance against these indicators is measured on a divisional basis (in the main, relative to production measured in terms of tonnes of product shipped). This also allows the use of an alternative metric for our Aerospace business where the drive towards ever lighter components means that sales, rather than weight of product shipped, is a more appropriate measure of activity. Performance data for CO_2 emissions includes direct emissions from our plants and indirect emissions from power stations that generate the electricity we use.

Overall, as shown in the charts on page 48, most divisions have maintained or improved their performance in 2008 compared with the two prior years.

3. Employees

Employees at the end of 2008 totalled 40,000 compared with 42,100 at the end of 2007, a decrease of 5% primarily reflecting action taken in response to difficult market conditions. Of the total, 36,500 were employed in subsidiaries (a 4.7% decrease compared with 2007) and 3,500 in joint ventures (a 7.9% decrease compared with 2007).

For 2008, employee turnover represented 12.5% of the average number employed during the year. Of this, 5.8% was accounted for by voluntary leavers and 6.7% by company instigated action.

Further information on health and safety, environmental and employee issues is given on pages 40 to 49.

Changes in the composition of the Group

Results for the year contain a full 12 month contribution from the Aerospace acquisition of the Teleflex Aerospace Manufacturing Group, completed on 29 June 2007.

Group performance

Management sales (subsidiaries and joint ventures) £4,617 million (2007 – £4,122 million)

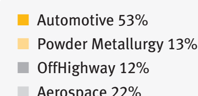
Combined sales of subsidiaries and share of joint ventures totalled £4,617 million compared with £4,122 million in 2007. Excluding the positive impacts of currency translation (£469 million) and of acquisitions (£46 million), there was a net underlying decrease of £20 million, with the benefit from continued strong OffHighway and Aerospace markets offsetting the overall declines experienced in all our businesses operating in automotive markets.

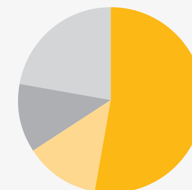
Sales of subsidiaries £4,376 million
(2007 – £3,869 million)

Sales of subsidiaries were £4,376 million compared with £3,869 million in 2007, an increase of £507 million (13%). Excluding the impact of currency translation, acquisitions, and the prior year sales of the UK cylinder liner business, there was an increase of £49 million (1%).

In Automotive businesses, subsidiaries' sales of £2,207 million compared with £2,031 million a year earlier. Currency translation was £263 million favourable and, excluding this and the £22 million negative impact of the UK cylinder liner closure, the underlying decrease was £65 million (3%). On a management basis, including our share of joint ventures and excluding the UK cylinder liner business, sales were £2,444 million (2007 – £2,259 million) and the underlying decline was £112 million (4%). The sales decline was most notable in the final quarter, with underlying sales down 25% on 2007 levels.

Sales
Total £4,617m





including subsidiaries and joint ventures

Powder Metallurgy sales were £618 million compared with £602 million in 2007. Currency translation was £68 million favourable, so that the underlying decrease was £52 million (8%) as the first half impact of weak sales to General Motors and the American Axle strike, and the significant deterioration in volumes in all regions in the final quarter of the year, adversely impacted sales.

In OffHighway, subsidiaries' sales improved to £549 million from £416 million in 2007. The favourable impact of currency translation was £53 million, with underlying sales ahead by £80 million (17%) as good market conditions, in both Europe and North America, for agricultural and heavy construction equipment continued throughout the year.

Aerospace sales increased to £1,002 million from £820 million in 2007. The impact of the 2007 Teleflex acquisition was £46 million and, with currency translation being £50 million favourable, the underlying sales improvement was £86 million (10%), reflecting strong demand in both civil and military markets and volumes on programme wins in recent years.

Management trading profit (subsidiaries and joint ventures) £221 million
(2007 – £309 million)

The aggregated trading profit of subsidiaries and our share of joint ventures was £221 million, a decrease of £88 million (28%). The net positive impact of currency translation and acquisitions was £57 million and, excluding these factors, the underlying decrease was £145 million (40%). Whilst OffHighway and Aerospace both delivered strong profit performances, with underlying increases of 18% and 13% respectively, the Automotive and Powder Metallurgy businesses' full year results reflect the severe operating conditions in the second half.

Overall margins fell to 4.8% (2007 – 7.5%) being adversely affected by the sharp deterioration in automotive markets.

Group	2008 £m	2007 £m
Sales		
Subsidiaries	**4,376**	3,869
Share of joint ventures	**241**	253
Total	**4,617**	4,122
Trading profit		
Subsidiaries	**201**	277
Share of joint ventures	**20**	32
Total	**221**	309
Return on sales	**4.8%**	7.5%

Trading profit of subsidiaries £201 million
(2007 – £277 million)

Group trading profit was £201 million compared with £277 million in 2007, a decrease of £76 million (27%). The currency impact on the translation of overseas profits was £47 million favourable and there was a net benefit of £6 million from 2007 acquisitions. Excluding these factors, the decrease was £129 million (40%).

Automotive subsidiaries' trading profit totalled £69 million compared with £146 million in 2007. There was a favourable currency impact of £29 million after which profits decreased by £106 million (61%).

Second half performance was severely impacted by the rapid fall in global automotive demand, particularly in the final quarter.

For Automotive as a whole, subsidiaries' margin of trading profit to sales was 3.1% (2007 – 7.2%). On a management basis, including our share of joint ventures, trading profit was £90 million (2007 – £178 million) with an underlying decrease of £121 million. Return on sales was 3.7% (2007 – 7.8%).

Powder Metallurgy reported a loss of £2 million in 2008, compared with a £29 million profit in 2007. The underlying reduction was £37 million, largely as a consequence of lower volumes in North America and Europe. Return on sales was (0.3)% (2007 – 4.8%).

OffHighway profit improved to £40 million from £29 million in 2007 with the underlying increase being £6 million. The benefit from higher underlying sales in both the wheels and driveline products businesses was the primary driver of the profit improvement, with increased raw material costs being fully recovered in the year. Margin was 7.3% compared with 7.0% in 2007.

Aerospace profit rose to £106 million from £83 million in 2007. Currency translation was £5 million favourable while there was a £6 million benefit from 2007 acquisitions, leaving an underlying improvement of £12 million (14%). Margin improved from 10.1% in 2007 to 10.6%.

Corporate and unallocated costs of £12 million (2007 – £10 million) represent stewardship, legacy, governance and compliance costs relating to activities undertaken on behalf of the whole Group.

The overall margin of subsidiaries was 4.6% compared with 7.2% in 2007.

Restructuring and impairment costs £153 million
(2007 – £31 million)
Net charges in the year relate to:

- the final charges (£4 million) on the 2004 strategic restructuring programme, as reported at the half year; and
- the initial charges, including impairments, in respect of the Group's current restructuring initiatives to respond to severe volume downturns affecting most of the Group's end markets and businesses.

The net £4 million charge in relation to the 2004 programme was entirely attributable to Driveline, and encompassed reorganisation costs on business transfers (£3 million) and asset write-downs (£1 million).

The restructuring and impairment of subsidiaries charge for the 2008 initiative totalled £149 million and includes impairment charges amounting to £129 million.

The impairment charges include a write-down of Powder Metallurgy's North American fixed assets (£92 million), £15 million for Driveline structural capacity changes and the charges attributable to restructuring actions within Aerospace (£3 million). An £11 million impairment charge was also taken on the UK automotive structural component business assets. Cash based restructuring charges amounted to £20 million in the period and included the cost of short-time working, redundancies and other reorganisation costs.

Amortisation of non-operating intangible assets arising on business combinations £10 million
(2007 – £8 million)
In accordance with IFRS 3, the Group recognises intangible assets arising on business acquisitions. The amortisation of non-operating intangible assets (e.g. customer contracts and relationships, trademarks, non-compete agreements and intellectual property rights) increased during the year as a result of the full year impact of the acquisition of Teleflex in June 2007.

Profits and losses on sale or closures of businesses £nil
(2007 – £7 million charge)
The prior year loss on closure of businesses of £7 million arose at the UK cylinder liner business (Sheepbridge) which ceased trading in September 2007.

Change in the value of derivative and other financial instruments £124 million charge
(2007 – £10 million charge)
The Group enters into foreign exchange contracts to hedge much of its transactional exposure. At 1 January 2008 the net fair value of such instruments was an asset of £18 million and at the end of 2008 the figure was a liability of £166 million.

Transactional hedge accounting has been applied to a small proportion of these transactions. Where transactional hedging has not been applied, the difference of £175 million has been charged (2007 – £9 million charged) separately as a component of operating profit. In addition, there was a £1 million charge in respect of commodity hedges in Powder Metallurgy (2007 – £1 million charge), a credit of £43 million arising on the change in the value of embedded derivatives (2007 – no charge), and a credit attributable to the translational currency impact on Group funding balances, leaving a net charge of £124 million (2007 – £10 million charge).

Operating loss £86 million
(2007 – profit £221 million)
The operating loss of £86 million compared with a profit of £221 million in 2007, reflecting the movements discussed above.

Post-tax earnings of joint ventures £6 million
(2007 – £24 million)
There was a decrease of £18 million in the Group's share of post-tax earnings of joint ventures. Within this figure, trading profit fell to £20 million from £32 million in 2007, a decline of 38%. The impact of currency was favourable at £4 million, leaving underlying trading profit adverse by £16 million (44%), this being attributable to falling volumes in all businesses, curtailment of diesel particulate retrofit demand in Emitec and a one-time commercial settlement in AutoStructures in 2007.

The post-tax earnings in 2008 include impairment charges of £10 million in respect of the planned winding up of two joint ventures as part of the Group's recently announced restructuring activities.

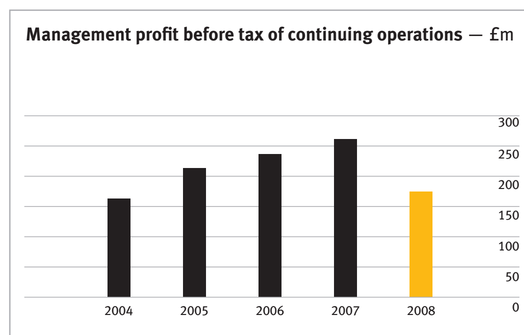
Net financing costs £50 million
(2007 – £46 million)

Interest payable totalled £66 million (2007 – £62 million) and arose mainly on the £675 million of bonds, £30 million debenture in issue and bank borrowings. This was partially offset by interest receivable of £19 million (2007 – £19 million) which arose on short term deposits, together with the benefits of lower borrowing costs on foreign currency synthetic debt instruments used to hedge the Group's overseas investments and £3 million interest received on the AgustaWestland deferred consideration released from escrow. The year on year movement also reflects the full year effect of acquisitions made in 2007.

Other net financing costs were £3 million (2007 – £3 million) and related to post-employment obligations. This charge has remained level with 2007 as adverse currency of £2 million offset a net underlying credit. The overall charge arises as the expected return on scheme assets of £163 million (2007 – £146 million) was more than offset by interest on post-employment obligations of £166 million (2007 – £149 million). Details of the assumptions used in calculating post-employment costs and income are provided in note 26 to the financial statements.

Profit/loss before tax

On a management basis Group profit before tax was £167 million, £88 million lower than 2007. The post-tax share of joint ventures contributed £16 million (2007 – £24 million) and subsidiaries £151 million (2007 – £231 million). On a statutory basis, including restructuring and impairment charges, amortisation of non-operating intangible assets arising on business combinations, profits and losses on the sale or closures of businesses and changes in the value of derivative and other financial instruments, a loss of £130 million was recorded (2007 – profit of £199 million).



Taxation

The tax credit on management profits of subsidiaries of £151 million (2007 – £231 million) was £3 million (2007 – £6 million charge), representing a negative 2.0% tax rate (2007 – 2.6% positive).

This £3 million tax credit arises due to the recognition of a tax credit relating to the use of previously unrecognised tax losses against certain taxable foreign exchange gains. There is a tax charge in relation to these gains shown in equity.

Adjusting for the above item, there is an increase in the effective rate from 2.6% in 2007 to 17.2%. This is predominantly attributable to the use of previously recognised deferred tax assets (tax losses and other temporary differences) against taxable profits in 2008. The charge arising from the use of these assets has been partially offset by tax credits in relation to the recognition of previously unrecognised deferred tax assets (principally in the UK) and the utilisation of other previously unrecognised deferred tax assets (principally in the UK and Germany). The recognition of previously unrecognised deferred tax assets has been based upon management projections of future taxable profits in the relevant territories.

GKN's tax strategy is aimed at creating a sustainable 'cash tax' charge (which excludes deferred taxes, movements in provisions for uncertain tax positions and tax relating to those non-trading elements of operating profit identified separately in the income statement) that balances the shareholders' interest of minimising tax payments with the need to comply with the tax laws of each country in which we operate. In 2008 the cash tax charge was 15% (2007 – 17%) and we expect cash tax to average 20% or less for the near term as we continue to make use of prior years' tax losses, incentives and deductions in the various countries in which we operate.

For 2009 and beyond, the overall reported tax rate is likely to continue to be volatile, being influenced by the possible further recognition of currently unrecognised deferred tax assets and the settlement of prior year tax disputes. These unrecognised, potential deferred tax assets principally relate to brought forward tax losses in the UK and US which, due to the structure of the Group and the geographic mix of profitability, have so far not been seen as realisable for tax purposes.

The total effective tax rate of subsidiaries was 7.4% (2007 – 0.6%) arising as a £10 million tax credit on losses of £136 million.

Tax charge analysis	2008 %	2007 %
Weighted average tax rates of major countries in which GKN operates	**30**	33
Benefits of GKN tax profile (tax losses and other factors)	**(15)**	(16)
2008 'cash tax' rate	**15**	17
Tax credit on foreign exchange gains in equity	**(20)**	—
Movement in provisions (2008 and prior years — net)	**—**	2
Deferred tax credit (net)	**3**	(16)
Tax charge as % of subsidiaries' underlying profit before tax	**(2)**	3

Computation of 'cash tax' rate	2008 £m	2007 £m
Current tax — total	**(10)**	36
Remove:		
net movement for provisions for uncertain tax provisions	**—**	(4)
Add back:		
tax credit on foreign exchange gains in equity	**29**	—
current tax on restructuring and impairment charges	**3**	7
'Cash tax' charge	**22**	39
Profit before taxation of subsidiaries (management basis)	**151**	231
'Cash tax' rate	**15%**	17%

Discontinued operations

As previously noted, negotiations over the AgustaWestland deferred consideration held in escrow were finalised in August 2008, resulting in a net of tax profit of £13 million. There were no discontinued operations in the prior period.

Minority interests

The share of profit relating to minority interests was £2 million (2007 – £2 million).

Earnings per share

Earnings per share were (17.3)p (2007 – 27.9p). Before restructuring and impairment charges, amortisation of non-operating intangible assets arising on business combinations, profits and losses on the sale or closures of businesses, changes in the value of derivative and other financial instruments and discontinued operations, the figure was 23.8p (2007 – 35.1p), a decrease of 32%.

Cash flow

Operating cash flow, which is defined as cash generated from operations (£328 million; 2007 – £299 million) adjusted for capital expenditure (£205 million; 2007 – £192 million), proceeds from the disposal of fixed assets (£7 million; 2007 – £21 million), proceeds from capital grants (£1 million; 2007 – £nil) and joint venture dividends (£24 million; 2007 – £13 million), was an inflow of £155 million compared with a £141 million inflow in 2007.

The outflow on working capital and provisions totalled £4 million (2007 – £49 million) largely reflecting favourable working capital movements. The figure also included a £3 million outflow in respect of legacy environmental obligations (2007 – £9 million) where a further £7 million is expected to be spent in 2009.

Capital expenditure (on tangible and intangible assets) totalled £204 million (2007 – £192 million). Of this, £192 million (2007 – £172 million) was on tangible assets representing property, plant and equipment and was 1.2 times (2007 – 1.2 times) the charge for depreciation. The ratio of capital expenditure to depreciation is expected to reduce significantly in 2009, recognising the level of prior years' investments and the need to fund the current restructuring programme.

Expenditure on intangible assets totalled £13 million (2007 – £20 million) and mainly reflected initial non-recurring costs on Aerospace programmes.

Net interest paid totalled £47 million compared with £44 million in 2007. The increase was largely due to higher net UK borrowings during the year, with the impact of prior year acquisitions being offset by the interest on the AgustaWestland deferred consideration released from escrow.

Tax paid in the year was £45 million (2007 – £28 million), the most significant increase being in respect of German taxes as cumulative prior year liabilities were settled.

Dividends received from joint ventures totalled £24 million (2007 – £13 million) including the Group's first dividend of £5 million from its UK Chassis Systems joint venture.

Business Review continued

Free cash flow

Free cash flow, which is cash flow excluding acquisitions and currency translation but including capital expenditure and dividends paid, is a key performance indicator of the Group. Free cash flow for the year was an outflow of £38 million (2007 – £23 million) after £28 million (2007 – £40 million) of expenditure on the Group's restructuring programmes. The year on year increase reflects investment in tangible fixed assets, net of property proceeds.

Acquisitions and divestments

The net expenditure on acquisitions and divestments in the year was £1 million (2007 – £71 million) being the final payments in respect of prior year acquisitions.

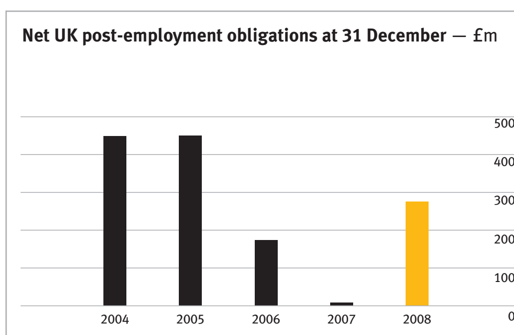
Net borrowings

At the end of the year the Group had net debt of £708 million (2007 – £506 million). This includes the negative impact of closing out Group balance sheet hedges in the final quarter (net cost £221 million) and the benefit of £79 million (2007 – £42 million) from customer advances in the Aerospace businesses which are shown in creditors in the balance sheet. The Group's share of net borrowings in joint ventures was £1 million (2007 – net funds £14 million).

Pensions and post-employment obligations

GKN operates a number of defined benefit and defined contribution pension schemes together with retiree medical arrangements across the Group. The total charge to trading profit in respect of current and past service costs, together with curtailments of defined benefit schemes and retiree medical arrangements was £25 million (2007 – £19 million), whilst other net financing charges included in net financing costs were £3 million (2007 – £3 million).

The increase in the charge to trading profit mainly reflects an increased UK current service cost, £4 million higher than in 2007. Changes to US pension benefit arrangements in Driveline, Sinter Metals and Hoeganaes in 2008, have resulted in a £12 million curtailment credit, broadly equivalent to the US past service credit recognised in 2007 on retiree medical changes. The ongoing annual benefit of the 2008 changes is £2 million to trading profit. Further information including asset, liability and mortality assumptions used is provided in note 26 to the financial statements.



UK pensions

The UK defined benefit scheme is considered to be relatively mature with just over 4,000 of its 52,000 members currently in service. As a UK defined benefit scheme, it is run on a funded basis with funds set aside in trust to cover future liabilities to members. The scheme specific funding valuation and schedule of contributions as at April 2007 remains in force. The current schedule of contributions does not require any deficit funding during 2009.

With the acquisition of the Airbus wing component and sub-assembly business at Filton in January 2009, the UK scheme membership increased by 1,200. These members joined the GKN pension scheme for future service benefits. There is a relatively small increase in past service liabilities of £22 million which was recognised in the purchase amount paid to Airbus, and which will be paid as a further contribution into the scheme.

The charge relating to the UK defined benefit scheme reflected in trading profit in respect of current and past service costs/curtailments was £21 million (2007 – £17 million), whilst other net financing credits included in net financing costs were £14 million (2007 – £13 million). Restructuring activities in the UK in the final quarter of the year attracted a past service charge of £1 million.

The accounting deficit at 31 December 2008 of £272 million (2007 – £3 million) was significantly higher than that at the end of 2007. This was as a result of the adverse impact of the actual asset returns compared with expected return more than offsetting both the benefit of the change in yields on long dated corporate bonds used to determine future liability values and the impact from a lower inflation assumption.

The next scheduled actuarial funding review of the scheme is due in 2010.

Overseas pensions
The principal countries involved in overseas pensions are the US, Germany and Japan.

The net charge to trading profit in respect of current and past service costs/curtailments was £4 million (2007 – £13 million), whilst other net financing charges included in net financing costs were £14 million (2007 – £12 million). The trading profit charge benefited from the one-time US curtailments of £12 million.

The increase in the deficit of £213 million to £494 million (2007 – £281 million) was largely a result of currency movements which increased this deficit by £125 million, and the net impact of actual asset returns experienced and discount rate changes which increased the deficit by a further £79 million.

Retiree medical
GKN operates retiree medical arrangements in the Americas and has a scheme, closed to new members, in the UK.

The charge to trading profit in 2008 was £nil (2007 – £11 million credit). The 2007 credit arose from changes in retiree medical arrangements in the US. Other net financing charges included in net financing costs were £3 million (2007 – £4 million).

As a result of these changes, the impact of currency translation and changes in the discount rates used to value the liabilities, the obligation in respect of all schemes at the end of the year was £68 million compared with £47 million at the end of 2007.

Summary
At 31 December 2008 the post-employment obligations of the Group totalled £834 million (2007 – £331 million), details of which can be found in note 26 to the financial statements.

Shareholders' equity
Shareholders' equity at the end of 2008 was £905 million compared with £1,177 million at the end of 2007.

Dividend
The Board has reviewed the full year dividend and has decided not to pay a final dividend for 2008. This decision was made due to the severe operating environment for GKN's businesses and the consequent need to adopt a more prudent liquidity policy for the Group. The Board's commitment to a progressive long term dividend policy continues.

The total dividend for the year is, therefore, the interim dividend of 4.5p. The dividend is covered 5.3 times (2007 – 2.6 times) by management earnings (i.e. before the impact of restructuring and impairment charges, amortisation of non-operating intangible assets arising on business combinations, profits and losses on the sale or closures of businesses, changes in the value of derivative and other financial instruments and discontinued operations). Using the cash tax rate for the year of 15%, the dividend was covered 4.6 times by earnings (2007 on the same basis – 2.3 times).

The Board's decision not to pay a final dividend was made due to the severe operating environment and the consequent need to adopt a more prudent liquidity policy for the Group. The Board's commitment to a progressive long term dividend policy continues.