



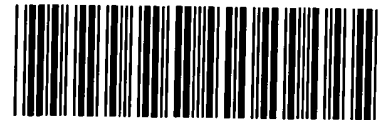
Buy  
Improve  
Sell

# Annual Report 2018

Melrose Industries PLC



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## Melrose Industries PLC

Acquiring good quality manufacturing businesses, making operational improvements, realising shareholder value at the appropriate time and then returning this value to shareholders, continue to be the fundamentals of the “Buy, Improve, Sell” business strategy that Melrose has followed since it was founded in 2003.

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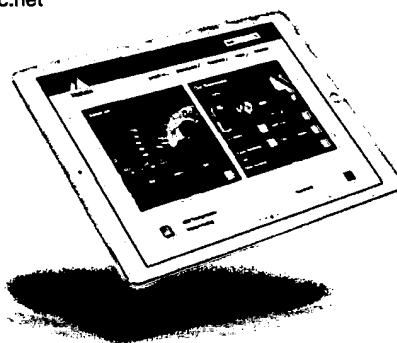
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For more information visit  
[melroseplc.net](http://melroseplc.net)



#### Cautionary statement

The Strategic Report and certain other sections of this Annual Report and financial statements contain forward-looking statements. These statements are made by the Directors in good faith based on the information available to them up to the time of their approval of this Annual Report and financial statements and such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information. Accordingly, readers are cautioned not to place undue reliance on any such forward-looking statements. Subject to compliance with applicable laws and regulations, Melrose does not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Annual Report and financial statements.

The Strategic Report has been prepared solely to provide additional information to shareholders to assess the Company’s strategies and the potential for those strategies to succeed. Some financial and other numerical data in this Annual Report and financial statements have been rounded and, as a result, the numerical figures shown as totals may vary slightly from the exact arithmetic aggregation of the figures that precede them.

# A transformational year for Melrose

“This has been a transformational year for Melrose and we are delighted to announce, on an annualised adjusted basis, an operating profit of over one billion pounds. The former GKN businesses are proving their potential to offer the outstanding opportunities we expected and much has already been achieved in the short period of ownership. Despite the current economically uncertain environment, we have every confidence that we will be able to continue to unlock the substantial shareholder value from the former GKN businesses and further improve Nortek.”

Justin Dowley, Non-executive Chairman

[For more information about our successful history of shareholder value creation](#)

[See pages 10 to 11](#)

Our strategy

# Our strategy and business model: "Buy, Improve, Sell"

## Our aim

Melrose aims to acquire high-quality manufacturing businesses with strong fundamentals and the potential for significant development and improvement under Melrose management.

## Our objective

Through investing in businesses, changing management focus and operational improvements, Melrose seeks to increase and realise the value in such businesses at the appropriate time and to return the proceeds to shareholders.

## Our strategy

### Buy

- Good manufacturing businesses whose performance can be improved.
- Use low (public market) leverage.
- Melrose management are substantial equity investors.

### Improve

- Free management from bureaucratic central structures.
- Change management focus, incentivise well.
- Set strategy and targets and sign off investments.
- Drive operational improvements.
- Invest in the business.
- Focus on profitability and operating cash generation – not growth for the sake of growth.

## Our business model

### Inputs

#### Industry expertise

Core management group has operated in the UK and the international manufacturing arena for over two decades.

#### Highly experienced management team

The current team founded Melrose in 2003 with a view to buying and improving underperforming businesses. Since then it has overseen transactions with a total market value of over £10 billion.

#### Strong track record

Melrose has generated significant financial returns for its shareholders, achieving an average return on equity of 2.6x across the businesses sold to date and returned over £4.5 billion of cash to shareholders.

#### Operational efficiency

Our businesses benefit from substantial investment and changed management focus in order to drive growth. Melrose increased the operating margins of businesses sold by between four and nine percentage points.

#### Effective governance

The Board maintains high standards of corporate governance to ensure Melrose achieves success for the benefit of the businesses we manage and our shareholders over the long term.

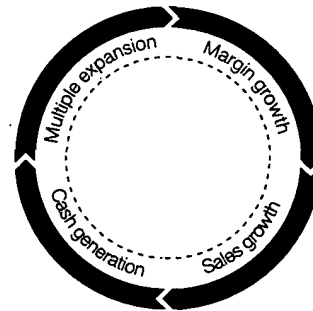
### Follow-on investment during Melrose ownership for businesses sold

+39% Further investment in the businesses to improve operations<sup>(1)</sup>

100% Equity raised to acquire businesses

Reinvestment

### Value creation model



#### Margin growth

Good manufacturing businesses whose previous potential was constrained by leverage.

#### Sales growth

Good demand drivers potentially suggest more than average top-line growth.

#### Cash generation

A key focus is to make significant improvement to cashflows in the businesses we acquire.

#### Multiple expansion

Multiple expansion is never assumed, but has been achieved on all previous deals (on average +30%) as the businesses have been improved.

<sup>(1)</sup> In respect of the McKechnie, Dynacast, FKI and Elster acquisitions.

### The Melrose philosophy

The improvements made by Melrose vary depending on the needs of the business but the common theme for all businesses is the implementation of the Melrose philosophy.

- 1** Giving ownership to the businesses.
- 2** Appropriately incentivising the management teams.
- 3** Freeing businesses from central bureaucracy.
- 4** Quick decision making.
- 5** Ready access to funds for capital expenditure, R&D and expansion projects.

## Sell

- Commercially choose the right time to sell, often between three to five years but flexible.
- Return value to shareholders from significant disposals.

### Value creation

#### Businesses under improvement



**Aerospace** See page 20



**Automotive** See page 24



**Powder Metallurgy** See page 28

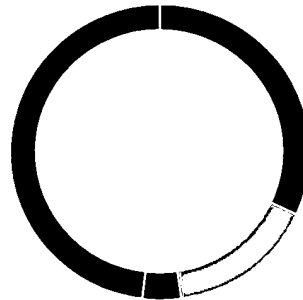


**Nortek Air & Security** See page 32



**Other Industrial** See page 36

#### How has Melrose created value?<sup>(1)</sup>



- Selling for a higher multiple than paid 32%
- Cash generation 16%
- Sales growth 4%
- Margin growth 48%

(1) In respect of the McKechnie, Dynacast, FKI and Elster acquisitions.

### Outputs

#### Shareholder investment and gain

(figures up to 31 December 2018):

Average return on equity across all businesses sold

**2.6x**

Cash return to shareholders since establishment

**£4.5bn**

#### Reinvestment

**£436m**

Spent on research and development for Nortek, Elster and GKN acquisitions being

**3%**

of revenue for the equivalent period.

Capital expenditure in 2018

**£422m**

## Strategy in action

Buy



Metrose underwent a transformation last year as part of its successful acquisition of GKN plc, following a high-profile takeover bid. This has resulted in GKN assets representing approximately 85% of Metrose's group sales.

Metrose had followed GKN plc for a number of years, noting that while it had quality businesses, its performance had diminished in recent times. Metrose was confident that, given the opportunity, it could improve performance for all stakeholders by applying its 'Buy, Improve, Sell' model. Metrose's acquisition strategy centres on pursuing fundamentally good but undermanaged manufacturing targets and investing heavily to achieve margin improvements, simplifying corporate structures and streamlining approval processes, rather than a simple sales or cycle opportunity, whilst enforcing discipline and financial controls.

GKN fitted the Metrose model for a number of reasons namely its businesses were typically either world number one or two in their

Share equity issued in relation to acquisition

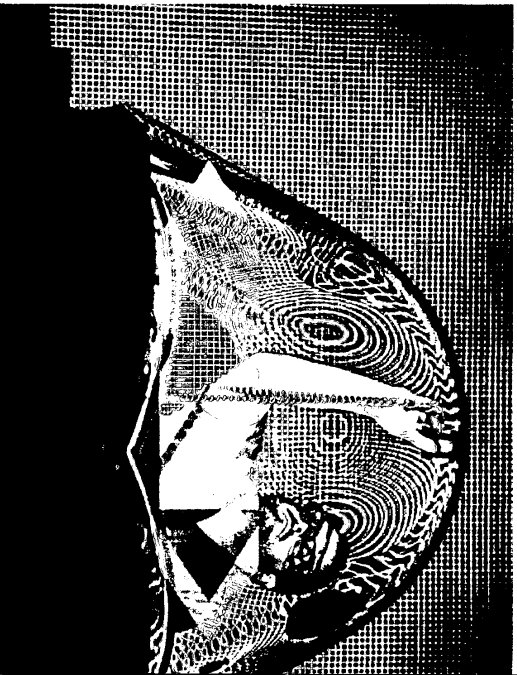
**£6.84bn**

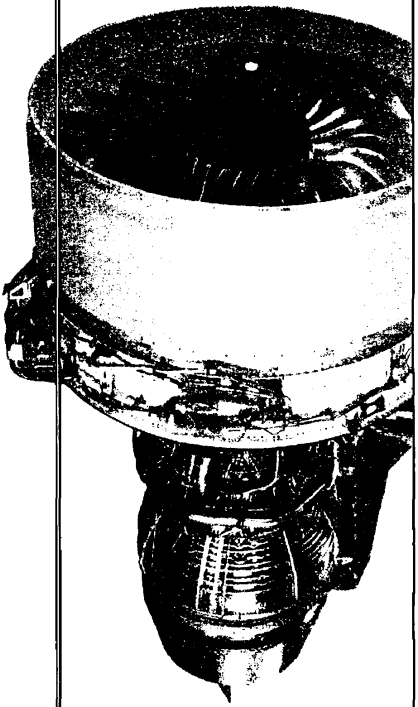
**100%**

Ownership assumed within 6 months of takeover

Improved funding commitment agreed with pensions trustees up to

**£1bn**





Buy

chosen sectors. However, its performance had consistently failed to fulfil its potential under previous GKN management. Further, the well-documented issues in North America presented the opportunity to approach GKN with an alternative solution under Malrose control.

Although the GKN board were not receptive to our approach, they nonetheless announced a similar strategy shortly after our offer was made. We were able to offer GKN shareholders the opportunity to take a majority share in the newly created industrial powerhouses and participate in the future improvement in performance. After pulling our proposed shareholders, we were pleased to be given the opportunity to unlock the value in the GKN business. We took control and secured 100% ownership on an accelerated timetable implementing the same methods applied with success to previously acquired companies. This included decentralisation, streamlining duplicate functions, securing operational management changes and an immediate focus on profit and cash rather than sales. We implemented appropriate incentives to drive positive change and effective financial and operational controls, improved investment in assets over the long term, made efficiency enhancements, corporate restructuring assessments and rigorous analysis of product profitability. Malrose was also focused on delivering for GKN's wider stakeholder community. Having agreed contributions and appointed GKN's first independent Chairman of Investors, Malrose commenced improving the inherited GKN UK pension schemes by setting an improved funding target of £1b +75bps for the GKN 2012 Pension Scheme, and £1b +25bps for the GKN 2016 Pension Scheme, the Company committed

to make an initial voluntary contribution to the two pension schemes totaling £50 million within the first 12 months, doubled annual payments to £60 million and promised to pay between 5% and 10% of net proceeds of any Malrose divestment of £20 million on the sale of GKN Powder Metallurgy (or as long as the schemes remain in deficit. This is consistent with our aim of ensuring that all UK defined benefit schemes end up stronger under Malrose ownership than when they join the Group, with many of them becoming fully funded during Malrose ownership.

GKN's primary business divisions, the Automotive division has the opportunity to attract further engineering talent and an more disciplined approach to sales growth and procurement. Such changes are already being addressed by the appointment of a new CEO and senior team, along with a new cost structure and increased investment in the business's R&D footprint. The Aerospace divisions receiving targeted investments to improve its performance, particularly in North America, as well as focus on research and development through the establishment of the Global Technology Centre in Filton, UK. Although GKN Powder Metallurgy was placed under strategic review, investment has continued to drive improved performance.

Other than the merits of ownership, Malrose has already demonstrated its ability to achieve a number of noticeable improvements in management, operational performance, financial stability and shareholder dividends. These improvements have set a solid foundation for optimising profit growth and will drive enhanced operational performance that the Malrose management team believe's achievable at GKN.



Strategy in action

Improve

# Nortek

**Melrose's focus since its inception has always been to generate superior returns for our shareholders through the acquisition of high-quality but underperforming manufacturing businesses, investing heavily to improve their operational performance before selling them at the appropriate time to a buyer who is looking to guide them through the next stage of their development.**

In August 2016, we acquired Nortek, a global, diversified group that manufactures innovative air management, security, home automation and productivity solutions. Nortek was a US publicly-listed company, which we acquired for £2.2 billion, including £1.6 billion in equity raised from our supportive shareholder base. Our acquisition of Nortek in 2016 came at a time when the businesses were struggling from underinvestment, a loss in focus, and lacking in coherent business strategies. We had identified strong brands and products within each of the Nortek businesses, but also fragmented operations and underperforming management, and we saw opportunities for significant improvement and for maximising the value inherent in these businesses.

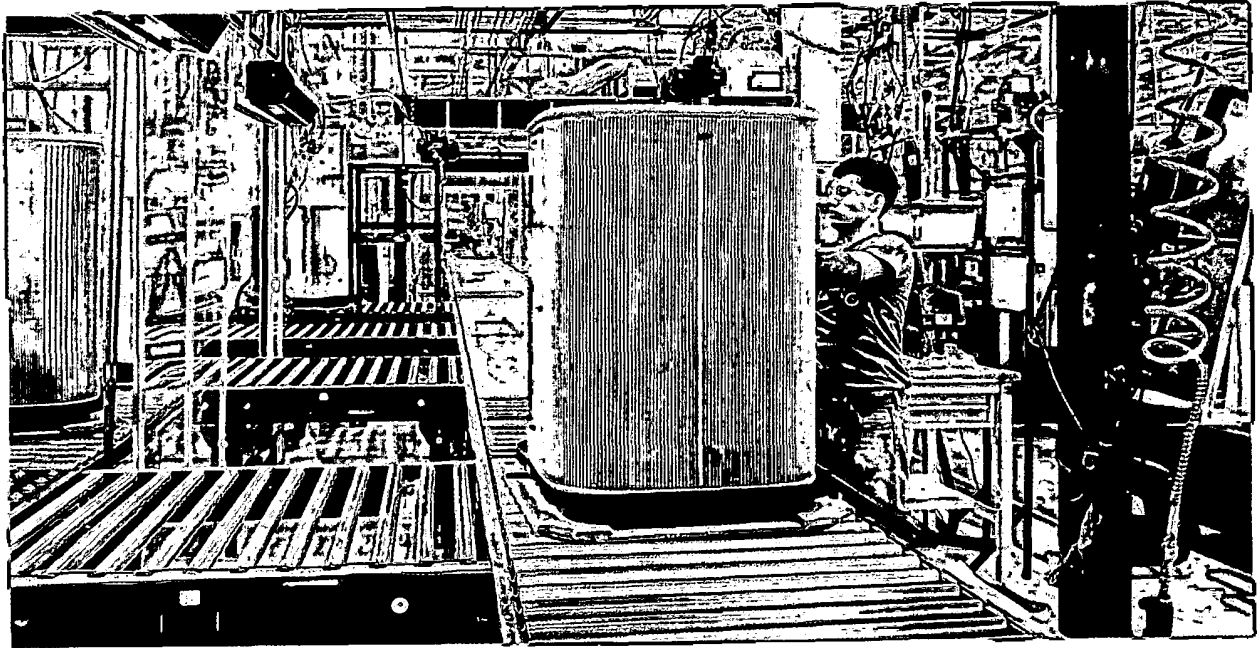
The businesses acquired with Nortek in 2016 now largely make up our Nortek Air & Security division, comprising the Global Heating, Ventilation & Air Conditioning business ("HVAC"), the Air Quality & Home Solutions business ("AQH") and the Security & Smart Technology business ("SST"), together with Ergotron, now in our Other Industrial division.

Each of the Nortek businesses have undergone a significant transformation, delivering a record performance in our first full year of ownership in 2017, on which we have continued to build. We have significantly reduced leverage from approximately US\$1.4 billion and over 5x EBITDA to the more prudent 2.3x levels of today. Freed from the restrictions of the formerly centralised group structure, including the closure

of the central headquarters and removal of duplicate group functions, operational improvements have significantly improved Nortek's adjusted operating profit, which has increased by 48%, and its operating margins, which have increased by 6ppts. These improvements have been funded by Melrose investments equal to approximately 1.6x depreciation. The businesses have also been extremely successful in converting this strong performance into cash, with a cash conversion rate under Melrose ownership of 100%.

As responsible stewards of our businesses, a fundamental part of our "Improve" strategy is to implement initiatives throughout the business in order to increase profitability, invest for its future and improve culture.

We have made significant financial investments into each of the businesses – during our ownership to date, Melrose has invested approximately £144 million in research and development, representing approximately 3.4% of revenue generated by Nortek during this period. Most materially, we have invested in developing product platforms and breakthrough technologies, such as the patented innovation of StatePoint®, an industry leader in data centre cooling that is being deployed across the globe in partnership with Facebook, as well as the integrated CLEANSUITE® product family. We have also focused on improving productivity across the businesses. In HVAC, a targeted £21 million capital investment into production facilities, warehousing systems and quality management



Improve

processes has reinforced a fundamental culture change throughout the business. This investment has included an increase in the capacity of HVAC's clean room, premium air handler and healthcare operating room, as well as upgrades to its next generation plant and equipment and the expansion of its two Canadian plants. We have also invested £9 million in new machinery and updated technologies at the Residential and Light Commercial facilities.

Excess manufacturing capacity in AQH has been eliminated through a £6 million site consolidation in Canada and a consolidation of US warehousing and distribution into the Hartford, Wisconsin site, which has also addressed the issue of inconsistent customer service and delivered significant improvements to AQH's 'On Time and Complete' delivery rates.

As well as the £16 million upgrade to its production facility in Hartford, Wisconsin, AQH has refocused on reversing a slow decline in its market share through investment in developing a robust product development pipeline, including the Alliance range hood platform. The sale of the loss-making European business Best S.p.A. also enabled the business to refocus on its core North America markets.

In SST, we have continued to focus efforts in consolidating supply chain management and distribution services through its facility in Carlsbad, California and a logistics partnership with a globally recognised provider to service the US west coast, and in improving the product mix to take advantage of customer changes in the market.

As well as consolidating into new headquarters and upgrading SST's R&D capabilities to support its leading

Elan platform development, we also funded the acquisition of IntelliVision Technologies Corp., a market leader in Artificial Intelligence and deep learning-based video analytics software for smart cameras, that is being introduced across its product portfolio to transformatory effect.

While we look to work with incumbent operational management teams, who often shine once freed from the distraction of a head office, we are focused on changing the culture of the businesses we buy and do not hesitate to introduce fresh leadership where required. Nortek is an example of this, with each of AQH and Ergotron having refreshed management teams hired by newly appointed CEOs, while HVAC and SST retain the CEOs we inherited with much of their legacy teams intact. All management teams are incentivised to align themselves to us and to our shareholders in increasing the value of their businesses.

The scale and rate of success achieved by Nortek demonstrates the continuing effectiveness of the Melrose model, which simplifies corporate structures and injects pace and accountability into businesses, while investing in their long-term success. Nortek has continued to invest in people, assets, technology and new products to ensure that the businesses are prepared to successfully execute the leverage and innovation/growth parts of their strategies, as reflected in the Nortek Group's increased adjusted<sup>(1)</sup> operating margins from 9% at acquisition to 15% in 2018 with the potential for further improvement. As detailed elsewhere in this Report, the businesses will seek to capitalise on their strong brands and distinctive capabilities to continue to grow and improve.

R&D investment

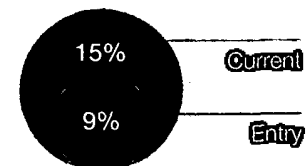
£144m

3.4%

of revenue

Adjusted operating margin improvement<sup>(1)</sup>

>60%



How Nortek's operating margin has improved

+6ppts

+4ppts

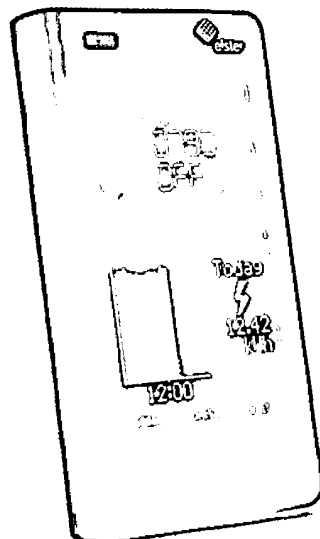
+1ppt

+1ppt

- Returns on capex and restructuring and other commercial actions
- Central cost savings
- Exit of low margin sales channels

<sup>(1)</sup> Described in the glossary to the financial statements on pages 193 to 196.

## Strategy in action



Sell

# Elster

Elster is the most recent Melrose acquisition to have completed its improvement cycle.

Equity rate of return

**33%**

Shareholder return on original equity

**2.3x**

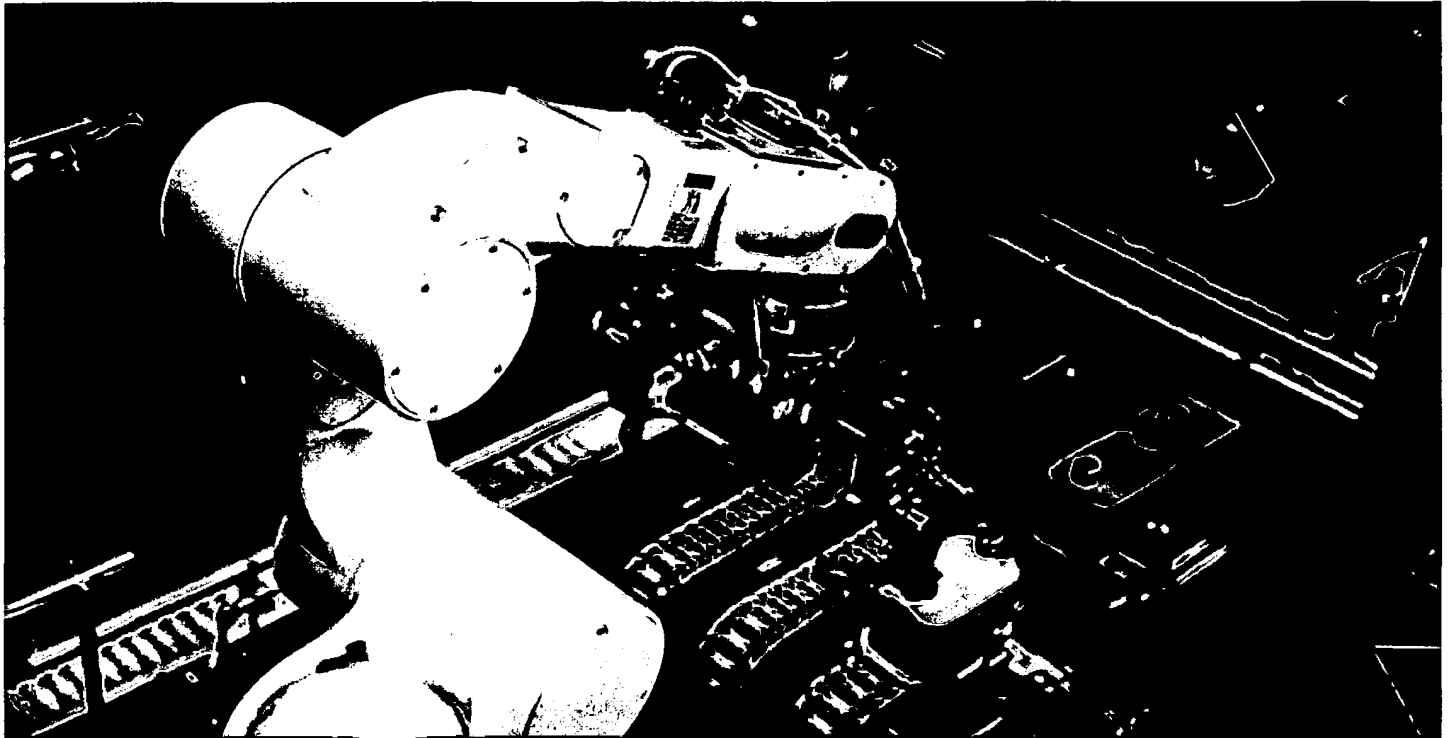
Sold within

**3 years**

of acquisition

Elster was a US publicly-listed, German-based manufacturer of meters operating through three separate divisions with different markets and drivers (gas, electricity and water). Elster had a global presence in 135 countries, large contracts, long-standing customers and was on the cusp of a technology revolution with smart metering.

However, the business had lost its focus and identity, with a centralised head office causing inefficiencies and issues for the businesses. Melrose acquired Elster in 2012 for £1.8 billion, including £1.2 billion of equity following a fully underwritten rights issue (which was one of the largest equity raises in the UK market at the time), and modest levels of leverage. Having decentralised its structure, the three distinct water, gas and electricity metering businesses were empowered to run autonomously in accordance with their own strategy.



Under Melrose ownership, operating profit margins increased from 13% to 22%, representing a 70% improvement in just three years. This was achieved by focusing each business on performance, end markets, customers and operations. Melrose significantly expanded on a footprint optimisation programme announced by Elster before the acquisition and significantly exceeded expectations. A complementary bolt-on acquisition was made for the Gas division, building out its product portfolio and geographic reach.

Melrose also focused on driving operational efficiencies and exiting loss-making sales, followed by production optimisation and a focused investment programme equal to a quarter of the initial equity price. In particular, Melrose focused on investing in research and development in order to strengthen and grow Elster's "smart" capabilities. Throughout the course of ownership, Melrose invested over £149 million in research and development, representing approximately 4.6% of revenue generated by Elster during this period.

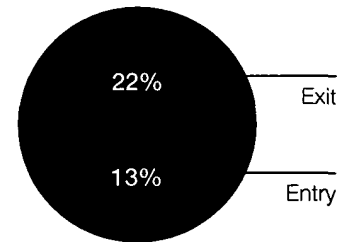
Three years after making the acquisition, Melrose sold all three businesses together to Honeywell International Inc. for £3.3 billion, representing approximately 14x 2014 headline EBITDA, and in February 2016 Melrose returned £2.4 billion in cash to shareholders.

Overall, Melrose generated over £2.5 billion in cash from Elster versus an equity investment of approximately £1.2 billion, resulting in a return of 2.3x on shareholders' investment.

In addition, Melrose transferred approximately £900 million in residual pension fund liabilities from prior businesses as part of the sale, ensuring the relevant members enjoyed the protection of a guarantee from Honeywell's US-listed parent, with a market capitalisation of over US\$100 billion. These schemes had entered Melrose stewardship chronically underfunded, but a series of significant contributions had overcome this so that they were transferred fully funded.

Adjusted operating margin improvement <sup>(1)</sup>

>70%



How Elster's operating margin improved

+9pppts

+6pppts +2pppts +1ppt

- Returns on capex and restructuring and other commercial actions
- Central cost savings
- Exit of low margin sales channels

(1) Described in the glossary to the financial statements on pages 193 to 196.

## Our track record

# Shareholder Value creation

Shareholder investment and gain  
(figures up to 61 December 2018)

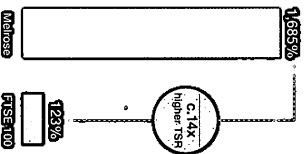
**£4.5bn**

Cash return to shareholders since establishment

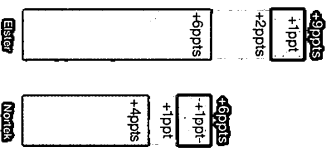
**2.6x**

Average annual return for a shareholder since the first acquisition

Total shareholder return (TSR)<sup>(1)</sup>



How Elster and Nortek operating margins improved<sup>(2)</sup>



- <sup>(1)</sup> Source: FTSE Russell, based on acquisition (7/2015)
- <sup>(2)</sup> Return on capital employed (ROCE) and operating margin
- <sup>(3)</sup> Source: Company Reports, based on the Standard & Poor's Industry Index
- <sup>(4)</sup> Return on capital employed (ROCE) and operating margin
- <sup>(5)</sup> Return on capital employed (ROCE) and operating margin

## Value creation on previous deals

McKechnie/Dynacast	Value
Equity based on acquisition	£0.4bn
Equity based on acquisition	£2.6bn
Post-acquisition investment	£1.24bn
Sold to	£0.8bn
Investment in business	£1.1%
Employed at return	30%
Shareholder return on original equity	<b>310x</b>

EKI	Value
Equity based on acquisition	£1.1bn
Equity based on acquisition	£6.2bn
Post-acquisition investment	£3.8bn
Sold to	£1.74bn
Investment in business	£6%
Equity value at return	29%
Shareholder return on original equity	<b>210x</b>

Elster	Value
Equity based on acquisition	£1.1bn
Equity based on acquisition	£1.7bn
Post-acquisition investment	£2.9bn
Sold to	£3.2bn
Investment in business	25%
Equity value at return	43%
Shareholder return on original equity	<b>2.3x</b>

## Responsible stewardship

Contributors to the UK pension schemes towards fully funded on departure from the Melrose Group.



Melrose has substantially improved all the UK pension schemes under its ownership.



Elster  Nortek   
 GKN 2012 scheme  GKN 2016 scheme

Malrose is very pleased with the track record achieved over its 15-year history since floating on AIM in 2003.

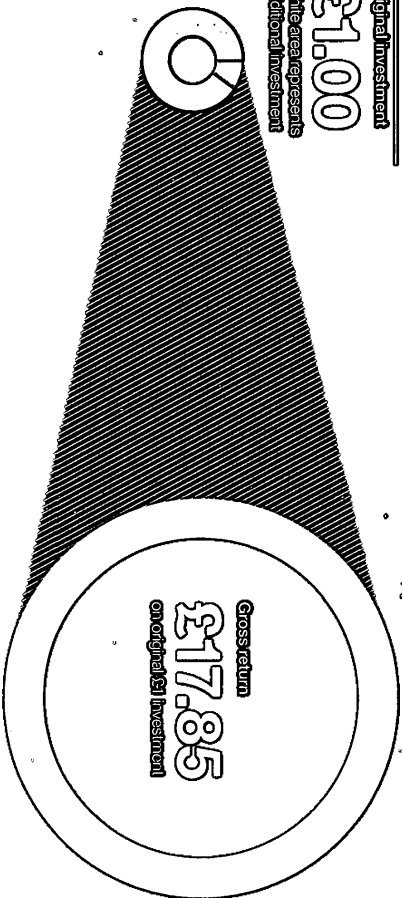
As at 31 December 2018, track record for £1 invested in Malrose

Investment in May 2003 with all dividends reinvested since (total shareholder return)\*

Original investment

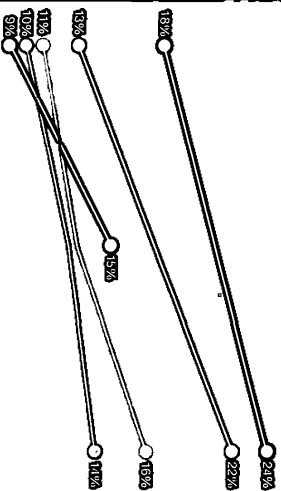
£1.00

While area represents additional investment



Gross return  
£17.85  
on original £1 investment

### Adjusted operating margin improvement



### Skills, Innovation and Productivity Fund

Our commitment to skills, innovation and productivity is clear. We made a commitment at the time of the GKN acquisition to invest at least 2.2% of GKN sales over the years to 2023. However, we consider this to be the floor, and not the ceiling, for our ambitions. Because we believe in building Britain's industrial base, and because we invest for the long term, regardless of how long we own our businesses, we have also created a new Malrose skills, innovation and productivity fund. This funding will be available to support our businesses, but will also be available to higher education colleges in the South West, the Midlands and Oxford, to create new opportunities for young people in these regions and help foster the next generation of great British engineers.

£436m

Spent on research and development for Norfolk, Esher and GKN acquisitions being

9%

of revenue for the equivalent period

Company	Entry	Current	Exit	Improvement
Usher	18%	20%	24%	+500%
Esher	13%	14%	22%	+490%
Dynacast	11%	12%	18%	+500%
IFK	10%	11%	14%	+400%
Norfolk	9%	15%	20%	+600%

# Highlights of the year

**The results for 2018 are ahead of  
the Board's previous expectations.**

## Headline figures

# 2.3x

The net debt to annualised adjusted EBITDA<sup>(1)</sup> leverage ratio has reduced to 2.3x, ahead of the previous guidance of 2.5x.

# £103m

The amount of the GKN UK defined benefit pension accounting deficit has reduced from £691 million to £588 million since December 2017.

# 14.7%

Nortek Group adjusted<sup>(1)</sup> operating margins have increased from 8.7% at acquisition to 14.7% in 2018 with the potential for further improvement.

(1) Described in the glossary to the financial statements on pages 193 to 196.

## Group performance summary

### Group results

	Statutory £m	Adjusted <sup>(1)</sup> £m
Revenue	8,605	9,102
Operating (loss)/profit	(392)	847
(Loss)/profit before	(550)	703
Diluted earnings per share	(12.0p)	13.3p

**£9.1bn**

Adjusted<sup>(1)</sup> revenue.

**£847m**

Adjusted<sup>(1)</sup> operating profit.

**£8.6bn**

Statutory revenue.

**£(392)m**

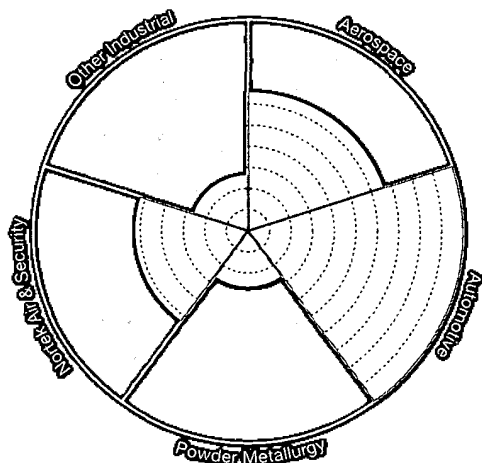
Statutory operating loss arising primarily due to significant acquisition accounting items, most of which arise from GKN.

## Divisional performance summary

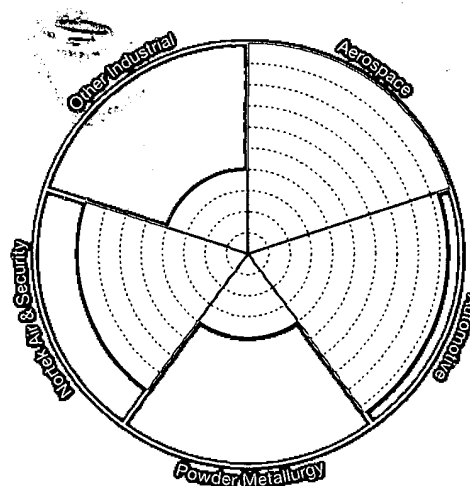
### Divisional results

	Adjusted revenue <sup>(1)</sup> £m	Adjusted operating profit <sup>(1)</sup> £m	Statutory revenue £m	Statutory operating (loss)/profit £m
Aerospace	2,521	250	2,479	(44)
Automotive	3,382	231	2,936	15
Powder Metallurgy	851	98	846	38
Nortek Air & Security	1,458	198	1,458	126
Other Industrial	890	98	886	(159)

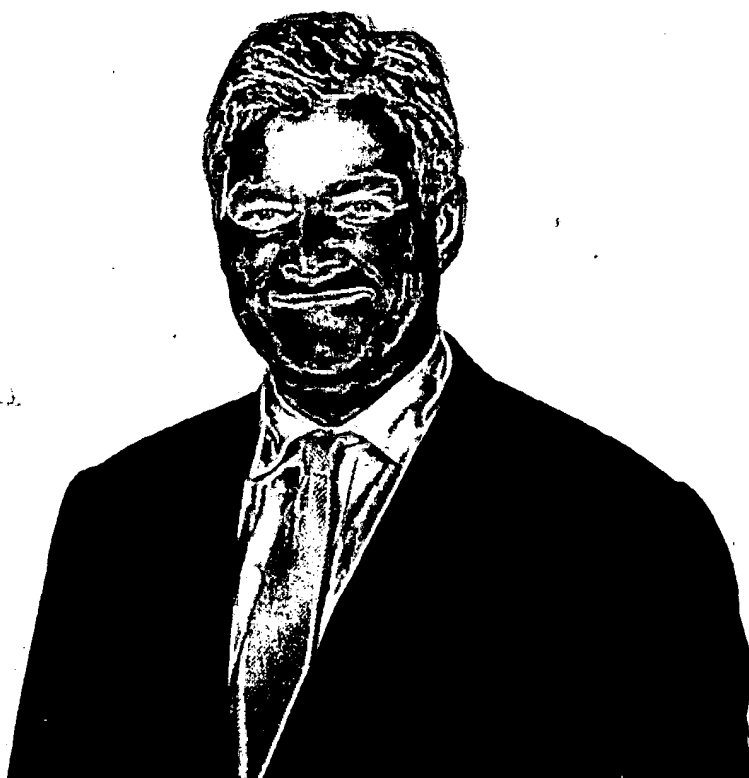
### Adjusted revenue £m<sup>(1)</sup>



### Adjusted operating profit £m<sup>(1)</sup>



(1) Described in the glossary to the financial statements on pages 193 to 196 and shown in note 5 to the financial statements.



# A transformational year for Melrose

**I am pleased to report on  
our 16th set of annual results  
since flotation in 2003.**

Justin Dowley, Non-executive Chairman

The past year has been transformational for Melrose in a number of ways. We achieved strong results, with statutory revenue for the Melrose Group of £8,605 million (2017: £2,092 million) and, despite declaring a statutory operating loss of £392 million (2017: £7 million) primarily as a result of the required accounting for the GKN acquisition, our adjusted<sup>(1)</sup> operating profit was £847 million (2017: £279 million), and adjusted diluted earnings per share were up 36% on last year.

(1) Considered by the Board to be a key measure of performance. Adjusted measures are defined in the glossary to the financial statements on pages 193 to 196.

This performance builds on the success of our public takeover of GKN plc. Following the bid, we immediately set about initiating the changes we believe are necessary to unlock the full potential of the GKN businesses. These changes are already having a positive effect, as shown in our 2018 results.

We continue to see many opportunities to improve GKN and have found enthusiastic and energised employees within the GKN businesses who are keen on partnering with us to achieve these ambitions. While it is still early days, I would like to thank them all for their hard work already and we look forward to continuing to work with them to deliver the exciting opportunity before us.

Although much of the public attention has been on the GKN businesses, we have continued to build and improve our existing businesses in 2018. Nortek Global HVAC is making good progress with its industry leading StatePoint Technology®, backed by the significant investment required to partner with some of the biggest global names in the data centre sector. Although facing challenges elsewhere, Security & Smart Technology made an important step in securing the acquisition of IntelliVision Inc., enabling the application of video analytics across its product range. While Brush has delivered its restructuring in accordance with its plans and is well set for the future, their generator services market has faced further declines.

Further details of these results are contained in the Chief Executive's review and Finance Director's review and I would like to thank all employees for their efforts in helping to produce this strong performance.

#### Dividend

The Board proposes to pay a final dividend of 3.05 pence per share (2017: 2.8 pence) making a total of 4.6 pence for the year (2017: 4.2 pence), an increase of 10% in line with its progressive annual dividend policy. This will be paid on 20 May 2019 to those shareholders on the register at 5 April 2019, subject to approval at the Annual General Meeting (AGM) on 9 May 2019.

#### Shareholders

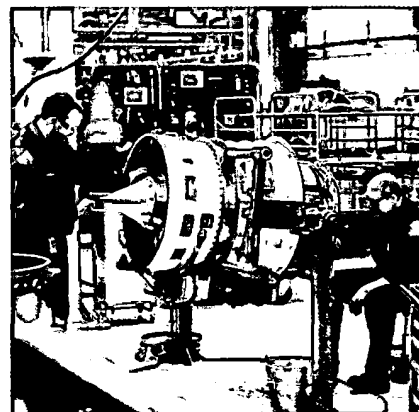
Melrose has been fortunate to enjoy long-term support from its key shareholders, many of whom have been investors since Melrose was established in 2003 and have experienced a sustained period of success. We are very pleased to welcome the large number of new shareholders who have joined the Melrose register as a result of our acquisition of GKN. These shareholders may be less familiar with the Melrose model and we are excited about the opportunity of delivering the same level of performance for them.

#### Board matters

We are pleased that Charlotte Twyning joined us as an additional independent Non-executive Director in October 2018. A lawyer by training and currently Consents Director with the Heathrow Expansion Programme Board, Charlotte is already making her mark at Melrose and we welcome her to the team.

From the start of this year, I relinquished my roles as Senior Independent Director and Chairman of the Remuneration Committee to take up the role of inaugural Non-executive Chairman. The previous Chairman, co-founder Christopher Miller, who had held the position since Melrose started in 2003, will continue in a full-time executive capacity as executive Vice-Chairman.

Further details on this and other changes are set out in the Nomination Committee report on pages 90 to 91, but I would like to thank Christopher for his contribution to the record of Melrose so far and look forward to working with him to achieve further success for Melrose and all of its stakeholders.



## Buy

## Improve

## Sell

Our strategy and business model  
See pages 2 to 3 ▶

#### Strategy

Melrose continues to demonstrate the success of its "Buy, Improve, Sell" strategy. There are already clear indicators in the GKN businesses that the Melrose model of simplifying corporate structures and injecting pace and accountability into businesses while investing heavily for their long-term success continues to be effective. The same strategic focus continues to be applied within Nortek to build on its recent successes.

#### Outlook

There were wider macro challenges for some of our businesses in 2018 and we see these continuing into this year. However, with culture change based on accountability, backed by significant investment and a more disciplined strategic focus being applied to improve all aspects of our businesses, we remain confident of further success as we enter 2019.

Justin Dowley  
Non-executive Chairman  
7 March 2019



## **An exciting time for shareholders**

**Strong customer relationships are at the centre of any business and our businesses have renewed their focus on improving their performance and delivery, particularly in critical supply chains.**

Simon Peckham, Chief Executive

2018 has obviously been a significant year in Melrose's history. We were pleased to be given the opportunity by shareholders to unlock the undoubted potential that exists within the GKN businesses and we look forward to delivering value to all of our shareholders.

Upon taking control of GKN, we immediately set about removing the duplicate central functions and decentralising the GKN businesses, simultaneously reorganising the Melrose Group into the five divisions we have today: GKN Aerospace; GKN Automotive; GKN Powder Metallurgy; Nortek Air & Security; and Other Industrial.

For the GKN businesses, decentralisation was the first step in bringing about the change in culture we believe is vital to securing long-term improvement. For GKN Aerospace and GKN Powder Metallurgy, we worked with incumbent management teams to agree their management plans.

For GKN Automotive, we were pleased to fill the CEO vacancy with a high calibre candidate with a strong track record in the sector. With an ambitious new executive team around him, the GKN Automotive business will be transformed. In all cases these businesses present the exciting opportunity to improve their performance, as expected.

Having agreed their approach, the GKN businesses have been given the freedom and responsibility to start to deliver on their commitments. Part of this has been a refocus on profitable sales rather than solely on growth. There is also a clear expectation that they be good stewards of their businesses for the benefit of all stakeholders. Despite inheriting the cash cost of unwinding the significant creditor stretch employed by the previous GKN management, net debt leverage was better than previous guidance at 2.3x EBITDA. Following this, a key task for this year is to have a better control and focus on the working capital in the GKN Group. Optimising cash management is a key area for improvement for all of the GKN businesses.

Strong customer relationships are at the centre of any successful business, but these had been troubled for the GKN businesses prior to our acquisition. With our support, the businesses have renewed their focus on improving their performance and delivery, particularly in critical supply chains. To reassure key customers of the strength of our commitment, Melrose has funded the significant investment required to achieve the necessary operational improvements fundamental to securing this improved performance.

Part of these improving relationships has been the focus coming from the opening balance sheet review that identified a significant number of poorly performing contracts, which are further detailed in the Finance Director's review. While we have adopted the appropriate accounting treatment for these, we have also been clear that addressing these is a key priority for each of the GKN businesses and progress is already being made which has been welcomed by customers. Some of our investments to date have also been supporting this. We look forward to further updating shareholders on progress

## **At each of our businesses, investment in technology and operational improvements is at the heart of our efforts to unlock their potential. This translates to ongoing support for the industry leading StatePoint Technology® for HVAC and the new Aerospace Global Technology Centre in Filton, UK.**

with these over the months to come. It is apparent that, at acquisition, these contracts constituted approximately 10% of GKN net sales, requiring a provision of £629 million as discussed in the Finance Director's review. We think these contracts offer a large potential for performance improvement in the future.

As we said at the time of the GKN acquisition, we will be responsible custodians of the GKN pension schemes and we stand by that commitment. Since acquisition we have improved their corporate governance by appointing the first independent Chairman of the UK schemes.

At each of our businesses, investment in technology and operational improvements are at the heart of our efforts to unlock their potential. For Nortek Air & Security, ongoing support for the industry leading StatePoint Technology® for HVAC, the refreshing of the product range for AQH and the data analytics acquired for SST through IntelliVision are vital to their ongoing development and are paying real dividends. This has been matched by investments to upgrade their production capacity and continue their operational improvements, which have been key to the increase in operating margins in Nortek businesses by approximately six percentage points since acquisition.

Whilst FKI has been a very successful acquisition for shareholders, Brush has in recent years suffered from very difficult markets. A large-scale restructuring was initiated in 2018 as a result, and it has been successfully implemented by Brush's management. This will be completed in 2019. Unfortunately, the well-publicised further difficult market conditions mean that your Board considers it should again reduce the holding value of this company and this has been done in these accounts.

For the GKN businesses, our commitment at the time of the acquisition to invest an amount equal to 2.2% of sales on research and development was always considered a floor, not a ceiling. We are tracking in line with expectations, including commencing work on the new Aerospace Global Technology Centre in Filton, UK. In parallel, we are also investing heavily to achieve the operational improvements and so far we have approved capital expenditure of more than £200 million in a mix of initiatives, including plant extensions, capacity upgrades and procurement efficiencies. This investment process has benefited from, and also been speeded up by, the more rigorous approval process we have introduced.

### **Outlook**

Alongside the continued progress in Nortek, we believe that our businesses will deliver some of the significant upside we see in 2019 despite continuing market volatility, particularly for GKN Automotive. Our businesses are not without their challenges, particularly geopolitical, with Brexit and automotive sector uncertainty continuing. However, our businesses are proactive and will adjust their operations where appropriate. We will continue to be prudent in our approach and ambitious in our aims. We believe the rigorous focus on cost control, productivity and improved customer delivery will continue to drive improvement in performance for all of our businesses. This gives us confidence that we will continue to meet our expectations and that 2019 will be another successful year.



**Simon Peckham**  
Chief Executive  
7 March 2019

# Key performance indicators

In order to support the Group's strategy and to monitor performance, the Board uses a number of financial and non-financial key performance indicators (KPIs). Details of a selection of the KPIs are shown here.

Additional business-level KPIs are also used, which are relevant to their particular circumstances. Further detail on these KPIs is disclosed in the glossary to the financial statements and further information regarding the performance of the Group against its financial KPIs is included in the Finance Director's review.

## Financial KPIs

### Adjusted<sup>(1)</sup> diluted earnings per share

13.3p



#### Method of calculation

Group adjusted<sup>(1)</sup> profit after tax, attributable to owners of the parent of businesses in existence during the year ended 31 December 2018, divided by the weighted average number of diluted ordinary shares in issue.

#### Strategic objective

To create consistent and long-term value for shareholders.

### Adjusted<sup>(1)</sup> operating profit

£847m



#### Method of calculation

Adjusted<sup>(1)</sup> operating profit for the businesses in existence during the year ended 31 December 2018.

#### Strategic objective

To improve profitability of Group operations.

### Net debt to annualised<sup>(2)</sup> adjusted<sup>(1)</sup> EBITDA<sup>(3)</sup>

2.3x



#### Method of calculation

Net debt at average exchange rates divided by annualised<sup>(2)</sup> adjusted<sup>(1)</sup> EBITDA<sup>(3)</sup> further adjusted to reflect covenant requirements, for existing businesses at each year end.

#### Strategic objective

To ensure the Group has suitable amounts of debt and remains within its banking covenants.

- (1) Considered by the Board to be a key measure of performance. A reconciliation of statutory results to adjusted performance results to adjusted profit is given in the Finance Director's review on page 41 and in the glossary to the financial statements on pages 193 to 196.
- (2) Adjusts result to reflect a full year's ownership of major acquisitions. In 2018, this assumes GKN was acquired on 1 January 2018 and in 2016 it assumes that Nortek was acquired on 1 January 2016.
- (3) Adjusted<sup>(1)</sup> operating profit before depreciation, and amortisation of computer software and development costs.

## Non-financial KPIs

### Health and safety

#### Method of calculation

A variety of different health and safety KPIs are used by the Group from time to time, which are specific to the exact nature of the business and its associated risks. In 2018, the Nortek and Brush businesses harmonised their KPI outputs and, following the acquisition of GKN, the KPI outputs for the GKN businesses were also migrated onto the Melrose reporting metrics. Given the expansion and diversified nature of the Group following the GKN acquisition, weightings have been applied to each division's reported health and safety performance according to the size of each division's workforce relative to the other divisions within the Group. This is to account for differences in the size of each division's workforce.

Therefore, the larger the workforce, the more heavily such divisions' health and safety performance drives the Group-wide performance figures.

#### Strategic objective

The Company has an objective to stop all preventable accidents.

### Performance

The Group's current businesses measure three key health and safety KPIs:

#### Major accident frequency rate

0.19



Records the average number of lost time accidents that have resulted in more than three days off work (defined as 'major' accidents), per 200,000 hours worked.

#### Accident frequency rate

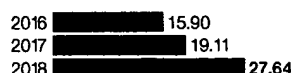
0.27



Records the average number of lost time accidents, both major and minor, per 200,000 hours worked.

#### Accident severity rate

27.64



Records the average number of days an employee takes off work following an accident at work.

**Adjusted<sup>(1)</sup> profit conversion to cash percentage**

86%

**Method of calculation**

Percentage of adjusted<sup>(1)</sup> EBITDA<sup>(2)</sup> conversion to cash for subsidiary businesses in existence during the year ended 31 December 2018, pre-capital expenditure.

**Strategic objective**

To ensure subsidiary businesses are suitably cash-generative in order to have adequate cash reserves for the effective running of the Group and for significant capital investment where required.

**Adjusted<sup>(1)</sup> operating profit margin**

9.3%

**Method of calculation**

Adjusted<sup>(1)</sup> operating profit as a percentage of adjusted<sup>(1)</sup> revenue, for the businesses in existence during the year ended 31 December 2018.

**Strategic objective**

To improve profitability of Group operations.

**Interest cover**

11.6x

**Method of calculation**

Adjusted<sup>(1)</sup> EBITDA<sup>(2)</sup> as a multiple of interest payable on bank loans and overdrafts for the Group during each year.

**Strategic objective**

To ensure the Group has sufficient profitability to meet the interest cost of debt and remain within its banking covenants.

**Final dividend per share**

3.05p

**Method of calculation**

Amount declared as payable by way of dividends in terms of pence per share.

**Strategic objective**

To operate a progressive dividend policy whenever the financial position of the Company, in the opinion of the Board, justifies the payment.

For discussions on the dividend, please refer to the Chairman's statement on page 15.

As at 31 December 2018, the GKN businesses accounted for nearly 85% of the Melrose Group workforce. Having been acquired in Q2 of 2018, the KPIs for the GKN businesses for 2016, 2017 and Q1 of 2018 relate to periods when the businesses were not owned by Melrose. However these figures have been included, conformed and weighted to Melrose's Group KPI framework to ensure a holistic comparison.

As set out in more detail in the health and safety section of the Corporate Social Responsibility report (see page 66), the Group tragically suffered a fatality in 2018 which has triggered a redoubling of efforts and increased focus on keeping our workforce safe.

The accident frequency rate and accident severity rate figures demonstrate an increase in 2018, principally due to the newly enlarged Melrose Group. The small size in the upward movements relative to the increase in the size of the Group's workforce reflects relatively high standards of health and safety performance within the GKN businesses, as well as investment in health and safety initiatives taking effect at the Nortek businesses for these two KPIs. On joining the Melrose Group in 2016, a full review was conducted and improvements implemented at the Nortek businesses, and health and safety remains a key focus for them.

**Environment and energy usage****Method of calculation**

Due to the decentralised nature of the Group and differing operations of businesses which the Company may acquire, there are no standardised environmental KPIs used throughout the Group. A range of environmental measures are utilised, including energy consumption, CO<sub>2</sub> emissions, water consumption, water contamination, waste disposal, solid and liquid waste generation, recycling and volatile organic compound emissions.

**Strategic objective**

Melrose fully understands the importance of the Group's environmental responsibilities and is committed to ensuring that operations have a minimum possible adverse effect on the environment.

**Performance**

Information in relation to the various environmental initiatives undertaken by the Group's business divisions during 2018 can be found within the

Corporate Social Responsibility report on pages 59 to 69. The Group is required to disclose Greenhouse gas emissions data for the year ended 31 December 2018. Such data can be found within the Corporate Social Responsibility report on pages 59 to 69.

**Other non-financial KPIs**

Due to the diverse nature of the Group, each business acquired by the Group uses a range of its own specific non-financial KPIs, which are used to drive business performance and assist in managing risk. This helps to ensure that the KPIs used are relevant to each business and take into account specific operational and reporting requirements. Such KPIs cover operational, quality, commercial and human resource measures. Further information regarding some of the Group's recent initiatives can be found within the Corporate Social Responsibility report on pages 59 to 69.

# Aerospace

GKN Aerospace is a world-leading multi-technology manufacturer of aircraft and engine structures and electrical interconnection systems for the global aerospace industry, supplying both civil and military platforms.



Key information

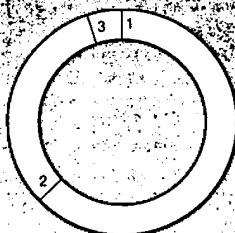
GKN Aerospace is the original aerospace innovator. For decades, GKN Aerospace technologies have inspired and industrialised the aerospace industry, combining engineering excellence and technology leadership.

Financial information

Financial results 2018

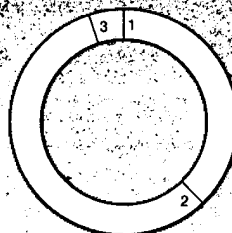
	£m
Statutory revenue	2,479
Adjusted revenue <sup>(1)</sup>	2,521
Statutory operating loss	(44)
Adjusted operating profit <sup>(2)</sup>	250

Revenue by business<sup>(1)</sup>



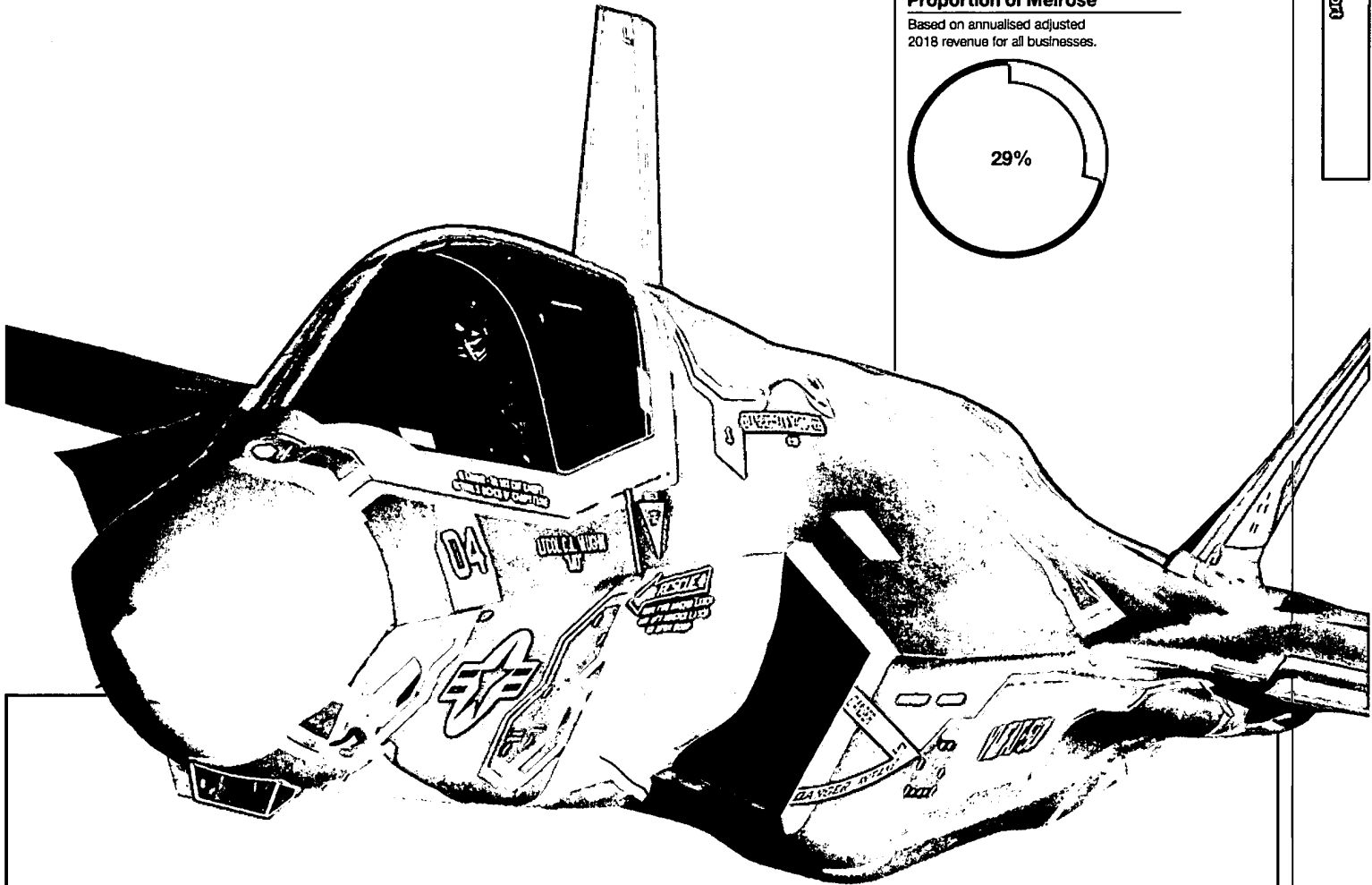
1 Aerostructures	63%
2 Engine Systems	32%
3 Special Technologies	5%

Revenue by geography<sup>(1)</sup>



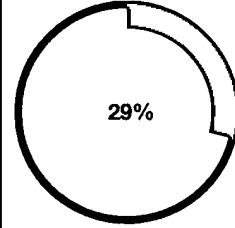
1 Europe	33%
2 Americas	57%
3 RoW	5%

(1) Described in the glossary to the financial statements on pages 198 to 199 and shown in note 6 to the financial statements.  
 (2) Based on annualised adjusted 2018 revenue.

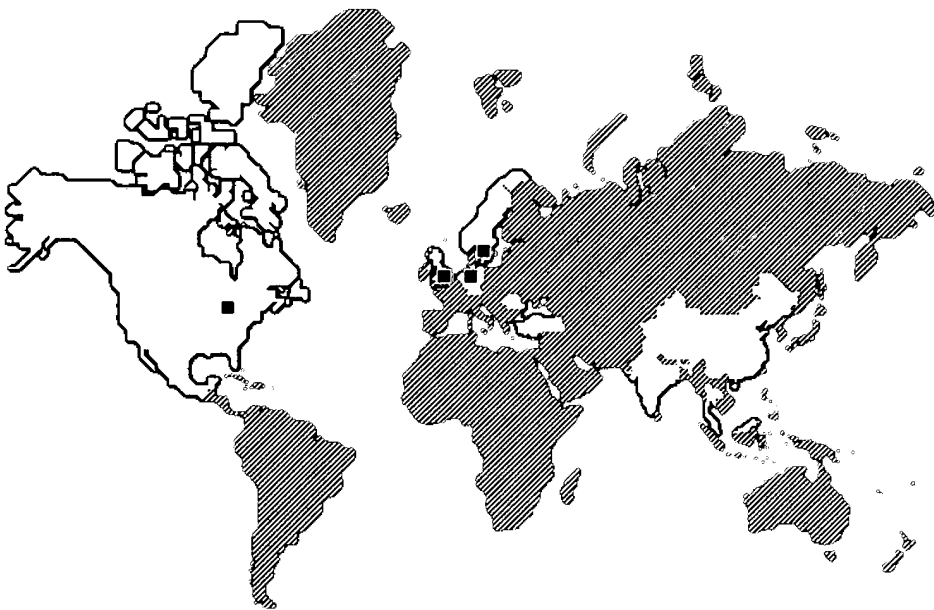


**Proportion of Melrose**

Based on annualised adjusted 2018 revenue for all businesses.



**Operational geographies**



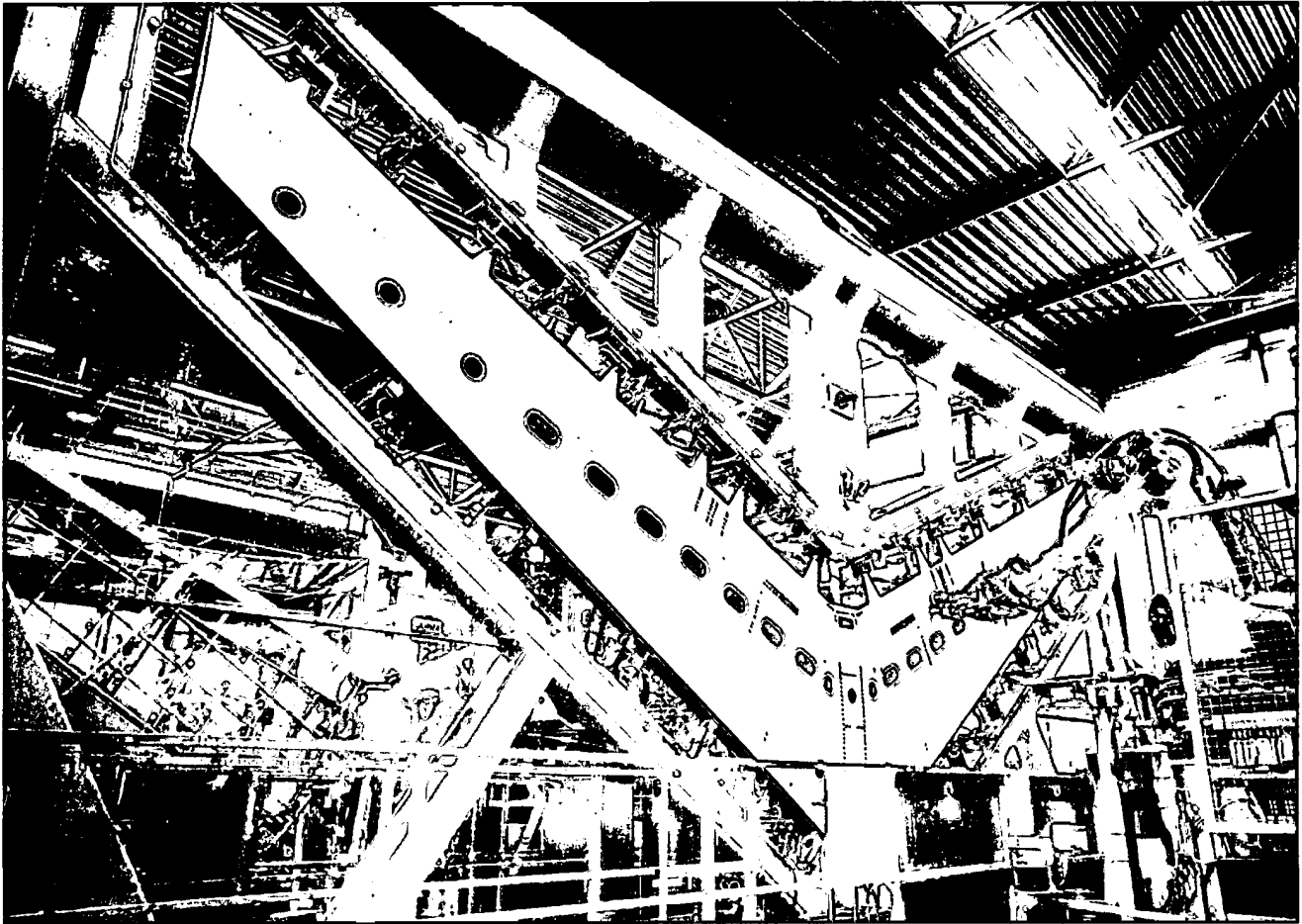
**Global Technology Centres**

- Netherlands
- Sweden
- UK
- USA

[gknaerospace.com](http://gknaerospace.com)

## Divisional review

Continued



# 15

Countries with GKN Aerospace manufacturing locations, serving over 90% of the world's aircraft and engine manufacturers

# 4

Global technology centres

GKN Aerospace's technology is used throughout the aerospace industry: from high-use single aisle aircraft and the world's largest passenger planes, through to business jets, helicopters and the world's most advanced fighter jets.

GKN Aerospace has manufacturing locations in 15 countries and supplies more than 90% of the world's aircraft and engine manufacturers. GKN Aerospace has three core competencies: (i) Aerostructures, which provides components for most of the major platforms, making use of lightweight composites, additive manufacturing and innovative high-speed machining technologies, as well as electrical wiring and interconnection systems and a complete aerostructures service business; (ii) Engine Systems, which is a systems integration partner for global aircraft engine programmes, supplying high-performance metallic and composite structural engine components; and (iii) Special Technologies, a global partner in transparencies and other specialist technologies for aircraft.

After a challenging end to 2017, particularly in North America, GKN Aerospace made substantial progress in 2018. Embracing the decentralisation and cultural change brought about by the Melrose acquisition, the business has invested heavily in its North American sites, which will continue into 2019, with a view to embedding improved manufacturing processes and driving long-term site performance. This was backed by a renewed focus on its North American footprint strategy that saw the opening of a new state-of-the-art advanced composites site in Florida, US, and the exit of three non-core sites.

Elsewhere, improving relationships with key blue-chip customers has helped in winning new, long-term contracts worth over £2 billion, as well as securing an important position on Airbus' *Wing of Tomorrow* development platform, all of which will position Aerostructures well for future programmes. The existing commercial position is also the subject of significant attention, with the opening balance sheet review undertaken on acquisition by Melrose having highlighted a number of loss-making contracts. Improvement in performance is being addressed as a priority.

# US\$40m

Investment to open new sites in Asia

With Melrose's support, GKN Aerospace has reinvigorated its investment in research and development. The centrepiece for this was the announcement of the development of a new £32 million UK Global Technology Centre near its Filton production facility in the UK. This will be a base for the *Wing of Tomorrow* programme to develop the next generation of composite and additive manufacturing technologies to 'Industry 4.0' standards, enabling GKN Aerospace to maintain its position as a technology leader, improving both productivity and profitability.

Recognising emerging opportunities in Asia, GKN Aerospace is opening three new sites in the region to support the growing market. This includes a new US\$30 million fan blade repair centre in Malaysia, a new US\$10 million wiring facility in Pune, India, and the signing of a framework agreement with Comac and AVIC for a new aerostructures joint venture in China.

The Aerospace division overall invested £154 million in 2018 in various parts of the business with a view to improve or accelerate key business cases. In North America, significant investment was made at previously underinvested sites. In Europe, investment was made to improve productivity and expand capacity for the benefit of ramp-up programmes such as for the F-35.

### Outlook

The global aerospace market remains strong and leading indicators – air passenger traffic, order backlog, and predicted aircraft requirements – appear positive. With the North American operational challenges being overcome, cultural change taking hold and a clear improvement plan set out for the business, GKN Aerospace has a well-balanced portfolio of work on growth platforms, improving relationships with a strong customer base across all major OEMs, world-leading technology, and a global footprint. The business is well-established in the strong US and European aerospace markets and is well-set for the growth of the Asian market in the years ahead, giving the business confidence in meeting its expectations for 2019.

## Market trends

### Aerospace

The global aerospace market remained healthy in 2018 with growth in both the commercial and military sectors, supported by the following market factors:

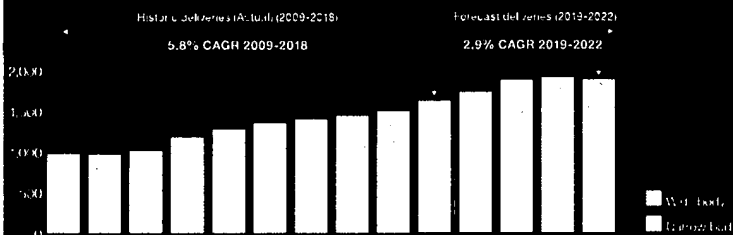
- Continued growth in global air passenger traffic of 6.1% compared to the prior year.
- Record delivery levels of commercial aircraft (1,780 in 2018).
- High backlog held by the major OEMs maintained through 1,640 new orders for commercial aircraft in 2018.
- Continued strong growth in the military market, driven by increased defence spending and the F-35 ramp-up.
- Continued evolution of existing aircraft platforms with new technology.

- Focus on the development of quieter and more fuel-efficient aircraft and aero engines.
- Continued demand growth in Asia.

GKN Aerospace has responded to these trends since being acquired by Melrose through rapidly implementing operational fixes within the business to deliver the production ramp-ups that customers are demanding, pursuing growth initiatives in Asia to take advantage of the growing market, streamlining in other markets where appropriate, focusing on technological improvement by investing in the development of the Filton Global Technology Centre, and continued participation in strategic development and partnership programmes.

### Number of commercial aircraft deliveries (historic & forecast)<sup>(1)</sup>

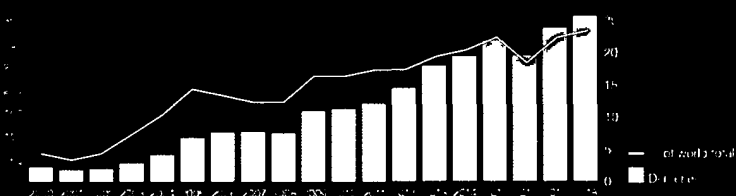
An extended period of strong commercial aerospace deliveries



(1) Teal Group, Aircraft Market Forecasts & History, Commercial Aircraft, January 2019

### Large jetliner deliveries to China: total and % of world<sup>(1)</sup>

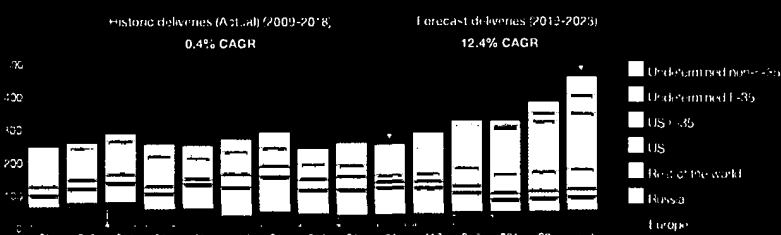
Asia-Pacific region has highest share of worldwide passenger traffic with Asia set to become the largest aerospace market



(1) Teal Group, Aircraft Market Forecasts & History, Commercial Aircraft, January 2019

### World fighter production in number of deliveries<sup>(2)</sup>

Military market deliveries set to grow significantly in coming years underpinned by F-35



(2) Teal Group, Aircraft Market Forecasts & History, Fighter Aircraft, January 2019 (US F-35 deliveries include partner country delivery numbers)

## Divisional review

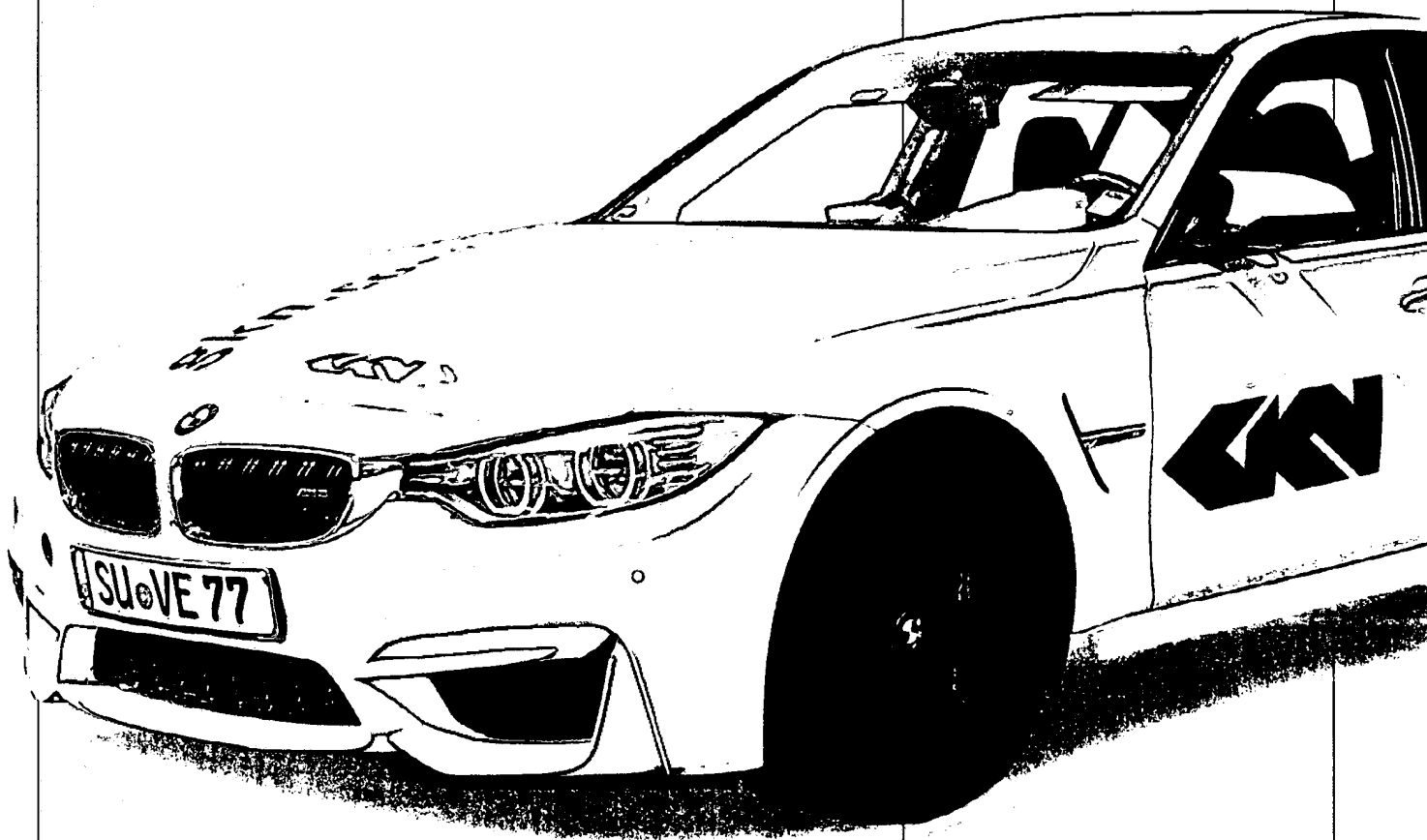
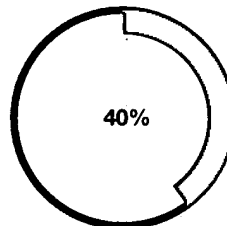
Continued

# Automotive

**GKN Automotive supports over 90% of the world's car manufacturers as a market leading developer, manufacturer and supplier of driveline products and systems throughout the global automotive industry.**

### Proportion of Melrose

Based on annualised adjusted 2018 revenue for all businesses.





Key information

GKN Driveline is the leading automotive driveline technology and systems engineer. GKN Driveline is a global partner to the automotive industry.

Financial information

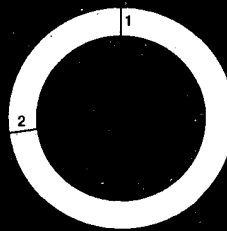
Financial results 2018

	£m
Statutory revenue	2,936
Adjusted revenue <sup>(1)</sup>	3,382
Statutory operating profit	15
Adjusted operating profit <sup>(1)</sup>	231

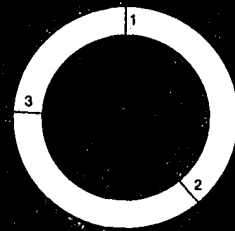
(1) Described in the glossary to the financial statements on pages 193 to 196 and shown in note 5 to the financial statements.

(2) Based on annualised adjusted 2018 revenue.

Revenue by business<sup>(2)</sup>



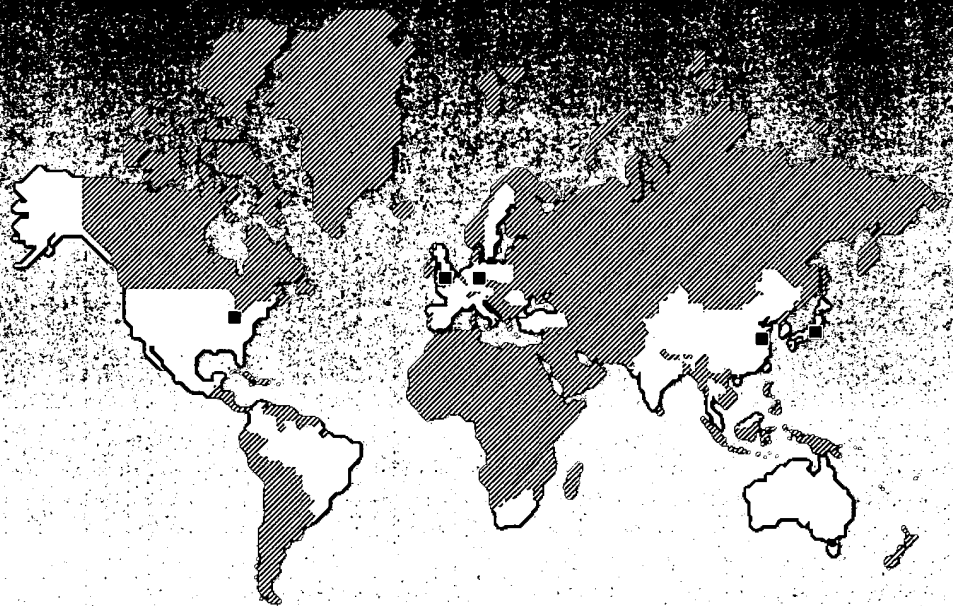
Revenue by geography



1 Driveline	73%
2 ePowertrain	27%

1 Europe	39%
2 Americas	37%
3 RoW	24%

Operational geographies



gkndriveline.com  
gknepowertrain.com

Global Technology Centres  
■ China ■ Germany ■ Japan ■ UK ■ US



## Divisional review

Continued



GKN Automotive's recent appointment of a new Chief Executive has led to the creation of a focused new central executive team and a reorganisation of the management structure of the business.

Internally the business is principally organised around its two core competencies: (i) Driveline, which is the world's pre-eminent driveshaft manufacturer; and (ii) ePowertrain, the industry leader in electric powertrains ("eDrive") and intelligent all-wheel drive ("AWD") systems.

GKN Automotive supplies to all subsections of the automotive industry, from small ultra-low-cost cars to the most sophisticated and dynamic premium and motorsport vehicles. The business is also centralising its commercial function to ensure that it presents a globally consistent and single face to customers, whilst ensuring the right level of commercial discipline is in place to drive profitable growth and manage key commercial relationships. Like all the GKN businesses, GKN Automotive is also working hard on addressing its loss-making contracts identified during the opening balance sheet review.

# £25m

Investment in new equipment in a Japanese manufacturing facility

# £50m

In powertrain research and development

# 21 countries

Global production footprint

# 5

Global technology centres

With an unrivalled global production footprint across 21 countries, GKN Automotive is closely aligned with its key customers. Its unparalleled experience in the traditional driveshaft business provides platform opportunities to be the premier technology partner for OEMs, as well as having the in-depth knowledge and unique perspective from which to grow its market-leading eDrive business.

Accordingly, this year GKN Automotive invested a further £50 million in powertrain research and development which was instrumental in delivering its first fully electric drive programme with a leading global OEM. This is an important step forward for the eDrive business and increases GKN Automotive's ability to further differentiate its business from competitors.

GKN Automotive has been able to successfully take advantage of the aggressive growth of the eDrive market in China by working in close collaboration with its long-standing partner HASCO, through its joint venture vehicle Shanghai GKN HUAYU Driveline Systems ("SDS"), which resulted in several significant business wins during 2018. GKN Automotive and SDS continue to work closely together as the focus turns to execution to ensure that these projects deliver their potential.

To further broaden its opportunities in Asia, the business opened a new manufacturing facility in Japan during 2018, investing over £25 million in new equipment to enable the specialist production of state-of-the-art AWD and eDrive systems. The factory will serve the growing demand in Asia, as well as global export markets and represents a substantial technological upgrade in capabilities for the production and delivery of advanced eDrive and AWD technologies.

The Driveline business has been and will continue to be heavily focused on reviewing its cost structure, driving operational performance and delivering market-leading technologies to its OEM customers around the world. A key component of this focus is to ensure Driveline's installed capacity is fully aligned to its core competencies and able to serve customers appropriately in addition to being located in the most appropriate countries. Under the direction of a newly appointed CPO and restructured operating model, GKN Automotive is conducting an ambitious procurement efficiency drive, looking to secure savings in both direct and indirect commodities and achieve further improvements across all sites in the business.

With the support of Melrose, further investment has been approved to deliver additional capacity expansion at the Bruneck, Italy site. Additional investment is scheduled to increase capacity in North America, Mexico, China and Japan, and to support automation projects to further improve productivity, output and the quality of Driveline products.

#### Outlook

GKN Automotive has very strong technology know-how ensuring that it is uniquely positioned in its markets. It will continue to build long-term customer relationships and invest in its world class manufacturing capabilities. The opportunities presented by the move to electrification are significant, but given the current uncertainties in the automotive market, GKN Automotive will continue to adopt a prudent approach. Investment initiatives are focused on driving towards a more flexible cost structure, reducing fixed costs and improving overall commercial discipline with customers and suppliers. The business is confident of delivering an improvement in its performance in 2019.

## Market trends

### Automotive

The GKN Automotive business has strong foundations. However, it is not immune to the wider challenges facing the automotive sector. There are several market factors impacting GKN Automotive's current business environment:

- The speed of change in the adoption of electrification and new mobility solutions is accelerating and driving significant change in GKN Automotive's supply base, competitive landscape and OEMs.
- The overall economic slowdown and in particular, a slower growth environment in China, is affecting the market and overall business sentiment.
- The competitiveness around emerging and new technologies is driving the continued growth of new OEMs as well as increasing collaboration amongst traditional OEMs to share platforms and development costs.
- Continued uncertainty around trade and tariffs particularly between US and China, as well as Brexit.
- Continued shift in demand for vehicle and platform types (for example, FWD/SUVs) driven by new propulsion technologies and a continued shift away from diesel due to environmental concerns.

The business has responded to those trends through expanding its leading position in ePowertrain, pursuing operational performance in the Driveline business, and continuing to build a lean, market-reactive and high-performing business model.

The business is also looking to secure savings with respect to its procurement of both direct and indirect commodities.

The continued shift away from diesel is not expected to have a material impact on the business.



# Divisional review

Continued



GKN POWDER METALLURGY

## Key information

We combine advanced powder metals with innovative production technologies to create unique metal products – smart, reliable and precise.

## Financial information

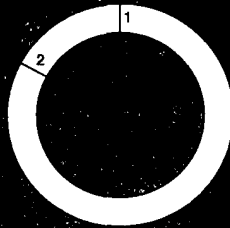
### Financial results 2018

	£m
Statutory revenue	846
Adjusted revenue <sup>(1)</sup>	851
Statutory operating profit	38
Adjusted operating profit <sup>(1)</sup>	98

(1) Described in the glossary to the financial statements on pages 193 to 196 and shown in note 5 to the financial statements.

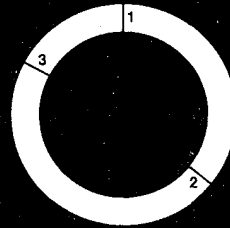
(2) Based on annualised adjusted 2018 revenue.

### Revenue by business<sup>(2)</sup>



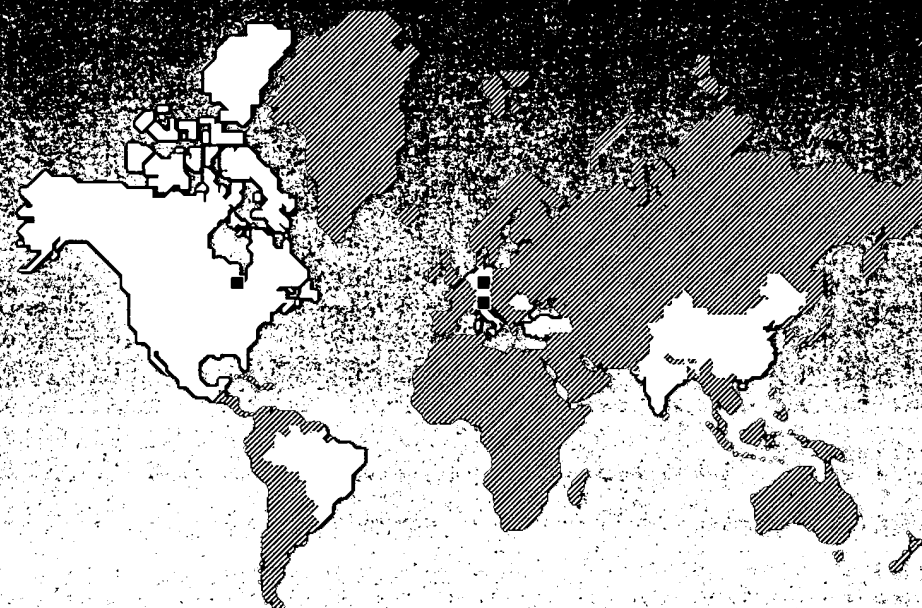
1 Sinter Metals	83%
2 Hoeganaes Metal Powder	17%

### Revenue by geography



1 Europe	36%
2 Americas	47%
3 RoW	17%

### Operational geographies



[gknpm.com](http://gknpm.com)

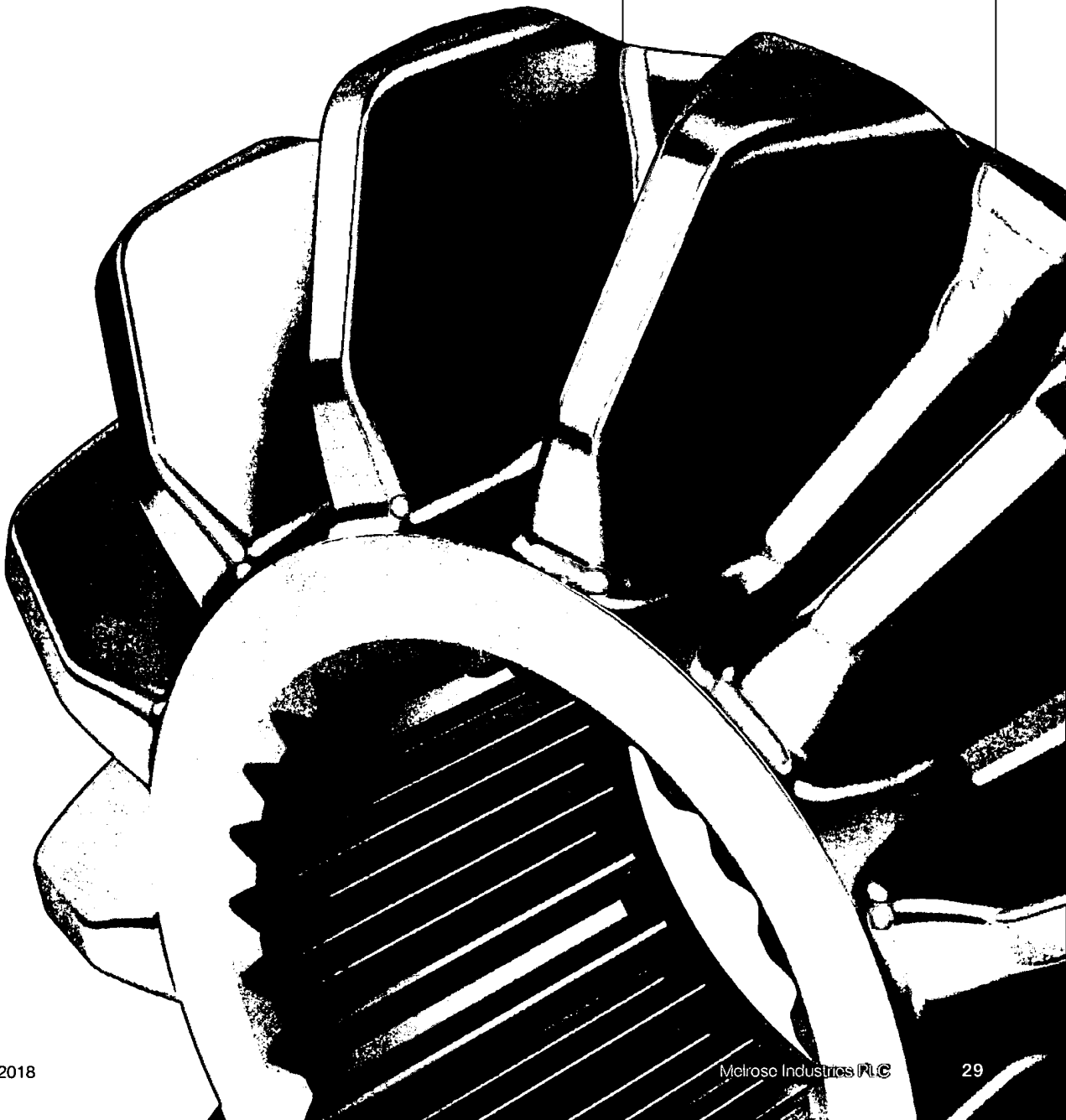
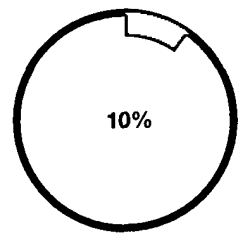
Global Technology Centres  
 ■ Germany ■ Italy ■ USA

# Powder Metallurgy

**GKN Powder Metallurgy is the top global producer of industrial powder metallurgy products and solutions.**

### Proportion of Melrose

Based on annualised adjusted 2018 revenue for all businesses.



## Divisional review

Continued

GKN Powder Metallurgy is the global leader in both precision powder metal parts for the automotive and industrial sectors, as well as the production of metal powder, through its prized vertically integrated business platform. Whilst we will continue to review the position in the months to come, we expect GKN Powder Metallurgy to remain in the Group for the present.

GKN Powder Metallurgy comprises:

- (i) Sinter Metals – the world's leading manufacturer of precision automotive components and components for industrial and consumer applications;
- (ii) Hoeganaes – the world's second largest manufacturer of metal powder, the essential raw material for powder metallurgy, with manufacturing facilities in North America, Europe and China; and
- (iii) Additive – a leading digital manufacturer of metal additive manufacturing parts and materials for prototypes, planning to quickly expand into medium series and the aftermarket.

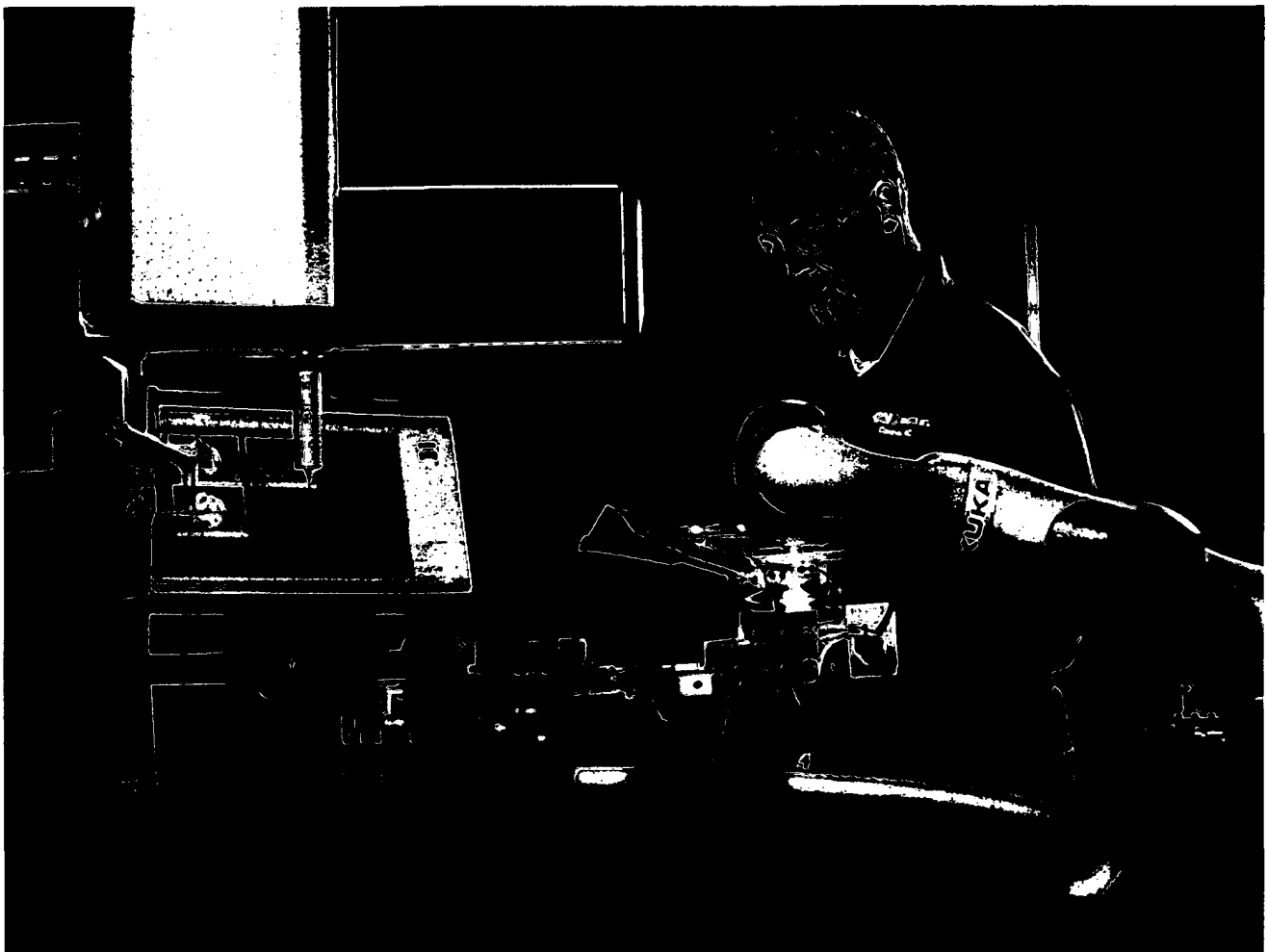
Since entering the Melrose Group, the GKN Powder Metallurgy business has continued to expand its partnerships with technology leaders of additive manufacturing equipment. As a sought-after partner with unique production capabilities, GKN Powder Metallurgy has recently entered into a new partnership with Hewlett Packard and Volkswagen to produce additive manufacturing parts through binder jetting technology, and a strategic partnership with EOS, the world's leading equipment supplier in the field of industrial 3D printing of metals and polymers.

These partnerships are dedicated to the design of a new, high-productivity process for laser metal 3D printing using GKN Powder Metallurgy proprietary additive manufacturing steel powder, which over time will reduce production time by up to 70% and overall production cost by up to 50%. As customisation trends drive customer demand for smaller lot sizes, GKN Powder Metallurgy's additive manufacturing expertise puts it ahead of its peers to benefit from the significant growth potential. 3D technology will also shorten time to market substantially as no tools are required.

Up to

# 70%

reduction in production time due to new laser metal 3D printing process

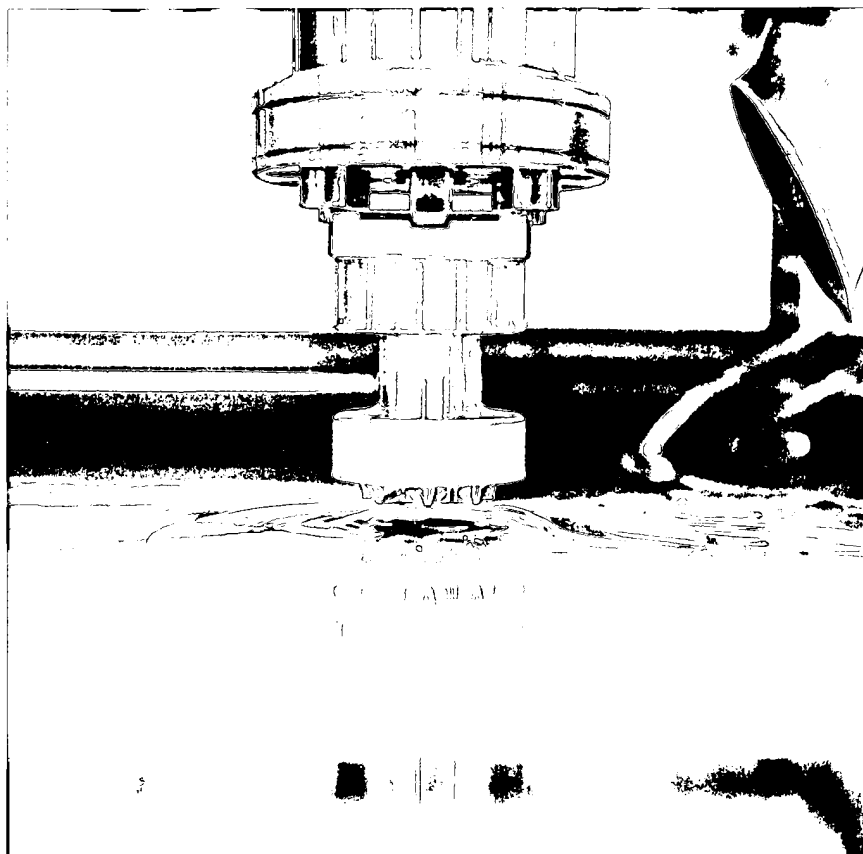


Having consistently outperformed peers' sales growth in recent years, GKN Powder Metallurgy is focused on continuous improvement to ensure its profitability better reflects its leading position and to improve its performance in the years to come. Investment in research and development as industry trends like electrification continue and regulatory requirements increase, have further differentiated GKN Powder Metallurgy from its peers.

With increasing automation across its production footprint, GKN Powder Metallurgy continues to concentrate on operational improvements, delivering high-performing continuous improvement plans, supported by further advances in the digital agenda. A detailed review has highlighted some loss-making contracts and under-performing sites and these are an area of focus to ensure an improved performance as well as a reduction in the overall cost of quality issues.

### Outlook

Although it is being prudent in the face of wider automotive sector uncertainty, with significant opportunities for organic improvement as well as step-change developments through identified acquisition targets, the confidence of the business is high. By continuing to put customer service even more in the centre of its business activities and enhance its partnerships to develop and commercialise new technologies, in particular in additive manufacturing, GKN Powder Metallurgy is optimistic of another strong performance in 2019.



### Market trends Powder Metallurgy

Growth opportunities for GKN Powder Metallurgy within its core automotive and industrial markets are primarily being driven by the following factors:

- Customers' pursuit of increased manufacturing efficiency, functionality and flexibility.
- Legislative clamp-downs to reduce emissions.
- The increase of electrified vehicles and manufacturing equipment.

The business continues to respond to these trends through its ongoing ramp-up in X-by-Wire applications, as electrification trends gather momentum. There continues to be significant growth potential to leveraging the business's strong additive manufacturing base to capture market share through customer demand for lightweight system components and higher speed transmissions.

The business supports customers' requirements for lower mass and higher functionality components with low and medium lot sizes driving new market development and new product development. Similarly, the additive manufacturing base offers reduced emissions and reduced cycle time for the production of parts by customers no longer having to first build manufacturing tools – for high growth sectors such as battery-powered electric vehicles this offers customers the opportunity to pursue their own early involvement strategies before scale is achieved, by being able to engage in lower volume and smaller series manufacturing.

## Divisional review

Continued

# Nortek Air & Security

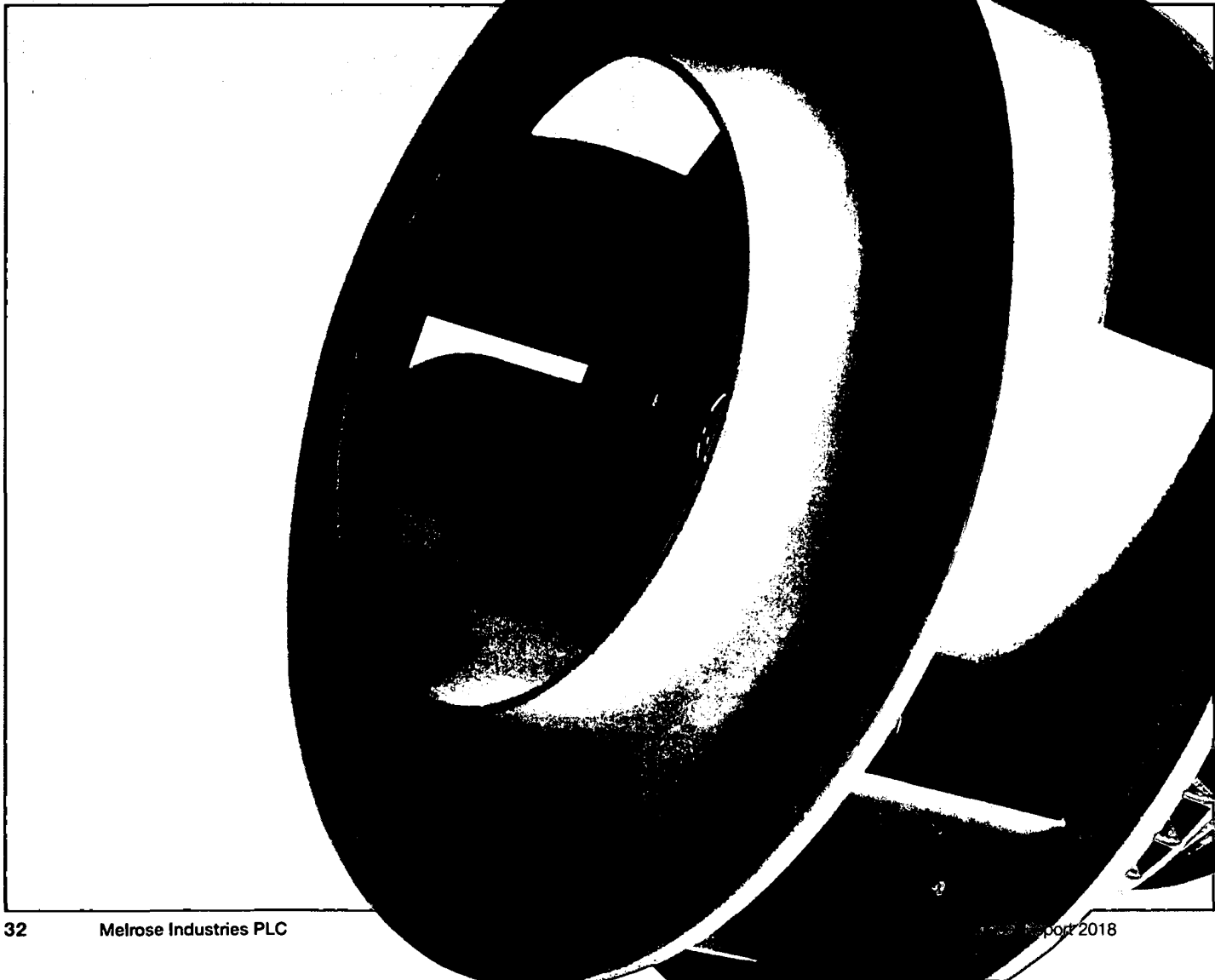
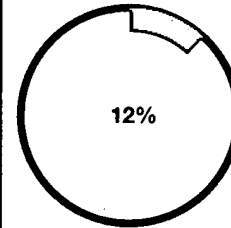
**The Nortek Air & Security Division**

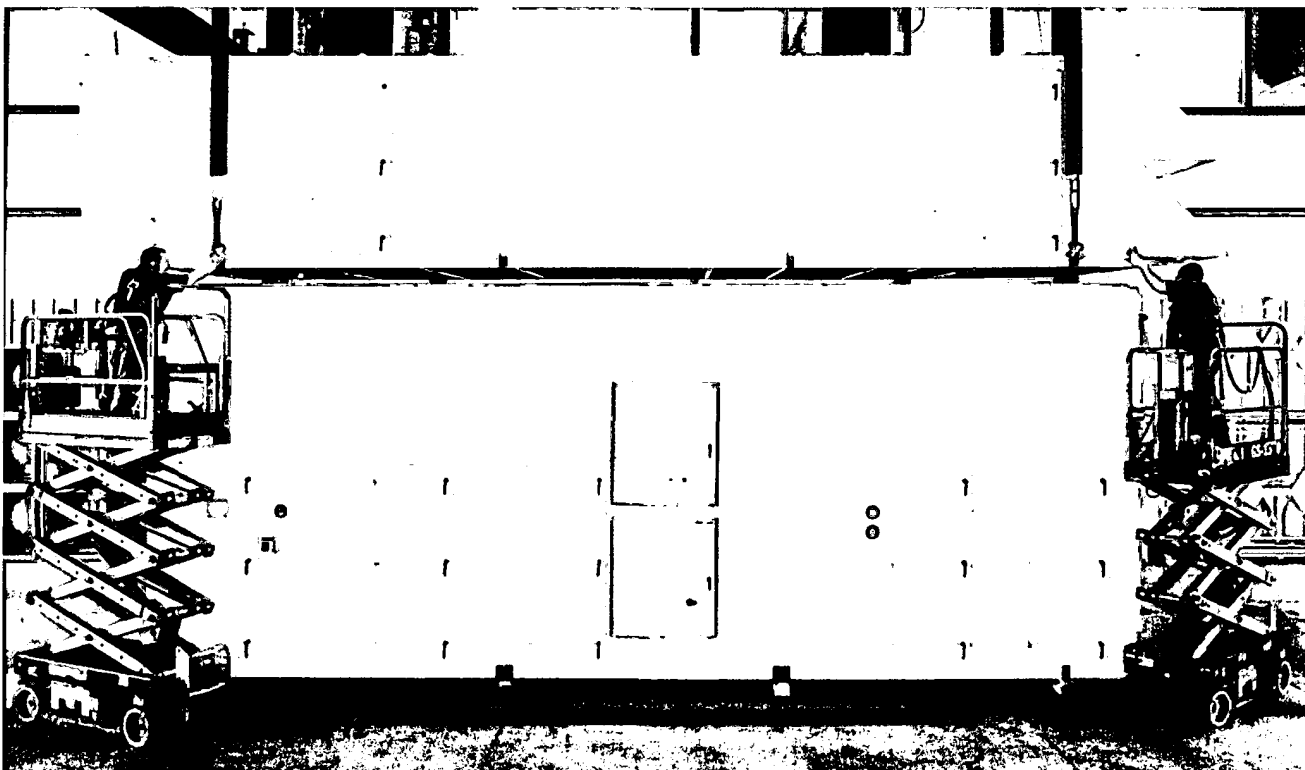
**comprises three businesses:**

**Nortek Global HVAC, Air Quality  
& Home Solutions and Security &  
Smart Technology.**

### Proportion of Melrose

Based on annualised adjusted  
2018 revenue for all businesses.





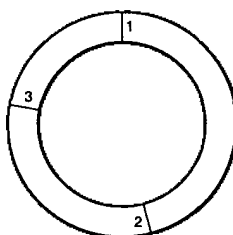
**NORTEK**

**Financial information**

**Financial results**

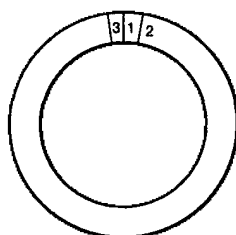
£m	2018
Statutory revenue	1,458
Adjusted revenue <sup>(1)</sup>	1,458
Statutory operating profit	126
Adjusted operating profit <sup>(1)</sup>	108

**Revenue by business<sup>(1)</sup>**



1 Nortek Global HVAC	46%
2 Air Quality & Home Solutions	32%
3 Security & Smart Technology	22%

**Revenue by geography**



1 Europe	3%
2 Americas	95%
3 RoW	2%

(1) Described in the glossary to the financial statements on pages 198 to 199 and shown in note 6 to the financial statements.

## Divisional review

Continued

### Nortek Global HVAC

Nortek Global HVAC ("HVAC") is led by a management team based in Missouri, US, and includes the custom and commercial business Nortek Air Solutions ("NAS"), a residential and light commercial business, as well as the dedicated StatePoint Liquid Cooling ("SPLC") business.

Investment in research and development has continued to enhance core product platforms and breakthrough technologies, including the launch of the business's StatePoint Technology® for the rapidly growing data centre sector and its integrated CLEANSUITE® product family to capitalise on the retrofit and new construction opportunity in medical operating rooms.

The SPLC system offers breakthrough technology at the heart of many challenges facing the hyper scale data centre space and addresses the need for companies to drive energy and water efficiency, while in parallel achieving lower lifecycle costs. Having already secured a commitment from one global customer with significant potential upside, HVAC continues to expand its blue-chip, hyper-scale customer relationships.

As well as some site consolidations in accordance with its footprint strategy, HVAC implemented common operating procedures across all NAS sites, with strong costing disciplines to drive further financial efficiency. The residential business focused on initiatives to address gaps in quality, customer service and speed-to-market, and delivering significant revenue improvements in end markets with greatest differentiation. The successful separation of the light commercial business has expanded margins and refocused capacity towards new products such as high-performance computing for mission-critical customers.

#### Outlook

This business is well positioned for further improvement this year. HVAC is committed to the successful commercialisation of the SPLC system and unlocking of the value within its supply chain and cost to manufacture products. HVAC is well placed to meet its expectations in 2019 with the potential for further upside identified.

#### Market trends

##### Nortek Global HVAC

Market demand for HVAC products is generally stable with few structural concerns. The HVAC market opportunity is approximately US\$118 billion globally, while the US market is expected to grow to US\$50 billion in 2022. Growth is generally split between residential (44%) and non-residential (56%); in parallel, growth is equally distributed between new construction and product replacement. HVAC's product scope is approximately US\$20 billion focused in the heating, unitary/duct and applied segments. Expected market drivers include:

- Continued growth in the data centre cooling market.
- Demand for energy efficient products driven by continued growth in energy consumption, alongside increased energy efficiency targets.
- Continued urbanisation – two thirds of the world's population by 2050 in cities; 90 trillion in urban investment; backlog of deferred maintenance and increase in renovations and retrofits.
- Shifting demands of customers, particularly in cities, resulting in increased demand for healthcare and understanding the importance of air quality.

HVAC continues to target the highly complex and critical data centre segment with differentiated product and value propositions, supported by state-of-the-art technology that addresses energy efficiency demand by lowering both power and water usage and addressing trends related to sustainability and life cycle technology costs. HVAC's manufacturing footprint rationalisation activities during the year have better aligned capacity with expected demand, with a view to enabling more profitable growth by improving asset utilisation. Footprint rationalisation is also expected to improve production agility and speed to market by repositioning HVAC's manufacturing infrastructure to support changing core markets underpinned by shifting consumer demand.



### Air Quality & Home Solutions

Air Quality & Home Solutions ("AQH") is a leading manufacturer of ventilation products for the professional remodelling and replacement market, new residential construction market and DIY market.

It supplies to distributors and dealers of electrical and lighting products, kitchen and bathroom dealers, retail home centres and private label customers from its four manufacturing locations around the world.

Despite macro headwinds, AQH had a strong end to 2018 with an increase in sales during the second half of the year. Commodity increases and tariff activity during the middle of the year presented some challenges. However, the arrival of a range of new products resulted in sales growth gaining momentum in the second half of the year.

Facility consolidations, capital investments, sourcing and engineering initiatives and other improvements yielded cost savings of over US\$10 million in 2018 and the new Hartford distribution centre has delivered significant improvements to "On Time and Complete" delivery rates. The sales organisation was also restructured in order to focus on distribution channels and the investment in digital activity has helped AQH to respond to new trends for consumer/distributor interactions.

#### Outlook

AQH is poised for continuing sales growth from all regions in the US in 2019, supported by the new product development pipeline. Operationally, further incremental improvement opportunities are planned for 2019, alongside mitigation plans for projected tariff and commodity increases. The business expects to continue operational improvements, operating profit gains and sales growth and is optimistic about its performance for the coming year.

## Market trends

### Air Quality & Home Solutions

Outlook for the home building improvement sector remains positive but not as strong as in previous years. The key challenges and opportunities presented by the market primarily comprise the following:

- Ventilation and air quality in home construction trends continue to be an important factor for builders looking to add differentiation to their customers.
- Smart homes and value-added features in home building is a desired formula for builders looking to grab more of the step-up premium home buyers.
- US codes for proper airflow and ventilation in newly built homes continue to be established and expanded for many major US states.
- Growth in connected products and smart home activity is emerging and omni channel research, shopping, and purchasing continue to put pressure on traditional channels of distribution for bricks and mortar.
- One of the major market headwinds is the impact of price inflation on the price of home building supplies, in line with commodities and tariffs. This continues to put pressure on growth.

To address these factors during 2018, the business:

- Prepared the launch of multiple new products for 2019 in order to continue to address market needs. Future product development is focused on 'smart' or 'connectable' products;
- The ventilation category has developed the largest bank of new products, highlighting Broan-NuTone's code compliant capabilities and product depth; and
- The business has also revitalised its brands' websites with the relaunch of the Broan website in 2018 and the launch of the NuTone and Canadian websites to follow in 2019.

## Security & Smart Technology

The Security & Smart Technology ("SST") business is a leading developer and manufacturer of security, home automation and access control technologies for the residential and commercial markets, principally in North America.

The business continues to build on its expertise in the design and manufacture of wireless connectivity devices, its strong brand presence in professional security, integrator and custom installer channels and its relationships with top resellers.

The business endured a difficult year in 2018. Whilst facing considerable market headwinds, it completed its move to its new headquarters in California, consolidating its management and back-office functions as well as significantly upgrading its research and development capabilities. This was further enhanced through the acquisition of IntelliVision, a pioneering leader in artificial intelligence, smart cameras and deep-learning based video analytics software which gives the business far more Smart capabilities across its product range.

SST has also restructured its production management and sales functions to place greater focus on lead times to market and to grow its international sales opportunities. The business is moving production away from China in response to the onset of higher tariffs, which will also reduce inventory requirements and increase supply chain flexibility.

### Outlook

SST's core US residential security market has declined in 2018 and has become more competitive, requiring a renewed focus on its differentiating technologies and the need to accelerate the development of new analytics-based products, adapt its sourcing and manufacturing strategies and reduce its overall cost base for its products. With these changes in progress, the business will be as well positioned as any competitor to participate in the development in its market.

## Market trends

### Security & Smart Technology

The SST division continues to operate in a residential security market that is:

- Increasingly driven by software and device-driven solutions that offer connectivity and interaction within the ever-expanding Internet of Things product space.
- Challenged by growing concerns about cyber security.
- Subject to growing pressures on pricing.
- The implementation of trade tariffs in the US.

In response to these market dynamics, the business has provided encrypted sensing technology within its security products thereby protecting the data that is wirelessly transmitted.

The business has also developed further intellectual property to support the development of analytics-driven products to meet the dynamic nature of current consumer demand in this space.

The business has acquired IntelliVision and incorporated its Smart capabilities into the product portfolio. In response to the onset of higher tariffs, production is being moved away from China.

## Divisional review

Continued

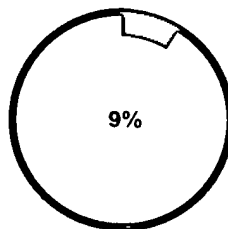
# Other Industrial

The Other Industrial division comprises four businesses.

(i) Brush; (ii) Ergotron; (iii) the Walterscheid Powertrain Group (previously GKN Off-Highway Powertrain); and (iv) GKN Wheels & Structures.

### Proportion of Melrose

Based on annualised adjusted 2018 revenue for all businesses.



brush.eu

## Brush

Having gone through a major restructuring in 2018, Brush is now structured around its core competencies of turbogenerators, switchgear, transformers and aftermarket services.

Whilst the restructuring announced at the start of 2018 has gone successfully, the market conditions for Brush in the generator services sector have worsened. This has negatively impacted the value of Brush which is discussed more in the Finance Director's review. The switchgear business continued to perform well during the year and launched the next generation of an 11KV AC indoor panel called Quantum, increasing its market penetration in the utility and industrial sectors, as well as securing its first significant order from the UK rail industry. The transformers business endured another difficult year but enters 2019 well placed to improve.

### Outlook

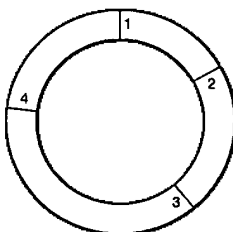
There is some optimism for aftermarket performance in 2019 with the expansion of the Brush field service network and repair capabilities. Nonetheless, global economic prospects still remain uncertain in Brush's main markets and the underlying trading environment in 2019 is expected to remain challenging.

### Financial Information

#### Financial results 2018

	£m
Statutory revenue	836
Adjusted revenue <sup>(1)</sup>	890
Statutory operating loss	(159)
Adjusted operating profit <sup>(2)</sup>	98

#### Revenue by business<sup>(2)</sup>



1 Brush	17%
2 Ergotron	22%
3 Walterscheid Powertrain Group	38%
4 GKN Wheels & Structures	23%

- (1) Described in the glossary to the financial statements on pages 196 to 198 and shown in note 6 to the financial statements.  
 (2) Based on annualised adjusted 2018 revenue for GKN businesses.

## Market trends

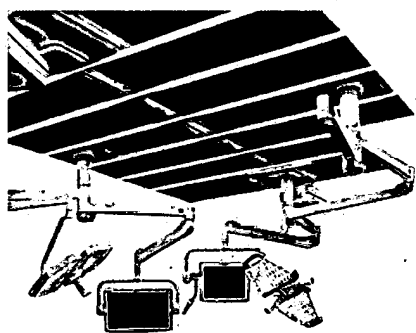
### Brush

The global power generation market, and in particular the gas turbine market, remains subject to the significant shifts in macro trends affecting energy consumption. Namely that:

- The expected increase in general global energy consumption is not driven by the traditional power markets, which have seen a significant disruption in recent years driven by the overall growth in renewables and a more efficient use of energy.
- The shift in the source of demand for energy has created substantial technological and structural demand change to the electricity generation sector, which has significantly impacted the gas turbine market which has seen orders falling more than 60% from the peak levels in 2011.
- Renewables such as wind and solar continue to feed variable decentralised power and can impact grid stability, meaning that gas-fired power generation will remain a major contributor to electricity supply.
- Electrification continues to take hold in developing markets.
- Investment continues to increase in rail and tram infrastructure.
- Regulatory strategies are favouring asset upgrade as opposed to replacement, which still presents growth opportunities.

Brush continues to respond to these structural market challenges in a number of ways:

- Nearing completion of a significant restructure of the entire business to realign its production footprint.
- With the fall in Generator demand, Brush has adapted to the new market realities including an increased focus upon Service activities.
- Growth strategies have been implemented to increase Services market penetration with the introduction of cost-effective product upgrades that extend asset life.



[ergotron.com](http://ergotron.com)

## Ergotron

Ergotron is a leading designer, manufacturer and distributor of ergonomic products for use in a variety of working, learning and medical care environments. Based in Minneapolis, US, Ergotron comprises three businesses: Commercial, Consumer and Original Design and Manufacturer.

The business continues to drive a quality and design-led product strategy, focusing on high-growth market segments. In 2018 the business revitalised its leadership team and launched its proprietary eCommerce channel supported by a successful digital marketing campaign. While continuing to face tariff headwinds that triggered a production review, there has been further investment in product leadership and agile processes and a US\$1 million capital investment in rapid prototyping equipment and laboratories.

### Outlook

Ergotron expects its core businesses to perform well in 2019, supported by its restructured leadership team and refined footprint. New sales leadership, fresh branding and investments in product development will accelerate innovative solutions to give confidence in the business for 2019.

## Market trends

### Ergotron

Within the workplace supplies and furniture market, key opportunities include:

- The pursuit of new growth opportunities within a corporate office market of US\$900 million+, driven by increasing user awareness about the negative effects of sedentary disease and its impact on employee health and wellbeing.
- Sit-to-stand solutions remain a primary product solution to the issue of sedentary disease. However, such products have experienced relatively low market penetration.
- In the healthcare market the US\$650 million+ opportunity for ergonomic solutions continues to be driven by the global expansion of electronic medical records and the integration of mobile and tablet devices into the healthcare environment.
- Similarly, within education, the evolution and adoption of active classrooms is creating a US\$500 million+ addressable market, driven by height-adjustable student desks and device/notebook charging.

The business continues to target the market potential for sit-to-stand product solutions and has invested in product development that will accelerate innovative offerings. Investment in branding has sought to project a modern image of the company to reflect its focus on designing products and services that progress the aesthetic appeal and ergonomic effectiveness of office, healthcare and education working environments. These efforts are supported by new sales leadership within the business and a vertically oriented sales organisation to drive informed and targeted sales activity.

## Divisional review

Continued

### Walterscheid Powertrain Group

The rebranded Walterscheid Powertrain Group is a leading supplier of engineered power transmission products, systems and service solutions to the world's leading off-highway and industrial equipment manufacturers, driving efficiency in the agriculture, construction, mining and industrial markets, as well as providing aftermarket services for powertrain solutions.

During 2018, the Walterscheid Powertrain Group delivered on expectations, with growth in both revenue and profit on the back of strong conditions in both the key agriculture and construction industries, despite headwinds from tariffs and raw material price increases, as well as growth in aftermarket.

The construction of the new highly automated manufacturing site in Welsburg, Italy was completed, and the business continues to adapt to the market's adoption of smart, connected drivetrain solutions, including further automation in the areas of standard manufacturing processes in its sites at Lohmar, Germany and Rockford and Woodridge in the US.

#### Outlook

As announced on 6 March 2019, Melrose has agreed to sell the Walterscheid Powertrain Group to One Equity Partners, a US-based private equity firm. The sale is subject to the customary regulatory conditions and is expected to complete in the first half of this year.

This coming year, the Walterscheid Powertrain Group will seek to capitalise on its distinctive capabilities and strong market positions to continue to grow and improve. Several key business growth initiatives are in place, including continued development of the Aftermarket & Services offering in North America, the growth of its business in China, and selected product initiatives, which reinforce the business's positive outlook for 2019.

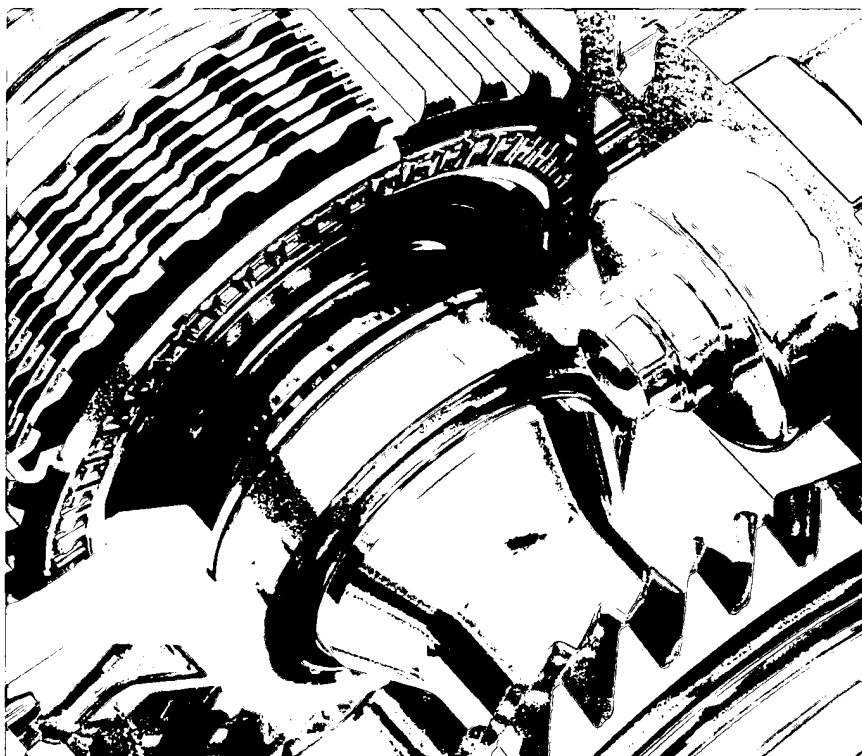
#### Market trends

##### Walterscheid Powertrain Group

The agriculture and construction sectors are each experiencing strong growth, largely due to:

- Growing shortage of farm land driving need for increased efficiency in farming, including smart, connected drivetrain solutions.
- Westernisation of diets in most emerging markets and growing global middle class leading to shift towards consumption of corn, wheat and less crop-efficient food, e.g. feed for livestock.
- Sustained increase in global infrastructure investment and trend to urbanisation across most geographies.
- Strong macro-economic environment in the US and Europe.

To pursue the opportunities presented by these trends, the business has focused on high horse power equipment and development of products with increased power density and longer lifetime, growth of its China operations and targeting the emerging markets, new product initiatives for construction equipment in Europe and Asia to target growing markets following success in the US within this product space. The business has also focused on further development of aftermarket business in the US to be prepared for future growth coming from a trend to a higher portion of leased equipment with much higher utilisation rates. Overlaying each of these solutions is the development of smart and connected products to drive efficiency of customers' equipment to avoid unplanned down time.



walterscheid-group.com



gknwheels.com

## GKN Wheels & Structures

GKN Wheels & Structures is a leading global manufacturer of off-highway wheels for agricultural, construction, mining and industrial use, as well as metallic structures for automotive and off-highway vehicles.

The business continued to make significant progress during 2018 with major investments coming on stream and excellent profit conversion on additional sales which outgrew the market. Over £20 million of new business was won during 2018, including diversifying its structures customer base into off-highway customers. Additionally, the business de-risked over 90% of its input steel price movement exposure. Improved performance has come about through more tightly controlled fixed costs and introduction of new technology, such as a fully flexible, automatic welding cell at the Denmark facility and a new automated off-highway rim line at the UK facility.

### Outlook

Market conditions have continued to improve and the full benefit from improvement initiatives implemented in 2018 is expected to flow from 2019. Although some uncertainty has been caused by the introduction of import tariffs in the US, the business is well placed to deal with this uncertainty and the outlook for 2019 remains positive.

## Market trends

### GKN Wheels & Structures

Looking at the current forces and drivers within the business's key sectors, being agricultural, construction and mining:

- The global agricultural segment continues to target greater efficiency and sustainability. This is driving demand for larger higher-powered tractors, automation and serviceability for increased efficiencies, productivity and greater machine uptime.
- The construction and mining segments are experiencing steady growth globally, fuelled by infrastructure spend.
- The container handling segment is investing in more automation globally to drive productivity and efficiencies at ports.

The business has responded to these opportunities by:

- Developing new patented technology with a solutions approach to industry challenges, including the Profi-Grip and Profi-Fit wheels;
- Continuing to capitalise on light-weight and engineered solutions to allow construction and mining customers to manufacture more efficient machinery also suitable for on-road regulations; and
- Continuing to invest in advanced manufacturing facilities to allow the efficient production of larger, more technologically advanced wheels.

## Finance Director's review



Geoffrey Martin  
Group Finance Director

**The acquisition of GKN plc ("GKN") on 19 April 2018 significantly increased the size of the Melrose Group. Consequently, the statutory and adjusted results for the year ended 31 December 2018 only include eight months of trading for GKN, whilst the prior year did not include any results for GKN. This makes a meaningful year-on-year comparison of statutory or adjusted results more difficult.**

### Acquisition of GKN

Under the terms of the acquisition, GKN shareholders received 1.69 new Melrose shares and 81 pence in cash for every GKN share. In addition, GKN shareholders received the final GKN dividend of 6.2 pence per share, which was paid in May 2018 during Melrose ownership.

In accordance with IFRS 3 "Business Combinations", the consideration paid to acquire GKN in the financial statements is calculated using the share price at the date of acquisition of £2.35 and only includes approximately 85% of the total amount paid, being the percentage of acceptances received from GKN shareholders by 19 April 2018. The remaining 15% of shares that were acquired in the period from 19 April 2018 to 30 June 2018 are treated as the purchase of non-controlling interests and are shown as a movement in equity.

Details of the banking facilities entered into to allow Melrose to acquire GKN are discussed later in this review.

### Melrose group results

Following the acquisition of GKN in the year, there are three sets of results to consider:

#### Statutory results

The statutory results include eight months of trading for GKN, are shown on the face of the Income Statement and are audited. The statutory results show revenue of £8,605 million (2017: £2,092 million), an operating loss of £392 million (2017: loss of £7 million) and a loss before tax of £550 million (2017: loss of £28 million). The diluted earnings per share ("EPS"), calculated using the weighted average number of shares in issue during the year of 3,959 million, were a loss of 12.0 pence (2017: loss of 1.2 pence).

The statutory loss before tax of £550 million arose primarily due to significant acquisition-related items and other adjusting items, most of which arise from GKN.

#### Adjusted results

The adjusted results include eight months of trading for GKN, are shown on the face of the Income Statement and are audited. They are adjusted to exclude certain items which are significant in size or volatility or by nature are non-trading or non-recurring, or are items released to the Income Statement that were previously a fair value item booked on an acquisition. It is Melrose's accounting policy to exclude these items from the adjusted results, which are used as an Alternative Performance Measure ("APM") as described by the European Securities and Markets Authority ("ESMA").

The Melrose Board considers the adjusted results to be an important measure used to monitor how the businesses are performing, as they achieve consistency and comparability between reporting periods when all businesses are held for the complete reporting period.

The adjusted results in the year ended 31 December 2018 show revenue of £9,102 million (2017: £2,095 million), an operating profit of £847 million (2017: £279 million) and a profit before tax of £703 million (2017: £258 million). Adjusted diluted EPS, calculated using the weighted average number of shares in issue during the year were 13.3 pence (2017: 9.8 pence).

The description of adjusting items and a reconciliation of the statutory results to the adjusted results is discussed later in the review.

#### Annualised adjusted results

The Melrose Board believes that the annualised adjusted results give a meaningful measure of annualised performance to guide ongoing results when adjusted results include businesses owned for part of a period. They include the adjusted results of the GKN businesses for twelve months, as if GKN had been acquired on 1 January 2018. They are calculated using the ongoing adjusted interest charge, the expected ongoing divisional long-term incentive plan charge, the effective tax rate of the enlarged Group and the diluted number of shares in issue at 31 December 2018.

Annualised adjusted results in the year ended 31 December 2018 show revenue of £12,247 million, an operating profit of £1,095 million and a profit before tax of £886 million. Annualised adjusted diluted EPS, calculated using the number of shares in issue at 31 December 2018, of 4,858 million were 13.8 pence.

A reconciliation of adjusted results to the annualised adjusted results is shown later in this review.

The statutory, adjusted and annualised adjusted results for the year included a positive impact from unwinding loss-making contract provisions which were required under IAS 37: "Provisions, contingent liabilities and contingent assets", and identified during the opening Balance Sheet review process for GKN, which is discussed later in this review.

Excluding the positive impact of the unwind of the loss-making contracts provision, the adjusted results would show an operating profit of £784 million, the annualised adjusted results would show an operating profit of £1,002 million and an EPS of 12.5 pence.

### Statutory, adjusted and annualised adjusted results by reporting segment

The following table shows revenue split by reporting segment, including equity accounted investments ("EAls") for adjusted revenue and annualised adjusted revenue:

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Total £m
<b>Statutory revenue</b>	<b>2,479</b>	<b>2,936</b>	<b>846</b>	<b>1,458</b>	<b>886</b>	<b>8,605</b>
<b>Reconciling item:</b>						
Revenue from EAls	42	446	5	-	4	497
<b>Adjusted revenue</b>	<b>2,521</b>	<b>3,382</b>	<b>851</b>	<b>1,458</b>	<b>890</b>	<b>9,102</b>
GKN revenue (1 January to 18 April)	1,013	1,567	361	-	204	3,145
<b>Annualised adjusted revenue</b>	<b>3,534</b>	<b>4,949</b>	<b>1,212</b>	<b>1,458</b>	<b>1,094</b>	<b>12,247</b>

The following table shows operating profit/(loss) split by reporting segment. Adjusting items are described later in this review.

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate £m	Total £m
<b>Statutory operating (loss)/profit</b>	<b>(44)</b>	<b>15</b>	<b>38</b>	<b>126</b>	<b>(159)</b>	<b>(368)</b>	<b>(392)</b>
<b>Reconciling item:</b>							
Adjusting items	294	216	60	72	257	340	1,239
<b>Adjusted operating profit</b>	<b>250</b>	<b>231</b>	<b>98</b>	<b>198</b>	<b>98</b>	<b>(28)</b>	<b>847</b>
GKN operating profit (1 January to 18 April)	91	130	45	-	18	(36)	248
<b>Annualised adjusted operating profit</b>	<b>341</b>	<b>361</b>	<b>143</b>	<b>198</b>	<b>116</b>	<b>(64)</b>	<b>1,095</b>

The performance of each of the reporting segments is discussed in the Chief Executive's review. The adjusted operating costs in the corporate cost centre of £28 million (2017: £23 million) included £20 million (2017: £15 million) of Melrose corporate costs, £6 million (2017: £nil) of the remaining GKN central costs and £2 million (2017: £8 million) of costs in respect of the divisional cash-based long-term incentive plans.

### Reconciliation of statutory results to adjusted results

The following table reconciles the statutory operating loss to adjusted operating profit:

	2018 £m	2017 £m
<b>Statutory operating loss</b>	<b>(392)</b>	<b>(7)</b>
<b>Adjusting items:</b>		
Amortisation of intangible assets acquired in business combinations	401	82
Restructuring costs	240	35
Acquisition and disposal costs, including associated transaction taxes	153	6
Impairment of assets	152	145
Currency movements in derivatives and associated financial assets and liabilities	143	-
Reversal of one-off uplift in the value of inventory in GKN businesses	121	-
Other	29	18
<b>Adjustments to statutory operating loss</b>	<b>1,239</b>	<b>286</b>
<b>Adjusted operating profit</b>	<b>847</b>	<b>279</b>

# Finance Director's review

Continued

## Adjusting items

The value of intangible assets acquired in business combinations has significantly increased during the year following the acquisition of GKN. As a result, the amortisation charge in the year was £401 million (2017: £82 million) and included eight months of amortisation of intangible assets acquired with GKN. This is excluded from adjusted results due to its non-trading nature and to enable comparison with companies that grow organically. Where intangible assets are trading in nature, such as computer software and development costs, the amortisation is not adjusted.

Restructuring and other associated costs totalled £240 million (2017: £35 million), including £7 million (2017: £1 million) of losses incurred following the announcement of the closure of certain businesses within the Group. Restructuring costs are adjusting items due to their size and non-trading nature and during the year ended 31 December 2018 they included:

- A charge of £156 million in respect of the GKN businesses. Within this, £56 million related to the Aerospace division, predominantly in North America, with key focus on improving quality and delivery for customers. Within the GKN Automotive business £46 million of costs have been incurred restructuring and enhancing the future performance of the business under new leadership. In addition, £54 million of restructuring costs were incurred in respect of early actions within other GKN businesses, including the ceasing of GKN head office functions.
- A charge of £59 million (2017: £6 million) in respect of the closure of the Dutch turbogenerator facility in Brush and the restructuring of its turbogenerator production in the UK following the announcement on 1 February 2018.
- A charge of £22 million (2017: £27 million) within Nortek Air & Security, which mostly related to footprint rationalisation within the HVAC business.

Acquisition and disposal costs of £153 million (2017: £6 million) were incurred in the year and included general transaction fees and associated transaction taxes, predominantly in respect of the acquisition of GKN. These costs also included a small amount of fees relating to the £26 million bolt-on acquisition of IntelliVision Inc., by the Security & Smart Technology business and the cost of certain other corporate deal activities in the year. These items are excluded from adjusted results due to their non-trading nature.

An impairment charge totalling £152 million (2017: £145 million) was incurred in the year ended 31 December 2018. This included £132 million in respect of the carrying value of assets held within the Brush business of which £123 million related to goodwill, discussed later in this review, and £9 million to property, plant and equipment. In addition, £15 million of intangible assets and £5 million of property, plant and equipment were impaired in respect of assets held within the GKN businesses. The impairment charges are shown as an adjusting item due to their non-trading nature and size.

Melrose policy is to hedge account where possible, however, hedge accounting has not historically been applied to the GKN businesses for transactional foreign exchange exposure. For consistency, the movement in the value of derivative financial instruments (primarily forward foreign currency exchange contracts) entered into to mitigate the potential volatility of future cash flows on long-term foreign currency customer and supplier contracts, along with foreign exchange movements on the associated financial assets and liabilities, totalling a charge of £143 million (2017: £nil), is shown as an adjusting item because of its volatility and size.

Finished goods and work in progress inventory which are present in a business when acquired, in accordance with IFRS 3, are required to be uplifted in value to closer to their selling price.

As a result, in the early months of an acquisition, reduced profits are generated as this inventory is sold. The one-off effect in the year, relating to GKN acquired inventory, was a charge of £121 million (2017: £nil) and is excluded from adjusted results due to its size and non-recurring nature.

The charge for the Melrose equity-settled Incentive Scheme, including its associated employer's tax charge, of £13 million (2017: £24 million), is excluded from adjusted results due to its volatility. The shares that would be issued, based on the Scheme's current value at the end of the reporting period, are included in the calculation of the adjusted diluted earnings per share, which the Board considers to be a key measure of performance.

On 26 October 2018, a High Court judgement was made in respect of the gender equalisation of guaranteed minimum pensions for occupational pension schemes. The judgement concluded the schemes should be amended to equalise pension benefits for men and women in relation to guaranteed minimum pension benefits, an issue which affects many UK defined benefit pension schemes. The impact of this amendment on the pension schemes within the Group resulted in a specific £11 million increase in the pension deficit with a corresponding past service cost in the Income Statement. This cost is excluded from adjusted results due to its non-trading and non-recurring nature.

The Group has a number of EAls in which it does not hold full control, the largest of which is a 50% interest in Shanghai GKN HUAYU Driveline Systems ("SDS"), within the GKN Automotive business. The EAls generated £497 million of revenue in 2018, which is not included in the statutory results but is shown within adjusted revenue so as not to distort the operating margins reported in the businesses when the adjusted operating profit earned from these EAls is included.

In addition, the profits and losses of EAls, which are shown after amortisation of intangible assets, interest and tax in the statutory results, are adjusted to show the adjusted operating profit consistent with the adjusted operating profits of the subsidiaries of the Group. The revenue and profit of EAls are adjusted because they are considered to be significant in size and are important in assessing the performance of the business.

Certain items recognised as fair value items on an acquisition totalling £20 million (2017: £6 million), which have been resolved for more favourable amounts than first anticipated, were released as an adjusting item to avoid positively distorting adjusted results.

## Reconciliation of adjusted results to annualised results

	2018 £m
<b>Adjusted operating profit</b>	<b>847</b>
<b>Reconciling item:</b>	
Adjusted operating profit of GKN (1 January 2018 to 18 April 2018)	248
<b>Annualised adjusted operating profit</b>	<b>1,095</b>

### Finance costs and income

The net finance costs in the year ended 31 December 2018 were £158 million (2017: £21 million), which included £15 million (2017: £nil) of finance costs treated as adjusting items. These adjusting items include £8 million relating to the fair value changes on cross-currency swaps entered into by GKN prior to Melrose ownership, along with £7 million relating to the acceleration of amortisation of debt fees associated with the previous Melrose bank facility, written off when the new bank facility was entered into to acquire GKN and the previous facility was repaid and cancelled. These charges are shown as adjusting items because of their volatility and non-trading nature.

The net adjusted finance costs in the year ended 31 December 2018 were £144 million (2017: £21 million), the year-on-year increase reflecting the increase in the size of the Group and the new debt facilities following the acquisition of GKN.

Net interest on external bank loans, bonds, overdrafts and cash balances was £98 million (2017: £16 million). Melrose uses interest rate swaps to fix the majority of the interest rate exposure on its drawn debt. More detail on these swaps is given in the finance cost risk management section of this review.

In addition, finance charges included an £11 million (2017: £2 million) amortisation charge relating to the arrangement costs of raising the bank facility in 2018, a net interest charge on net pension liabilities of £24 million (2017: £1 million), a charge for the unwind of discounting on long-term provisions of £10 million (2017: £2 million), of which £9 million related to the unwind of discounts on the loss-making contract provisions identified within GKN businesses, and £1 million relating to the interest charge in EAls.

### IFRS 3 "Business combinations"

In accordance with IFRS 3, the GKN assets, liabilities and accounting policies were reviewed following the acquisition, resulting in a significant amount of required adjustments to the acquired GKN Balance Sheet.

A summary of these adjustments is shown in the table below:

	GKN acquired Balance Sheet at 19 April 2018 £m	Fair Value & other adjustments £m	GKN Balance Sheet at Fair Value £m
Goodwill	466	2,056	2,522
Intangible assets acquired with business combinations	488	5,243	5,731
Tangible assets, computer software and development costs	3,043	44	3,087
Equity accounted investments ("EAls")	272	240	512
Net working capital	886	(131)	755
Retirement benefit obligations	(1,369)	–	(1,369)
Provisions	(144)	(1,036)	(1,180)
Deferred tax and current tax	58	(908)	(850)
Net debt	(1,159)	–	(1,159)
Net other	(28)	(73)	(101)
<b>Total Net Assets</b>	<b>2,513</b>	<b>5,435</b>	<b>7,948</b>

Third party experts were appointed to value intangible assets, freehold property, the significant EAI in the GKN Automotive business, SDS, leasehold property commitments and retirement benefit obligations. Adjustments identified in respect of these valuations are included in the table above.

Acquisition-related intangible assets identified and independently valued on the acquisition of GKN totalled £5,731 million and are discussed later in this review. A deferred tax liability of £1,285 million was also recognised in respect of the GKN intangible assets, which is not expected to give rise to a cash liability.

In addition to the independent valuations, external advisers carried out a comprehensive series of visits to all GKN sites to perform balance sheet reviews line by line. These reviews identified a number of required adjustments, in particular in respect of net working capital and provisions.

### Tax

The statutory results show a tax credit of £75 million (2017: £4 million) which arises on a statutory loss before tax of £550 million (2017: £28 million), a statutory tax rate of 14% (2017: 13%). This rate is lower than the adjusted effective tax rate because many of the adjusting items, discussed earlier in this review, do not give rise to tax deductions.

The effective rate on the adjusted profit before tax for the year ended 31 December 2018 was 23% (2017: 26%). The adjusted tax rate that is applicable to GKN profits is similar to the expected average tax rate of the Melrose Group had the acquisition of GKN not happened. In both cases, the reduction in the tax rate between 2017 and 2018 is predominantly due to the reduction of US Federal tax rates.

The Group has tax losses and other deferred tax assets with a value of £898 million (31 December 2017: £193 million). These are offset by deferred tax liabilities of £1,446 million (31 December 2017: £198 million) on intangible assets and £177 million (31 December 2017: £15 million) of other deferred tax liabilities. The Group tax losses will generate future cash tax savings, whereas the deferred tax liabilities on intangible assets are not expected to give rise to cash tax payments.

Cash tax paid in the year ended 31 December 2018 was £66 million (2017: £16 million) representing 9% (2017: 6%) of adjusted profit before tax. This was lower than the effective tax rate because the Group benefits from certain adjusting items being tax allowable, from existing tax assets brought forward, and the new tax losses and other deferred tax assets acquired with GKN.

# Finance Director's review

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The required adjustments to net working capital included a £252 million reduction in receivables and inventory, partially offset by the £121 million IFRS 3 uplift to the value of inventory, discussed in the adjusting items section of this review. Within this, the receivables balance acquired was reduced by £63 million, 2%, aligning provisioning policy. The gross reduction in inventory of £189 million included the reclassification of £52 million of long-life tooling assets as tangible fixed assets and £137 million, 11% of the acquired balance, relating to inventory write-offs and alignment of provisioning policy.

A significant adjustment to the GKN Balance Sheet was the requirement to increase provisions to £1,180 million, which included £629 million relating to loss-making contracts identified in GKN at the time of acquisition. These are discussed later in the provisions section of this review.

## Adoption of IFRS 15 "Revenue from contracts with customers" and the future impact of IFRS 16 "Leases"

IFRS 15 was adopted on 1 January 2018 and had a sizeable impact within the Aerospace division but did not materially impact the other businesses in the Melrose Group.

The overall impact of IFRS 15 was to recognise a contract asset which was recorded at a fair value of £524 million upon the acquisition of GKN and predominantly in the Aerospace division. The impact of IFRS 15 has reduced annual revenue by approximately £80 million, mainly as a result of the netting of certain expenses against revenue that were previously shown within cost of sales, and to increase annual adjusted operating profit by approximately £15 million, mainly as a result of the earlier recognition of variable consideration from risk and revenue sharing partnerships.

IFRS 16 is effective from 1 January 2019 and requires all leases to be recognised on the Balance Sheet. Currently only finance leases are recognised on the Balance Sheet, with leases categorised as operating leases expensed through the Income Statement. The impact of IFRS 16 will be to recognise a lease liability in the range £550 million to £600 million, with a corresponding asset in the Balance Sheet. The expected annual impact of IFRS 16 on the Income Statement in 2019 will be to increase operating profit, but is not expected to be significant, and will be more than offset by an associated increase in finance costs in the year of approximately £20 million. In addition, approximately £75 million of costs will be reclassified from a lease expense to depreciation.

## Cash generation and management

Group net debt at 31 December 2018, translated at closing exchange rates (being US\$1.27 and €1.11), was £3,482 million (31 December 2017: £572 million). For bank covenant purposes, the Group's net debt is calculated at average exchange rates (being US\$1.33 and €1.13), to align the calculation with the currency rates used to calculate profits, and was £3,396 million.

The movement in net debt in the year is summarised as follows:

	2018 £m	2017 £m
<b>Movement in Group net debt</b>		
<b>At 1 January</b>	<b>(572)</b>	<b>(542)</b>
<b>Non-trading items:</b>		
Net debt acquired with GKN	(1,159)	-
Cash consideration for GKN (81 pence per share)	(1,398)	-
Payment of GKN 2017 final dividend	(107)	-
Acquisition costs and related transaction tax costs	(177)	(3)
Acquisition of IntelliVision Inc.	(26)	-
Dividend paid to Melrose shareholders	(129)	(63)
Foreign exchange and other non-cash movements	(110)	48
<b>Cash flow from non-trading items</b>	<b>(3,106)</b>	<b>(18)</b>
<b>Free cash flow (after all costs including tax)</b>	<b>196</b>	<b>(12)</b>
<b>At 31 December at closing exchange rates</b>	<b>(3,482)</b>	<b>(572)</b>
<b>At 31 December at average exchange rates</b>	<b>(3,396)</b>	<b>(595)</b>

The significant increase in Group net debt in the year includes £3,106 million relating to non-trading items, of which £2,867 million, 92% was in respect of acquisition related activity. The remaining 8% was in respect of the £129 million payment of dividends to Melrose shareholders and £110 million of foreign exchange and non-cash movements.

The GKN net debt acquired on 19 April 2018 was higher than GKN plc announced for 31 December 2017 predominantly because of trading movements, the payment of £129 million of GKN defence costs by the GKN Board and a working capital outflow of £182 million which included resolving the previous late payments to suppliers.

An analysis of the free cash flow (after all costs) is shown in the table below:

	2018 £m	2017 £m
<b>Free cash flow (after all costs)</b>		
<b>Adjusted operating cash flow (pre-capex)</b>	<b>921</b>	<b>298</b>
Net capital expenditure	(359)	(49)
Net interest and net tax paid	(172)	(31)
Defined benefit pension contributions	(102)	(4)
Incentive scheme payments (including associated employer's tax)	-	(148)
Restructuring	(122)	(48)
Dividend income from equity accounted investments	66	-
Net other	(36)	(30)
<b>Free cash flow (after all costs)</b>	<b>196</b>	<b>(12)</b>

The total free cash flow (after all costs) of £196 million is after cash spent on restructuring projects of £122 million (2017: £48 million). The restructuring activities are described earlier in this review, in the reconciliation of statutory results to adjusted results section.

In addition, net capital expenditure spent in the year was £359 million (2017: £49 million), representing 1.3x depreciation.

Net interest paid in the year was £106 million (2017: £15 million) and tax was £66 million (2017: £16 million) representing 9% (2017: 6%) of adjusted profit before tax. This rate was lower than the effective tax rate as explained earlier in the tax section of this review.

Defined benefit pension scheme cash contributions of £102 million included £56 million of the Melrose commitment to contribute £150 million to the GKN UK 2012 and 2016 plans within the first twelve months of GKN ownership, in addition to ongoing payments. The remainder of this upfront commitment is to be paid by 19 April 2019 as agreed with the Trustees.

### Assets and liabilities

The summarised Melrose Group assets and liabilities are shown below:

	2018 £m	2017 £m
Goodwill and intangible assets acquired with business combinations	10,591	2,229
Tangible fixed assets, computer software and development costs	3,651	228
Equity accounted investments	492	–
Net working capital	960	241
Retirement benefit obligations	(1,413)	(18)
Provisions	(1,445)	(209)
Deferred tax and current tax	(788)	(27)
Net other	(305)	13
<b>Total</b>	<b>11,743</b>	<b>2,457</b>

These assets and liabilities are funded by:

	2018 £m	2017 £m
Net debt	(3,482)	(572)
Equity	(8,261)	(1,885)
<b>Total</b>	<b>(11,743)</b>	<b>(2,457)</b>

### Goodwill, intangible assets and impairment review

The total value of goodwill as at 31 December 2018 was £4,052 million (31 December 2017: £1,432 million) and intangible assets acquired with business combinations was £6,539 million (31 December 2017: £797 million). These items are split by division as follows:

31 December 2018	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Total £m
Goodwill	974	1,049	529	973	527	4,052
Intangible assets acquired with business combinations	3,410	1,478	736	543	372	6,539
<b>Total goodwill and intangible assets</b>	<b>4,384</b>	<b>2,527</b>	<b>1,265</b>	<b>1,516</b>	<b>899</b>	<b>10,591</b>

The goodwill and intangible assets have been tested for impairment as at 31 December 2018. In accordance with IAS 36 "Impairment of assets" the recoverable amount is assessed as being the higher of the fair value less costs to sell and the value in use.

The Board is comfortable that no impairment is required in respect of the goodwill and intangible assets of the recently acquired GKN businesses or the Nortek businesses.

Both Security & Smart Technology and Ergotron have manufacturing facilities located in China that export to the US and their results in 2018, and the ongoing market environment, have been negatively impacted by the increase in US tariffs placed on Chinese goods. The intention is to pass any increased tariffs through to customers, but the uncertainty around how customers will react and/or a further escalation of US tariffs on Chinese goods and the impact that this could have on the behaviour of competitors means that there is a risk that future forecasts could be negatively impacted.

In the previous year, the assets of the Brush business were impaired by £145 million to a value of £300 million, using the fair value less costs to sell basis. This method of valuation, at the time, was higher than the value in use method, because that excluded the benefits of the restructuring announced in February 2018, and would have given a value of £178 million.

The restructuring of the Brush business that was announced in February 2018 followed a full review of the power generation industry and highlighted the surplus generator manufacturing capacity existing in the market. The restructuring programme has been implemented in line with plan.

However, in 2018 the conditions in the generator services business have also become more challenging as the year has progressed, with competitors taking a decision to look to service opportunities to offset surplus capacity issues in the generator manufacturing market. Alongside this, customers and competitors in the power generation sector have continued to reorganise and restructure in the second half of 2018.

These newly developed generator services market conditions and the decisions from significant market participants have had a direct impact on the trading of Brush and reduced forecasts in the Brush generator servicing business.

At 31 December 2018, the recoverable amount of the Brush assets, using the reduced forecasts and the value in use method, was £103 million, resulting in a further impairment to Brush goodwill of £123 million in the year.

# Finance Director's review

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## Provisions

Total provisions at 31 December 2018 were £1,445 million (31 December 2017: £209 million), a significant increase from the previous year, due to the acquisition of GKN and inheriting provisions with a fair value of £1,180 million in the opening Balance Sheet, discussed earlier in this review.

The following table details the movement in provisions in the year:

	Total £m
<b>At 1 January 2018</b>	<b>209</b>
Acquisition of GKN	1,180
Net charge to adjusted operating profit	89
Net charge shown as an adjusting item in the Income Statement	168
Spend against provisions	(221)
Unwind of loss-making contract provision	(63)
Other (including foreign exchange)	83
<b>At 31 December 2018</b>	<b>1,445</b>

As discussed earlier in this review, £1,180 million of provisions were recognised on the acquisition of GKN. These included £629 million in respect of loss-making contracts, of which £63 million was utilised in the Income Statement in the eight months of ownership. Approximately half of the loss-making contract provisions were recorded in the Aerospace division, approximately one third in the Automotive division and the remainder predominantly within Powder Metallurgy. The loss-making contract review identified approximately 10% of GKN's annual revenue requiring some provision, with the majority of relevant contracts spanning multiple years and with a tail of certain smaller contracts spanning approximately 15 years.

The provisions in GKN also include warranty related items totalling £295 million and environmental and litigation related items of £123 million, equivalent to 1.0% and 0.4% respectively of the previous three years' total revenue.

The increase to provisions in the year arising from a net charge to adjusted operating profit of £89 million relates primarily to warranty, product liability and workers' compensation, which are matched by similar cash payments in the year.

The increase to provisions in the year arising from the net charge shown as an adjusting item in the Income Statement of £168 million, primarily related to charges associated with restructuring, which are discussed in the adjusting items section of this review. During the year £111 million of cash was spent on restructuring provisions.

Included within other movements in provisions are foreign exchange movements and the unwind of discounting on certain provisions.

## Pensions and post-employment obligations

Melrose operates a number of defined benefit pension schemes and retiree medical plans across the Group, accounted for using IAS 19 Revised: "Employee Benefits". During the year the acquisition of GKN has significantly increased the Melrose Group's IAS 19 net deficit, with £1,402 million of the £1,413 million Group net deficit recorded in the Balance Sheet at 31 December 2018 relating to the acquired business.

At 31 December 2018, total plan assets of the Group's defined benefit pension plans were £3,273 million (31 December 2017: £524 million) and total plan liabilities were £4,686 million (31 December 2017: £542 million), of which £749 million (31 December 2017: £4 million) related to unfunded plans.

The most significant pension plans in the Group are the GKN UK 2012 and 2016 plans. The net accounting deficit on these plans was £579 million at 31 December 2018. These plans had assets at 31 December 2018 of £2,529 million and liabilities of £3,108 million. In addition, there are GKN UK post-employment medical plans with a net deficit of £9 million at 31 December 2018.

Melrose committed to contribute £150 million in total to the GKN UK 2012 and 2016 plans in the first 12 months of ownership, as well as ongoing annual contributions of £60 million. In addition, Melrose has committed to contribute £270 million upon the disposal of GKN Powder Metallurgy, 10% of the proceeds from disposal of other GKN businesses and 5% of the proceeds from disposal of non-GKN businesses to the GKN UK pension plans. These commitments cease when the funding target which has been agreed with Trustees is achieved, being gilts plus 25 basis points for the GKN UK 2016 plan and gilts plus 75 basis points for the GKN UK 2012 plan.

The GKN UK 2012 and 2016 plans are closed to new members and the 2012 plan is closed to the accrual of future benefits for current members, whilst the 2016 plan has no active members.

The values of the Group plans were updated at 31 December 2018 by independent actuaries to reflect the latest key assumptions. A summary of the assumptions used is shown in note 23 of the financial statements.

It is noted that a 0.1 percentage point decrease in the discount rate would increase the pension accounting liabilities of the Group, on an IAS 19 basis, by £73 million, or 2%, and a 0.1 percentage point increase to inflation would increase the liabilities by £52 million, or 1%. Furthermore, an increase by one year in the expected life of a 65-year-old member would increase the pension liabilities on these plans by £163 million, or 3%.

Contributions to the Melrose Group defined benefit pension plans and post-employment plans are expected to be approximately £192 million in 2019, consisting of £94 million of one-off special payments, being the balance of the £150 million upfront commitment, and £98 million of ongoing commitments.

## Financial risk management

The financial risks the Group faces were considered and re-evaluated following the acquisition of GKN and policies have been implemented to appropriately deal with each risk. The most significant financial risks are considered to be liquidity risk, finance cost risk, exchange rate risk, contract and warranty risk and commodity cost risk.

These are discussed in turn below.

## Liquidity risk management

The Group's net debt position at 31 December 2018 was £3,482 million (31 December 2017: £572 million).

A new multi-currency committed bank facility was entered into on 17 January 2018 to assist with the acquisition of GKN, which replaced the previous bank facility of US\$1.25 billion. The US\$1.25 billion facility was repaid and cancelled on 30 April 2018. The new facility included a £1.5 billion multi-currency term loan with a duration of three years and six months. In addition, the new facility included a five-year multi-currency revolving credit facility, denominated £1.1 billion, US\$2.0 billion and €0.5 billion.

On 29 October 2018, £663 million of the new term loan was surplus to requirements, and therefore cancelled, because potential change of control clauses on the bonds were not exercised by the relevant bond holders.

At 31 December 2018 the drawings on the term loan were £100 million and US\$960 million. There was a significant amount of headroom on the multi-currency committed revolving credit facility, as at 31 December 2018. Applying the exchange rates at 31 December 2018 the headroom equated to £1,352 million, which includes an amount available to replace the 2019 bond when it matures, or before. There are also a number of uncommitted overdraft, guarantee and borrowing facilities made available to the Group. These uncommitted facilities have been lightly used.

Cash, deposits and marketable securities amounted to £415 million at 31 December 2018 (31 December 2017: £16 million) and are offset to arrive at the Group net debt position of £3,482 million (31 December 2017: £572 million). The combination of this cash and the headroom on the new facility allows the Directors to consider that the Group has sufficient access to liquidity for its current needs. The Board takes careful consideration of counterparty risk with banks when deciding where to place cash on deposit.

As with previous facilities the new facility has two financial covenants being a net debt to adjusted EBITDA covenant and an interest cover covenant, both of which are tested half yearly in June and December.

The EBITDA covenant test is set at 3.5x leverage for each of the half yearly measurement dates for the remainder of the term of the facility. For the year ended 31 December 2018 it was 2.3x (31 December 2017: 1.9x), showing reasonable headroom compared to the covenant test.

The interest cover covenant is set at 4.0x throughout the life of the facility and was 11.6x at 31 December 2018 (31 December 2017: 19.6x), affording comfortable headroom compared to the covenant test.

The GKN net debt at acquisition included three capital market borrowings totalling £1.1 billion, which are detailed in the table below. The bonds maturing in 2019 and 2022 have cross-currency swaps associated with them.

Maturity date	Notional amount £m	Coupon % p.a.	Cross-currency swaps million	Interest rate on swaps % p.a.
October 2019	350	6.75%	US\$578	6.80%
September 2022	450	5.375%	US\$373	5.70%
			€284	3.87%
May 2032	300	3.375%	n/a	n/a

The coupon rate on the £300 million bond, maturing in 2032 is expected to increase to 4.625% from May 2019.

The series of cross-currency swaps which were acquired with GKN had a fair value liability at the date of acquisition of £109 million. At 31 December 2018 they were valued at a liability of £199 million, the rise being predominantly due to the change in foreign exchange rates.

The bonds remain within the Group at 31 December 2018, but to simplify the corporate reporting requirements of the Group, the 2019 bonds were transferred onto the Professional Securities Market in September 2018 and the 2022 and 2032 bonds will transfer during March 2019. Bond holders and rating agencies no longer require Consolidated financial statements for GKN Holdings Limited, but instead will receive the detailed information they require from the Melrose Group Consolidated financial statements. The 2022 and 2032 bond holders will have the same guarantees from the Melrose Group companies as those provided to the banks lending in the new bank facility.

The Group has a small number of uncommitted working capital programmes, which predominantly relate to programmes inherited as part of the GKN acquisition. These programmes provide favourable financing terms on eligible customer receipts and competitive financing terms to suppliers on eligible supplier payments.

Businesses which participate in the receivables working capital programme have the ability to choose whether to receive payment earlier than the normal due date, for specific customers on a non-recourse basis. Due to the short-term nature of the financing, the interest cost to the Group for this beneficial cash flow is favourable compared to the interest cost of the Group's committed bank facilities. As at 31 December 2018, the drawings on these facilities were £139 million, compared to £189 million by GKN as at 31 December 2017.

#### Finance cost risk management

The bank margin on the bank facility depends on the Group leverage, and ranges from 0.75% to 2.0% on the term loan, and 0.95% to 2.25% on the revolving credit facility. As at 31 December 2018 the margin was 1.4% on the term loan and 1.65% on the revolving credit facility (31 December 2017: 1.35% on the Melrose committed bank debt).

The Group holds interest rate swap instruments to fix the cost of LIBOR. The policy of the Board is to hedge approximately 70% of the interest rate exposure of the Group. Given the recent restructuring of the bonds and noting that the 2019 bonds mature this year, the Group is in the process of increasing the interest rate swaps to be in line with Group policy. Under the terms of the existing swap arrangements and excluding the bank margin, the Group will pay a weighted average fixed cost of approximately 2% until the swaps terminate on 17 January 2023.

The average cost of the debt for the new enlarged Group is expected to be approximately 3.8% over the next 12 months.

#### Exchange rate risk management

The Group trades in various countries around the world and is exposed to movements in a number of foreign currencies. The Group therefore carries exchange rate risk that can be categorised into three types: transaction, translation and disposal related risk, as described in the paragraphs below. The Melrose policy is designed to protect against the majority of the cash risks but not the non-cash risks.

The most common exchange rate risk is the transaction risk the Group takes when it invoices a customer or purchases from suppliers in a different currency to the underlying functional currency of the business. The Melrose policy is to review transactional foreign exchange exposures and place contracts quarterly on a rolling basis. To the extent the cash flows associated with a transactional foreign exchange risk are committed, Melrose will hedge 100%. For forecast cash flows, Melrose hedges a proportion of the expected cash flows, with the percentage being hedged lowering as the time horizon lengthens. The average time horizons are longer for GKN Aerospace, GKN Automotive and GKN Powder Metallurgy to reflect the long-term nature of the contracts within these divisions. Typically, the Group hedges around 90% of foreign exchange exposures expected over the next twelve months and approximately 60% to 70% of exposures expected between 12 and 24 months. This policy does not eliminate the cash risk but does bring some certainty to it.

The translation rate risk is the effect on the Group results in the period due to the movement of exchange rates used to translate foreign results into Sterling from one period to the next. No specific exchange instruments are used to protect against the translation risk because it is a non-cash risk to the Group, unless foreign currency is converted to Sterling. However, the Group has debt

# Finance Director's review

Continued

drawn in Euros and US Dollars, and the hedge of having debt drawn in these currencies funding the trading units with US Dollars or Euro functional currencies protects against some of the Balance Sheet and banking covenant translation risk.

Lastly, and potentially most significantly for Melrose, exchange rate risk arises when a business that is predominantly based in a foreign currency is sold. The proceeds for those businesses may be received in a foreign currency and therefore an exchange rate risk may arise on conversion of foreign currency proceeds into Sterling, for instance to pay a dividend or Capital Return to shareholders. Protection against this risk is considered on a case-by-case basis.

Exchange rates used for currencies most relevant to the Group in the year are:

	Twelve month average rate	8 month average (GKN businesses)	Closing rate
<b>US Dollar</b>			
2018	1.33	1.31	1.27
2017	1.29	n/a	1.35
<b>Euro</b>			
2018	1.13	1.13	1.11
2017	1.14	n/a	1.13

A 10% strengthening of the major currencies, if they were to strengthen in isolation against all other currencies, within the Group would have the following impact on the re-translation of annualised adjusted operating profit into Sterling:

£m	USD	EUR	CNY	Other
Movement in adjusted operating profit	72	24	11	17
% impact on adjusted operating profit	6%	2%	1%	2%

The impact from transactional foreign exchange exposures is not material in the short term due to hedge coverage being approximately 90%.

A 10% strengthening in either the US Dollar or Euro would have the following impact on net debt as at 31 December 2018:

£m	USD	EUR
Increase in debt	176	59

## Contract and warranty risk management

Under Melrose management a robust bid and contract management process exists in the businesses, which includes thorough reviews of contract terms and conditions, contract-specific risk assessments and clear delegation of authority for approvals. These processes aim to ensure effective management of risks associated with complex contracts. The financial risks connected with contracts and warranties include the consideration of commercial, legal and warranty terms and their duration, which are all considered carefully by the businesses and Melrose centrally before being entered into.

## Commodity risk management

The cumulative expenditure on commodities is important to the Group and under Melrose management the risk of base commodity costs increasing is mitigated, wherever possible, by passing on the cost increases to customers or by having suitable purchase agreements with suppliers which fix the price over a future period. These risks are also managed through sourcing policies, including the use of multiple suppliers, where possible, and procurement contracts where prices are agreed in advance to limit exposure to price volatility. On occasion, Melrose does enter into financial instruments on commodities when this is considered to be the most efficient way of protecting against price movements.

## Brexit

Whilst the effect of Brexit on the European economy is unclear at present, due to the Group's geographically balanced manufacturing footprint, resulting tariffs and customs clearance are not expected to have material negative effects on the Group as a whole.

Sales of product between the UK and Europe are a small minority of the Group's overall revenues. Aerospace components are typically exempt from import duties under global agreements, whilst Automotive parts tariffs typically range between tariff-free and up to 7%, with the blended result somewhere midway between. However, the outcome of any Brexit agreement is unknown, which is also the case for any legal or regulatory changes.

On a wider macro level, the Group's financial results may be impacted by general lack of confidence and economic instability arising from a delayed or disruptive exit from the EU. Depending on the outcome of Brexit, the Group could be exposed to translational and transactional foreign exchange fluctuations. The impact from movements in foreign exchange rates on translating profits into Sterling is provided in the table above, whilst transactional exposures are generally well protected in the short-term due to approximately 90% of exposures being hedged for the next 12 months.

The Board will continue to monitor Brexit developments and adjust the plans for its businesses accordingly.

## Post balance sheet event

On 6 March 2019 the Group announced the agreement to sell the Walterscheid Powertrain Group to One Equity Partners, a US-based private equity firm. In addition the Group announced the completion of the sale of the minority 43.57% interest in Société Anonyme Belge de Constructions Aéronautiques ("SABCA"), previously held within the Aerospace reporting segment, to SABCA's majority shareholder, Dassault Belgique Aviation S.A. The sale of the Walterscheid Powertrain Group is subject to the customary regulatory conditions and is expected to complete in the first half of this year. The combined net proceeds of the sales are approximately £200 million.

## Going concern

The Melrose Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's review. In addition, the Consolidated financial statements include details of the Melrose Group's borrowing facilities and hedging activities along with the processes for managing its exposures to liquidity risk, finance cost risk, exchange rate risk, contract and warranty risk and commodity cost risk.

The Melrose Group has a strong record of cash management, and, as a consequence, the Directors believe that the Melrose Group is well placed to manage its business risks successfully despite the more economically uncertain environment.

After making enquiries, the Directors have a reasonable expectation that the Melrose Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.



**Geoffrey Martin**  
Group Finance Director  
7 March 2019

## Longer-term viability statement

In accordance with provision C.2.2 of the UK Corporate Governance Code, the Directors have assessed the prospects of the Company over a longer period than the 12 months required by the "Going Concern" provision. A period of three years is believed to be appropriate for this assessment since this is consistent with the Group's financing cycle, whereby on average the Group has refinanced debt in line with this timescale, usually as a result of acquisition or disposal activity.

The Directors confirm that they have a reasonable expectation that the Group will continue in operation and meet its liabilities, as they fall due, up to December 2021:

The Directors' assessment has been made by reference to the Group's financial position as at 31 December 2018, its prospects, the Group's strategy, the Board's risk appetite and the Group's principal risks and their management, all of which are described in the Strategic Report.

The Directors' assessment of the Group's viability is underpinned by a paper prepared by management. The paper is supported by comprehensive and detailed analysis and modelling. The model underpinning this statement is stress-tested, proven and is frequently used by management when determining working capital requirements for transactions and corporate restructuring. The main assumptions included in the model relate to forecast revenue, operating margin and cash generation. The model includes three years of forecast data from the Group's business assets and incorporates agreed sensitivities for economic risk (impacting revenue and margins to replicate a sales downturn in line with those experienced in previous downturns), foreign exchange risk (impacting net debt and assuming adverse movements in foreign exchange rates) and liquidity risk (impacting net debt and assuming a deterioration in working capital)<sup>(1)</sup>, each of which have been considered both individually and in combination by the Board, together with expected achievable mitigating actions from the working capital model to create severe, but plausible, scenarios. These scenarios sensitise the main assumptions noted above and also consideration of relevant cross-border trade risk, as well as the uncertainty surrounding the UK's exit from the EU.

In preparing this statement, the following qualifications and assumptions are made:

- (i) the viability model is based on the Group as at the date of this Annual Report, with no consideration of any further acquisitions or future disposals of continuing businesses. We note future acquisitions would be based on the same proven business model applied previously, with related bank debt and equity raised to support the acquisition with sufficient headroom to cover business risks; and
- (ii) financing arrangements and bank covenant testing are in line with the current facility which is committed for the period under review.

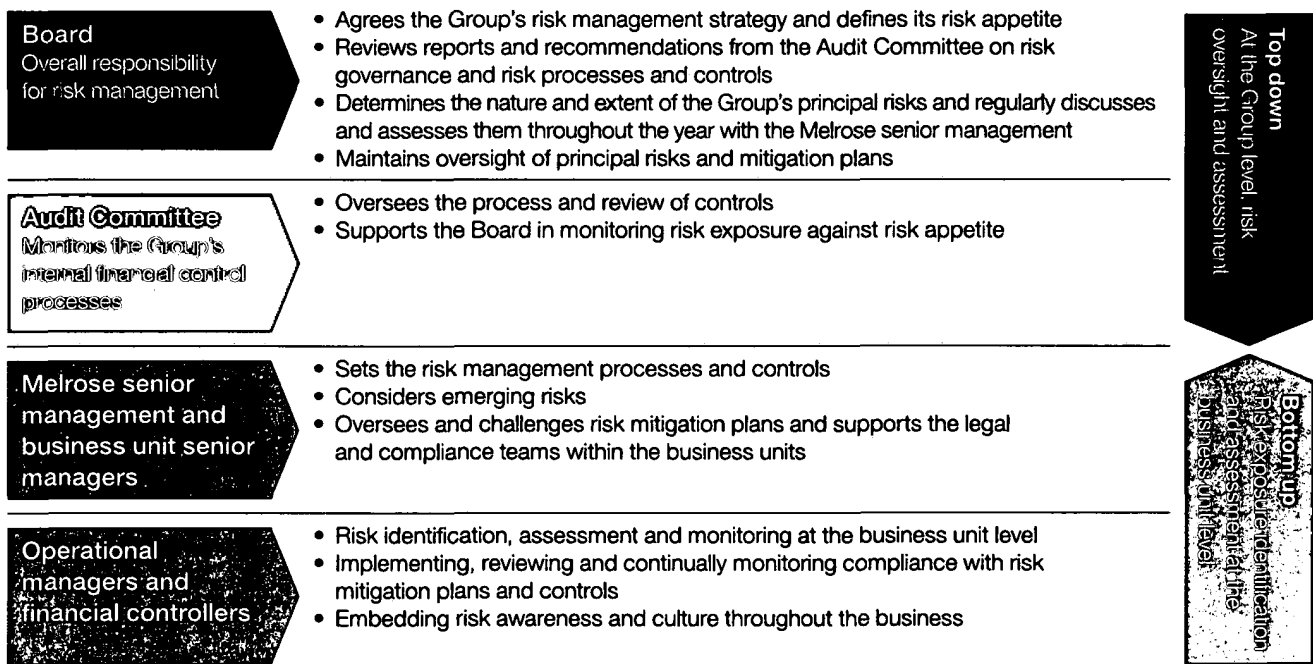
<sup>(1)</sup> For further details on the economic risk, foreign exchange risk and liquidity risk, and the mitigating actions being taken by management, please refer to the Risks and Uncertainties section of the Strategic Report on pages 52 to 58.

# Risk management

**The Board recognises that operating in a dynamic and rapidly evolving commercial environment requires a pragmatic, flexible and responsive risk management framework comprising policies, visibility and controls that change with the business and provide management with a comprehensive view of the Group's risk profile at any given time, enabling risk to be identified, assessed and managed.**

## Risk management responsibilities

The Board, having overall responsibility for risk management, has approved a formalised but pragmatic Group risk management framework.



The Board's view of our principal risks and uncertainties is detailed in the table on pages 52 to 58.

## Risk management strategy and framework

The objectives of the Directors and Melrose senior management are to safeguard and increase the value of the businesses and assets of the Group. Achievement of these objectives requires the development of policies and appropriate internal control frameworks to ensure the Group's resources are managed properly and any key risks are identified and mitigated where possible.

The Board recognises that it is ultimately responsible for determining the nature and extent of the principal risks it is willing to take in the pursuit of its strategic objectives. It also recognises the need to define a risk appetite for the Group, to maintain sound risk management and internal control systems and to monitor its risk exposures and mitigation measures to ensure that the nature and extent of risks taken by the Group are aligned with, and proportionate to, its strategic objectives.

The Group operates on a decentralised basis and the Board has established an organisational structure with clear reporting procedures, lines of responsibility and delegated authority as depicted in the diagram above. Consistent with this, the Group operates a top-down, bottom-up approach to risk management, comprising Board and Melrose senior management oversight coupled with bottom-up risk management embedded in the day-to-day activities of its individual businesses.

The Board confirms that there is an ongoing process for identifying, evaluating, tracking and managing the principal risks faced by the Group and that these systems, which are subject to regular monitoring and review, have been in place for the year under review up to the date of approval of the Annual Report and financial statements. The Board further confirms that the systems, processes and controls that are in place accord with the guidance contained in the Financial Reporting Council's "Guidance on Risk Management, Internal Control and Related Financial Business Reporting".

The Audit Committee monitors the effectiveness of the risk management and internal control processes implemented across the Group, through regular updates and discussions with management and a review of the key findings presented by the external and internal auditors. The Board is responsible for considering the Audit Committee's recommendations and ensuring implementation by divisional management of those recommendations it deems appropriate for the business. A description of the Audit Committee's activities during the year on risk management can be found on pages 80 and 81.

The management team of each business unit is responsible for monitoring business level risk and implementing and maintaining an effective risk and control environment within their business unit as part of day-to-day operations, in line with the risk management framework and internal control systems determined by the Board.

## Risk management framework



The Melrose senior management team set out the procedures and controls that each divisional management team is required to implement and operate. The legal and compliance teams of each division report to the Melrose senior management team on a regular basis in respect of specific and ongoing risks related to their respective business division and report formally to the Melrose senior management team twice per year.

During 2018, in recognition of the enlarged Melrose Group as a result of the GKN acquisition and in accordance with provision C2.3 of the UK Corporate Governance Code, the Audit Committee undertook a robust review of the effectiveness of the Group's risk management and internal control systems, covering all material controls including financial, operational and compliance controls. The Audit Committee reported its findings to the Board. From this review of the risk management and internal control systems, the Board did not identify, nor was it advised of, any failings or weaknesses which it would determine to be significant. The Board concluded that the Group's risk management and internal control systems and processes were operating effectively and therefore a confirmation in respect of necessary actions to be undertaken has not been considered appropriate.

Due to the size and scale of GKN, following its acquisition Melrose engaged additional advisors to support the preparation of the opening balance sheet. A programme of site visits took place between May and October, covering a significant proportion of the GKN businesses with a detailed work plan to identify the fair value of operational assets and liabilities. The Audit Committee reviewed a final paper prepared by management prior to the 2018 audit close, which comprehensively addresses the methodologies, assumptions and judgements taken in preparing the opening balance sheet. The Melrose senior management team continue to assess the impact of the resultant findings on the Group's principal risks and internal control and risk management systems and the Board has directed management that the monitoring, mapping and reporting of the Group's risk management performance will be further enhanced by an intelligent data-driven Group reporting tool to automate the aggregation of Group risks identified from the diligence efforts and site visits undertaken to prepare the GKN opening balance sheet, in conjunction with ongoing divisional risk reporting. Melrose senior management are working with external risk management advisors to build a risk management aggregation tool to enhance both the business units' management and the Board's visibility of risk reporting of the enlarged Group, to be implemented in 2019.

### Risk appetite

The Board has undertaken a comprehensive exercise to consider its risk appetite across a number of key business risk areas. The results of this review indicate the relative appetite of the Board across the risk factors at a specific point in time. Any material changes in risk factors will impact the Board's assessment of its risk appetite.

The Board has a higher risk appetite towards its strategic and operational risks and a balanced appetite towards macro-economic and political risk. The Board seeks to minimise all health and safety risks and has a low risk appetite in relation to legal, compliance and regulatory risk. Similarly, a conservative appetite is indicated by the Board with respect to pension and finance-related risks.

The results of the risk appetite review will support the Board's decision making processes during 2019. It is the intention to undertake a review of the Board's risk appetite at least annually.

### Risk management actions

During 2018, the Board continued to deliver on the key management priorities identified in the 2017 review across the Group, utilising and updating where necessary the enhanced risk management framework implemented in 2015. Specific actions undertaken during the year include:

- reviewing and reaffirming the Board's risk appetite;
- updating and monitoring the implementation of the risk management governance framework across all business units. This framework defines the Melrose principles for risk management and sets the standards for the identification, evaluation, prioritisation, recording, review and reporting of risks and their management or mitigation throughout the organisation;
- fully embedding the Melrose risk register methods and risk profile mapping application throughout the GKN businesses and maintaining this practice within the Nortek and Brush divisions. These provide the Board with greater levels of detail and visibility on the risk management systems and processes in place, and illustrate each principal risk facing the Group from both a gross risk (pre-mitigation) and net risk (post-mitigation) position. The risk mapping application provides Directors with a clear risk profile for the Group and enables the Board to determine the degree to which its profile is aligned with its risk appetite;
- a review and reconciliation of the principal risks identified by the previous GKN board against those of the Melrose Board; and
- reviewing and improving the Group's processes around the assessment of principal risks and the monitoring and reporting of the Group's risk management performance.

### Assessment of principal risks

During the year the Board undertook a robust, in-depth and comprehensive assessment of the principal risks facing the Group and specifically those that might threaten the delivery of its strategic business model, its future performance, solvency or liquidity.

A summary of the principal risks and uncertainties that could impact on the Group's performance is shown on pages 52 to 58. Further information detailing the internal control and risk management policies and procedures operated within the Group is shown on pages 78 to 81 of the Corporate governance report.

### Risk management priorities for 2019

Continual improvements have been made during 2018 in respect of the Group's risk management processes. However, the Board recognises that Melrose cannot be complacent. In 2019, management will continue to focus on refining the risk management framework and embedding a culture of effective risk management across the newly enlarged Group to ensure that risks and opportunities are identified and managed, to support the delivery of long-term value creation. Further resources will be devoted to strengthening the mechanisms for providing independent assurance on the effectiveness of the Group's risk management governance, processes and controls.

# Risks and uncertainties

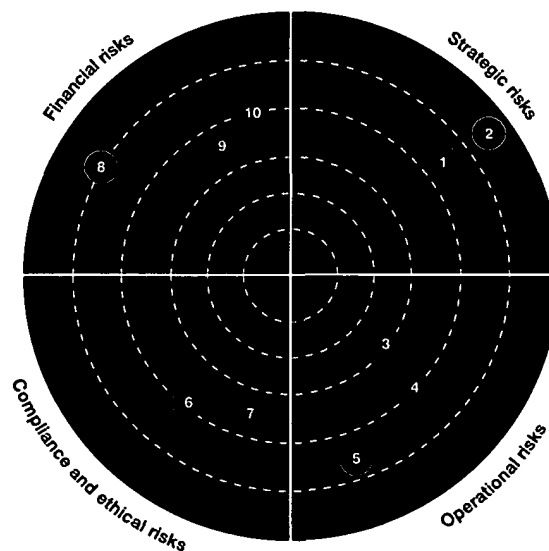
This section outlines the principal risks and uncertainties that may affect the Group and highlights the mitigating actions that are being taken. This section is not intended to be an exhaustive list of all the risks and uncertainties that may arise and nor is the order of the content intended to be any indication of priority.

A risk management and internal controls framework is in place within the Group and has been reviewed and adapted following the acquisition of GKN to reflect the risk profile of the newly enlarged Group and to continue to ensure that such risks and uncertainties can be identified and, where possible, managed suitably. Each Group business unit maintains a risk register which is reviewed regularly by Melrose senior management and by the Melrose Board.

## Strategic risk profile

Our updated view of the current strategic risk profile is shown below. The residual risk scores have been calculated on a post-mitigation basis.

No.	Risk rating	Risk title	Risk trend since last Annual Report
1	Moderate	Acquisition of new businesses and improvement strategies	⬆ Increase
2	Moderate	Timing of disposals	➡ No change
3	Moderate	Economic and political	⬆ Increase
4	Moderate	Commercial	n/a
5	Moderate	Loss of key management and capabilities	➡ No change
6	Moderate	Legal, regulatory and environmental	⬆ Increase
7	Moderate	Information security and cyber threats	⬆ Increase
8	Moderate	Foreign exchange	⬆ Increase
9	Moderate	Pensions	⬆ Increase
10	Moderate	Liquidity	⬆ Increase



### Risk rating

● Moderate impact

### Likelihood

Likely .....> Unlikely

## Strategic risks

### Risk 1 Acquisition of new businesses and improvement strategies

#### Description and impact

The success of the Group's acquisition strategy depends on identifying available and suitable targets, obtaining any consents or authorisations required to carry out an acquisition and procuring the necessary financing, be this from equity, debt or a combination of the two. In making acquisitions, there is a risk of unforeseen liabilities being later discovered which were not uncovered or known at the time of the due diligence process, particularly in the context of limited access in public bids. Further, as per the Group's strategy to buy and improve good but underperforming manufacturing businesses, once an acquisition is completed, there are risks that the Group will not succeed in driving strategic operational improvements to achieve the expected post-acquisition trading results or value which were originally anticipated, that the acquired products and technologies may not be successful or that the business may require significantly greater resources and investment than anticipated. If anticipated benefits are not realised or trading by acquired businesses falls below expectations, it may be necessary to impair the carrying value of these assets. The Group's return on shareholder investment may fall if acquisition hurdle rates are not met. The Group's financial performance may suffer from goodwill or other acquisition-related impairment charges, or from the identification of additional liabilities not known at the time of the acquisition.

#### Mitigation

- Structured and appropriate due diligence undertaken on potential new targets where permitted and practicable.
- Focus on acquisition targets that have strong headline fundamentals, high-quality products, leading market share but which are underperforming their potential and ability to generate sustainable cash flows and profit growth.
- Hands-on role taken by executive Directors and other senior employees of the Group.
- Development of strategic plans, restructuring opportunities, capital expenditure, procurement and working capital management.
- Proper incentivisation of operational management teams to align with Melrose strategy.

**Responsibility** Executive management <sup>(1)</sup>

**Risk trend** 

#### Trend commentary

Having acquired GKN this year, the Group is focused principally on improvement but is considering a number of bolt-on acquisitions, some of which it completed in the year, that would materially improve the businesses owned by the Group.

**Strategic priorities** Buy Improve Sell

### Risk 2 Timing of disposals


#### Description and impact

In line with our strategy and depending where the Group is within the "Buy, Improve, Sell" cycle, the expected timing of any disposal of businesses is considered as a principal risk which could have a material impact on the Group strategy. Further, due to the Group's global operations, there may be a significant impact on the timings of disposals due to political and macroeconomic factors. Depending on the timings of disposals and nature of businesses' operations there may be long-term liabilities which could be retained by the Group following a disposal. Insufficient allowance for such retained liabilities may affect the Group's financial position.

#### Mitigation

- Directors are experienced in judging and regularly reviewing the appropriate time in a business cycle for a disposal to realise maximum value for shareholders.
- Each disposal is assessed on its merits, with a key focus on a clean disposal.
- Melrose is not bound by a set investment or divestment period, enabling it to choose the opportune time.

**Responsibility** Executive management <sup>(1)</sup>

**Risk trend** 

#### Trend commentary

Although global M&A markets have been experiencing some uncertainty there remain opportunities for value realisation. Management will remain disciplined and there is no obligation to sell before it is appropriate to do so.

**Strategic priorities** Buy Improve Sell

(1) Comprises executive Directors and Melrose senior management.

# Risks and uncertainties

Continued

## Operational risks

### Risk 3

#### Economic and political

##### Description and impact

The Group operates, through manufacturing and/or sales facilities, in numerous countries and is affected by global economic conditions. Businesses are also affected by government spending priorities and the willingness of governments to commit substantial resources. Current global economic and financial market conditions, including headwinds in the automotive sector, any fluctuation in commodity prices, the potential for a significant and prolonged global recession and any uncertainty in the political environment may materially and adversely affect the Group's operational performance, financial condition and could have significant impact on timing of acquisitions and disposals.

A recession may also materially affect customers, suppliers and other parties with which the Group does business. Adverse economic and financial market conditions may cause customers to terminate existing orders, to reduce their purchases from the Group, or to be unable to meet their obligations to pay outstanding debts to the Group. These market conditions may also cause our suppliers to be unable to meet their commitments to the Group or to change the credit terms they extend to the Group's businesses.

Whilst it is anticipated that the UK will leave the EU in 2019, there continues to be some uncertainty in the UK regarding the nature of Brexit and what this will mean for business and the UK economy. Whilst Brexit is not isolated as a principal risk to the Group as a whole, it does present potential risks that the business units continue to monitor and assess closely relating to potential changes to the cross-border trade and regulatory environment. The Board continues to assess and review mitigation plans.

Prior to the GKN acquisition, the majority of the Group's revenue was generated in North America, which this year has experienced challenges such as increasing tariffs from the US/China trade war. Whilst the impact from Brexit is expected to be minimal in respect of North America operations, since acquiring GKN a larger proportion of the Group's revenue is now generated from the UK and European-based GKN Aerospace and GKN Automotive divisions. Therefore, the GKN Automotive and Aerospace divisions continue to assess the potential short- to medium-term impact of changes to international trading relationships, border controls, supply chain friction and customs tariffs following a 'No Deal' Brexit and if the UK reverts to WTO rules. However, the Group's geographically balanced manufacturing footprint is expected to mitigate negative impacts which may arise from such changes on the Group as a whole.

##### Mitigation

- Regular monitoring of order books, cash generation and other leading indicators, to ensure the Group and each of its businesses can respond quickly to any adverse trading conditions. This includes the identification of cost reduction and efficiency measures.
- Finance for acquisitions is readily available to the Group from banking syndicates. This has proven to be available to the Group even during periods of economic downturn, for example during the global financial crisis in 2008.
- Short-term inventory buffers are being planned to minimise the initial impact of a 'No Deal' Brexit on import costs and tariffs and border disruption.
- Sales from the EU to the UK within the GKN Automotive and GKN Aerospace divisions are frequently on ex works terms and therefore a cost to customers. This continues to be reviewed in light of the various potential forms of UK exit from the EU being considered by the UK Government.
- Strong customer relationships built on long-term partnerships often with plants in close proximity, technical excellence and quality. Planning for potential discussions in respect of increased tariff costs that materialise from a 'No Deal' Brexit.
- Applications for third country status for two UK GKN Aerospace sites holding production organisation approvals or maintenance organisation approvals have been submitted.
- Actions underway to arrange relevant WTO tariff administrative requirements.
- The Group remains agile, diversified and well positioned to deal with any short-term uncertainty in the UK.

##### Responsibility

Executive management<sup>(1)</sup>

##### Risk trend



##### Trend commentary

There continues to be a degree of geopolitical uncertainty into 2019. However, the Board notes that economic uncertainty can depress business valuations and this may increase the number of potential acquisition opportunities for Melrose.

The Group's senior management are actively engaging with the executive teams of each division to track the potential impacts of Brexit, engage actively with those who are working on the impact assessments and mitigation actions, and report the material findings to the Board.

##### Strategic priorities

Buy Improve Sell

(1) Comprises executive Directors and Melrose senior management.

## Operational risks

**Risk 4  
Commercial****Description and impact**

The Group operates in competitive markets throughout the world and is diversified across a variety of industries and production and sales geographies. This provides a degree of Group-level impact mitigation from the potential commercial challenges and market disruptions that face each of the divisions.

Each division is exposed to particular commercial and market risks, which are primarily accentuated where customer/competitor concentration is high within their respective market segments.

Melrose operates a decentralised control and management structure which empowers divisional management teams to take full responsibility for planning, mitigating, navigating and responding to the specific commercial risks and challenges facing their respective businesses. Melrose senior management monitor the aggregated impact of such risks and provides active support to the divisional management teams in fulfilling their responsibilities.

Common commercial risk areas that potentially affect a large proportion of the Melrose businesses include those related to production quality assurance, health and safety performance, customer concentration and uncertainties related to future customer demand, the impact of increased competitive pressures on the maintenance/improvement of market share, potential disruptions to supply chains and increases to the price of raw materials, technological innovation and market disruption, and the performance and management of programme partners.

**Mitigation**

- The Group continued to actively invest in research and development activities in 2018 to augment its platforms for future product expansion, quality improvements, customer alignment and achieving further production efficiencies. Details about the Group's research and development activities are provided on page 76.
- Health and safety, awareness initiatives and performance enhancements continued to be implemented in alignment with regulation, market practice and site-based risk assessments and requirements. Further details are provided on pages 66 and 67.

- Since acquiring GKN, Melrose senior management have actively engaged with and supported the GKN Aerospace and GKN Automotive divisional management teams in identifying embedded contractual and business conduct risks relating to key supply chain and production programme partners. The management teams of the GKN Aerospace and GKN Automotive divisions have begun to implement and direct a series of operational change management programmes to mitigate the risks they have identified.

<b>Responsibility</b>	Executive management <sup>(1)</sup>
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<b>Risk trend</b>	n/a
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**Trend commentary**

Melrose senior management engage actively with the divisional executive teams to track, monitor and support strategic planning activities and impact mitigation assessments in respect of ongoing commercial risks. Particular focus is placed on certain GKN Aerospace and GKN Automotive market segments where customer and/or competitor concentration is high and heavier reliance is placed on supply chain efficiency and programme partner management. With support from the Melrose senior management, the divisional Chief Executives report material updates directly to the Group's executive Directors.

**Strategic priorities**

Buy	Improve	Sell
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(1) Comprises executive Directors and Melrose senior management.

# Risks and uncertainties

Continued

## Operational risks

### Risk 5 Loss of key management and capabilities


#### Description and impact

The success of the Group is built upon strong management teams. As a result, the loss of key personnel could have a significant impact on performance, at least for a time. The loss of key personnel or the failure to plan adequately for succession or develop new talent may impact the reputation of the Group or lead to a disruption in the leadership of the business. Competition for personnel is intense and the Group may not be successful in attracting or retaining qualified personnel, particularly engineering professionals.

#### Mitigation

- Succession planning within the Group is coordinated via the Nomination Committee in conjunction with the Board and includes all Directors and senior employees. In line with the Group's decentralised structure, each divisional CEO, in consultation with the Chief Executive, is responsible for the appointment of their respective executive team members, with disclosure to the Nomination Committee.
- The Company recognises that, as with most businesses, particularly those operating within a technical field, it is dependent on Directors and employees with particular managerial, engineering or technical skills. Appropriate remuneration packages and long-term incentive arrangements are offered in an effort to attract and retain such individuals.

**Responsibility** Executive management <sup>(1)</sup>

**Risk trend** 

#### Trend commentary

Succession planning remains a core focus for the Nomination Committee and the Board. Succession planning of executive Directors and senior management, together with visibility of potential successors within the Group, has been selected as an area for targeted management focus during 2019.

**Strategic priorities** Buy Improve Sell

## Compliance and ethical risks

### Risk 6 Legal, regulatory and environmental

#### Description and impact

There is a risk that the Group may not always be in complete compliance with laws, regulations or permits, for example concerning environmental requirements. The Group could be held responsible for liabilities and consequences arising from past or future environmental damage, including potentially significant remedial costs. There can also be no assurance that any provisions for expected environmental liabilities and remediation costs will adequately cover these liabilities or costs.

The Group operates in highly regulated sectors, which has been accentuated by the GKN acquisition. In addition, new legislation, regulations or certification requirements may require additional expense, restrict commercial flexibility and business strategies or introduce additional liabilities for the Group or Directors. For example, the Group's operations are subject to anti-bribery and anti-corruption, anti-money laundering, competition, anti-trust and trade compliance laws and regulations. Failure to comply with certain regulations may result in significant financial penalties, debarment from government contracts and/or reputational damage and impact our business strategy.

#### Mitigation

- Regular monitoring of legal and regulatory matters at both a Group and business unit level. Consultation with external advisers where necessary.
- A robust control framework is in place, underpinned by comprehensive corporate governance and compliance procedures at both a Group and business unit level.
- Where possible and practicable, due diligence processes during the acquisition stage seek to identify legal, regulatory and environmental risks. At the business unit level, controls are in place to prevent such risks from crystallising.
- Any environmental risks that crystallise are subject to mitigation by specialist consultants engaged for this purpose. External consultants assist the Group in complying with new and emerging environmental regulations.
- Insurance cover mitigates certain levels of risk.

**Responsibility** Executive management <sup>(1)</sup>

**Risk trend** 

#### Trend commentary

The Group undertakes annual reviews to ensure it has a robust legal and compliance framework and considers the risk to be consistent with prior years.

**Strategic priorities** Buy Improve Sell

(1) Comprises executive Directors and Melrose senior management.

## Compliance and ethical risks

**Risk 7**  
**Information security and cyber threats**
**Description and impact**

Information security and cyber threats are an increasing priority across all industries and remain a key UK government agenda item.

Like many businesses, Melrose recognises that the Group may have a potential exposure in this area. Potential exposure to such risks has increased in the year due to the scale, complexity and public-facing nature of the acquisition of GKN. In addition, Melrose recognises that the inherent security threat is considered highest in GKN Aerospace where data is held in relation to civil aerospace technology and controlled military contracts.

**Mitigation**

- Management continues to work with its business leaders and external security consultants to better understand the Group's increased exposure to cyber security risk and to ensure appropriate mitigations are in place for the enlarged Group.
- Melrose has deployed its information security strategy and risk-based governance framework to the acquired GKN group within the year to mitigate the Group's exposure to cyber risk, which follows the UK government's recommended steps on cyber security. This strategy has been successfully implemented across the whole Group with significant progress made during the year in both our GKN and existing businesses.
- The progress of each business is measured against the information security strategy and is monitored on a quarterly basis.

<b>Responsibility</b>	Executive management <sup>(1)</sup>
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<b>Risk trend</b>	↑
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**Trend commentary**

Information security and cyber threats are an increasing priority across all industries. Cyber security breaches of the Group's IT systems could result in the misappropriation of confidential information belonging to it or its customers, suppliers or employees. In response to the increased sophistication of information security and cyber threats, the Group has worked, and continues to work, with external security consultants to monitor, improve and refine its Group-wide strategy to aid the prevention, identification and mitigation of any threats.

<b>Strategic priorities</b>	Buy Improve Sell
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## Financial risks

**Risk 8**  
**Foreign exchange**
**Description and impact**

Due to the global nature of operations and volatility in the foreign exchange market, exchange rate fluctuations have and could continue to have a material impact on the reported results of the Group.

The Group is exposed to three types of currency risk: transaction risk, translation risk and risk that when a business that is predominantly based in a foreign currency is sold, it is sold in that foreign currency. The Group's reported results will fluctuate as average exchange rates change. The Group's reported net assets will fluctuate as the year-end exchange rate changes.

**Mitigation**

- The Group policy is to protect against the majority of foreign exchange risk which affects cash, by hedging such risks with financial instruments.
- Protection against specific transaction risks is taken by the Board on a case-by-case basis.

<b>Responsibility</b>	Executive management <sup>(1)</sup>
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<b>Risk trend</b>	↑
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**Trend commentary**

Group results are reported in Sterling but a large proportion of the revenues are denominated in currencies other than Sterling, primarily US Dollar and Euro. Following the GKN acquisition, the Group has exposure on both a transactional and translational basis to more currencies. Sensitivity to the key currency pairs is shown in the Finance Director's review on pages 47 and 48.

<b>Strategic priorities</b>	Buy Improve Sell
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(1) Comprises executive Directors and Melrose senior management.

# Risks and uncertainties

Continued

## Financial risks

### Risk 9 Pensions

#### Description and impact

The defined benefit pension schemes acquired with GKN were proportionately less well funded and higher profile than those of the 2017 Group.


Any shortfall in the Group's defined benefit pension schemes may require additional funding. As at 31 December 2018, the Group's pension schemes had an aggregate deficit, on an accounting basis, of £1,413 million. Changes in discount rates, inflation, asset values or mortality assumptions could lead to a materially higher deficit. For example, the cost of a buyout on a discontinued basis uses more conservative assumptions and is likely to be significantly higher than the accounting deficit.

Alternatively, if the plans are managed on an ongoing basis, there is a risk that the plans' assets, such as investments in equity and debt securities, will not be sufficient to cover the value of the retirement benefits to be provided under the plans. The implications of a higher pension deficit include a direct impact on valuation, implied credit rating and potential additional funding requirements at subsequent triennial reviews. In the event of a major disposal that generates significant cash proceeds which are returned to the shareholders, the Group may be required to make additional cash payments to the plans or provide additional security.

#### Mitigation

- The Group's key funded pension plans, including the GKN plans, are closed to new entrants and future service accrual. Long-term funding arrangements are agreed with the Trustees and reviewed following completion of actuarial valuations.
- Active engagement with Trustees on pension plan asset allocations and strategies.

**Responsibility** Executive management <sup>(1)</sup>

**Risk trend** 

#### Trend commentary

Although the risks are well understood and funding plans for the GKN Schemes have already been agreed with Scheme Trustees, the size of the gross liabilities as a proportion of the Group's net assets has increased significantly.

**Strategic priorities** Buy Improve Sell

### Risk 10 Liquidity

#### Description and impact

The ability to raise debt or to refinance existing borrowings in the bank or capital markets is dependent on market conditions and the proper functioning of financial markets. As set out in more detail in the Finance Director's review on pages 46 to 47, the Group has term loans of US\$960m and £100m and revolving credit facilities comprising US\$2 billion, €0.5 billion and £1.1 billion.

In addition, the GKN net debt at acquisition included capital market borrowings across three unsecured bonds which in total amount to £1.1 billion. These bonds remain outstanding as at 31 December 2018 and further detail is provided in the Finance Director's review on pages 46 to 47.

Furthermore, in line with the Group's strategy, investment is made in the businesses (capital expenditure in excess of depreciation) and there is a requirement to assess liquidity and headroom when new businesses are acquired. In addition, the Group may be unable to refinance its debt when it falls due.

#### Mitigation

- To ensure it has comprehensive and timely visibility of the liquidity position, the Group conducts monthly reviews of its cash forecast, which are in turn revised quarterly.
- The Group operates cash management mechanisms, including cash pooling across the Group and maintenance of revolving credit facilities to mitigate the risk of any liquidity issues.
- The Group operates a conservative level of headroom across its financing covenants which is designed to avoid the need for any unplanned refinancing.

**Responsibility** Executive management <sup>(1)</sup>

**Risk trend** 

#### Trend commentary

The Group is satisfied that it has adequate resources available to meet its liabilities.

**Strategic priorities** Buy Improve Sell

(1) Comprises executive Directors and Melrose senior management.



# Corporate Social Responsibility

**Melrose supports and monitors the Corporate Social Responsibility policies, practices and initiatives across its businesses.**

Reflecting the decentralised nature of the Group, responsibility for the adoption of policies, practices and initiatives sits at a divisional level. This ensures that rigorous and targeted policies and procedures are implemented that meet local regulatory requirements and guidance, whilst also taking into account the size and nature of the business.

The information set out in this Corporate Social Responsibility Report focuses on the initiatives taken during 2018 by each of the five divisions that now make up the Melrose Group. The policies, practices and initiatives set out in this report are indicative of the approach taken with any new business Melrose acquires.

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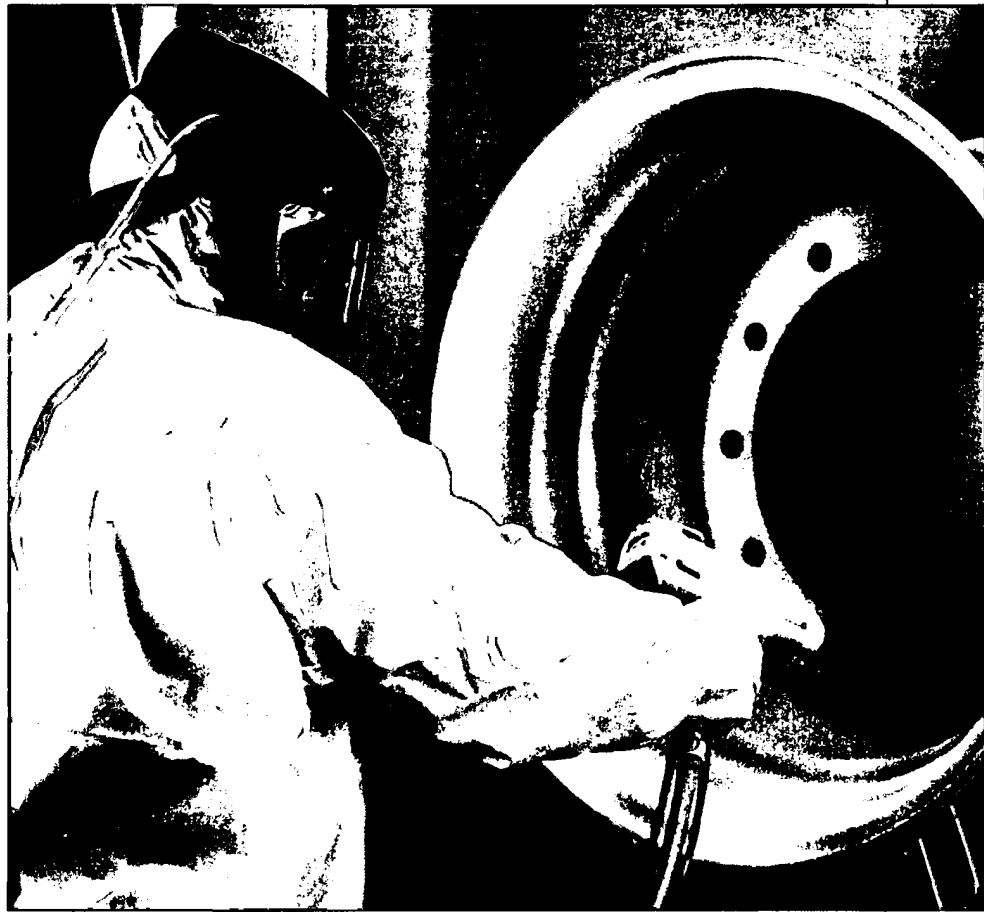
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07

Human rights and ethical standards  
page 69

# Corporate Social Responsibility

Continued



# 01

## Employment matters

**The Group recognises its responsibilities for the fair treatment of all its current and potential employees, in accordance with legislation applicable to the territories within which it operates, together with relevant guidance on good practice where appropriate.**

## Employment policies

As part of the Group's decentralised approach, each of Melrose's businesses is responsible for setting and measuring its own employment and employee related KPIs and, as such, these can vary throughout the Group. However, such measurements will generally include absenteeism, punctuality, headcount and employee relations issues. Any concerns or adverse trends are responded to in a timely manner.

Equal opportunities for appropriate training, career development and promotion are available to all employees within the Group regardless of any disability, gender, religion, race, nationality, sexual orientation or age.

Applications for employment by disabled persons are always fully and fairly considered by the Group and are considered on merit, with regard only to the job-specific requirements and the relevant applicant's aptitude and ability to carry out the role. Furthermore, as a Group-wide policy and so far as particular disabilities permit, Melrose and each of its businesses will, where practicable, make every effort to provide continued employment in the same role for employees who are disabled during their period of employment or, where necessary, provide such employees with a suitable alternative role, together with appropriate training.



It is the Group's policy that in recruitment, training, career development and promotion, the treatment of disabled persons should, as far as possible, be identical to that of other employees. Melrose is proud to be a member of the Business Disability Forum, a not-for-profit member organisation that works with the business community to understand the changes required in the workplace in order that disabled persons are treated fairly, so that they can contribute to business success, to society and to economic growth.

### Employee involvement, consultation and development

The Group places great importance on good labour relations, employee engagement and employee development. The responsibility for the implementation and management of employment practices rests with local management, in a manner appropriate to each business.

A culture of clear communication and employee consultation and engagement is inherent across the Group. Employee briefing sessions with employee representatives are held on a regular basis to communicate strategy, key changes, financial results, achievements and other important issues to employees, and to receive feedback from them on these

issues. Regular appraisals, employee surveys, notice boards, team meetings, suggestion boxes and newsletters are also used to communicate and engage with employees, and to solicit their feedback on issues of concern to them.

During 2019, the Board established a workforce advisory panel ("WAP") in order to further promote effective engagement with, and encourage participation from, its workforce. Given the Group's decentralised nature and Melrose's strategic business model and frequent turnover of businesses, the WAP comprises of the Chief Human Resources Officer (or equivalent) from each business unit and a Melrose Group representative. Each member of the WAP is responsible for promoting workforce engagement, collating the voice of the workforce and demonstrating how that voice is fed into executive discussions for their respective business unit. This information is then fed back to the Board for consideration in its discussions and decision making.

Extensive training is available to all staff and is actively encouraged to ensure that high standards of skills are maintained across the Group. Inter-departmental training programmes are also put in place across the Group to ensure that skills are shared between operations. The importance of training extends beyond on-the-job training and also focuses on enhancing personal development. In addition, apprenticeship programmes help to assist with training a new generation of employees and to ensure knowledge is retained within the businesses. Employees across the Group are encouraged to think innovatively and to have regard for both financial and economic factors affecting the Group.

The Group regards employee engagement, training and advancement as an essential element of industrial relations.

### Employee initiatives

During 2018, a range of employee-related initiatives were implemented across the Group:

- GKN Aerospace piloted and launched 'Talent Assessment and Development Centres' which focus on career development in addition to individual assessment. The 'transition centres' are offered at two levels; those individuals wanting to become a leader and those looking to move from being a leader to leading other managers. The assessments cover a range of psychometric testing, real-life simulations and in one of the centres, a coaching academy.
- GKN Automotive has focused on investment in its future workforce by standardising its global graduate programme with reinforcement of the importance of development, mentoring, performance management and Corporate Social Responsibility. GKN Automotive has increased its total number of graduates to 24, a quarter of whom are female.
- GKN Powder Metallurgy has a number of employee training programmes. In particular, GKN Powder Metallurgy offers engineering development programmes, as well as various leadership training programmes. In order to adapt to changing market trends and to help foster talent, some of these programmes are in the process of being reviewed.
- The SST division continued its emphasis on improving its products and services through the employee invention process. The Innovation Committee meets monthly to review employee submissions, the committee consisting of internal counsel, external patent counsel, senior engineering leadership, and the inventors themselves. Incentives are in place for employees to submit their invention ideas, including financial incentives if a submission results in applications filed and patents granted. In 2018, the Innovation Committee heard 52 invention idea presentations by employees. At present, 22 of these invention ideas are in various stages of either business development or drafting of a patent application.
- Brush HGI has partnered with Toyota Manufacturing (UK) and has enrolled two HGI staff onto the Toyota Engineering apprenticeship scheme. The apprentices will be based at both HGI and Toyota Manufacturing (UK) for the duration of their 44-month apprenticeship, where they will train at Toyota's world class training facility in Derby and they will be taught by some of the UK's leading trainers, who will help develop, support and guide them into HGI's engineers of the future. Not only will this apprenticeship bridge the gap between education and the workplace, it will also help HGI address current and future engineering skills gaps whilst focusing on the development of younger people in this specialist sector.

# Corporate Social Responsibility

Continued

## 02

### Community and charitable matters

#### Melrose Skills Fund

In 2018, Melrose committed to setting up the 'Melrose Skills Fund', with the ambition to create a supply chain of high calibre engineers for the whole of the UK. This forms part of Melrose's wider ambition to create an engineering and manufacturing powerhouse for the UK. Melrose is contributing £10 million to the 'Melrose Skills Fund' over five years. The Fund will operate in collaboration with NGOs.

The funding will be available to support the Group's Aerospace and Automotive divisions, but will also be available to higher education colleges to create new opportunities for young people and help foster the next generation of great British engineers. In order for this Fund to operate effectively, Melrose is currently conducting a Training Needs Analysis to understand what skills are needed and for whom, where operational inefficiencies lie, and speaking to potential partners across business, government, academia and institutions.

Proposals have already been suggested to develop the GKN Innovation Centre in Abingdon, near Oxford, as a global centre of excellence for eDrive technology, composites and additive manufacture. Melrose has also identified potential university partners, high value 'manufacturing catapults', and developed relationships with institutions including the Institute of Mechanical Engineers. In particular, this Centre will be sponsoring select teams who are building electric powertrain cars for Formula Student, a prestigious educational engineering competition. This Centre would be at the forefront of creating highly skilled jobs for the UK manufacturing industry.

In Filton, near Bristol, where GKN Aerospace has a manufacturing site, proposals have also been put forward for a Global Technology Centre, a Digital Training Centre and Proving Ground where local communities can be trained to better utilise the digital capabilities our country needs. As the technological world around us accelerates, it is important that the UK has the digital literacy to remain not just globally competitive but emerge as a global leader and this is the vision behind this Centre.

In addition, Brush is setting up a 'Skills Development Fund'. This Fund will identify internal and external development needs, engage and collaborate with partners and ensure that sustainable development is at the heart of its business.

From the creation of STEM programmes, apprenticeships and degrees, to investment in manufacturing hubs, digital skills, and employee development, Melrose is equipping the UK with the future skills our country needs.

In addition, employees of the Group continued to support a number of worthwhile charities and community projects during 2018. Here are a few examples of the great contributions that have been made.



#### Samarthanam, India

Since 2016, GKN Aerospace in India has worked alongside the Samarthanam Trust to develop a five-year plan to support 450 children with disabilities and from underprivileged backgrounds. As part of their commitment, GKN Aerospace has established a computer-based resource centre at Samarthanam to help the children gain essential skills and play an active role in society. The centre also provides training to improve their job prospects. So far, GKN Aerospace has funded 1,824,500 Indian Rupees for the project.



#### Sea turtle conservation

Employees at GKN Automotive in Thailand joined a sea turtle conservation programme with the aim of creating awareness amongst the younger generation of the endangered nature of sea turtles, whilst teaching children about how they can better protect them. The employees, together with school children, created nesting areas on Kerachut Beach in Penang National Park for the sea turtles by planting Merambung trees to attract the turtles to the area so that they can safely hatch their eggs away from predators.



#### American Cancer Society

HVAC held several fundraising activities for the American Cancer Society, a US voluntary health organisation that is dedicated to eliminating cancer. These activities included participating in the 'Relay for Life' team fundraising cancer walk and a 'Pink Day' that was held at the Dyersburg plant in October 2018. The Dyersburg plant has raised over US\$28,000 to date for the benefit of the American Cancer Society, and employees are looking forward to participating in the 'Relay for Life' in 2019.



# 03

## Diversity

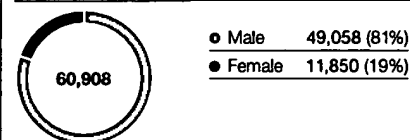
The charts to the right show the total number of males and females working within the Group as at 31 December 2018.

Melrose is a meritocracy and individual performance is the key determinant in any appointment, irrespective of ethnicity, gender or other characteristic, trait or orientation. The Board recognises the importance of diversity throughout the workforce and the Board is committed to equality of opportunity for all employees. Further details on the Group's Diversity Policy can be found on page 91 of this Annual Report.

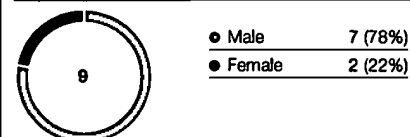
The Group currently takes into account a variety of factors before determining suitability for vacancies, including relevant skills to perform the role, experience and knowledge. The most important priority, however, has been and will continue to be ensuring that the best candidate is selected.

Melrose is a participant of the Hampton-Alexander Review and also notes the recommendations of Lord Davies' review, "Women on Boards". Melrose continues to encourage gender diversity throughout the Group. Although not appropriate to set specific gender diversity targets at Board level or throughout the Group's workforce due to Melrose's strategic business model and frequent turnover of businesses, Melrose is actively engaged in finding ways to increase the Group's diversity.

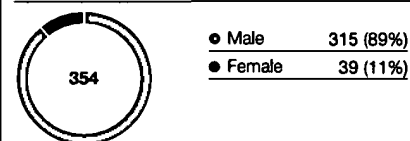
### Total Group Employees



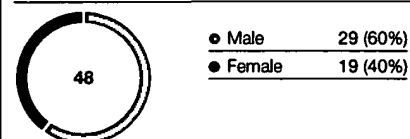
### Board



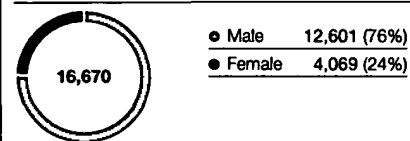
### Senior Managers<sup>(1)</sup>



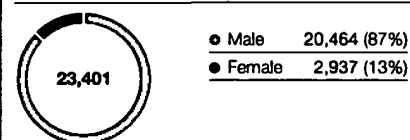
### Melrose – Central



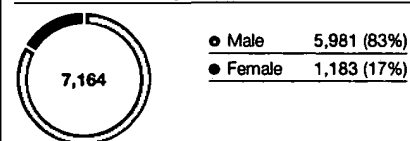
### Aerospace



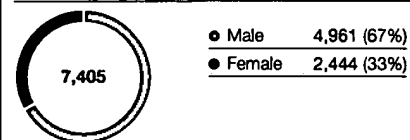
### Automotive



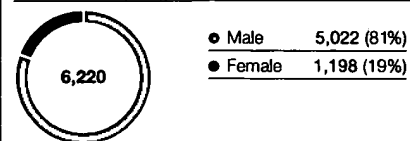
### Powder Metallurgy



### Nortek Air & Security



### Other Industrial



(1) Senior Managers include the Melrose senior management team and, as required by s414C of the Companies Act 2006, this figure excludes the Board of Melrose Industries PLC and includes Melrose subsidiary company directors.

# Corporate Social Responsibility

Continued

## 04

The environment

**The Melrose Board fully understands the importance of the Group's environmental responsibilities and is committed to ensuring that the operations of its businesses have the minimum possible adverse effect on the environment.**

The Group ensures that its businesses understand the importance of monitoring the impact of their operations on the environment, although there are no standardised environmental KPIs currently used within the Group. A range of KPIs are used as environmental measures, including energy consumption, CO<sub>2</sub> emissions, water consumption, water contamination, waste disposal, solid and liquid waste generation, recycling and volatile organic compound emissions. These KPIs are then used to plan for ongoing improvements.

During 2018, the Company continued to comply with the ongoing annual reporting requirements of the UK's Carbon Reduction Commitment Energy Efficiency Scheme.

### Environmental initiatives

During 2018, a range of environmental initiatives were implemented within the Group's divisions. Some of these are listed below:

- GKN Aerospace remained committed to further environmental improvements across the business. By the end of 2018, 84% of GKN Aerospace's sites achieved ISO 14001 certification. In addition, the business's first certification to ISO 50001 was achieved at its site in Munich, Germany. The site at El Cajon, California, US as part of a consortium of six large industrial facilities in San Diego,

entered into a Strategic Energy Management Agreement whereby it has committed for two years to identify energy savings measures, with an ultimate goal of reducing 2019 usage by 5% (with a 1% reduction already achieved by the end of 2018).

- ISO 14001:2015 accreditations were retained by all GKN Automotive sites, with 13/14 European plants being certified within ISO 50001. In 2018 all of the Driveline plants were contributing to the doMORE! Campaign, which aims to improve use of energy, and we implemented over 100 energy efficiency activities. The energy savings projects in the European sites alone saved over 1.3 million kWh in 2018. In addition, the business managed to achieve its landfill reduction target of 10%.
- All GKN Powder Metallurgy sites successfully finalised the transition to ISO 14001:2015 and completed a comprehensive third-party compliance audit during the second half of 2018. To continue its focus on environmental protection and energy efficiency goals, Hoegenaes Corporation Romania, recognized as one of the highest energy consumers in the business, successfully obtained a third-party Stand-Alone Certification for its Energy Management System according to ISO 50001.



In addition, the business achieved a 3.7% global reduction in energy resulting in savings of 25,000 MWh (vs. 2017) and a 9.3% global reduction in landfill waste equalling 242 tons (vs. 2017).

- HVAC continues to look for opportunities to reduce its environmental footprint: its Montreal, Canada facility reduced the use of wood packaging by approximately US\$48,000 in favour of recyclable materials for interplant shipments. In Tualatin, the conversion to LED lighting is approximately 60% complete and the business received a three-year Silver Green Business Certification. Further, in 2018 the business procured an enterprise-wide software that will enable tracking of hazardous waste generation, recycling of cardboard, paper, metals, electricity and water use by site by month with future plans to track CO<sub>2</sub> emissions.
- AQH launched the Hartford Energy Team with support from WPPI, a local electric utility, and Focus on Energy, a state-wide programme in Wisconsin, US, which have built a robust energy consumption model to understand current consumption of electric power and natural gas and to review the impact of energy reduction projects. AQH has also implemented measures to look for reduction opportunities and to identify and quickly correct leaks in its compressed air system. The business has replaced fluorescent bulbs with LED tubes at certain facilities and remodelling projects now use only LED lighting. As a result of the above activities, AQH qualified for US\$60,000 in rebates in 2018. In addition, the GBIS Huizhou site maintained its ISO 14001:2015 registration.
- The SST sites continue to ensure that they either meet or exceed the Universal Waste and Recycling regulations, as well as maximising their recycling efforts. In order to reduce electrical consumption and Universal Waste category reductions, the use of fluorescent bulbs was eliminated and replaced with LED lighting at two facilities, as well as implementing energy efficient exterior LED fixtures at another. The new Carlsbad, California, US site was developed with bioswale storm water collection/subsequent recycled water distribution for all site irrigation purposes.
- All GKN Wheels & Structures sites retained their ISO 14001:2015 accreditations. The Armstrong, US site installed a new interface to control the

light and air system in the plant, which resulted in reduced energy usage and a US\$20,000 rebate on lighting. All GKN Wheels & Structures sites undertook an independent environmental audit in 2018 to help identify opportunities for further improvement.

- Brush continued to focus on making further energy savings. Lighting initiatives across the Blackwood, UK, Ridderkerk, The Netherlands and Brisbane, Australia sites continue, with the installation of LED lights in the factory and surrounds, which will deliver an annual CO<sub>2</sub> reduction and generate savings for the business. The Blackwood site also completed its transition to ISO 14001:2015 and recycled 100% of its mixed wood waste in 2018. A paper reduction initiative was also introduced in Brisbane, which saw paper consumption reduce by more than 50% over the year.

### Greenhouse gas emissions

The Group is required to measure and report its direct and indirect Greenhouse gas ("GHG") emissions in the UK pursuant to the Companies Act 2006 (Strategic Report and Directors' Reports) Regulations 2013. The reported emissions cover all entities over which the Group had financial control over for a period of at least one year as of 31 December 2018. Emissions from entities acquired or disposed of during the reporting period (i.e. disposed of before 31 December 2017 or acquired after 1 January 2018) are not accounted for in the report. Note the emissions associated with the purchase of the GKN group midway through 2018 have not been included in the report as per the GHG accounting procedure, and will be included in next year's reporting period and lead to a significant increase in the overall Group emissions (GKN's last reported emissions for 2017 amounted to 1.29 million tonnes).

The year-on-year like-for-like emissions were down by around 10% mainly due to continuing significant reductions in reported energy usage at the Brush Loughborough, UK and Czech Republic sites, and the Nortek Saskatoon, Canada and Shenzhen, China sites and the closure of the Mississauga, Canada site and a near 20% reduction in the Ergotron group emissions. These have outweighed an increase in process related emissions at the Brush Blackwood and Brisbane sites and a 12% increase in emissions across the HVAC division.

The GHG reporting period is aligned to the Company's financial reporting year.

The data has been prepared in accordance with the principles and requirements of the Greenhouse Gas Protocol, Revised Edition, ISO 14064 Part 1 and the Department for Environment, Food & Rural Affairs (DEFRA) guidance on how to measure and report on Greenhouse gas emissions, as first published in 2013 and subsequently updated.

We have reported on all emission sources required under the Companies Act 2006 (Strategic Report and Directors' Reports) Regulations 2013.

All material emissions from within the organisational and operational scope and boundaries of the Group are reported. The emissions from owned vehicle transport (i.e. Group owned cars and vans, lorries and fork lift trucks) and the emissions associated with refrigeration have been excluded from the report on a de minimis basis.

Given that the Melrose business model is to acquire and divest businesses over a three to five-year time frame, there may be significant year-on-year changes in the reported emissions data, which may not reflect the underlying GHG performance of the Group's businesses.

### Global GHG emissions data for period 1 January 2018 – 31 December 2018 (tonnes CO<sub>2</sub>e<sup>(1)</sup> unless stated)

Emissions sources	2018 <sup>(2)</sup>	2017	Change
Combustion of fuel & operation of facilities (scope 1) <sup>(3)</sup>	23,261	23,680	-2%
UK electricity	1,718	3,236	-47%
Overseas electricity	29,592	33,273	-11%
Total purchased electricity (scope 2) <sup>(4)</sup>	31,310	36,509	-14%
Other purchased energy (scope 2) <sup>(4)</sup>	1,801	2,027	-11%
<b>Company's chosen intensity measurement:</b>			
Emissions reported above normalised to tonnes per £1,000 turnover	0.030	0.030	0%

(1) CO<sub>2</sub>e – carbon dioxide equivalent, this figure includes Greenhouse gases in addition to carbon dioxide.

(2) The 2018 emissions data does not include the GKN businesses as they were acquired part way through that year.

(3) Our scope 1 estimates include emissions from fuel used on premises, transport emissions from owned or controlled vehicles, losses of refrigerant, and process and fugitive emission.

(4) Our scope 2 estimates include emissions from electricity and heat purchased by the Group's businesses. Scope 2 emissions, and total Greenhouse gas emissions, are calculated using Market based methods.

# Corporate Social Responsibility

Continued

## 05

Health and safety

**The Board is committed to minimising the health and safety risks that each Group employee is exposed to by promoting the effective use and management of business-specific policies and procedures.**

All divisions in the Group have the health and safety of their workforce as a key priority. Each business unit uses data collection methods of comparable scope, frequency and quality. We have been working with the GKN businesses to conform their KPIs to those reported by the non-GKN businesses, and can now confirm that all businesses are reporting in accordance with the usual Melrose calculations.

The Group has a policy in place, which is supported by regular top-down monitoring and bottom-up reporting and continuous improvement procedures, to ensure that the Directors are made aware of any serious health and safety incidents wherever they occur in the world without delay and enable suitable investigative, preventative and corrective actions to be implemented. Current events and issues relating to health and safety matters are also discussed at quarterly Board meetings of the Company in consultation with the divisional health and safety leads. Where an urgent or high priority matter arises, the Melrose senior executive management team will monitor and discuss it on an expedited basis to determine a responsive action plan for implementation by the relevant divisional management team.

Tragically, a fatality occurred at the GKN Wheels & Structures facility in Telford, Shropshire, UK at the end of 2018. The incident remains under investigation by the UK Health and Safety Executive and the business is cooperating fully whilst implementing its own health and safety action plan.

Any fatal incident is one too many and the Company has responded to this incident by closely supporting and monitoring the divisional management team in implementing a comprehensive detailed action plan for corrective and improvement measures without delay, which include actions related to the accident as well as a wider health and safety review at the relevant facility. The business has extended its support to the family involved and those working at the plant who have been affected by the incident. In line with the Group's commitment to health and safety excellence the Board continues to impress upon divisional management teams the importance of maintaining high levels of health and safety awareness that align not only with regulation, but also good industry practice and site-specific risk profiles. The Group emphasises to all divisional management teams that health and safety performance and vigilance must be prioritised at all sites, with focus placed on those sites that contain production facilities.

Each division is responsible for setting its own detailed arrangements concerning health and safety policies and procedures, in accordance with local health and safety legislation and as is appropriate to the activities undertaken at each facility. As a general rule, the Board regularly directs divisions to strive to achieve best practice in terms of what is suitable and practical for the size and nature of their operations. Defined and business-specific health and safety key performance indicators are also used. Reports detailing each division's performance in relation to three health and safety KPIs (major accident frequency rate, accident frequency rate and accident severity rate) are presented to the Board and reviewed at each quarterly Board meeting.

The year was overshadowed by the tragic accident at Telford and efforts have been redoubled in order to avoid any recurrence. As would be expected, health and safety remains the primary focus and there were no consistent or repeated material issues or concerns identified by the Board during 2018. Behaviour-based safety programmes and reinforcement training remain at the forefront of all business divisions' health and safety initiatives, with additional focus on strengthening near-miss and hazard awareness programmes to maintain a culture of safety awareness, informed risk mitigation, regular workplace training and reduction of hazardous behaviours in each division.

For more information on the Group's health and safety KPIs, see the key performance indicators section on pages 18 to 19 of the Strategic Report.

During 2018, the recently acquired GKN businesses introduced a number of targeted safety-enhancing initiatives in respect of hazard identification, working at height, manual handling and ergonomic safety. Reported attendance at the relevant information and training sessions was high. Safety awareness amongst employees continues to grow and be reinforced as part of the quarterly "ThinkSAFE" training, with different topics being aimed at groups of employees based on their business function. Monthly refresher sessions are held on specific topics such as personal protection equipment and the manual handling of parts, all within the facility environment on a localised basis and tailored to the requirements of each site where appropriate.



Within the Automotive division (which makes up over 35% of the total Group workforce) the major accident frequency rate and total accident frequency rate decreased compared to 2017. This followed increased prominence of specific practical safety initiatives such as machine risk assessments, safety in setting and changeover assessments, safe working on high-voltage automotive systems and workplace transport risk assessments – the latter seeing a concurrent reduction in the number of risks that were identified in the Automotive division relating to the interaction between employees and fork lift trucks. Safety awareness continues to be conducted in a targeted manner.

The Automotive division's US plants in Alamance, Rockwell and Sanford received safety excellence awards from the US Department of Labor in acknowledgement of their injury reduction and risk management.

Other notable site-specific initiatives include the implementation of a behaviour-based safety improvement model at the Aerospace site in Pune, India which saw a reduction of 81% in the total incident rate at that facility.

The Powder Metallurgy division's Sinter Metals Conover facility in North Carolina, US received an award from the North Carolina Department of Labor recognising the site's outstanding health and safety efforts. The Hoeganaes Cinnaminson site in New Jersey, US received an MPPA

award for several years of zero lost time accidents in the workplace and an award from the New Jersey Governor's Counsel in recognition of zero work-related injuries.

Brush continued to focus on enhancing employee engagement and hazard reduction across its facilities, with its UK site continuing to see good performance and the Czech Republic facility implementing additional initiatives including increased visual inspections of key constructions and lifting devices, and replacement of manual machines for CNC machines. In the UK, Czech Republic and The Netherlands, ISO 14001 and OHSAS 18001 standards continue to be maintained and the transition from ISO 9001:2008 to ISO 9001:2015 was completed across all facilities. In the UK, Brush was awarded the ROSPA Gold Award in Health and Safety, signalling industry recognition for its high standards in health and safety.

Brush's behavioural safety programme has continued to improve the strong health and safety culture within the business. The programme focuses on developing a proactive approach among Brush employees to increase responsibility and accountability for their own and their working group's actions, whilst ensuring that employees intervene at the earliest opportunity to stop hazardous acts or correct any unsafe conditions.

At HVAC, behaviour-based observations, job safety analysis and personal protection equipment assessments continued.

A Nortek Safety Executive Council was formed and the Dyersberg, US facility received the Safety Award from the State of Tennessee for having an outstanding safety programme.

Facilities within the Group generally hold the ISO 14001 and OHSAS 18001 certifications where appropriate with a number of sites planning to roll out ISO 45001 next year.

Following these initiatives, among others, the Group has recognised the benefits of a workforce engaged in matters of health and safety, management teams committed to the continuous improvement of health and safety standards throughout the Group's businesses to keep the workforce safe.

# Corporate Social Responsibility

Continued

## 06

### Supply chain assurance

**Each business is responsible for the management of its supplier base, including the application of the appropriate policy, which best suits the geographical and operational diversity of the Group.**

The security, assurance and ethical compliance of business supply chains are very important to Melrose and its businesses. Responsibility for the implementation and management of all supplier-related policies rests with local management. Such policies are used in a manner appropriate to the size and complexity of the business and also take into account the nature and geographical representation of key suppliers. A supplier approval process exists within all business divisions, which is linked to specific and tailored supplier assessments and due diligence requirements utilising third party resources and the implementation of appropriate terms and conditions for the protection of the Group.

A number of initiatives were undertaken during 2018 to improve supply chain in light of the acquisition of GKN. With Melrose support, the GKN divisions have renewed their focus on improving their performance and delivery, particularly in critical supply chains. This requires a focus, on both its own suppliers, as well as delivering for its customers.

As part of its supplier focus, as well as working to ensure its on time payment, GKN Aerospace and GKN Automotive launched a joint global procurement transformation plan to drive business improvement, which seeks to optimise its £1.4 billion of spend on indirect products and services. This involves partnering with suppliers for indirect products and services across these divisions. Preferred suppliers are in the process of being selected for these indirect products and services, including consumables and non-OEM parts. Concurrently, all businesses are working to achieve similar improvements with their direct commodity suppliers.

Steps have also been taken to improve relationships with customers. In particular, Melrose has funded the significant investment required to achieve the necessary operational improvements fundamental to securing this improved performance.





# 07

**Human rights and ethical standards  
Sound business ethics  
and integrity are core  
to the Group's values  
and a high importance  
is placed on dealings  
with all employees,  
customers, suppliers  
and other stakeholders.**

The decentralised nature of the Group means there is no over-arching policy currently in place with regard to human rights; however Melrose is committed to good practice in respect of human rights. Employees across the Group are required, at all times, to exhibit the highest levels of integrity and to maintain the highest ethical standards in business affairs. The full text of the Melrose Code of Ethics, which all employees of the Group are required to familiarise themselves with, can be found on the Company's website at: [www.melroseplc.net/about-us/governance/code-of-ethics](http://www.melroseplc.net/about-us/governance/code-of-ethics).

In addition to the Melrose Code of Ethics, each Group business is expected to have its own code of ethics dealing with matters such as human rights. All business-specific employee policies are prepared locally within each business in order to ensure compliance with local laws and standards as a minimum. Responsibility for the communication and implementation of such policies rests with the relevant senior managers within the Group's businesses.

Finally, the Company's Modern Slavery Statement is available on the Company's homepage at [www.melroseplc.net](http://www.melroseplc.net). The Group has taken steps to implement effective and proportionate procedures to ensure that there are no forms of modern slavery in the Group's business or supply chains. This has included ensuring that all businesses have implemented a robust policy regarding the prevention of modern slavery and human trafficking and that online training has been made available to employees as the businesses have determined to be appropriate.

The Strategic Report, as set out on pages 10 to 69, has been approved by the Board.

On behalf of the Board

**Simon Peckham  
Chief Executive  
7 March 2019**

## Governance overview



**Justin Dowley**  
Non-executive Chairman

**The Board remains committed to maintaining the high standards of corporate governance required to ensure that the Company can continue to deliver on its strategic goals and to achieve long-term success for the benefit of its shareholders.**

### Introduction from the Chairman

As part of this approach, the Board has supported, applied and complied with the applicable Main Principles, the Supporting Principles and the respective related provisions of corporate governance contained in the UK Corporate Governance Code 2016 (the "Code") issued by the Financial Reporting Council (the "FRC") and available to view on the FRC's website at: [www.frc.org.uk](http://www.frc.org.uk).

In support of this commitment, the Board carried out a number of key governance activities during 2018 designed to ensure that Melrose remains compliant with the provisions of the Code and to enable continuous improvement in line with best practice corporate governance guidelines and to ensure that Melrose complies with the new UK Corporate Governance Code that was published in July 2018 and applies to accounting periods beginning on or after 1 January 2019.

### Succession planning

Succession planning was an area of focus for Melrose in 2018. The Nomination Committee and the Board has considered the leadership needs of the Group, present and future, together with the skills, experiences and diversity needed from its Directors going forward. We recognise that succession planning is an ongoing process and is critical to maintaining an effective and high-quality board.

Following the Company's elevation to the FTSE 100 and in compliance with amendments to the Code, a review and refresh of the Board was undertaken. I was elected to the inaugural role of Non-executive Chairman of the Board, effective 1 January 2019. Further detail about my appointment, background and experience can be found on page 72.

The previous Chairman, co-founder Mr Christopher Miller, who had held the position of Chairman since Melrose's establishment in 2003, will continue in a full-time executive capacity as Executive Vice Chairman alongside fellow co-founder Mr David Roper.

Ms Liz Hewitt, who has served as a Non-executive Director since 2013, was elected to the role of Senior Independent Director of the Board as my replacement, while continuing to perform her role as the Chairman of the Audit Committee. Ms Hewitt is the second-longest serving Non-executive Director and brings with her extensive business, financial and investment experience gained from a number of senior roles in international companies, including as independent member of the House of Lords Commission, and as non-executive director of Novo Nordisk A/S and Savills PLC.

Mr David Lis stepped down as Chairman of the Nomination Committee and was appointed as Chairman of the Remuneration Committee as my replacement, having served as a member of the Remuneration Committee since joining the Board as a non-executive director in March 2016.

Further detail about Mr Lis' appointment, background and experience can be found on page 73.

Mr Archie G. Kane was appointed as Chairman of the Nomination Committee in replacement of Mr Lis, having served as a member of the Nomination Committee since his appointment as a Non-executive Director in May 2017.

Further detail about Mr Kane's appointment, background and experience can be found on page 73.

Following a review by the Nomination Committee of the composition of the Board and a subsequent recommendation by the Committee that the number of independent Directors be increased, external recruitment consultants, Stonehaven International, were retained to identify suitable candidates for the Board's consideration. Stonehaven International provided an initial list of potential candidates which the Committee reviewed and produced a shortlist of candidates, from which several candidates were invited to interview with members of the Nomination Committee. Ms Charlotte Twyning was identified as the Board's preferred candidate and was appointed to the Board with effect from 1 October 2018. In accordance with the Articles, Ms Twyning will stand for election at the 2019 AGM.

### Remuneration

The Directors' Remuneration report, comprising the Annual Report on Remuneration, is available on pages 92 to 112.

After the renewal of the Company's former long-term incentive plan in 2017, the second tranche of options over 2017 Incentive Shares was allocated in 2018 as planned.

As further detailed in the Directors' Remuneration report, having undertaken a detailed engagement process with key shareholders following the 2018 AGM (see below) we are making some adjustments to the implementation of the Directors' Remuneration Policy for 2019 (see pages 104 to 107), to ensure that it remains appropriate and compliant with the UK Corporate Governance Code. No material changes are required to the Directors' Remuneration Policy or its implementation in 2019, and all other elements will remain the same as approved at the 2017 General Meeting.

Melrose's remuneration philosophy remains unchanged in order to align senior management with shareholders; executive remuneration should be simple, transparent, support the delivery of the Melrose value creation strategy and only pay for performance.

### Risk management and compliance

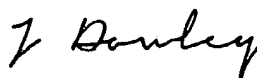
Melrose has implemented a uniform Enterprise Risk Management programme across all its business units including the newly acquired GKN businesses. Brush and the Nortek businesses have fully embedded our processes and procedures.

The Group's compliance policies have been fully implemented across all GKN, Nortek and Brush business units and continue to be monitored to ensure their effectiveness for the enlarged Group. Taken together, these initiatives have enhanced the GKN, Nortek and Brush businesses' effectiveness at identifying and managing risks and have promoted and embedded a more risk-aware culture. Further details on the Group's management of risk can be found on pages 50 to 51 of this Annual Report.

Melrose's reputation for acting responsibly plays a critical role in its success as a business and its ability to generate shareholder value. We maintain high standards of ethical conduct and take a zero-tolerance approach to bribery, corruption, modern slavery and human trafficking and any other unethical or illegal practices. Supporting our updated compliance policies are a comprehensive online training platform and an industry-leading whistleblowing reporting facility. The integrity of the compliance framework is further reinforced by the use of independent assurance and compliance audits.

### Engagement with shareholders

During 2018, the Company continued its programme of engagement with major investors and the governance bodies in respect of our Directors' Remuneration Policy and incentive arrangements. In particular, although the 2017 Remuneration Report received strong support from shareholders, it also received significant votes against. Recognising this, the Chairman of the Remuneration Committee and other members of the Board met with major shareholders in the months following the 2018 AGM to discuss shareholders' views in respect of executive remuneration. The Board is pleased with the support and constructive feedback received throughout these discussions, which is set out in the Directors' Remuneration report on pages 92 to 112, and it is our intention to continue this programme for the foreseeable future, especially ahead of seeking approval for the renewal of the long-term incentive plans next year. Further engagement with key shareholders and governance bodies was a central part of our bid for GKN and has continued since its acquisition and the 2018 AGM.



**Justin Dowley**  
Non-executive Chairman  
7 March 2019

### Main responsibilities of the Board

- Effectively manage and control the Company via a formal schedule of matters reserved for its decision
- Determine and review Group strategy and policy and provide strategic leadership to the Group
- Consider acquisitions, disposals and requests for major capital expenditure
- Review financial and trading performance in line with the Group's strategic objectives
- Ensure that adequate funding and personnel are in place
- Report to shareholders and give consideration to all other significant financial matters
- Agree Board succession plans and consider the evaluation of the Board's performance over the preceding year
- Review the Group's risk management and internal control systems
- Determine the nature and extent of the risks the Group is willing to take
- Agree the Group's governance framework and approve Group governance policies
- Monitor, assess and review cyber security and fraud risk for the Group
- Delegate and oversee responsibility for entrepreneurial leadership and strategic management of the Group to the Group senior executives
- Challenge, review and exercise robust managerial oversight across key decisions, actions and processes performed by the Group's business units

# Board of Directors

## 1. Justin Dowley

Non-executive Chairman

### Year appointed

Appointed as Chairman on 1 January 2019, having previously served as a Non-executive Director from 1 September 2011 and as Senior Independent Director from 11 May 2017 to 31 December 2018.

### Skills and experience

Justin has extensive experience with over 35 years spent within the banking, investment and asset management sector. A Chartered Accountant, Justin qualified with Price Waterhouse and was latterly Vice Chairman of EMEA Investment Banking, a division of Nomura International PLC. He was also a founder partner of Tricorn Partners, Head of Investment Banking at Merrill Lynch Europe and a director of Morgan Grenfell.

Board meetings attended <sup>(1)</sup>	3
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Business reviews attended	3
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### Other significant appointments

- Non-executive Director of Scottish Mortgage Investment Trust PLC
- Director of a number of private companies
- Steward of the Jockey Club
- Deputy Chairman of The Panel on Takeovers and Mergers

### Committee membership

- Nomination
- Remuneration

Independent	Yes
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## 2. Christopher Miller

Executive Vice-Chairman

### Year appointed

Appointed as Executive Vice-Chairman on 1 January 2019, having previously served as Executive Chairman from May 2003.

### Skills and experience

Christopher's longstanding involvement in manufacturing industries and private investment brings a wealth of experience to the Board.

A Chartered Accountant, Christopher qualified with Coopers & Lybrand, following which he was an Associate Director of Hanson PLC. In September 1988, Christopher joined the board of Wassall PLC as its Chief Executive. Between October 2000 and May 2003, Christopher was involved in private investment activities.

Board meetings attended <sup>(1)</sup>	4
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Business reviews attended	3
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### Other significant appointments

- Trustee of the Prostate Cancer Research Centre

### Committee membership

- Nomination

Independent	Not applicable
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## 3. David Roper

Executive Vice-Chairman

### Year appointed

Appointed as Executive Vice-Chairman on 9 May 2012, having previously served as Chief Executive from May 2003.

### Skills and experience

From a wide range of roles in corporate finance, private investment and management in manufacturing industries, David brings significant investment, financial and operational expertise.

A Chartered Accountant, David qualified with Peat Marwick Mitchell, following which he worked in the corporate finance divisions of S.G. Warburg, BZW and Dillon Read. In September 1988, David was appointed to the board of Wassall PLC, before becoming its deputy Chief Executive in 1993. Between 2000 and 2003, David was involved in private investment activities and served as a non-executive director on the boards of two companies in France.

Board meetings attended <sup>(1)</sup>	4
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Business reviews attended	3
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Independent	Not applicable
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## 4. Simon Peckham

Chief Executive

### Year appointed

Appointed as Chief Executive on 9 May 2012, having previously served as Chief Operating Officer from May 2003.

### Skills and experience

Simon provides widespread expertise in corporate finance, mergers and acquisitions, strategy and operations. Simon qualified as a solicitor in 1986, before moving to Wassall PLC in 1990, where he became an executive director in 1999. Between October 2000 and May 2003, Simon worked for the equity finance division of The Royal Bank of Scotland where he was involved in several high-profile transactions.

Board meetings attended <sup>(1)</sup>	4
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Business reviews attended	3
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Independent	Not applicable
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## 5. Geoffrey Martin

Group Finance Director

### Year appointed

Appointed as Group Finance Director on 7 July 2005.

### Skills and experience

Geoffrey provides considerable public company experience and expertise in corporate finance, raising equity finance and financial strategy. A chartered accountant, Geoffrey qualified with Coopers & Lybrand, where he worked within the corporate finance and audit departments. In 1996, Geoffrey joined Royal Doulton PLC, serving as Group Finance Director from October 2000 until June 2005.

Board meetings attended <sup>(1)</sup>	4
--	---

Business reviews attended	3
---------------------------	---

Independent	Not applicable
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1



Justin Dowley  
Non-executive Chairman

2



Christopher Miller  
Executive Vice-Chairman

3



David Roper  
Executive Vice-Chairman

4



Simon Peckham  
Chief Executive

5



Geoffrey Martin  
Group Finance Director

6



Liz Hewitt  
Independent Non-executive Director

7



David Lis  
Independent Non-executive Director

8



Archie G. Kane  
Independent Non-executive Director

9



Charlotte Twynning  
Independent Non-executive Director

## 6. Liz Hewitt

Independent Non-executive Director

### Year appointed

Appointed as Senior Independent Director on 1 January 2019, having previously served as a Non-executive Director from 8 October 2013.

### Skills and experience

Liz has extensive business, financial and investment experience gained from a number of senior roles in international companies. A chartered accountant, Liz qualified with Arthur Andersen & Co., following which she held a variety of positions within Gartmore Investment Management, CVC and 3i Group PLC. Between 2004 and 2011, Liz was the Group Director of Corporate Affairs for Smith & Nephew PLC, following a secondment to the Department for Business, Innovation and Skills and the HM Treasury, where Liz worked to establish The Enterprise Capital Fund.

Board meetings attended <sup>(1)</sup>	4
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Business reviews attended	3
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### Other significant appointments

- Non-executive director of Novo Nordisk A/S, Savills PLC, Silverwood Property Ltd, St George's Fields Ltd and St George's Fields (No2) Ltd
- Independent Member of the House of Lords Commission

### Committee membership

- Audit (Chairman)
- Nomination
- Remuneration

Independent	Yes
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## 7. David Lis

Independent Non-executive Director

### Year appointed

Appointed as a Non-executive Director on 12 May 2016.

### Skills and experience

David has held several senior roles in investment and fund management and brings extensive financial experience to the Board. David commenced his career at NatWest, and held positions at J Rothschild Investment Management and Morgan Grenfell after which David founded Windsor Investment Management. David joined Norwich Union Investment Management in 1997 (later merging to form Aviva Investors), before becoming Head of Equities in 2012 and latterly Chief Investment Officer, Equities and Multi Assets, until his retirement in March 2016.

Board meetings attended <sup>(1)</sup>	4
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Business reviews attended	3
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### Other significant appointments

- Non-executive director of Electra Private Equity PLC and BCA Marketplace PLC

### Committee membership

- Audit
- Nomination
- Remuneration (Chairman)

Independent	Yes
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## 8. Archie G. Kane

Independent Non-executive Director

### Year appointed

Appointed as a Non-executive Director on 5 July 2017.

### Skills and experience

Archie qualified as a Chartered Accountant with Mann Judd Gordon and Company. After a move into the financial services sector as Group Financial Controller of the TSB subsidiary United Dominions Trust, Archie became Group Strategy Director. Archie later served in senior roles for Lloyds Bank and was CEO of the former mutual Scottish Widows in 2003. In 2009 he moved to become Group Executive Director for all the group's insurance businesses and for Scotland, until his retirement in May 2011.

Board meetings attended <sup>(1)</sup>	4
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Business reviews attended	3
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### Other significant appointments

- Non-executive Governor of the Board of Bank of Ireland
- Non-executive Chairman of ReAssure Group Limited (with effect from 18 January 2019)

### Committee membership

- Audit
- Nomination (Chairman)
- Remuneration

Independent	Yes
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## 9. Charlotte Twynning

Independent Non-executive Director

### Year appointed

Appointed as a Non-executive Director on 1 October 2018.

### Skills and experience

Charlotte brings a diverse range of experience to the Board. After a decade specialising in competition and M&A law in the City, Charlotte moved to BT in 2007. Whilst there, she held various senior roles in legal, policy and customer service strategy. In 2016, she joined Abellio as an executive Director to establish a policy, communications and strategy function commensurate to its FTSE 250 size. Charlotte is currently Consents Director on the Heathrow Expansion Programme Board responsible for securing the approvals for its expansion.

Board meetings attended <sup>(1)</sup>	1 <sup>(2)</sup>
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Business reviews attended	1
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### Committee membership

- Audit
- Nomination
- Remuneration

Independent	Yes
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(1) Meetings attended refers to scheduled meetings.

(2) Charlotte has attended one meeting, being all meetings that occurred since her appointment.

# Directors' report

## **The Directors of Melrose Industries PLC present their Annual Report and financial statements of the Group for the year ended 31 December 2018.**

### **Incorporated information**

The Corporate governance report set out on pages 78 to 81, the Finance Director's review on pages 40 to 48 and the Corporate Social Responsibility section of the Strategic Report on pages 59 to 69 are each incorporated by reference into this Directors' report.

Disclosures elsewhere in the Annual Report are cross-referenced where appropriate. Taken together, they fulfil the combined requirements of the Companies Act 2006 (the "Act") and of the Disclosure Guidance and Transparency Rules (the "DTRs") and the Listing Rules of the Financial Conduct Authority.

### **AGM**

The Annual General Meeting of the Company will be held at Barber-Surgeons' Hall, Monkwell Square, Wood Street, London EC2Y 5BL at 11am on 9 May 2019. The notice convening the meeting is shown on pages 197 to 201 and includes full details of the resolutions to be proposed, together with explanatory notes in relation to such resolutions (the "AGM Notice").

### **Directors**

The Directors of the Company as at the date of this Annual Report, together with their biographical details, can be found on pages 72 to 73.

Changes to the Board during the year are set out in the Corporate governance report on pages 78 to 81. Details of Directors' service contracts are set out in the Directors' Remuneration report on page 112.

The Statement of Directors' responsibilities in relation to the consolidated financial statements is set out on page 113, which is incorporated into this Directors' report by reference.

### **Appointment and removal of Directors and their powers**

The Company's articles of association (the "Articles") give the Directors the power to appoint and replace other Directors. Under the terms of reference of the Nomination Committee, any appointment must be recommended by the Nomination Committee for approval by the Board.

Pursuant to the Articles and in line with the UK Corporate Governance Code, all of the Directors of the Company are required to stand for re-election on an annual basis. With the exception of Ms Charlotte Twyning who will be standing for election for the first time following her appointment on 1 October 2018, all current Directors of the Company will be standing for re-election by the shareholders at the forthcoming AGM.

The Directors are responsible for managing the business of the Company and exercise their powers in accordance with the Articles, directions given by special resolution and any relevant statutes and regulations.

### **Insurance and indemnities**

In accordance with the Articles and the indemnity provisions of the Act, the Directors have the benefit of an indemnity from the Company in respect of any liabilities incurred as a result of their office. This indemnity is provided both within the Articles and through a separate deed of indemnity between the Company and each of the Directors.

The Company has taken out an insurance policy in respect of those liabilities for which the Directors may not be indemnified. Neither the indemnities nor the insurance provides cover in the event that a Director is proved to have acted dishonestly or fraudulently.

### **Post balance sheet events**

On 6 March 2019, the Group announced the agreement to sell the Walterscheid Powertrain Group to One Equity Partners, a US-based private equity firm. In addition, the Group announced the completion of the sale of the minority 43.57% interest in Société Anonyme Belge de Constructions Aéronautiques ("SABCA"), previously held within the Aerospace reporting segment, to SABCA's majority shareholder, Dassault Belgique Aviation S.A. The sale of the Walterscheid Powertrain Group is subject to the customary regulatory conditions and is expected to complete in the first half of this year. The combined net proceeds of the sales are approximately £200 million.

### **Capital structure**

The Company's shares are admitted to the premium segment of the official list.

As at 1 January 2018, the issued share capital of the Company was 1.9 billion ordinary shares, following which it made an offer to buy GKN plc on 17 January 2018 for 1.49 new Melrose shares and £0.81 for every GKN plc share. This initial offer was increased to 1.69 new Melrose shares and £0.81 per GKN plc share as part of the full and final offer of 13 March 2018. This offer went unconditional as to acceptances on 29 March 2018 and the Company took control on 19 April 2018 once all conditions had been satisfied or waived.

On the basis of authorities obtained at the 2018 AGM, the Directors allotted a number of shares in connection with the Company's acquisition of GKN plc. Following the various share issuances as part of the acquisition of GKN plc the Company's issued share capital now consists of 4,858,254,963 ordinary shares of 48/7 pence each, with each ordinary share carrying the right to one vote, and 12,831 Incentive Shares (2017) which do not carry the right to vote.

The table below shows details of the Company's issued share capital as at 31 December 2017 and as at 31 December 2018.

Share class	31 December 2017	31 December 2018
Ordinary shares of 48/7 pence each	1,941,200,503	4,858,254,963 <sup>(1)</sup>
Incentive Shares (2017)	12,831 <sup>(2)</sup>	12,831

- (1) Includes ordinary shares issued in connection with the Company's takeover of GKN plc.  
 (2) The Incentive Plan (2017) was approved by the Company's shareholders at a general meeting of the Company held on 11 May 2017, and these Incentive Shares were issued pursuant to the authority granted at such meeting to issue Incentive Shares up to an aggregate nominal amount of £50,000.

### Shareholders' voting rights

Subject to any special rights or restrictions as to voting attached to any class of shares by or in accordance with the Articles, at a general meeting of the Company, each member who holds ordinary shares in the Company and who is present (in person or by proxy) at such meeting is entitled to:

- on a show of hands, one vote; and
- on a poll, one vote for every ordinary share held by them.

With the exception of the Incentive Shares (2017), which do not carry voting rights, there are currently no special rights or restrictions as to voting attached to any class of shares.

The Company is not aware of any agreements between shareholders that restrict voting rights attached to the ordinary shares in the Company.

Where any call or other amount due and payable in respect of an ordinary share remains unpaid, the holder of such shares shall not be entitled to vote or attend any general meeting of the Company in respect of those shares. As at 7 March 2019, all ordinary shares issued by the Company are fully paid.

Details of the deadlines for exercising voting rights in respect of the resolutions to be considered at the 2019 AGM are set out in the AGM Notice on pages 197 to 201.

### Restrictions on transfer of securities

The Articles do not contain any restrictions on the transfer of ordinary shares in the Company, aside from the usual restrictions applicable where shares are not fully paid up, if entitled to do so under the Uncertificated Securities Regulations 2001, where the transfer instrument does not comply with the requirements of the Articles or, in exceptional circumstances, where approved by the UK Listing Authority provided such refusal would not disturb the market in such shares. Restrictions may also be imposed by laws and regulations (such as insider trading and market abuse provisions). Directors and certain senior employees of the Group may also be subject to internal approvals before dealing in ordinary shares of the Company and minimum shareholding requirements.

The Company's incentive shares may only be transferred with the prior written consent of the Board (such consent expressly provided in respect of transfers to personal trusts, companies wholly-owned by the relevant holder and certain of their close relatives).

The Company is not aware of any agreements between shareholders that restrict the transfer of ordinary shares in the Company.

### Articles of association

The Articles may only be amended by a special resolution at a general meeting of the shareholders of the Company. There are no amendments proposed to be made to the Articles at the forthcoming AGM.

### Substantial shareholdings

As at 31 December 2018, the following voting interests in the ordinary share capital of the Company, disclosable under DTR 5, had been notified to the Directors:

Shareholder	Shareholding	% of ordinary share capital as at 31 December 2018
BlackRock Inc	332,302,037	6.84
The Capital Group Companies, Inc	238,555,954	4.91
Aviva Plc	153,648,939	3.16

Between 1 January 2019 and 7 March 2019 no changes to the voting interests in the ordinary share capital of the Company, disclosable under DTR 5, were notified to the Directors.

### Shareholder dividend

The Directors are pleased to recommend the payment of a final dividend of 3.05 pence per share (2017: 2.8 pence) to be paid on 20 May 2019 to ordinary shareholders on the register of members of the Company at the close of trading on 5 April 2019. This dividend recommendation will be put to shareholders at the forthcoming AGM of the Company, to be held on 9 May 2019. Subject to shareholder approval being obtained at the AGM for the final dividend, this will mean a full year 2018 dividend of 4.6 pence per share (2017: 4.2 pence).

For discussions on the Board's intentions with regard to the dividend policy, please see the Chairman's statement on pages 14 to 15, which is incorporated into this report by reference.

The Company offers a Dividend Reinvestment Plan ("DRIP"), which gives shareholders the opportunity to use their dividend payments to purchase further ordinary shares in the Company. Further details about the DRIP and its terms and conditions can be found within the Investors section of the Company's website at [www.melroseplc.net](http://www.melroseplc.net).

### Historic dividends

The Company administers the unclaimed dividends of the former FKI plc (now "Brush Holdings Limited"). Pursuant to law and the Articles, the Company is obliged to pay such unclaimed dividends 12 years from the date of the last dividend claim of the particular shareholder ("Unclaimed Dividends"). Six months after this time period has expired, the Company's policy is to donate the amount of the Unclaimed Dividend to a charity of the Company's choice. As at 31 December 2018, the amount of such Unclaimed Dividends was £149,687.87. If the Unclaimed Dividends are not claimed by 30 September 2019, the Company will donate the funds to charity.

# Directors' report

Continued

## Ability to purchase own shares

Pursuant to sections 693 and 701 of the Act and a special resolution passed at a general meeting of the Company on 10 May 2018, the Company is authorised to make market purchases of up to 488,894,454 of its ordinary shares, representing approximately 10% of the expected issued ordinary share capital of the Company following the acquisition of GKN plc. The Company has not made any purchases of its own shares pursuant to this authority. This authority will expire at the end of this year's AGM, at which the Company is seeking approval to make market purchases of its ordinary shares up to 485,825,496, being approximately 10% of the current issued ordinary share capital, thereby renewing the authority. The full text of the resolution, together with minimum and maximum price requirements, is set out in the AGM Notice on pages 197 to 201.

## Financial instruments

The disclosures required in relation to the use of financial instruments by the Company, including the financial risk management objectives and policies (including in relation to hedging) of the Company and the exposure of the Company to liquidity risk, cash flow risk, exchange rate risk, contract and warranty risk and commodity cost risk, can be found in the Finance Directors' review on pages 40 to 48, the risks and uncertainties section of the Strategic Report on pages 52 to 58 and in note 24 to the financial statements, which are incorporated by reference into this Directors' report.

## Research and development activities

The industries in which the Melrose Group invests are highly competitive and the businesses within the Group are encouraged to research and develop new and innovative product lines and processes in order to meet customer demands in a continuously evolving environment.

As noted in the Divisional reviews on pages 20 to 39, which are incorporated by reference into this Directors' Report, within the GKN businesses investment is being made into research and development activities: for example, in 2018 Melrose committed to setting up the 'Melrose Skills Fund', with the ambition to create the next generation of high calibre engineers in the UK, as well as investing 2.2% of GKN plc sales in R&D over the next five years. Further details of this are set out in the Corporate Social Responsibility section of this report on page 62. So far, such investment has included the development of a new £32 million UK Global Technology Centre for GKN Aerospace near its Filton production facility, GKN Automotive's £50 million e-Powertrain R&D investment strategy, and GKN Powder Metallurgy's strategic technology partnership with EOS to design a new high-productivity process for laser metal 3D printing and strategic partnership with Hewlett Packard to deploy the HP Metal Jet within leading automotive and industry manufacturers.

An example of the types of new products being launched within the Nortek businesses include HVAC's Statepoint Technology®, an industry leader in data centre cooling, and AQH's Alliance range hood platform, as noted in the Divisional reviews on pages 20 to 39, which are incorporated by reference into this Directors' report.

## Business review and risks

A review of the Group's performance, the key risks and uncertainties facing the Group and details on the likely development of the Group can be found in the Chairman's statement on pages 14 to 15 and the Strategic Report on pages 10 to 69 of this Annual Report (including the longer-term viability statement on page 49 and the risks and uncertainties section on pages 52 to 58) which are incorporated into this Directors' report by reference.

## Employees

Details in relation to employment policies, employee involvement, consultation and development, together with details of some of the human resource improvement initiatives implemented during 2018 are shown on pages 59 to 69 of the Corporate Social Responsibility section of the Strategic Report, which is incorporated by reference into this Directors' report.

## Environmental

Details of the Group's environmental initiatives, Greenhouse gas emissions and the methodology used to calculate such emissions are set out on pages 64 to 65 of the Corporate Social Responsibility section of the Strategic Report, which is incorporated by reference into this Directors' report.

## Political donations

The Group's policy is not to make any political donations and there were no political donations made during the year ended 31 December 2018 (2017: nil).

## Branches

The Melrose Group and its businesses operate across various jurisdictions. The GKN businesses, through their various subsidiaries, have established branches in a number of different countries in which they operate.

## Disclosures required under Listing Rule 9.8.4R

Other than the following, no further information is required to be disclosed by the Company in respect of Listing Rule 9.8.4R:

- details of the 2017 Incentive Plan, which are set out on page 98 of the Directors' Remuneration report and note 22 to the financial statements (incorporated by reference into this report); and
- GKN had historically operated employee share option plan trusts to satisfy the vesting and exercise of awards of ordinary shares made under GKN's share-based incentive arrangements. On the acquisition of GKN, these shares were converted into Melrose shares. A dividend waiver is in place on the shareholdings in respect of relevant trusts in part, or in full, in accordance with the provisions of the relevant trust deeds.

## Significant agreements and change of control

With the exception of the Group's banking facilities, the Incentive Plan (2017) (including the options granted under this plan), and the divisional management long-term incentive plans, there are no other agreements that would have a significant effect upon a change of control of Melrose Industries PLC as at 7 March 2019.

In January 2018, in connection with the Company's acquisition of GKN plc, the Group entered into a new committed bank facility, comprising of a multi-currency term loan of £1.5 billion and a multi-currency revolving credit facility denominated £1.1 billion, US\$2.0 billion and €0.5 billion. Details of this facility are provided in the Finance Director's review on pages 44 to 45 and note 24 to the financial statements. On 29 October 2018, £663 million of the new term loan was surplus to requirements, and therefore cancelled, because potential change of control clauses of the bonds were not exercised by the relevant bondholders.

In the event of a change of control of the Company following a takeover bid, the Company and lenders under the facility agreement are obliged to enter into negotiations to determine whether, and if so how, to continue with the facility. There is no obligation for the lenders to continue to make the facility available for more than 30 days beyond any change of control. Failure to reach agreement with parties on revised terms could require an acquirer to put in place replacement facilities.

The Company's wholly owned subsidiary, GKN Holdings Limited, has in issue £450 million fixed rate notes paying 5.375% p.a. interest and maturing on 19 September 2022 and £300 million variable rate notes paying 3.375% p.a. interest and maturing on 12 May 2032, in each case issued under Euro medium-term note programmes (the "Notes"). Pursuant to the terms attaching to the Notes, a holder of the Notes has the option to require GKN Holdings Limited to redeem or (at GKN Holdings Limited's option) purchase the holder's Notes at their principal amount if there is a change of control of GKN Limited and either (i) the Notes are unrated or do not carry an investment grade credit rating from at least two ratings agencies; or (ii) if the Notes carry an investment grade credit rating from at least two ratings agencies, the Notes are downgraded to a non-investment grade rating or that rating is withdrawn within 90 days of the change of control and such downgrade or withdrawal is cited by the ratings agencies as being the result of the change of control.

In the event of a takeover of the Company, options granted under the Incentive Plan (2017) would be exercised and any Incentive Shares (2017) resulting from such exercise, or that had previously been issued, would convert into ordinary shares in the Company or an entitlement to a dividend paid in cash. The rate of conversion is based upon the offer price of the Company's ordinary shares as calculated on the date of the change of control of the Company. If the offer price, or any element of the offer price, is not in cash, the Remuneration Committee will determine the value of the non-cash element, having been advised by a reputable investment bank that such valuation is fair and reasonable.

Long-term management incentive plans have been put in place for our key divisions which would be triggered upon a sale of their respective business or a takeover of the Company. The plans provide for the payment of bonuses to certain key managers of these divisions based upon the increase in value of their respective business. If a sale of the relevant business has not occurred within a certain period, the incentive plan will crystallise and any payment to be made to participants will be based on the increase in value of the business during this period.

### Commitments

Melrose entered into certain undertakings and other continuing obligations with the UK government and other regulatory bodies in connection with its acquisition of GKN plc. Some of these are summarised below.

In April 2018, the Company agreed to certain (a) undertakings and consent requirements with the UK Secretary of State (SoS) for Business, Energy and Industrial Strategy (BEIS) to preserve the core GKN Aerospace business until April 2023; and (b) restrictions and consent requirements with the UK SoS for Defence related to GKN's dealing in controlled items and its status as a government contractor.

The Company also provided post offer undertakings to the UK Panel on Takeovers and Mergers, which expire in April 2023. These include the maintenance of a UK group headquarters, the Company's listing on the LSE's Main Market, maintaining its majority of UK resident board directors, preserving the GKN trademarks and maintaining an agreed R&D spend.

Outside of its formal undertakings and commitments, the Company commenced improving the inherited GKN UK pension schemes by setting an improved funding target of Gilts +75bps for the GKN 2012 Pension Scheme, and Gilts +25bps for the GKN 2016 Pension Scheme. The Company committed to make an initial voluntary contribution to the two pension schemes totalling £150 million within the first 12 months, annual payments of £60 million, and to pay between 5% and 10% of net proceeds of any Melrose divestment, or £270 million on the sale of GKN Powder Metallurgy, for as long as the schemes remain in deficit. This is consistent with our aim of ensuring that all UK defined benefit schemes end up stronger under Melrose ownership than when they join the Group, with many of them becoming fully-funded during Melrose ownership.

The Company agreed with the SoS for BEIS to create the 'Melrose Skills Fund', with the ambition to create a supply chain of high calibre engineers for the whole of the UK. Further details of this are set out in the Corporate Social Responsibility section of this report on page 62.

The Company's offer document in respect of the acquisition of GKN plc (published on 1 February 2018) sets out its intentions relating to its GKN businesses in further detail.

### Auditor

So far as each Director is aware, there is no relevant audit information (being information that is needed by the Company's auditor to prepare its report) of which the Company's auditor is unaware. Each Director has taken all the steps that he or she ought to have taken as a Director to make him or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Act.

On behalf of the Board, the Audit Committee has reviewed the effectiveness, performance, independence and objectivity of the existing external auditor, Deloitte LLP, for the year ended 31 December 2018 and concluded that the external auditor was in all respects effective. Deloitte LLP has expressed its willingness to continue in office as auditor of the Group. Accordingly, resolutions will be proposed at this year's AGM for the reappointment of Deloitte LLP as auditor of the Group and to authorise the Audit Committee to determine its remuneration.

### Approval

Approved by the Board and signed on its behalf by:



**Jonathon Crawford**  
Company Secretary  
7 March 2019

# Corporate governance report

In line with the UK Corporate Governance Code 2016 (the "Code") and the Listing Rules issued by the Financial Conduct Authority, this section of the Annual Report and financial statements details the ways in which the Company has applied and complied with the principles and provisions of the Code applicable during the year ended 31 December 2018.

In July 2018, the Financial Reporting Council ("FRC") amended the Code, a copy of which is available at [www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF](http://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF). This new version of the Code applies to accounting periods beginning on or after 1 January 2019 and will form the basis of the Company's 2019 Annual Report and financial statements, although the Company notes its voluntary material compliance during 2018.

The Audit Committee report, Nomination Committee report, Directors' Remuneration report, Statement of Directors' responsibilities and the risk management and risks and uncertainties sections of the Strategic Report also form part of this Corporate governance report.

## Statement of compliance

Throughout the year ended 31 December 2018, the Company has applied and complied with the main principles, the supporting principles and the respective related provisions of the Code.

### Main principle A: Leadership

#### The Board

Details of the structure of the Board and its key responsibilities are shown on pages 72 to 73.

There were four formally scheduled Board meetings held during the year and the attendance of each Director at these meetings is shown on page 80. A number of unscheduled Board meetings were also held during the year in connection with corporate transactions, for example in relation to the acquisition of GKN plc.

In addition, business review meetings are held between scheduled Board meetings. There were three business review meetings held during the year for each non-GKN division and two business review meetings held for each GKN division. The attendance of each Director at these review meetings is set out on page 80. These meetings are critical to providing the Directors with a comprehensive understanding of the current performance of, and the key issues affecting, the Group's businesses, without the formality or rigidity of a Board meeting. Divisional CEOs and other senior management from the Melrose businesses are periodically invited to attend and present to these meetings, providing the Directors with an opportunity to discuss each business directly and to develop relationships with their leadership teams.

A pack of briefing papers and an agenda are provided to each Director in advance of each Board, Committee or business review meeting. The Directors are able to seek further clarification and information on any matter from any other Director, the Company Secretary or any other employee of the Group whenever necessary.

Decisions are taken by the Board in conjunction with the recommendations of its Committees and advice from external consultants, advisers and senior management.

The Board has a fully encrypted electronic board portal system, enabling Board, Committee and review papers to be delivered securely and efficiently to Directors. This facilitates a faster and more secure distribution of information, accessed using electronic tablets and reduced resource usage.

The Company Secretary is responsible for advising and supporting the Chairman and the Board on corporate governance matters as well as ensuring a smooth flow of information to enable effective decision making. All Directors have access to the advice and services of the Company Secretary and, through him, have access to independent professional advice in respect of their duties, at the Company's expense. The Company Secretary acts as secretary to the Board, the Audit Committee, the Nomination Committee and the Remuneration Committee.

In accordance with its Articles and in compliance with the Act, the Company has granted a qualifying third-party indemnity to each Director. This indemnity is provided both within the Company's Articles and through a separate deed of indemnity between the Company and each of the Directors. The Company also maintains Directors' and Officers' liability insurance.

### Chairman, Vice-Chairmen and Chief Executive

The roles of each of the Chairman, the Vice-Chairmen and the Chief Executive of the Company are, and will remain, separate in accordance with best practice and Board policy.

The Chairman, with the assistance of the Vice-Chairmen, is responsible for leadership of the Board. The Chairman sets the Board agenda and ensures that adequate time is given to the discussion of issues, particularly those of a strategic nature. Responsibility for ensuring effective communications are made to shareholders rests with the Chairman, Vice-Chairmen and the two other executive Directors.

The Board notes, and confirms, its decision to elect Mr Justin Dowley to the inaugural position of Non-executive Chairman of the Board, effective 1 January 2019. Mr Dowley was the Senior Independent Director and Chairman of the Remuneration Committee and it was decided that following the acquisition of GKN, the appointment of Mr Dowley as Chairman and the retention of Mr Christopher Miller as Vice-Chairman, being one of the founding members of Melrose and a Director since its incorporation in 2003, would provide the Board with the necessary continuity and stability it required. Mr Miller shall continue to play an active executive role in identifying and evaluating new opportunities for the Group.

The Chief Executive is responsible for strategic direction and decisions involving the day-to-day management of the Company.

### Non-executive Directors

The Company's Non-executive Directors are encouraged to, and do, scrutinise the performance of the executive Directors in all areas, including on strategy, risks and financial information, through their roles on the Company's Committees, at the Board's scheduled meetings and review sessions and on an ad hoc basis.

### Main principle B: Effectiveness

#### Board composition

As at 1 January 2019, the Board comprises a Non-executive Chairman, four executive Directors and four Non-executive Directors. The Board believes that the Directors possess diverse business experience in areas complementary to the activities of the Company. Biographies of the Directors are shown on pages 72 and 73 and on the Company's corporate website at [www.melroseplc.net](http://www.melroseplc.net).

These biographies identify any other significant appointments held by the Directors.

The Board and the Nomination Committee undertake an annual review of the time commitment required from both the executive and Non-executive Directors. The consensus view between the Directors is that the current time commitment is appropriate.

On the recommendation of the Nomination Committee, the Board decided to increase the number of independent Directors. External recruitment consultants Stonehaven International were retained to identify suitable candidates for the Board's consideration. Stonehaven International provided an initial list of potential candidates which the Nomination Committee reviewed and produced a shortlist of candidates, from which several candidates were invited to interview with members of the Committee. Ms Charlotte Twyning was identified as the Board's preferred candidate and accepted the offer of appointment subject to certain necessary approvals. Those approvals were granted and Ms Twyning was appointed to the Board with effect from 1 October 2018.

The Board is satisfied that there will be sufficient challenge by Non-executive Directors of executive management in meetings of the Board and that no individual or small group of individuals dominates its decision making.

#### **Non-executive Director independence**

In accordance with the provisions of the Code, consideration has been given to the independence of all Non-executive Directors. The Board considers all of the Non-executive Directors to be independent.

Under the Code, the Board is required to state its reasons if it determines that a Director is independent notwithstanding the existence of any circumstances which may appear relevant to its determination.

On Mr Dowley's appointment to the role of Chairman of the Board he was considered independent. Ms Liz Hewitt was concurrently elected to the role of Senior Independent Director. These changes took effect from 1 January 2019. In accordance with the Code requirements, at least half the Board, excluding the Chairman of the Board, comprises Non-executive Directors determined by the Board to be independent.

The Non-executive Directors are not entitled to any cash bonus or shares under the Incentive Plan (2017).

#### **Board induction, training and support**

An induction programme tailored to the needs of individual Directors is provided for new Directors joining the Board. The primary aim of the induction programme is to introduce new Directors to, and educate new Directors about, the Group's businesses, its operations and its governance arrangements. Individual induction requirements are monitored by the Chairman and the Company Secretary to ensure that new Directors gain sufficient knowledge to enable them to contribute to the Board's deliberations as quickly as possible.

#### **Board evaluation**

##### **Evaluation approach and process**

The Code requires that FTSE 350 companies undertake an externally facilitated Board and Committee evaluation once every three years. The last external Melrose Board and Committee review was in 2017, whereby the Company engaged Lintstock Ltd.

Whilst the Company is not required to undertake another externally facilitated Board and Committee evaluation until 2020, during 2018 the Company continued its ongoing internal review of the Board and each Committee, both internally within each of those bodies and with the Chairman and Chairs of each Committee respectively. In previous years, this review has been conducted as a discussion at the Board meeting. Members were also given the option for direct calls to be scheduled with the Chairman or Chair of the relevant Committee about any relevant matters that the members wish to raise as part of the ongoing review.

#### **Outputs of the evaluation**

Overall, the Board was satisfied with its performance, and agreed that the appointment of a new Non-executive Chairman and the new Senior Independent Director would further bolster its effectiveness, whilst the retention of the current Chairman and co-founder as an Executive Vice Chairman would retain stability and depth of experience on the Board.

In order to further enhance the Board's effectiveness, the following areas were designated as the subject of management focus during 2019:

- continued monitoring of senior management succession (both in Melrose and its Group);
- further enhancement of Board visibility over the impact of principal risks on the business divisions;
- although considerable steps were taken to improve cyber security across all business units in 2018, it was recognised that cyber security is an ongoing risk and will, therefore, be focused on again in 2019;
- continued improvement and monitoring of the cash management culture within the businesses (particularly within the GKN businesses) and improvement of cash performance;
- address onerous contracts and contract dispute resolution trends within the GKN businesses;
- continue to impress upon all business divisions that the health and safety of their workers is of utmost importance and ensure that the business divisions' senior management teams place a high degree of focus on implementing, monitoring and maintaining high standards of health and safety awareness, coupled with appropriate protective measures and high performance, with a view to eliminating preventable accidents; and
- update and implement the Board's overarching corporate governance framework to ensure continued alignment of the Board and Committee members' roles and division of responsibilities with the recent changes to the Code, Melrose's top-down Board and senior management risk oversight, and the business divisions' bottom-up risk management responsibilities.

In accordance with the provisions of the Code, it is anticipated that externally facilitated Board evaluations will be carried out at least once every three years. The scope for each evaluation is designed to build upon the previous evaluation to ensure that the recommendations agreed are implemented and that year-on-year progress is measured and reported upon.

#### **Annual re-election of Directors**

Pursuant to the Company's Articles and in accordance with the provisions of the Code, all of the Directors (with the exception of Ms Twyning who was appointed with effect from 1 October 2018) stood for re-election at the 2018 AGM. With the exception of Ms Twyning who is standing for election for the first time, all current Directors of the Company will be standing for re-election by shareholders at this year's AGM.

# Corporate governance report

Continued

Following performance evaluations of each of the Directors, and having carefully considered the commitments required and the contributions made by each Director, the Chairman is of the opinion that each Director's performance continues to be effective and demonstrates commitment to the role. Similarly, following performance evaluations of the Chairman, and having carefully considered the commitments required and the contributions made by the Chairman, the Non-executive Directors, led by the Senior Independent Director, are of the opinion that the Chairman's performance continues to be effective and that he continues to demonstrate commitment to the role.

## Attendance of Directors at meetings

The following table shows the attendance of each of the Directors at the scheduled meetings of the Board and its Committees held during the year. The quorum necessary for the transaction of business by the Board and each of its Committees is two. Briefing papers and meeting agendas are provided to each Director in advance of each meeting. Decisions are taken by the Board in conjunction with the recommendations of its Committees and advice from external advisers and senior management as appropriate. The representations of any Director who is unable to attend a meeting of the Board or a standing Committee are duly considered by those Directors in attendance.

The table also shows attendance at business review meetings held between scheduled Board meetings.

## Attendance of Directors

	Board	Audit	Nomination	Remuneration	Business review
<b>Number of meetings<sup>(1)</sup></b>	<b>4</b>	<b>4</b>	<b>2</b>	<b>2</b>	<b>3</b>
Justin Dowley	3	3	2	2	3
Christopher Miller	4	–	2	–	3
David Roper	4	–	–	–	3
Simon Peckham	4	–	–	–	3
Geoffrey Martin	4	4 <sup>(2)</sup>	–	–	3
Liz Hewitt	4	4	2	2	3
David Lis	4	4	2	2	3
Archie G. Kane	4	4	2	2	3
Charlotte Twynning <sup>(3)</sup>	1	1	1	1	1

(1) In addition to the above scheduled meetings, ad hoc Board and Committee meetings are held from time to time which are attended by a quorum of Directors and are convened to deal with specific items of business.

(2) Geoffrey Martin attends by invitation.

(3) Charlotte Twynning was appointed as a Non-executive Director with effect from 1 October 2018 and has attended all meetings since that date.

## Main principle C: Accountability

### Objectives and policy

The objectives of the Directors and senior management are to safeguard and increase the value of the business and assets of the Group for the benefit of its shareholders. Achievement of their objectives requires the development of policies and appropriate internal control frameworks to ensure the Group's resources are managed properly and any key risks are identified and mitigated where possible.

The Board is ultimately responsible for the development of the Group's overall risk management policies and system of internal control frameworks and for reviewing their respective effectiveness, while the role of senior management is to implement these policies and frameworks across the Group's business operations. The Directors recognise that the systems and processes established by the Board are designed to manage, rather than eliminate, the risk of failing to achieve business objectives and cannot provide absolute assurance against material financial misstatement or loss.

The Board is committed to satisfying the internal control guidance for Directors set out in the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting. In accordance with this guidance, the Board assumes ultimate responsibility for risk management and internal controls, including determining the nature and extent of the principal risks it is willing to take to achieve its strategic objectives (its "risk appetite") and ensuring an appropriate culture has been embedded throughout the organisation. The establishment of a revised risk management and internal control system has been complemented by ongoing monitoring and review, to ensure the Company is able to adapt to an evolving risk environment.

A separate Audit Committee report is set out on pages 82 to 89 and provides details of the role and activities of the Audit Committee and its relationship with the internal and external auditors.

## Managing and controlling risk

Since 2016, the Group's approach to risk management has been reviewed and enhanced. The systems, processes and controls in place accord with the Code and the FRC's updated guidance. Details on the Group's risk management strategy are set out on pages 50 to 51.

Further information regarding the Group's financial risk objectives and policies can be found in the Finance Director's review on pages 40 to 48. A summary of the principal risks and uncertainties that could impact upon the Group's performance is set out on pages 52 to 58.

## Internal financial controls and reporting

The Group has a comprehensive system for assessing the effectiveness of the Group's internal controls, including strategic business planning and regular monitoring and reporting of financial performance. A detailed annual budget is prepared by senior management and thereafter is reviewed and formally adopted by the Board.

The budget and other targets are regularly updated via a rolling forecast process and regular business review meetings are held with the involvement of senior management to assess performance. The results of these reviews are in turn reported to, and discussed by, the Board at each meeting. As discussed in the Audit Committee report on pages 82 to 89, the Group engages BM Howarth as internal auditor. A total of 18 internal audit visits were completed by BM Howarth during 2018 in respect of the Nortek and Brush businesses. As a result of the GKN acquisition and as part of the process of determining the post-acquisition opening balance sheet for the GKN businesses BM Howarth, with support from Ernst & Young, reviewed a significant proportion of the GKN sites.

The Directors are pleased to report that there has been progress across the Group following the 2018 internal audit programme and, that the majority of the recommendations presented in the internal audit report have been or are in the process of being implemented. Some deficiencies in respect of controls relating to inventory balances were identified at one of the North American Brush sites, which resulted in the requirement for an immaterial adjustment. The control weaknesses were identified following a change in the finance team at the site and plans were immediately put in place to rectify them. The internal auditor has performed two visits to this site in 2018 and have scheduled a further follow-up visit in 2019.

The Audit Committee also monitors the effectiveness of the internal control process implemented across the Group through a review of the key findings presented by the external and internal auditors. Management are responsible for ensuring that the Audit Committee's recommendations in respect of internal controls and risk management are implemented.

#### Compliance and ethics

The Company takes very seriously its responsibilities under the laws and regulations in the countries and jurisdictions in which the Group operates and has in place appropriate measures to ensure compliance. A compliance framework is in place comprising a suite of policies governing anti-bribery and anti-corruption, anti-money laundering, competition, trade compliance, data privacy, whistleblowing, document retention and joint ventures. These policies are in place within each business and apply to all Directors, employees (whether permanent, fixed-term, or temporary), pension trustees, consultants and other business advisers, contractors, trainees, volunteers, business agents, distributors, joint venture partners or any other person working for or performing a service on behalf of the Company, its subsidiaries and/or associated companies in which the Company or any of its subsidiaries has a majority interest.

In addition, as part of their internal audit function, BM Howarth include compliance audit questions to identify any areas for improvement across the Group and its businesses. During 2019 the Company is considering engaging an alternative provider to augment this review.

During 2018, the Company completed its roll-out of its online compliance training platform to Nortek, covering topics such as antitrust, trade compliance and export controls, data privacy, anti-bribery and anti-corruption and anti-money laundering. The Company has made positive progress in rolling this out within the GKN businesses, to enhance and supplement its existing compliance regime.

The Company produced its first Modern Slavery Statement in June 2017 which is available at [www.melroseplc.net](http://www.melroseplc.net). To support the Company's belief in the importance of this matter it also produced a Group-wide policy on the prevention of modern slavery and human trafficking which was rolled out to Nortek and Brush employees along with an online compliance training module. The Company also rolled out an online whistleblowing training module for all employees to promote awareness of the importance of whistleblowing and the Company's externally hosted whistleblowing portal. The whistleblowing portal received reports, the majority of which were identified as employee related matters. Each report was fully investigated by the Company and all reports were presented to the Audit Committee for their review.

#### Main principle D: Remuneration

Details regarding Directors' remuneration, both generally and in relation to the requirements of the Code, are set out in the Directors' Remuneration report, which is presented in the following three sections:

- the introduction to the Annual Report on Remuneration which can be found on page 92;
- the annual statement from the Chairman of the Remuneration Committee, which can be found on pages 93 to 95; and
- the Annual Report on Remuneration, which can be found on pages 96 to 112.

In addition, the Directors' Remuneration Policy, which can be found in the circular dated 7 April 2017 available at [www.melroseplc.net/media/1728/21347274--1-\\_circular.pdf](http://www.melroseplc.net/media/1728/21347274--1-_circular.pdf), subject to the clarifications on pages 104 to 107, remains unchanged.

#### Main principle E: Relations with shareholders

Through regular meetings and presentations between the executive Directors, analysts and institutional shareholders, including those following the announcements of the Company's annual and interim results, the Company seeks to build on a mutual understanding of objectives with its shareholders. During 2018, in addition to the usual disclosure rounds following the release of results, the Company continued its programme of engagement with major investors and the governance bodies in respect of its Directors' Remuneration Policy and incentive arrangements recognising the votes against the 2017 Directors' Remuneration Report at the 2018 AGM. In particular, the Chairman, the Chairman of the Remuneration Committee and other members of the Board met with major shareholders following the AGM vote in respect of the 2017 Incentive Plan, further details of which are set out on page 95. Further engagement with key shareholders and governance bodies remains a central part of the Company's approach to shareholder communication and governance management and has continued in the lead up to the 2019 AGM.

The Non-executive Directors are also available to meet institutional shareholders should there be unresolved matters shareholders wish to bring to their attention. The views of key analysts and shareholders are generally reported to the Board directly by individual Directors or via the Company's brokers. This helps to ensure that all members of the Board develop an understanding of the views and any concerns of shareholders.

Recognising the recent GKN acquisition, the Company is also organising a Capital Markets Day on 3 April 2019 so that investors can hear direct from the operational management in the GKN businesses about their improvement plans.

The Board welcomes the attendance of shareholders at the AGM, the notice for which can be found on pages 197 to 201. The AGM provides all shareholders with the opportunity to attend and vote on the matters put to shareholders, either in person or by proxy. The results of the voting on each of the resolutions proposed will be announced shortly after the AGM has concluded, via the Melrose corporate website at [www.melroseplc.net](http://www.melroseplc.net).

Details of the deadlines for exercising voting rights in respect of the resolutions to be considered at the 2019 AGM are set out in the AGM Notice on pages 197 to 201.

# Audit Committee report



Liz Hewitt  
Audit Committee Chairman

**The responsibilities of the Audit Committee (the “Committee”) include overseeing financial reporting, risk management and internal financial controls, in addition to making recommendations to the Board regarding the appointment of the Company’s internal and external auditors.**

Member	No. of meetings <sup>(1)</sup>
Liz Hewitt (Chairman)	4/4
David Lis	4/4
Justin Dowley <sup>(2)</sup>	3/4
Archie G. Kane	4/4
Charlotte Twyning <sup>(3)</sup>	1/1

- (1) In addition to the usual scheduled 3 meetings per year, an exceptional meeting was held shortly after taking control of GKN to review and analyse the GKN financial statements and audit papers with the Company’s external audit partners.  
(2) Stepped down from the Audit Committee with effect from 1 January 2019.  
(3) Appointed to the Audit Committee with effect from 1 October 2018.

## Role and responsibilities

The Committee’s role and responsibilities are set out in its terms of reference. These were updated in August 2018 in line with best practice and are available on the Company’s website and from the Company Secretary at the Company’s registered office. In discharging its duties, the Committee embraces its role of protecting the interests of all stakeholders with respect to the integrity of financial information published by the Company and the effectiveness of the audit. The responsibilities of the Committee include:

- reviewing and monitoring the integrity of the financial statements of the Group, including the Annual Report and interim report, and reviewing and reporting to the Board on significant financial reporting issues and judgements which they contain;
- keeping under review the effectiveness of the Group’s financial reporting;
- reviewing the effectiveness and monitoring and overseeing the Group’s risk management (excluding cyber security and fraud risk, which are retained by the Board), internal financial control systems and processes and compliance controls;

- monitoring and evaluating the effectiveness of the internal audit function and approving the internal audit plan and fee;
- monitoring and evaluating the effectiveness of the external audit and approving the external audit plan and fee;
- reviewing, challenging and reporting to the Board on the going concern assumption and the assessment forming the basis of the longer-term viability statement;
- focusing and challenging the consistency of accounting policies, methods used to account for significant or unusual transactions and compliance with accounting standards;
- reviewing the Group’s arrangements for its employees to raise concerns in confidence in accordance with the Company’s whistleblowing policy;
- reviewing the Company’s procedures for detecting fraud;
- assessing annually the external auditor’s independence and objectivity, taking into account relevant UK law, regulation, the Ethical Standards and other professional requirements and the relationship with the auditor as a whole, including the provision of any non-audit services;
- developing, implementing and monitoring the Group’s policy on external audit and for overseeing the objectivity and effectiveness of the external auditor;
- reviewing and challenging the provision of non-audit services by the external auditor; and
- reviewing and considering the Annual Report and financial statements to ensure that it is fair, balanced and understandable and advising the Board on whether it can state that this is the case.

## Composition

Following Mr Justin Dowley’s appointment as Chairman of the Board effective 1 January 2019, Mr Dowley stepped down from the Audit Committee. Ms Liz Hewitt continues to serve as the Chairman of the Committee and brings her recent and relevant financial experience to that role, as described in her biography on page 73. The Board also appointed Ms Charlotte Twyning as Non-executive Director and member of the Audit Committee with effect from 1 October 2018. Ms Twyning serves as a member of the Remuneration and Nomination Committees.

The Company Secretary acts as secretary to the Committee.

The Committee invites the Group Finance Director, the Head of Financial Reporting and senior representatives of the external and internal auditors to attend its meetings. The Committee has the right to invite any other Directors and/or employees to attend meetings where this is considered appropriate. In addition, the Committee meets at least once per year with both the external and internal auditors without management present, and the Chairman of the Committee speaks with both the external and the internal auditors prior to each Committee meeting.

## Summary of meetings in the year

The Committee is expected to meet not less than three times a year. In 2018, the Committee met in February, September and November. The scheduling of these meetings is designed to be aligned with the financial reporting timetable, thereby enabling the Committee to review the Annual Report and financial statements, the interim financial report and the audit plan ahead of the year-end audit and to maintain a view of the internal financial controls and processes throughout the year.

In addition to the three scheduled meetings, an exceptional meeting was held in June 2018, shortly after taking control of GKN, to review, analyse and understand the risks identified from the previous GKN financial statements and audit committee papers.

At this meeting, which included the Company's external and internal auditors, the Committee considered the initial scoping of the audit in relation to the acquisition of GKN. A major item that was discussed during the course of this initial review related to the previous control breakdowns and risks that had been identified at a number of the GKN Aerospace North America businesses. The Committee was briefed on the key issues and risks that had previously been identified, including the inappropriate recording of inventory on the GKN balance sheet which culminated in a significant exceptional charge being recorded in GKN's results for the year ended 31 December 2017.

#### Significant activities related to the financial statements

As part of its duties the Committee undertook the following recurring activities that receive annual scrutiny:

- reviewed the Annual Report and financial statements and interim financial report, including the going concern assumption and the assessment forming the basis of the longer-term viability statement. As part of this review, the Committee received reports from the external auditor on their audit of the Annual Report and financial statements and their review of the interim financial report, as well as a paper on viability and a presentation from management;

- reviewed the GKN financial information, including an extensive opening balance sheet review and outputs from the fair value exercise and received presentations from external advisors involved in that work;
- considered the Annual Report and financial statements in the context of being fair, balanced and understandable and reviewed the content of a paper prepared by management in relation to the 2018 Annual Report and financial statements. The Committee advised the Board that, in its view, the 2018 Annual Report and financial statements when taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's performance, business model and strategy;
- reviewed the effectiveness of the Group's risk management and internal financial controls and disclosures made in the Annual Report and financial statements on this matter;
- reviewed the effectiveness of the Group's internal and external auditors; and
- reviewed and agreed the scope of work to be undertaken in respect of the 2018 annual accounts by the external auditor and the scope of work to be undertaken in 2019 by the internal auditor.

In addition to these matters, the Committee considered the following significant issues in relation to the financial statements during the year:

#### The Audit Committee's activities during 2018

##### Significant issue considered by the Audit Committee

###### GKN Acquisition Accounting

The GKN acquisition was completed on 19 April 2018, and the consolidated Group financial statements include the results of the GKN businesses for the period from acquisition to 31 December 2018. Judgement was required in identifying the fair values of certain assets and liabilities acquired.

Due to the size and scale of the GKN businesses, advisors were engaged to support the preparation of the opening balance sheet for the GKN businesses. A programme of site visits took place between May and October 2018, covering a significant portion of the GKN businesses with a detailed work plan to identify the fair value of operational assets and liabilities. In addition, specialist valuers were engaged to appraise the land and buildings, intangible assets, post-retirement obligations and the value of equity accounted investments on acquisition.

(Refer to note 12 of the financial statements)

##### How the issue was addressed by the Audit Committee

The Committee reviewed a paper prepared by management which explained the methodologies, assumptions and judgements taken in preparing the opening balance sheet.

Specifically, the Committee focused on:

- the inclusion of certain provisions and liabilities, principally in relation to loss-making contracts, which included consideration of potential plans to address the contractual positions on acquisition, ongoing warranty matters and commercial obligations and unresolved regulatory exposures;
- the valuation of intangible assets which involved valuing customer contracts and relationships, technology assets and brands. Assumptions included growth rates, discount rates, royalty rates and the achievement of operational plans that underpinned future cash flow; and
- valuation and appraisal of property, plant and equipment which involved independent evaluation of 81 properties as well as a detailed appraisal of the acquired plant and equipment.

The Group's external advisors were invited to Committee meetings to present the results of their work which were discussed in detail. The Committee discussed with Deloitte the audit work performed by them, including the sites visited, to assess whether the assets and liabilities were properly included at fair value.

Considering all of the above, management responses to challenge and Deloitte's views, the Committee was satisfied that the assumptions used were reasonable and that the provisional fair value of assets and liabilities had been established appropriately.

# Audit Committee report

Continued

## The Audit Committee's activities during 2018

### Significant issue considered by the Audit Committee

#### IFRS 15

The Group adopted IFRS 15 "Revenue from Contracts with Customers" on 1 January 2018 using the modified retrospective approach and for Melrose, at that date, the impact was not material. However, for the acquired GKN business, IFRS 15 which requires revenue to be allocated to performance obligations identified in a contract, had a significant impact within the GKN Aerospace division, specifically regarding recognition of variable consideration.

(Refer to note 16 of the financial statements)

### How the issue was addressed by the Audit Committee

In September 2018, the Committee reviewed a management report on the implications of IFRS 15. The assessment considered areas of the new standard that drive changes in the Group's financial statements as well as the estimates and judgement in application, particularly in the GKN Aerospace division. Changes impact both the amount and timing of revenue recognition and more details can be found in notes 4 and 16 to the financial statements.

The Committee discussed the audit work performed by Deloitte, to assess whether the revenue recognised together with contract assets and liabilities recorded in the balance sheet were appropriate.

Considering the judgements made in applying the new accounting standard and Deloitte's views, the Committee was satisfied that the approach and assumptions used were reasonable and that judgements made were appropriate.

### GKN Aerospace North America financial information in relation to inventory balances

During 2017 GKN made a number of external announcements regarding its GKN Aerospace North American business. This culminated in a significant charge being recorded in its results for the year ended 31 December 2017. The majority of the charge related to inventory that was assessed as having been inappropriately recorded on the balance sheet.

The Group has reviewed the issues in GKN Aerospace in North America during its fair value process to ensure that inventory balances were appropriately valued on acquisition and further evidence that any defective product produced in post-acquisition period has been expensed.

(Refer to note 15 of the financial statements)

During the year, the Committee reviewed a report addressing the concerns relating to GKN Aerospace's North American business. The assessment considered trends in inventory carrying amounts, scrap values expensed as well as the overall control environment and progress since the prior year. As a result of the known pre-acquisition issues, Group management had overseen additional work designed to provide incremental assurance that financial results and the balance sheet were appropriate.

The Committee discussed the results with management and sought a view from Deloitte following their additional audit work, to assess whether the financial information included in the Group consolidated financial statements was appropriate.

Having considered the matters presented and evidence provided, the Committee concluded that management's response to issues was appropriate and balances were reasonably stated.

### Provisions for loss-making contracts, warranty, legal and environmental claims

The level of provisioning for loss-making contracts, warranty, legal and environmental claims, restructuring and other provisions requires estimation and assumptions.

Although provisions are reviewed on a regular basis and adjusted for management's best views, the inherently subjective nature of these items means that future amounts settled may be different from those provided.

(Refer to note 20 of the financial statements)

The Committee considered management's proposed provisioning in respect of material exposures including the key assumptions and estimates used and relevant legal advice. Amounts recorded at 31 December 2018 were materially impacted by the acquisition of GKN, which is discussed above.

Deloitte also reported on all provisions in the GKN businesses on acquisition to the Committee.

Having considered the matters presented and responses to challenge, the Committee concluded that management's proposed provisioning and the associated disclosures in the financial statement were appropriate and the approach taken was consistent with previous years.

## The Audit Committee's activities during 2018

Significant issue considered by the Audit Committee	How the issue was addressed by the Audit Committee
<p><b>Impairment testing of goodwill</b></p> <p>Impairment testing is inherently subjective as it includes assumptions in calculating the recoverable amount of the cash-generating unit ("CGU") being tested. Assumptions include future cash flows of the relevant CGU, discount rates that reflect the appropriate risk and long-term growth rates which are applicable to the geography of operations.</p> <p>In 2017 there was an impairment of goodwill and other assets in the Brush CGU totalling £145 million, which reduced the value to £300 million. This was primarily driven by a decline in the generator market. Following any impairment, a CGU is immediately sensitive to any new decline in operating cash flows not forecast, or changes to either the discount rate or long-term growth rate.</p> <p>During 2018, following a new decline in market conditions in generator services that was not anticipated, as well as announcements by key customers during the second half of the year, management have concluded that another impairment charge is required to bring the carrying value to £103 million. The revised carrying amount has been derived from a value-in-use calculation and as a consequence an impairment charge of £123 million has been recognised in the income statement during the second half of 2018.</p> <p>(Refer to note 11 of the financial statements)</p>	<p>The Committee challenged the outcome of the impairment review in respect of the Brush group CGUs and also considered the proposed disclosures in respect of the SST and Ergotron groups of CGUs. In doing so the Committee considered the following:</p> <ul style="list-style-type: none"> <li>• a paper prepared by management, which included the key outputs of the impairment model;</li> <li>• the trading assumptions, including macroeconomic factors such as trade tariffs applied in the model, in particular those that were key, being revenue growth and operating margin;</li> <li>• the market-based assumptions for the long-term growth rates and the discount rate;</li> <li>• risk adjustments that were applied to the model, in particular regarding the extent of market decline and timing of when volume reductions would cease; and</li> <li>• the appropriateness of the full disclosures in the financial statements in respect of the impairment review performed and the impact, together with sensitivities that could cause a future impairment.</li> </ul> <p>The Committee discussed with Deloitte the audit work performed by them and their conclusion regarding the impairment charge recorded.</p> <p>Considering all of the above, management responses to challenge and Deloitte's views, the Committee was satisfied that the assumptions used were reasonable and that the impairment charge together with disclosures were appropriately presented.</p>
<p><b>Classification of adjusting items and use of Alternative Performance Measures ("APMs")</b></p> <p>The reporting, classification and consistency of adjusting items continues to be an area of focus for the Committee. In particular, given the guidance on APMs provided by the European Securities and Markets Authority ("ESMA").</p> <p>The Committee considers this to be a key consideration when reviewing whether the financial statements give a fair, balanced and understandable view of events.</p> <p>(Refer to note 6 of the financial statements and the glossary to this Annual Report and financial statements)</p>	<p>The Committee has considered the nature, classification and consistency of adjusting items, whilst addressing the guidance provided by ESMA. These items are defined and discussed in the Finance Director's review and detailed in note 6 to the financial statements together with the glossary to this Annual Report and financial statements.</p> <p>The Committee has reconsidered the Company's accounting policy in light of the material acquisition during the year and evolving reporting practice for adjusting items. Following review of management's paper and challenge, the Committee is satisfied that whilst additional items have been included, such as the proportionate share of turnover and adjusted operating profit from equity accounted investments and changes in fair value of derivative instruments, as a result of the acquisition of GKN, there has not been any change to the policy. The Committee has determined that disclosures are clear and transparent, thereby assisting shareholders in measuring the operating performance of the Group. The Committee therefore concluded that these adjusting items were appropriately captured and disclosed.</p> <p>The Committee also considered disclosure of the Group's APMs with respect to applicable guidelines and noted that these are set out in detail in the glossary to this Annual Report and financial statements together with reconciliations of adjusted performance measures to statutory results in note 6 to the financial statements. The Committee found disclosures to be clear and transparent.</p>
<p><b>Non-audit fees</b></p> <p>Under EU and Competition Commission rules, effective from 17 June 2016, there are restrictions on non-audit services.</p>	<p>The Committee has considered the application of rules to the Group, noting in particular the cap on permitted non-audit services of 70% of average audit fees over a three-year period, to be first applied in December 2020. Audit fees in 2018, 2019 and 2020 will be relevant and the average of these three years will be compared to the non-audit fees in 2020.</p> <p>The Company's non-audit fee of £1 million represents 14% of the audit fees for 2018.</p> <p>The Committee completed its annual review of the Group's Non-Audit Services Policy, whereby the Committee reviewed the services provided by the audit firm, considered the impact of the services and threats and safeguards to ensure that the auditor remained independent and the services provided were in line with the Group's non-audit services policy. The Audit Committee Chairman approves all non-audit services in advance of the service being provided and cumulative non-audit fees are reviewed at Committee meetings.</p>

# Audit Committee report

Continued

## The Audit Committee's activities during 2018

Significant issue considered by the Audit Committee	How the issue was addressed by the Audit Committee
<b>Risk management and internal control</b> Monitored the risk management and the internal financial control systems and conducted a review of their effectiveness.	<p>The Committee received updates during the year from senior management on the Company's risk management framework and internal financial control systems.</p> <p>The Committee received a presentation from senior management on the risk management framework and on the financial, operational and compliance controls in place.</p> <p>In addition, the Committee was presented with the findings of the internal audit visits on a bi-annual basis to assist them with determining the effectiveness of internal financial controls within the Group.</p> <p>The Committee considered the risk management and internal financial control systems and concluded that they were effective and reported this to the Board.</p>
<b>Going concern and viability</b> Assessment of the going concern assumptions and the basis of the viability statement.	<p>The Committee reviewed and supported management's recommendation to prepare the financial statements on a going concern basis.</p> <p>The Committee also considered papers prepared by management in respect of the longer-term viability statement to be included in the 2018 Annual Report. The Committee concurred with the assumptions and judgements made by management and concluded that the longer-term viability statement was appropriate.</p>
<b>Internal audit</b> Monitoring and evaluating the effectiveness of the internal audit function.	<p>The Committee reviewed and approved the new Internal Audit Charter and committed to annually reviewing the Internal Audit Charter.</p> <p>The Committee reviewed and assessed the effectiveness of the internal audit process, by use of a questionnaire completed by each member and key representatives of the Company and deemed it to be thorough and effective.</p> <p>The Committee reviewed the reappointment of BM Howarth as internal auditor and, following an assessment of the services delivered to the Company by BM Howarth in 2018, approved their reappointment.</p>
<b>External audit</b> Monitoring and evaluating the effectiveness of the external audit function.	<p>The Committee reviewed the independence of the external auditor, whilst considering fees in respect of the audit and non-audit services, and deemed the external auditor to be independent.</p> <p>The Committee reviewed the remuneration paid to the external auditor in 2018 in light of the services provided to the Company during 2018 and deemed it fair and reasonable.</p> <p>The Committee reviewed and assessed the effectiveness of the external audit process. In doing so the Committee consulted the views of its members, the Group Finance Director, the Chief Executive, the divisional finance directors and the internal auditor.</p> <p>Following the assessment, the Committee reviewed and approved the reappointment of Deloitte LLP as external auditor.</p>
<b>Committee evaluation</b> Monitoring and evaluating the effectiveness of the Committee.	<p>In 2017, an externally facilitated review of the Committee was undertaken by Lintstock Ltd. During 2018 the Company continued its ongoing internal review of the Committee and collected feedback from Committee members within a similar range of focal topics as featured in last year's review. Alongside such formal feedback, the Committee continued to facilitate direct ongoing contact between its members and the Chair about any relevant matters that the members wish to raise as part of the ongoing review. The Code requires the Company to undertake another externally facilitated Board and Committee evaluation by 2020.</p>

### Risk management and internal control

During 2018, the Committee monitored the effectiveness of the Group's risk management and internal control systems through regular updates from management and a review of the key findings presented by the external and internal auditors.

In accordance with the UK Corporate Governance Code, the Board instructed the Committee to undertake a review of the effectiveness of the Group's risk management and internal control systems, covering all material controls including financial, operational and compliance controls.

This review took the form of management presentations followed by a Committee discussion. The Company Secretary briefed the Committee on the key elements of the Melrose risk management framework including an updated risk strategy, a best practice risk register with risk mapping and profiling application, an education and training programme and an audit and assurance process, as well as a confirmation to the Committee that this has been implemented across the Brush and Nortek business units, and that changes and adaptations were made to a similar risk management framework already in place at GKN prior to its acquisition by the Company.

Management then reported on the Group's internal control systems supported by the internal audit review. Samples of both Group and business unit controls, including financial, operational and compliance controls, were presented and examined. The Group's risk management and internal financial control systems were reviewed and the Committee approved the implementation of an enhanced Enterprise Risk Management programme across all Group business units, which build on their pre-existing internal risk management processes, to account for the Group's enlarged size as a result of the GKN acquisition. The improvements involved regular input from the senior executives heading the key business functions to ensure that a comprehensive view of the Group's risk exposure is captured. The Committee concluded that these systems were effective. The Committee reported its conclusions to the Board at the next scheduled Board meeting.

Following the acquisition of GKN, the Committee reviewed and assessed the findings of the internal financial controls review conducted by the previous GKN group management, paying particular attention to the issues in respect of inventory management and related controls, policy application, management review and oversight that led to the GKN inventory adjustment in 2017. After the acquisition of GKN, the Committee immediately began to monitor and oversee the integrity and application of the corrective measures in respect of those issues that were put in place by the previous GKN senior management, primarily by way of reports from the internal auditor to each Committee meeting and ongoing Group senior management risk reporting, which continued throughout 2018.

### External audit

#### Assessment of effectiveness and reappointment

The Committee reviews and makes recommendations with regard to the reappointment of the external auditor. In making these recommendations, the Committee considers auditor effectiveness and independence, partner rotation and any other factors which may impact the external auditor's reappointment.

The Committee has reviewed the external auditor's performance and effectiveness. For 2018, a series of questions covering the key areas of the audit process that the Committee is expected to have an opinion over were put to the Committee, including:

- the calibre, experience, resources, leadership and technical and industry knowledge of the engagement partner and of the wider external audit team;
- the planning and execution of the audit process;
- the quality and timeliness of communications from the external auditor; and
- the quality of support provided to the Committee by the external audit partner.

The Committee, together with the Group Finance Director and the divisional finance directors, was requested to complete a questionnaire containing these questions. The Chairman also sought feedback from the Chief Executive and the internal auditor. The Company Secretary subsequently produced a report summarising the responses. Based on this report, the Committee concluded that the quality of the external audit team remains very high, the external audit process is operating effectively and Deloitte LLP continues to prove effective in its role as external auditor.

#### UK Financial Reporting Council ("FRC") Audit Quality Review

The FRC's Audit Quality Review team selected to review the audit of the 2017 Melrose Industries PLC financial statements as part of their 2017 annual inspection of audit firms. The focus of the review and their reporting is on identifying areas where improvements are required rather than highlighting areas performed to or above the expected level. The Chairman of the Committee received a full copy of the findings of the Audit Quality Review team and has discussed these with Deloitte. The Committee confirmed that there were no significant areas for improvement identified within the report and was satisfied that there is nothing within the report which might have a bearing on the audit appointment.

As detailed below, the Committee regularly monitors the objectivity and independence of the external auditor. Deloitte LLP was appointed in 2003 when the Company commenced trading and the external audit has not been formally tendered since then. The Committee is satisfied that the effectiveness and independence of the external auditor is not impaired in any way. There are no legal or contractual obligations that restrict the Group's capacity to recommend a particular firm for appointment as auditor and therefore a resolution proposing the reappointment of Deloitte LLP as external auditor will be put to the shareholders at the 2019 AGM.

# Audit Committee report

Continued

## Audit tendering

The Committee has considered the audit tendering provisions outlined in the Code. The Committee has also reviewed the guidance provided by the European Commission and the Competition and Markets Authority ("CMA"). It is the Committee's understanding that, under the CMA and the EU rules, rotation of the external audit firm is required by 2024. It is the Committee's intention to put the external audit out to tender in accordance with the CMA and the EU timeframes.

The current audit engagement partner was appointed in 2015. The Company's audit firm is required to be rotated by 2024, this will be the last partner rotation and the decision was made for the current engagement partner to rotate off the audit team after the financial year ended 31 December 2018, such that the new audit engagement partner will serve a full five-year term for the enlarged Group from the financial year ending 31 December 2019 until the firm rotation in 2024.

## Non-audit services

Under EU and Competition and Markets Authority rules, effective from 17 June 2016, restrictions on non-audit services now apply, which cap the level of permissible non-audit services awarded to the external auditor at 70% of the average audit fee for the previous three years. The cap applies prospectively and so will first apply in respect of the Company's 2020 financial year, audit fees in 2018, 2019 and 2020 being relevant.

A policy on the engagement of the external auditor for the supply of non-audit services is in place to ensure that the provision of non-audit services does not impair the external auditor's independence or objectivity. In accordance with best practice FRC guidelines, the Company policy in relation to non-audit services is kept under regular review (it was revised in 2016). The policy outlines which non-audit services are pre-approved (being those which are routine in nature, with a fee that is not significant in the context of the audit or audit-related services), which services require the prior approval of the Committee and which services the auditor is excluded from providing. The general principle is that the audit firm should not be requested to carry out non-audit services on any activity of the Company where the audit firm may, in the future, be required to give an audit opinion.

During 2018, the main non-audit services provided by Deloitte LLP were in relation to the reporting accountant's role for the profit estimate made by the Company as part of its bid for GKN, non-statutory audit of carve out financial statements services for GKN including assurance reports for government grants or subsidies and tax compliance in non-EU subsidiaries. The Company did not use Deloitte for any taxation services and does not intend to during 2019. The Company's non-audit fee represents 14% of the audit fees for 2018.

The Committee closely monitors the amount of non-audit work undertaken by the external auditor and considers using other firms for transaction-related work. However, there are occasions when it is appropriate, because of background knowledge, to use our auditor for non-audit work, for example on certain advisory and compliance projects.

Despite being well within the CMA guidance, the Committee has taken into account feedback from institutional shareholder services and has been actively migrating non-audit work to other firms and has recently worked with Ernst & Young and KPMG in respect of corporate finance affairs and risk management and obtained tax advice and advice on remuneration reporting regulations from PricewaterhouseCoopers.

An analysis of the fees earned by the external auditor for audit and non-audit services can be found in note 7 to the consolidated financial statements.

As in previous years, the Audit Committee specifically considered the potential threats that each of these limited non-audit engagements may present to the objectivity and independence of the external auditor. In each case, the Committee was satisfied with the safeguards in place to ensure that the external auditor remained independent from the Company and its objectivity was not, and is not, compromised.

## Auditor objectivity and independence

The Committee carries out regular reviews to ensure that auditor objectivity and independence are maintained at all times.

No fees were paid to Deloitte LLP on a contingent basis. Based on these strict procedures, the Committee remains confident that auditor objectivity and independence have been maintained but accepts that non-audit work should be controlled to ensure that it does not compromise the auditor's position.

At each year end, Deloitte LLP submits a letter setting out how it believes its independence and objectivity have been maintained. As noted above, Deloitte LLP is also required to rotate the audit partner responsible for the Group audit every five years and significant subsidiary audits every five years.

## Internal audit

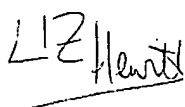
Due to the size and complexity of the Group, it is appropriate for an internal audit programme to be used within the business. BM Howarth Ltd, an external firm, provides internal audit services to the Group in accordance with an annually agreed Internal Audit Charter and internal audit plan. Where additional or specific resource is required, additional support is provided by Ernst and Young. A rotation programme is in place, such that every business unit site will have an internal audit at least once every three years, with the largest sites being reviewed at least once every two years. Upon acquisition, each site of any new business is promptly visited as part of the acquisition accounting exercise, which better informs the internal audit rotation process. The rotation programme allows divisional management's actions and responses to be followed up on a timely basis. The internal audit programme of planned visits is discussed and agreed with the Committee during the year.

The internal auditor's remit includes assessment of the effectiveness of internal financial control systems, compliance with the Group's Policies and Procedures Manual and a review of the businesses' balance sheets. A report of key findings and recommendations is presented to the Group Finance Director and the Head of Financial Reporting, followed by a meeting to discuss these key findings and to agree on resulting actions. Internal audit site visits were conducted by BM Howarth across a total of 18 sites, in respect of the Nortek and Brush businesses. In addition to this, BM Howarth visited 67 of GKN's sites to support the acquisition accounting process.

During the previous year deficiencies were found in Nortek Global HVAC's internal financial controls at two sites which prompted immediate action by the Group Finance Director and the Melrose accounting function, and resulted in the strengthening of the local accounting functions, implementation of more comprehensive and robust controls and a specific action plan to address the shortcomings identified. Follow-up visits were performed during the first half of 2018 which identified significant progress in the improvement of financial controls at both sites.

During 2018 some deficiencies in respect of controls relating to inventory balances were identified at one of the North American Brush sites, which resulted in the requirement for an immaterial adjustment. The control weaknesses were identified following a change in the finance team at the site and plans were immediately put in place to rectify. The internal auditor has performed two visits to this site in 2018 and have scheduled a further follow-up visit in 2019.

A review of the internal audit process and scope of work covered by the internal auditor is the responsibility of the Committee, to ensure their objectives, level of authority and resources are appropriate for the nature of the businesses under review. A report of significant findings is presented by the internal auditor to the Committee at each meeting and implementation of recommendations by the Board is followed up at the subsequent Committee meeting. The Committee also reviews BM Howarth's performance against the agreed internal audit programme.



**Liz Hewitt**  
**Chairman, Audit Committee**  
7 March 2019

# Nomination Committee report



Archie G. Kane  
Nomination Committee Chairman

**The Nomination Committee (the “Committee”) has overall responsibility for making recommendations to the Board on all new appointments and for ensuring that the Board and its Committees have the appropriate balance of skills, experience, independence, diversity and knowledge of the Company to enable them to discharge their respective duties and responsibilities effectively.**

Member	No. of meetings
Archie G. Kane (Chairman) <sup>(1)</sup>	2/2
David Lis	2/2
Christopher Miller	2/2
Justin Dowley	2/2
Liz Hewitt	2/2
Charlotte Twyning <sup>(2)</sup>	1/1

(1) With effect from 1 January 2019, Mr David Lis stepped down from his position as Chairman of the Committee and was replaced by Mr Archie G. Kane.  
 (2) Ms Charlotte Twyning was appointed as a Non-executive Director with effect from 1 October 2018. Ms Twyning attended all Board and Committee meetings held during the period 1 October 2018 to 31 December 2018.

## Discharge of responsibilities

The Committee discharges its responsibilities through:

- regularly reviewing the size, structure and composition of the Board and providing recommendations to the Board of any adjustments that may be necessary from time to time;
- giving full consideration to succession planning in order to ensure an optimum balance of executive and Non-executive Directors in terms of skills, experience and diversity, and in particular formulating plans for succession for the key roles of Chairman and Chief Executive;
- reviewing the career planning and talent management programme related to senior executives of the Company and the senior executives of the business units to ensure that it meets the needs of the business;
- managing the Board recruitment process and evaluating the skills, knowledge and experience of potential Board candidates in order to make appropriate nominations to the Board;

“Melrose is a meritocracy and individual performance is the key determinant in any appointment, irrespective of ethnicity, gender or other characteristic, trait or orientation.”

- approving the diversity policy of the Company; and
- keeping up to date and fully informed on strategic issues and commercial changes affecting the Company and the markets in which it operates.

The Committee is expected to meet not less than twice a year and during 2018, the Committee met twice. The attendance of its members at these Committee meetings is shown in the table opposite.

The Committee's terms of reference, which were last revised in December 2018, are available to view on the Company's website at: [www.melroseplc.net/about-us/governance/nomination-committee](http://www.melroseplc.net/about-us/governance/nomination-committee).

Further details regarding the composition, diversity policy and the 2018 activities of the Committee are set out below and overleaf.

## Composition

The majority of the members of the Committee were independent Non-executive Directors throughout 2018, with Mr Christopher Miller being the only non-independent member.

In compliance with amendments to the UK Corporate Governance Code, Mr Justin Dowley was elected to the inaugural role of Non-executive Chairman of the Board, effective 1 January 2019. Mr Dowley brings a wealth of skills and experience to the role garnered over a 35-year career in banking, investment and asset management. It was decided that Mr Dowley provided the necessary continuity and stability that the Company and the Board required following the acquisition of GKN as Mr Dowley understood intimately the Company model and the key drivers of its success since his appointment in 2011. Mr Dowley was the Senior Independent Director and Chairman of the Remuneration Committee. His appointment as Non-executive Chairman therefore led to a change in the composition of the Board and Committees effective 1 January 2019.

Mr Miller, who has served as Chairman since May 2003, stepped down from his role as executive Chairman. It was decided that Mr Miller should continue to serve as an executive Director of the Board given his exemplary service to date and as such, Mr Miller was appointed as executive Vice Chairman to act alongside Mr David Roper.

Ms Liz Hewitt, who has served as a Non-executive Director since 2013, was elected to the role of Senior Independent Director of the Board in replacement of Mr Dowley, while continuing to perform her role as the Chairman of the Audit Committee. Ms Hewitt is the longest serving Non-executive Director and brings with her extensive business, financial and investment experience gained from a number of senior roles in international companies, including as independent member of the House of Lords Commission, and as non-executive director of Novo Nordisk A/S and Savills PLC.

Mr David Lis stepped down as Chairman of the Nomination Committee and was appointed as Chairman of the Remuneration Committee in replacement of Mr Dowley, having served as a member of the Remuneration Committee since joining the Board

as a Non-executive Director in March 2016. Mr Lis brings a wealth of experience to the role, including as non-executive director of Electra Private Equity PLC and BCA Marketplace PLC.

Mr Archie G. Kane was appointed as Chairman of the Nomination Committee in replacement of Mr Lis, having served as a member of the Nomination Committee since his appointment as a Non-executive Director in May 2017. Mr Kane brings a wealth of experience to this role, including as non-executive Governor of the Bank of Ireland and non-executive Chairman of ReAssure Group Limited.

Following a review by the Committee of the composition of the Board and a subsequent recommendation by the Committee that the number of independent Directors be increased, external recruitment consultants, Stonehaven International, were retained to identify suitable candidates for the Board's consideration. Stonehaven International provided an initial list of potential candidates which the Committee reviewed and produced a shortlist of candidates, from which several candidates were invited to interview with members of the Nomination Committee. Ms Charlotte Twyning was identified as the Board's preferred candidate and was appointed to the Board with effect from 1 October 2018.

Ms Twyning brings a diverse range of experience to the Board. After a decade specialising in competition and M&A law in the City, Ms Twyning moved to BT in 2007. Whilst there, she held various senior roles in legal, policy and customer service strategy. In 2016, Ms Twyning joined Abellio as an executive director to establish a policy, communications and strategy function commensurate to its FTSE 250 size. Ms Twyning is currently Consents Director on the Heathrow Expansion Programme Board responsible for securing the approvals for its expansion. In accordance with the Articles, Ms Twyning will stand for election at the 2019 AGM.

The Company Secretary acts as secretary to the Nomination Committee. On occasion, the Nomination Committee invites the Chief Executive, the executive Vice-Chairmen (to the extent not already on the Nomination Committee) and the Group Finance Director to attend discussions where their input is required.

### Diversity

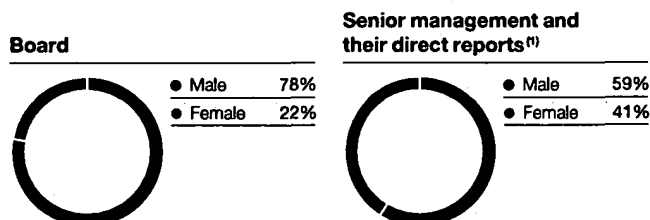
Melrose is a meritocracy and individual performance is the key determinant in any appointment, irrespective of ethnicity, gender or other characteristic, trait or orientation. The Board recognises the importance of diversity throughout the workforce, be it geographical, cultural or market-aligned and encompassing gender, race, sexual orientation and disability, and the Board is committed to equality of opportunity for all employees. For example, Melrose is proud to support the Business Disability Forum, a body committed to understanding the changes required in the workplace so that disabled people are treated fairly and they can contribute to business success, to society and to economic growth.

The Committee currently takes into account a variety of factors before recommending any new appointments to the Board, including relevant skills to perform the role, experience and knowledge. The most important priority of the Committee, however, has been, and will continue to be, to ensure that the best candidate is selected to join the Board and this approach will remain in place going forward.

The Committee will endeavour to pursue diversity, including gender and ethnic diversity, throughout the Melrose Group and notes the recommendations of Lord Davies' review, "Women on Boards" and Sir John Parker's review "Report into Ethnic Diversity of UK Boards" and continues to encourage diversity throughout the Group. Although it is not appropriate to set specific diversity targets at Board level and throughout the Group's workforce due to

Melrose's strategic business model and frequent turnover of businesses, Melrose is actively engaged in finding ways to increase the Group's diversity.

The charts below show the gender balance of the Board and senior management and their direct reports as at 31 December 2018.



(1) In accordance with the UK Corporate Governance Code, senior management is defined as the executive committee or the first layer of management below board level, including the Company Secretary.

### What the Committee did in 2018

The principal focus of the Committee during 2018 has been to consider the items set out below:

- the Committee considered the composition and balance of the Board and the timing of future Board changes and reviewed the succession plans in place in respect of executive Directors and Non-executive Directors in conjunction with the provisions of the UK Corporate Governance Code. In particular, action was taken to appoint Mr Dowley as Non-executive Chairman of the Board in replacement of Mr Miller as executive Chairman, such change effective from 1 January 2019. The Committee further recommended the appointment of Ms Twyning with effect from 1 October 2018 to increase the number of Non-executive Directors on the Board;
- the existing time commitment of the Company's Non-executive Directors was reviewed and confirmed as appropriate;
- consideration was given to the reappointment of each of the Directors (with the exception of Ms Twyning who is standing for election for the first time since her appointment took effect on 1 October 2018) before making a recommendation to the Board regarding each Director's re-election at the 2019 AGM;
- a review of the leadership requirements of Melrose, both executive and non-executive, was undertaken and this confirmed that the existing management team are appropriate for the Group. This review also demonstrated that appropriate and effective leadership is in place within the businesses and that processes are in place to ensure that performance is reviewed regularly against operational and financial criteria;
- the Committee examined the career planning and talent management programmes in operation across the Group and concluded that these were appropriate for the needs of the business;
- the Committee reviewed and re-affirmed the principles underlying the Company's diversity policy;
- the Committee's terms of reference were reviewed and updated in line with best practice; and
- the Committee participated in an internal evaluation of itself to identify areas where performance and procedures might be further improved.



**Archie G. Kane**  
Chairman, Nomination Committee  
7 March 2019

# Directors' Remuneration report

## Introduction to Directors' Remuneration report

### Strategy

Since the Company was first established, the Remuneration Committee has pursued a remuneration strategy designed to closely align the executive Directors and Melrose senior management team with the Company's shareholders. Accordingly, base salaries for the executive Directors are kept low in comparison to peers, and the maximum annual bonus is capped at 100% of base salary. The opportunities for significant reward rest with the Company's long-term incentive plan, regularly renewed with the support of shareholders and only creating significant reward for participants where they have delivered outperformance for shareholders. This heavy weighting to variable remuneration that is entirely dependent on performance and vests in shares (not cash) remains unchanged, irrespective of the Company's position in the FTSE indices, and the Committee feels it has been central to the success of the Company to date.

### Business Performance

Since its first acquisition in 2005, Melrose has sought to generate superior returns for its shareholders, through the acquisition of underperforming but high-quality businesses, investing heavily to improve operational performance before selling at an appropriate time to a buyer who is looking to guide the business through the next stage of its development.

2018 was a transformational year for Melrose. As well as continuing to build upon the success of Nortek, we embarked upon the much-publicised takeover of GKN. The Board has immediately started initiating the changes it believes are necessary to unlock the full potential of the GKN businesses and to deliver substantial returns for its shareholders.

The Group's KPIs monitor progress towards the achievement of our objectives. All of the Group's strategic KPIs have moved forward strongly during 2018. See pages 18 to 19 for detailed analysis of our KPIs.

The Company's Annual Bonus Plan focuses directly and indirectly on rewarding executive Directors and Melrose senior management for delivering these KPIs. The 2017 Incentive Plan is designed to reward the flow-through of the successful implementation of the strategy into longer-term sustainable shareholder returns.

### Outcomes for 2018

Page 97 sets out the performance conditions, targets set, level of satisfaction and the corresponding percentages of salary earned under the Annual Bonus Plan in 2018 by the executive Directors. Simon Peckham, Chief Executive, received a bonus equal to 95% of his base salary (maximum 100%), and Geoffrey Martin, Group Finance Director, received a bonus equal to 95% of his base salary (maximum 100%).

No 2017 Incentive Plan Shares were eligible to crystallise in this financial year, with the first crystallisation date being 31 May 2020.

### Discretions

It should be noted that the Remuneration Committee felt that the incentive outcomes were in line with the overall performance of the Group and therefore did not exercise any discretion to alter the outcomes from the application of the performance conditions. The Remuneration Committee did not adjust any incentive plan share outcome due to share price appreciation as none crystallised during the year being reported on.

### Responsibilities

The Remuneration Committee's responsibilities include:

- Establishing and maintaining an executive director remuneration policy that is appropriate, consistent and reflective of Melrose's remuneration philosophy.
- Determining the remuneration packages of the executive Directors.
- Setting and managing remuneration of the executive Directors and the Chairman of the Board in accordance with the Directors' Remuneration Policy.
- Oversight of remuneration of Melrose senior management and divisional CEOs, to enable the Committee to consider their consistency with the executive Director remuneration packages.
- Operating the Company's share incentive arrangements.

The Committee is not responsible for setting and managing the remuneration of Melrose senior management and divisional CEOs nor is the Committee responsible for determining wider business unit employee pay, both of which are the responsibility of the Chief Executive, for the reasons set out in further detail in this report. Responsibility for determining the remuneration of the Non-executive Directors sits with the Board.

No Director plays a part in any decision about his or her own remuneration.

All members of the Committee are independent Non-executive Directors within the definition of the UK Corporate Governance Code. None of the Committee members have any personal financial interest (other than as shareholders in the Company) in matters to be decided, nor do they have any conflicts of interest from cross-directorships or any day-to-day involvement in running the business.

### Our terms of reference

Our terms of reference were reviewed by the Remuneration Committee in light of the recent changes to the UK Corporate Governance Code and were subsequently amended and approved by the Board on 7 March 2019. They are available on our website, [www.melroseplc.net](http://www.melroseplc.net), and from the Company Secretary at Melrose's registered office.

### Structure of the report

- Introduction to Directors' Remuneration report (page 92).
- Chairman's Annual Statement (pages 93 to 95).
- Annual Report on Remuneration (pages 96 to 112).

During the year, the Committee received advice on the remuneration reporting regulations and preparation of the Directors' Remuneration report from PwC LLP. PwC LLP's fees for this advice were £46,500, which were charged on a time/cost basis.

PwC LLP is a member of the Remuneration Consultants' Group, and as such chooses to operate pursuant to a code of conduct that requires remuneration advice to be given objectively and independently. The Committee is satisfied that the advice provided by PwC LLP in relation to remuneration matters is objective and independent.

The Company Secretary acts as secretary to the Committee and attends Committee meetings.

This Directors' Remuneration report has been prepared in accordance with the Companies Act 2006 and Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. It also meets the requirements of the UK Corporate Governance Code and the UK Listing Authority's Listing Rules and Disclosure Guidance and Transparency Rules.

Chairman's Annual Statement



**David Lis**  
Remuneration Committee Chairman

**The Board has delegated to the Remuneration Committee (the "Committee") responsibility for overseeing the remuneration of the Company's Chairman, executive Directors, Company Secretary and other senior employees.**

Member	No. of meetings <sup>(1)</sup>
David Lis (Chairman) <sup>(2)</sup>	2/2
Justin Dowley <sup>(3)</sup>	2/2
Liz Hewitt	2/2
Archie G. Kane	2/2
Charlotte Twynning <sup>(4)</sup>	1/1

(1) Reflects regularly scheduled meetings. No other meetings of the Committee took place in 2018.  
 (2) Appointed as Chairman of the Committee with effect from 1 January 2019.  
 (3) Retired as Chairman of the Committee with effect from 31 December 2018.  
 (4) Appointed to the Committee with effect from 1 October 2018 and attended all Committee meetings held during the period 1 October 2018 to 31 December 2018.

**"Melrose's philosophy is that executive remuneration should be simple and transparent, support the delivery of the value creation strategy and pay only for performance."**

Dear Shareholder,

On behalf of the Board, I am pleased to present our report on Director remuneration (the "Annual Report on Remuneration") at the end of yet another successful year for Melrose. Adjusted diluted earnings per share were up 36% on last year, with a proposed final dividend of 3.05 pence per share (up 9% on last year), giving a full year dividend of 4.6 pence per share (up 10% on last year). The acquisition of GKN in 2018 was a significant transaction for the Company and one that was not without its complexities. However, as set out elsewhere in this Annual Report on Remuneration, the benefits of Melrose ownership are already being felt by the GKN businesses, with improvement strategies agreed with the management teams, significant investment being made and tangible gains shown in the annual results. Notably, the GKN UK defined benefit pension accounting deficit has reduced from £691 million to £588 million since December 2017, and an independent Chairman of the Trustees has been appointed. The existing Melrose businesses also made progress over the year, with the Nortek Group adjusted operating margins increasing from 9% at acquisition to 15% in 2018, with the potential for further improvement.

**Performance in 2018**

2018 was another very strong year for Melrose and marked another milestone in our "Buy, Improve, Sell" strategy. It is with this performance in mind, and in line with Melrose's remuneration philosophy of paying only for performance, that the Committee has taken its decisions in respect of executive Director remuneration arrangements for 2018 and 2019.

**Our remuneration structure**

Melrose's philosophy is that executive remuneration should be simple and transparent, support the delivery of the value creation strategy and pay only for performance. This philosophy is reflected in our remuneration structure that restricts the opportunity in annual salary and bonus, and weights potential reward to the variable long-term incentive plan based entirely on performance. The Committee feels strongly that rewards should be linked to generation and delivery of real returns to shareholders.

The Company's long-term incentive arrangements have applied since Melrose was floated in 2003 and have been regularly renewed with shareholder approval since then. Consistent with Melrose's remuneration principles, they are intended to align management's incentive arrangements directly with the interests of shareholders by linking remuneration specifically to shareholder value.

# Directors' Remuneration report

Continued

The awards paid under the 2012 Incentive Plan were based on value created between March 2012 and 31 May 2017, during which time Melrose's management created £3.6 billion in value for shareholders, equating to an average annual return of 22%. In the view of the Committee, this validates the incentive arrangements as a highly effective and essential mechanism in establishing the necessary environment for management to produce the significant returns enjoyed by shareholders to date. We believe that this remuneration strategy has also directly driven historical outperformance when compared with our competitors and supported the Company's success. In this regard, our remuneration arrangements are tailored to the culture and strategy of the Company and provide a strong platform for the ongoing long-term success of the Company. To build on the success of this approach, the 2017 Incentive Plan was adopted in May 2017 on similar terms, but with additional shareholder protections.

The first tranche of awards under the 2017 Incentive Plan was allocated on establishment, and we have included on page 98 details of the second tranche of awards provided to the executive Directors in 2018 under the 2017 Incentive Plan, in line with the expected allocation of options in three tranches over the vesting period. The 2017 Incentive Plan provides its participants with 7.5% of the increase in the index-adjusted value of the Company over the course of the performance period from and including 31 May 2017, to (but excluding) 31 May 2020.

## 2018 key decisions and incentive payouts

The Committee remains committed to a responsible approach to executive pay.

In line with increases in previous years, an increase of 3% was made to the executive Directors' base salaries with effect from 1 January 2018. This rise was consistent with the salary rises awarded to the wider head office population, other than where other such employees' salaries have been increased on a different basis to reflect individual circumstances, such as promotions. Non-executive Directors' basic fees were increased by 3% with effect from 1 January 2018. However, the additional fees payable to the Committee Chairs and the Senior Independent Director were left unchanged.

Annual bonuses for executive Directors are calculated using two elements, 80% being based on diluted earnings per share growth and 20% based on the achievement of strategic elements, consistent with UK Corporate Governance Code expectations that at least 70% should be based on financial performance. The maximum bonus opportunity is set at 100% of base salary, which is significantly below the maximum lower quartile annual bonus opportunity for other FTSE 100 companies, and reflects the participation of the Chief Executive and Group Finance Director in the 2017 Incentive Plan. The Chairman and the executive Vice-Chairmen do not participate in the annual bonus scheme. Information on the bonuses earned during the year and the relevant performance measures is set out on page 97.

The second tranche of options to acquire incentive shares under the 2017 Incentive Plan was allocated on 7 June 2018. No value can be realised in respect of these shares until crystallisation of the 2017 Incentive Plan, which is intended to occur on 31 May 2020.

## Approach to Director remuneration for 2019

The executive Directors' base salaries have been increased by 3% with effect from 1 January 2019. Again, this is consistent with the salary rises awarded to the wider head office population, other than where such employees' salaries have been increased on a different basis to reflect individual circumstances, such as promotions. After conducting a benchmarking exercise against our peers, Non-executive Directors' basic fees for 2019 have been increased by 8%, with effect from 1 January 2019, to reflect the fact that while all Non-executive Directors serve on the Company's committees, there are no additional base committee membership fees. There were also increases made to the fees payable to the Committee Chairs and the Senior Independent Director as set out on page 111. These were the first changes to these fees for a number of years, and the Committee's view is that these increases are appropriate.

The overall framework for the executive Directors' annual bonus arrangements for 2019 will remain the same as in 2018, with a maximum bonus opportunity of 100% of salary, 80% of which is based on financial performance metrics and 20% of which is based on strategic performance metrics. However, the Committee has revised its approach to the operation of the performance conditions to bring it more into line with UK Corporate Governance Code standard practice; details are set out on page 105.

In accordance with terms of the 2017 Incentive Plan, allocations of options are phased over the course of the performance period. Accordingly, the Committee expects to make a further allocation of options over incentive shares in the 2017 Incentive Plan to executive Directors and other participants on 8 March 2019.

## Compliance with the updated UK Corporate Governance Code

We have considered the current compliance of our Directors' Remuneration Policy and its operation with the new UK Corporate Governance Code, which applies to financial years beginning on or after 1 January 2019. While we were not required to comply with the new UK Corporate Governance Code for the current year being reported, the Committee has reviewed the Directors' Remuneration Policy in light of these changes and as a result we have made a very small number of clarificatory changes to the Directors' Remuneration Policy, as set out on pages 104 to 107. We are already compliant with the following key provisions of the new UK Corporate Governance Code, as demonstrated by the table below:

Key remuneration element of the UK Corporate Governance Code	Company position
Five year period between the date of grant and realisation	The 2017 Incentive Plan has a five year period including the performance and holding periods
Phased release of equity awards	The 2017 Incentive Plan provides for a phased release of equity awards
Discretion to override formulaic outcomes	The Directors' Remuneration Policy approved by shareholders in 2017 provides the Committee with such discretion

Key remuneration element of the UK Corporate Governance Code	Company position
Post-termination holding requirements	The Directors' Remuneration Policy approved by shareholders in 2017 has been clarified for 2019 to include such a requirement – see pages 104 to 107
Pension alignment	The pension provision for the current executive Directors is within the range provided to the wider workforce of the Group and this will continue to be the case for future executive Directors
Extended malus and clawback	The current malus and clawback provisions in the Directors' Remuneration Policy already exceed the best practice suggested in relation to the new UK Corporate Governance Code

#### Wider workforce considerations

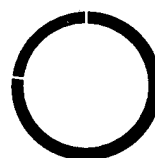
Melrose is committed to creating an inclusive working environment and to rewarding our employees throughout the organisation in a fair manner. In making decisions on executive pay, the Committee is alive to wider workforce remuneration and conditions. See page 91 of the Nomination Committee report and page 63 of the Corporate Social Responsibility report for further details on some of the work being done in this area.

#### Shareholder engagement

We remain committed to maintaining an open and transparent engagement with our investors. We believe that a key objective of the Annual Report on Remuneration is to communicate clearly to shareholders how our Directors' Remuneration Policy is operating in practice and to demonstrate how our executive remuneration is clearly linked to the Company's performance. We are engaged in an ongoing dialogue with investors and corporate governance advisory agencies in order to better understand their views on Melrose's approach to executive remuneration.

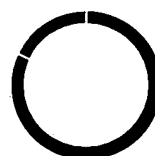
Specifically, during 2018, the Company conducted a formal engagement with key shareholders and corporate governance advisory agencies in respect of feedback received at the 2018 AGM and the vote on the 2017 Directors' Remuneration Report. We listen to our shareholders and the clarifications to the implementation of the Directors' Remuneration Policy that we are making in 2019 (see pages 104 to 107) have been influenced by this dialogue. Furthermore, following feedback from the shareholder engagement, advice is being sought on potential changes to the long-term incentive arrangements at the next proposed renewal in 2020.

#### Resolution to approve the Directors' Remuneration Report for the year ended 31 December 2017



Percentage of votes cast for the resolution	77.13%
Percentage of votes cast against the resolution	22.87%
Percentage of votes withheld	4.9%

#### Resolution to approve the Directors' Remuneration Policy (11 May 2017)



Percentage of votes cast for the resolution	82.04%
Percentage of votes cast against the resolution	17.96%
Percentage of votes withheld	2.1%

The Remuneration Committee believes that the strong level of shareholder support received for the Directors' Remuneration Policy at the 2017 General Meeting and the Annual Report on Remuneration at the 2018 AGM, as well as the feedback received during discussions with shareholders in 2018, means that no material changes are required to the approach behind the Directors' Remuneration Policy or its implementation in 2019.

David Lis  
Chairman, Remuneration Committee  
7 March 2019

# Directors' Remuneration report

Continued

## Annual Report on Remuneration

In this section, we set out:

- the actual performance and executive remuneration outcomes for the 2018 financial year;
- the application of the Directors' Remuneration Policy to the 2018 financial year, how the Directors' Remuneration Policy was operated in 2018 and the proposed alterations to how it is to be applied from 1 January 2019 onwards; and
- the link between our strategy for 2019 and the Directors' Remuneration Policy.

The Directors' Remuneration Policy was approved by shareholders on 11 May 2017 with over 80% of votes cast in favour of the resolution, a level of support which was also reflected in the approval of the 2017 Incentive Plan.

The following table sets out the key elements of the Annual Report on Remuneration and where to find them.

## Element

Single figure of remuneration	See page 96
Share Interests awarded in the Financial Year	See pages 100 and 112
Payments to Past Directors / For Loss of Office	None
Statement of Director Shareholdings and Interests	See pages 100 and 112
Performance Graph and Table	See page 102
Percentage Change in Remuneration of the CEO	See page 111
Relative Importance of Spend on Pay	See page 111
Statement of Implementation of the Directors' Remuneration Policy for 2019	See pages 104 to 107
Consideration of Matters Relating to Directors' Remuneration	See pages 97 to 98
Statement of Voting	See page 95

## How have we performed in 2018?

### Single total figure of remuneration for the Chairman and the executive Directors for the 2018 financial year (audited)

The following chart summarises the single figure of remuneration for 2018 in comparison with 2017.

Chairman	Period	Total salary and fees £000	Taxable benefits £000	Bonus £000	LTIP <sup>(1)</sup> £000	Pension <sup>(2)</sup> £000	Total £000
Justin Dowley <sup>(3)</sup>	2018	85	n/a	n/a	n/a	n/a	85
	2017	81	n/a	n/a	n/a	n/a	81
<b>Executive Directors</b>							
Christopher Miller	2018	490	11	n/a	–	74	575
	2017	475	19	n/a	41,770	71	42,335
David Roper	2018	490	19	n/a	–	74	583
	2017	475	18	n/a	41,770	71	42,334
Simon Peckham	2018	490	19	466	–	74	1,049
	2017	475	20	428	41,770	71	42,764
Geoffrey Martin	2018	392	28	373	–	63	856
	2017	380	27	342	41,770	57	42,576
<b>Total (executive Directors)</b>	<b>2018</b>	<b>1,862</b>	<b>77</b>	<b>839</b>	<b>–</b>	<b>285</b>	<b>3,063</b>
	<b>2017</b>	<b>1,805</b>	<b>84</b>	<b>770</b>	<b>167,080</b>	<b>270</b>	<b>170,009</b>

(1) The 2012 Incentive Plan crystallised in 2017. The values included in the above table are calculated in accordance with the applicable regulations. The 2017 Incentive Plan is a five-year plan in total (comprised of a three-year performance period and a two-year holding period) and, accordingly, no value was vested to participants in respect of the year to 31 December 2018.

(2) All of the amounts attributable to pension contributions were paid as supplements to base salary in lieu of pension arrangements.

(3) Appointed as Chairman of the Board with effect from 1 January 2019.

## Base Salary

Salaries are fixed at a level which is considered low in comparison to peers. Each executive Director received an increase in base salary of approximately 3% effective from 1 January 2018.

## Benefits

The range of benefits provided to executive Directors, including a pension contribution equal to 15% of base salary (which the Committee notes is materially below the lower quartile of pension contributions in the FTSE 100 of 20%), has not changed since the inception of Melrose and there is no intention to widen the range of benefits Directors may receive. All of the executive Directors received certain benefits during 2018, being a company car allowance, fuel allowance, private medical insurance, life insurance and group income protection. Geoffrey Martin also received paid train travel to and from London. No executive Director participates in, or has ever participated in, a Group defined benefit or final salary pension scheme.

### 2018 Annual Bonus (audited)

The maximum bonus opportunity is capped at 100% of base salary, which is significantly below the maximum lower quartile annual bonus opportunity for other FTSE 100 companies, reflecting the participation of the Chief Executive and Group Finance Director in the 2017 Incentive Plan. Following the application of the formulaic basis used in previous years and as explained below, it was determined by the Committee that Simon Peckham and Geoffrey Martin (being the only executive Directors participating in the annual bonus plan) should be awarded a bonus of 95% of base salary.

KPIs	Actual out-turn				Percentage of maximum bonus earned	Bonus (%) of base salary
<b>Annual Bonus Plan</b>						
<b>EPS Growth (80%)</b>	<b>5%</b>	<b>10%</b>	<b>15%</b>	<b>20%</b>	EPS Growth of 25%, resulting in the maximum award.	
% payout	25%	50%	75%	100%		
<b>EPS Growth sub-total:</b>					<b>100%</b>	<b>80%</b>
<b>Strategic Objectives (20%)</b>						
<ul style="list-style-type: none"> <li>Secure the GKN bid within the parameter for price and terms approved by the Board – maximum 20%</li> </ul>	Management secured the successful takeover of GKN within the parameters for price and other terms approved by the Board, and therefore the Committee considers this strategic objective to have been fully achieved.				20%	
<ul style="list-style-type: none"> <li>Take control of GKN, including decentralising Group functions and implementing controls – maximum 20%</li> </ul>	Management secured 100% ownership within six months of launch of the offer and immediately set about decentralising former GKN Group functions and to implement various controls throughout the GKN businesses. The majority of the decentralisation was completed within one month, whilst certain separation projects continue. In light of this, the Committee considers this strategic objective to have been achieved in full.				20%	
<ul style="list-style-type: none"> <li>Establish the GKN divisions as standalone businesses, including security operational management teams and agree strategic plans with the GKN businesses and commence implementation of improvement actions – maximum 20%</li> </ul>	Management moved quickly to establish the GKN divisions as standalone businesses, in particular focusing on ensuring strong executive leadership for each of the businesses. Management confirmed the continued executive leadership of the GKN Aerospace and GKN Powder Metallurgy businesses, and secured a new CEO to lead the GKN Automotive division. The Committee further notes the work of Management in agreeing strategic plans with each of the GKN businesses. As a result of these achievements, the Committee considers this strategic objective to have been largely achieved.				15%	
<ul style="list-style-type: none"> <li>Conduct a strategic review of Melrose's non-core businesses – maximum 20%</li> </ul>	A review of Melrose's non-core businesses, particularly those within the GKN group, was undertaken during the year. This has resulted in agreements to dispose of the Walterscheid Powertrain Group (previously GKN Off-Highway Powertrain), which was announced on 6 March 2019, and other smaller non-core businesses. There are, however, businesses that remain under strategic review. As a result, the Committee therefore feels that an award of 50% of the maximum for this strategic element is appropriate.				10%	
<ul style="list-style-type: none"> <li>Progress improvement plans for Nortek and restructuring for Brush – maximum 20%</li> </ul>	Although improvement plans for Nortek and the Brush restructuring were successfully progressed during the year, the Committee felt that in light of further impairments for Brush and challenging trading years for the SST and Ergotron businesses, an award of 50% of the maximum for this strategic objective is considered appropriate.				10%	
<b>Strategic Objectives sub-total:</b>					<b>75%</b>	<b>15%</b>
<b>Total annual bonus for 2018:</b>					<b>95%</b>	

All bonus payments for 2018 will be made in cash, as both the Chief Executive and Group Finance Director have exceeded their minimum shareholding requirements. See page 105 for details of the requirements.

# Directors' Remuneration report

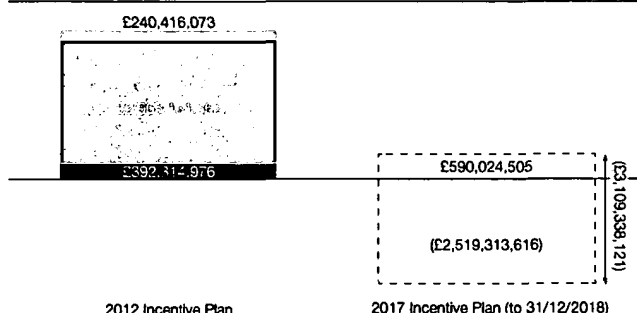
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## 2017 Incentive Plan (audited)

No long-term incentives crystallised during the 2018 financial year, although options were allocated during it. On 7 June 2018, each executive Director was granted options over Incentive Shares (2017) as part of the second tranche of the 2017 Incentive Plan: Christopher Miller was granted 2,583 options, David Roper was granted 2,583 options, Simon Peckham was granted 2,833 options and Geoffrey Martin was granted 2,833 options.

As part of an ongoing commitment to full transparency around remuneration structures at Melrose, set out below is a 'snapshot' of the current value of the 2017 Incentive Plan as if the crystallisation date was 31 December 2018 instead of the actual crystallisation date in May 2020.

### Value delivered under 2012 Incentive Plan and illustrative increase in value for 2017 Incentive Plan, if crystallised on 31 December 2018



- Index adjustment/minimum return
- Value delivered to shareholders
- Value delivered to participants

Please note that as at 31 December 2018 the minimum return hurdle of £590,024,505 had not been achieved. Melrose would need to create £3,109,338,121 of value for shareholders in order for the 2017 Incentive Plan to begin to accrue value for participants.

## Shareholder Protections

As part of the shareholder consultation that took place during the course of 2018, Melrose was asked to clarify the leaver provisions of the 2017 Incentive Plan. The section below sets out the leaver provisions in detail for the 2017 Incentive Scheme, as well as the applicable malus and clawback provisions, as so clarified.

### Good leaver definition

A good leaver is defined as cessation in the following circumstances: death; permanent ill-health; permanent disability; retirement at or above 65 years of age; resignation in connection with a "Change of Control"; and at the discretion of the Committee. Cessation in any other circumstances constitutes a bad leaver.

### Application

If an executive Director holding 2017 Incentive Shares or Options ceases employment in circumstances where he is a "good leaver", the Committee may require that he transfer some or all of the "unvested portion" of his 2017 Incentive Shares for the lower of their nominal value and the price of an Ordinary Share and any Options he has may lapse.

As the table demonstrates, no value has currently accrued to the 2017 Incentive Plan.

<b>Theoretical value under the 2017 Incentive Plan if crystallised on 31 December 2018 rather than on the 2020 scheduled payment date</b>
<b>2017</b>
Invested capital from (and including) May 2017 up to (and including) December 2018
£10,691,202,105
Index adjustment/minimum return
£590,024,505
<b>Indexed capital</b>
£11,281,226,610
<b>2018</b>
Number of issued ordinary shares on 31 December 2018
4,858,254,963
Average price of an ordinary share for 40 business days prior to 31 December 2018
£1.682
Deemed market capitalisation of Melrose based on average price of an ordinary share for 40 business days prior to 31 December 2018
£8,171,888,489
<b>Overall change in value for shareholders since 31 May 2017</b>
<b>(£3,109,338,121)</b>
<b>Theoretical value to management and shareholder dilution calculated at 31 December 2018</b>
<b>7.5% of change in value</b>
0
Total number of new shares issued under the 2017 Incentive Plan
0
Theoretical dilution to shareholders due to the 2017 Incentive Plan
0
Break-even price of an ordinary share at 31 December 2018 for the 2017 Incentive Plan to deliver value
232p

If an executive Director holding 2017 Incentive Shares or Options ceases employment in circumstances where he is a "bad leaver", every 2017 Incentive Share he holds shall, unless the Committee determines otherwise, be transferred for the lower of their nominal value and the price of an Ordinary Share and any Options he has may lapse.<sup>(1)</sup>

### Malus and clawback

The 2017 Incentive Plan includes a three-year performance period, during which any 2017 Incentive Shares and Options are subject to malus, and a two-year holding period post-crystallisation, during which any ordinary shares arising from crystallisation of 2017 Incentive Shares are subject to clawback.

(1) The "unvested portion" of the participant's 2017 Incentive Shares means any such shares acquired pursuant to an option granted within less than one year of the date on which that participant becomes a leaver and the "unvested portion" of the participant's unexercised options to acquire 2017 Incentive Shares means any option granted within less than one year of the date on which that participant becomes a leaver.

## Remuneration Philosophy

Melrose's remuneration philosophy is that executive remuneration should be simple and transparent, support the delivery of the value creation strategy and pay only for performance. This philosophy is reflected in our remuneration structure, whereby:

- the base salary, benefits and annual bonus of the executive Directors are positioned below the lower quartile maximum opportunity for FTSE 100 companies; and
- long-term incentive remuneration is intended to directly align the executive Directors' remuneration with that of shareholders by connecting remuneration specifically to the creation of shareholder value and with any award typically being granted in shares, not cash.

The Remuneration Committee strongly believes that this simple and transparent incentive framework is aligned with the Company's strategy for creation of shareholder value. The Company's long-term incentive arrangements have applied since Melrose was floated in 2003 and have been regularly renewed with shareholder approval since then. Consistent with Melrose's remuneration principles, they are intended to align management's incentive arrangements directly with the interests of shareholders by linking remuneration specifically to shareholder value.

To help illustrate the application of this philosophy, we have set out below a series of tables that clearly demonstrate the alignment between the executive Directors and our shareholders.

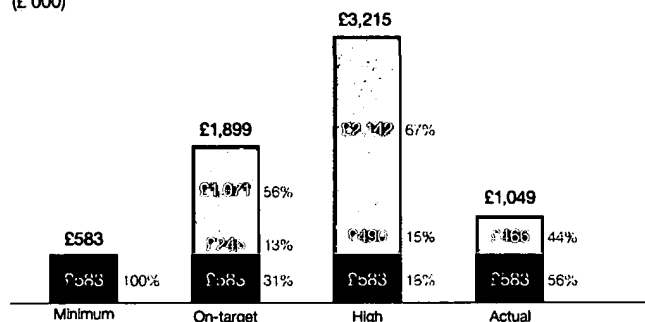
### Illustration and application of the Directors' Remuneration Policy in 2018

The charts set out below are updated versions of charts which appeared in the Directors' Remuneration Policy shareholder circular approved in May 2017. These set out an illustration of the Directors' Remuneration Policy compared to the actual executive Director remuneration paid in 2018.

The executive Directors' options under the 2017 Incentive Plan will deliver to them part of the growth in value of the Company from May 2017 to May 2020 (or an earlier trigger date determined in accordance with the Articles). Accordingly, the value of participation in the 2017 Incentive Plan was not expressed as a multiple of salary but on a valuation done at the time of the renewal of the incentive plan in 2017 (see shareholder circular dated 7 April 2017 available at [www.melroseplc.net/media/1728/21347274\\_-\\_1\\_-\\_circular.pdf](http://www.melroseplc.net/media/1728/21347274_-_1_-_circular.pdf)).

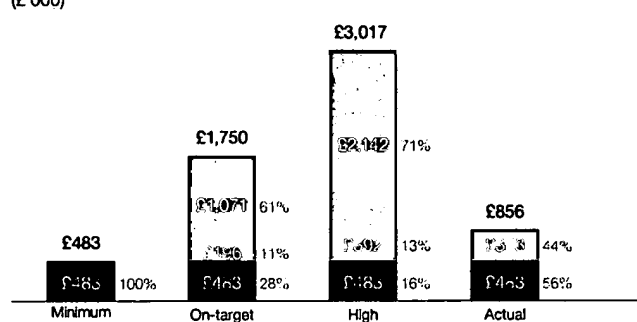
#### Simon Peckham

(£'000)



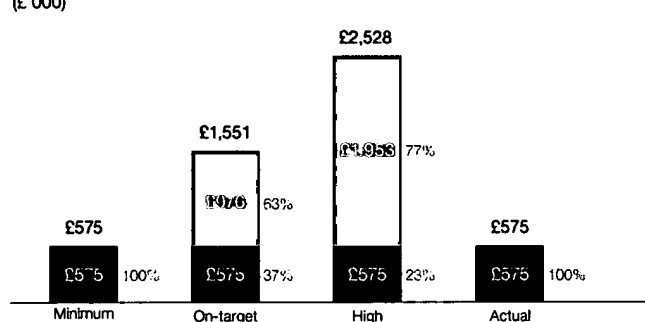
#### Geoffrey Martin

(£'000)



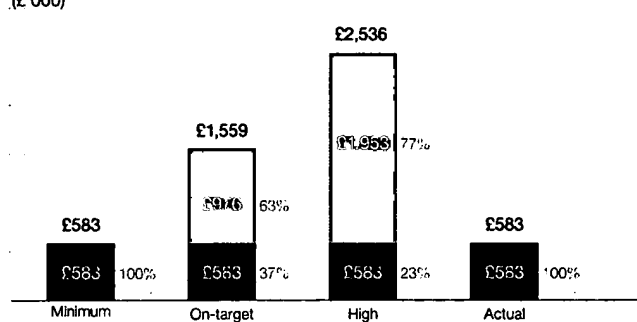
#### Christopher Miller

(£'000)



#### David Roper

(£'000)



● Fixed ● Annual variable ● LTI ● Fixed ● Annual variable ● LTI

(1) In illustrating the potential reward under the Directors' Remuneration Policy (set out in this Annual Report on Remuneration) compared to the actual single figures awarded for 2018, the following assumptions have been made:

- **Minimum performance:** fixed elements of remuneration only. Base salary effective from 1 January 2018, and benefits and pension rate as set out in the single figure table for the year ended 31 December 2018 on page 96.
- **On-Target:** fixed elements of remuneration as above, plus a bonus of 50% of salary (other than in the case of Christopher Miller and David Roper, who do not participate in the annual bonus arrangements), plus an amount in relation to the executive Directors' entitlements under the 2017 Incentive Plan, being 50% of the fair value of the award, calculated as set out above.
- **High-performance:** fixed elements of remuneration as above, plus a bonus of 100% of salary (other than in the case of Christopher Miller and David Roper who do not participate in the annual bonus arrangements), plus an amount in relation to the executive Directors' entitlements under the 2017 Incentive Plan, being 100% of the fair value of the award, calculated as set out above.

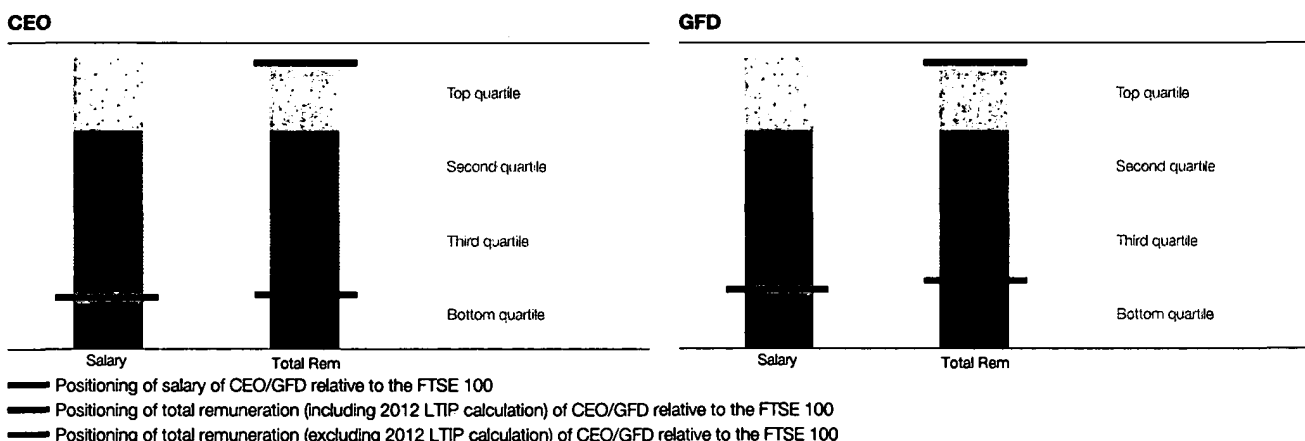
# Directors' Remuneration report

Continued

## Comparison to Peers

The following chart shows the relative position of base salary and total compensation for our executive Directors in 2018 compared to the FTSE 100 in 2018. The charts demonstrate the Remuneration Committee's policy of providing conservative salary, benefits and annual bonus to the executive Directors, with heavily-weighted variable incentives in the form of the 2017 Incentive Plan, which ensures that the executive Directors only receive very substantial rewards when they have outperformed and created very significant value for shareholders.

The chart below includes the actual salary, benefits and annual bonus awarded to the Chief Executive and Group Finance Director in 2018. Although no value accrued to the executive Directors under the 2017 Incentive Plan during 2018, for comparison purposes only, we have included in the LTIP element of total remuneration in the chart below an amount equivalent to the annualised award from the crystallisation of the 2012 Incentive Plan. This is the total award under the 2012 Incentive Scheme in 2017 as set out on page 98, divided by the five year performance period, which equates to £8.354 million per year for the Chief Executive and Group Finance Director. No payment under the 2017 Incentive Plan was due in 2018 and this figure is therefore an assumed amount.



## Equity exposure of the Board (audited)

The following table and chart set out all subsisting interests in the equity of the Company held by the executive Directors as at 31 December 2018:

Director	Minimum number of ordinary shares to be held by executive Directors as at 31 December 2018 <sup>(1)</sup>	Additional shareholding requirement (% salary) <sup>(2)</sup>	Current shareholding (% salary) <sup>(3)</sup>	Ordinary shares held <sup>(4)</sup>	Invested interests under share schemes			Shareholding requirement met?
					Subject to performance conditions <sup>(5)</sup>	Not subject to performance conditions		
<b>Executive Directors</b>								
Christopher Miller	4,802,159	200%	10,078%	30,108,510 <sup>(4)</sup>	5,166 <sup>(5)</sup>	n/a	Yes	
David Roper	4,802,159	200%	5,481%	16,373,732	5,166 <sup>(5)</sup>	n/a	Yes	
Simon Peckham	4,627,535	200%	5,779%	17,265,565	5,666 <sup>(5)</sup>	n/a	Yes	
Geoffrey Martin	4,627,535	200%	3,093%	7,395,256	5,666 <sup>(5)</sup>	n/a	Yes	

(1) This threshold is subject to adjustments related to the reductions in capital as the Company returns proceeds to shareholders following the sale of businesses.

(2) In addition to the obligations in (1), the shareholding requirement under the adjusted Directors' Remuneration Policy will be 200% of base salary.

(3) For these purposes, the value of a share is 163.85 pence, being the closing mid-market price on 31 December 2018, the last business day of the 2018 financial year.

(4) As at 31 December 2018, the interest of Christopher Miller included 8,750,000 ordinary shares held by Harris & Sheldon Investments Limited, a company which is connected with Christopher Miller within the meaning of section 252 of the Act.

(5) An additional amount of 10,386 options over Incentive Shares (2017) is expected to be allocated on 8 March 2019 to the executive Directors as follows: Christopher Miller will be granted 2,584 options, David Roper will be granted 2,584 options, Simon Peckham will be granted 2,834 options and Geoffrey Martin will be granted 2,834 options.

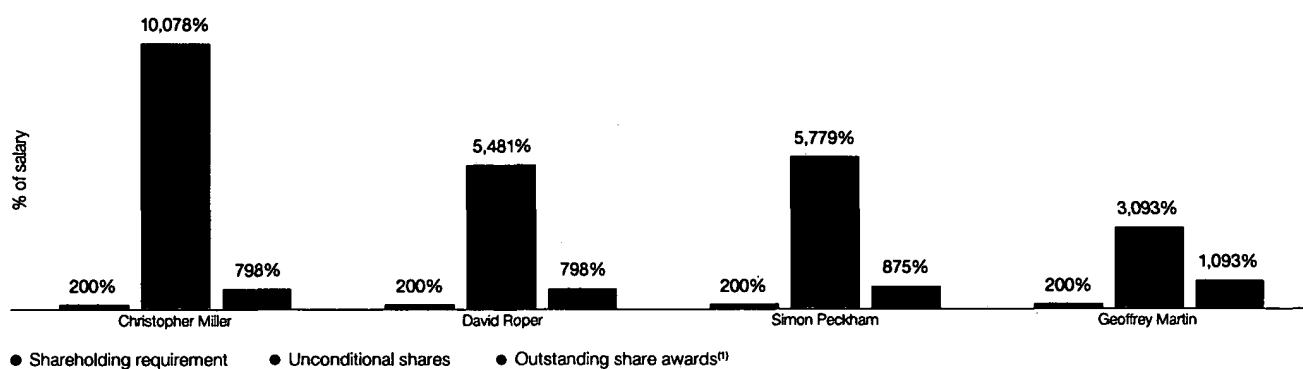
(6) Each executive Director was granted options over Incentive Shares (2017) on 31 May 2017: Christopher Miller was granted 2,583 options, David Roper was granted 2,583 options, Simon Peckham was granted 2,833 options and Geoffrey Martin was granted 2,833 options. Each executive Director exercised his options on 29 June 2017 and 2,583 Incentive Shares (2017) each were issued to Christopher Miller and David Roper and 2,833 Incentive Shares (2017) each were issued to Simon Peckham and Geoffrey Martin. In addition, each executive Director was granted options over Incentive Shares (2017) on 7 June 2018: Christopher Miller was granted 2,583 options, David Roper was granted 2,583 options, Simon Peckham was granted 2,833 options and Geoffrey Martin was granted 2,833 options. The value which may be derived from the Incentive Shares (2017) acquired on exercise will be determined on 31 May 2020, or any other earlier crystallisation date in accordance with the Incentive Plan (2017). For accounting purposes, the IFRS 2 charge has been calculated as if all tranches have been granted on day one because of a common expectation, established at that date but subject to changes to take account of exceptional circumstances, between participants and the Company that the remaining options will be allocated annually in two more equal tranches over the three-year performance period.

As disclosed at the time of crystallisation of the 2009 Incentive Plan, the executive Directors considered it appropriate that they, together with their immediate families, would hold at least half of the shares acquired pursuant to that crystallisation (after satisfying tax obligations following the crystallisation of that plan and subject to capital adjustments) for the foreseeable future. Accordingly, the Committee has adopted the minimum share retention guidelines outlined above in relation to the holding of ordinary shares by executive Directors who participated in the 2009 Incentive Plan and the Incentive Plan (2012) and who participate in the Incentive Plan (2017), reinforcing the executive Directors' long-term stewardship of the Company and long-term investment in the Company's shares.

No executive Director may dispose of any ordinary shares without the consent of the Committee, which will not normally be withheld provided the executive Director will continue to hold at least the "minimum number" of ordinary shares referred to in the table above following any such disposal.

As at 31 December 2018, each executive Director held much more than the minimum number of ordinary shares and so satisfied the guidelines. Internal Company rules on shareholdings are extended to senior management in addition to the executive Directors, in order that appropriate remuneration principles are applied to Melrose senior management on a similar basis to executive Directors.

There have been no changes in the shareholdings of the executive Directors between 31 December 2018 and 7 March 2019.



(1) The value of the outstanding share awards in this chart, which includes both 2017 Incentive Shares and options over 2017 Incentive Shares held as at 31 December 2018, has been calculated as the fair value of the 2017 Incentive Plan awards based on the estimated binomial option pricing model value per 2017 Incentive Share (£756 as at the last practical date before the finalisation of the Directors' Remuneration Policy, 11 May 2017) multiplied by the number of 2017 Incentive Shares and options over 2017 Incentive Shares held by or granted to the executive Directors in 2018, in each case as a percentage of base salary.

Please see page 112 for a table setting out the equity interests of the Non-executive Directors as at 31 December 2018.

# Directors' Remuneration report

Continued

## Overall Link to Remuneration, Equity and Wealth of the executive Directors

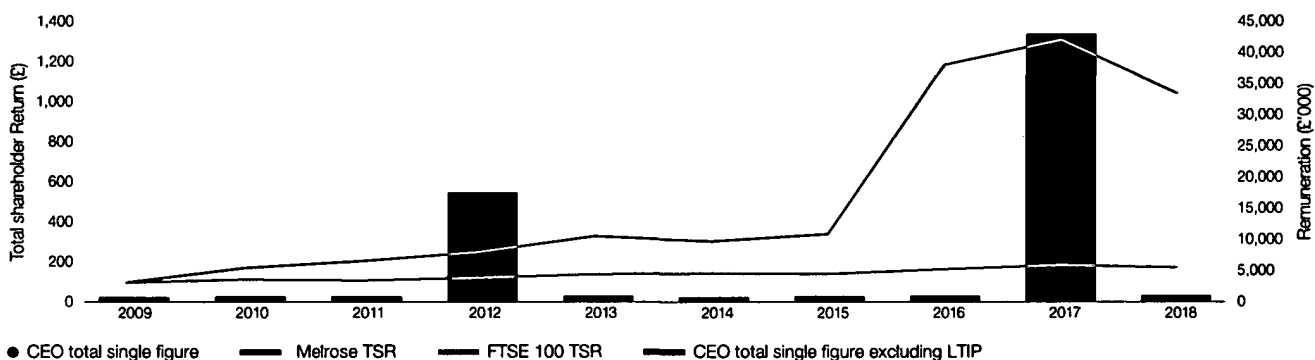
It is the Remuneration Committee's view that it is important when considering the remuneration paid in the year under the single figure to take a holistic view of how each executive Director's total wealth is linked to the performance of the Company. In the Committee's opinion, the impact on the total wealth of the executive Director is as important as the single figure in any one year; this approach encourages executive Directors to take a long-term view of the sustainable performance of the Company and aligns them with shareholders. A key facet of the Directors' Remuneration Policy is the ability for the executive Directors to gain and lose dependent on the share price performance of the Company at a level which is material to their total remuneration. The following table sets out the single figure for 2018, the number of ordinary shares of the Company held by each executive Director at the end of the 2017 and 2018 financial years and the impact on the value of these ordinary shares taking the closing mid-market prices for those dates.

	2018 single total figure of remuneration £000	Shares beneficially held on 31 December 2017	Shares beneficially held on 31 December 2018	Value of shares on 31 December 2017 (£) <sup>(1)</sup>	Value of shares on 31 December 2018 (£) <sup>(2)</sup>	Difference in value of shares between 31 December 2017 and 31 December 2018 (£)
Christopher Miller	575	30,108,510 <sup>(3)</sup>	30,108,510 <sup>(4)</sup>	63,890,258	49,332,794	-14,557,464
David Roper	583	15,730,130	16,373,732	33,379,336	26,828,360	-6,550,976
Simon Peckham	1,049	17,265,565	17,265,565	36,637,529	28,289,628	-8,347,901
Geoffrey Martin	856	7,395,256	7,395,256	15,692,733	12,117,127	-3,575,606

- (1) For these purposes, the value of a share is 212.20 pence, being the closing mid-market price on 29 December 2017, the last business day prior to 31 December 2017.
- (2) For these purposes, the value of a share is 163.85 pence, being the closing mid-market price on 31 December 2018, being the last business day of the 2018 financial year.
- (3) As at 31 December 2017, the interest of Christopher Miller included 8,750,000 ordinary shares held by Harris & Sheldon Investments Limited, a company which is connected with Christopher Miller within the meaning of section 252 of the Act.
- (4) As at 31 December 2018, the interest of Christopher Miller included 8,750,000 ordinary shares held by Harris & Sheldon Investments Limited, a company which is connected with Christopher Miller within the meaning of section 252 of the Act.

## Long-term Performance

The following chart shows the single figure of remuneration for the Chief Executive over the last ten financial years compared to the Company's comparative (FTSE 100) and absolute shareholder return. The chart demonstrates a strong correlation between Company performance demonstrated by these measures and the remuneration paid to the Chief Executive.



## Determining the Directors' Remuneration Policy

When determining the Directors' Remuneration Policy specifically for the executive Directors, the Committee addressed the following:

Factor	How the Committee has addressed
<b>Clarity</b>	The Company's performance remuneration is based on supporting the implementation of the Company's strategy, which is primarily to create sustainable long-term shareholder value. This provides clarity to all stakeholders on the relationship between the successful implementation of the Company's strategy and the remuneration paid.
<b>Simplicity</b>	The operation of the Annual Bonus Plan is linked to an earnings-based target (80%) and the achievement of strategic factors (20%). The 2017 Incentive Plan simply rewards the creation of shareholder value and has been awarded in shares, not cash. In the Committee's view, this provides a simple incentive framework which can be understood by all of the Company's stakeholders.
<b>Risk</b>	<p>The Directors' Remuneration Policy includes the following:</p> <ul style="list-style-type: none"> <li>• Setting defined limits on the maximum award which can be earned.</li> <li>• Requiring the deferral of a substantial proportion of the incentives in shares for a material period of time.</li> <li>• Aligning the performance conditions with the strategy of the Company.</li> <li>• Ensuring there is sufficient flexibility to adjust payments through malus and clawback and an overriding discretion to depart from formulaic outcomes.</li> </ul> <p>These elements mitigate against the risk of target-based incentives by:</p> <ul style="list-style-type: none"> <li>• Capping the maximum annual bonus to 100% of base salary.</li> <li>• The requirement to hold any ordinary shares arising from crystallisation of Incentive Shares (2017) for a period of two years post-crystallisation date and the ability to defer 50% of the annual bonus into shares where the minimum shareholding requirement is not met, which help ensure that the performance earning the award was sustainable and thereby discouraging short term behaviours.</li> <li>• Aligning any reward to the agreed strategy of the Company.</li> <li>• Reducing the award or cancelling it if the behaviours giving rise to the award are inappropriate or if it appears that the criteria on which the award was based do not reflect the underlying performance of the Company.</li> </ul>
<b>Predictability</b>	The Committee sets out the possible values on approval of the Company's incentive plan by shareholders. In addition, the limits and discretions under the Directors' Remuneration Policy were clearly set out on shareholder approval.
<b>Proportionality</b>	The Annual Bonus Plan clearly rewards the successful implementation of the Company's strategy and the 2017 Incentive Plan ensures that the executive Directors have a strong drive to ensure that the performance is sustainable over the long-term.
<b>Alignment to culture</b>	The focus on ownership and long term sustainable performance is a key part of the Company's culture. This is supported by the Directors' Remuneration Policy.

It should be noted that the Directors' Remuneration Policy operated over the 2018 financial year as intended by the Committee.

### The link between our strategy and the Directors' Remuneration Policy

The Company's "Buy, Improve, Sell" strategy, full details of which are set out in the Strategic Report on pages 2 to 3, is well formulated and known by our shareholders. The Committee believes that the strategy is clearly linked to the Directors' Remuneration Policy, which sets the base salary, benefits and annual bonus for the executive Directors low, but with a heavy weighting towards long-term incentives, which reward only for significant outperformance and where our shareholders also share in that success.

In particular:

- The executive Directors are wholly aligned with shareholders as substantial equity investors themselves (see page 100 for further details), and are also required to defer their annual bonus payments if they do not meet the shareholding requirement of 200% of base salary (and it is noted that all executive Directors meet – and exceed – this shareholding requirement).
- Strategic metrics for use in calculating the strategic elements of the annual bonus are focused on the specific investments of the Company and its strategy.
- Fixed remuneration for the executive Directors is set at the lower end of the market to limit fixed costs for the Group and to ensure desirable levels of profitability.
- Management are incentivised to maximise returns for shareholders through the LTIP metrics, which entitle incentive shareholders to 7.5% of the increase in the index-adjusted value of the Company from and including May 2017 to May 2020 – i.e., returns are only received for successful investment strategies – and have been awarded in shares, not cash.

# Directors' Remuneration report

Continued

## Operation of the Directors' Remuneration Policy in 2018 and 2019

The Committee has taken into account feedback received from shareholders over the course of the year on the current Directors' Remuneration Policy (a copy of which can be found in the circular dated 7 April 2017, available at [www.melroseplc.net/media/1728/21347274\\_-\\_1\\_-\\_circular.pdf](http://www.melroseplc.net/media/1728/21347274_-_1_-_circular.pdf)), and will be using such feedback to guide the Directors' Remuneration Policy review ahead of the new Directors' Remuneration Policy being put to shareholders in 2020. For 2019, the Committee has made clarifications to the implementation of the Directors' Remuneration Policy to ensure alignment with the new UK Corporate Governance Code, which takes effect for financial years on and from 1 January 2019, and to reflect shareholder feedback received during 2018.

The table below summarises the following information:

- A summary of the key terms of the Directors' Remuneration Policy;
- The operation of the key terms of the Directors' Remuneration Policy in 2018; and
- The proposed operation of the key terms of the Directors' Remuneration Policy in 2019.

Element	Current Directors' Remuneration Policy	Proposed adjustments to implementation for 2019	Operation in 2018	Operation in 2019
<b>Base Salary</b> Base salaries are considered reasonably conservative in comparison to a market-competitive range for companies of similar size and complexity. See the benchmarks set out on page 100. Since Melrose was floated in 2003, all current executive Directors have received the same annual increases to base salary. In the last eight years these increases have averaged 3%.	Normally reviewed annually and fixed for 12 months from 1 January, although salaries may be reviewed more frequently or at different times of the year if the Committee determines this to be appropriate.  Salaries are paid in cash and levels are determined by the Committee taking into account a range of factors including: <ul style="list-style-type: none"> <li>• role, experience and performance;</li> <li>• prevailing market conditions;</li> <li>• external benchmarks for similar roles at comparable companies; and</li> <li>• salary increases awarded for other employees in the Group.</li> </ul>	No change.	Executive Directors received a 3% increase on 1 January 2018. As a result, the salaries for the executive Directors in 2018 were: <ul style="list-style-type: none"> <li>• Christopher Miller: £490,000</li> <li>• David Roper: £490,000</li> <li>• Simon Peckham: £490,000</li> <li>• Geoffrey Martin: £392,000</li> </ul>	Executive Directors received a 3% increase on 1 January 2019. As a result, the salaries for the executive Directors are: <ul style="list-style-type: none"> <li>• Christopher Miller: £505,000</li> <li>• David Roper: £505,000</li> <li>• Simon Peckham: £505,000</li> <li>• Geoffrey Martin: £403,000</li> </ul>
<b>Benefits</b>	Executive Directors receive benefits in line with market practice and these include a company car allowance, fuel allowance, private medical insurance, life insurance and group income protection.  Other benefits may be provided based on individual circumstances, such benefits may include (but are not limited to) travel costs to and from London and accommodation in London for executive Directors who are not based in London but who are required to work there and relocation allowances.	No change.	Standard benefits.	No change.
<b>Pension</b>	Executive Directors may elect to receive a Company contribution to an individual defined contribution pension arrangement or a supplement to base salary in lieu of a pension arrangement.	It is the Committee's intention that any new executive Directors will receive a pension contribution that is in line with the range of contributions provided to the wider workforce of the Group.	All executive Directors received a supplement in lieu of their pension contribution.	No change.

Element	Current Directors' Remuneration Policy	Proposed adjustments to implementation for 2019	Operation in 2018	Operation in 2019
<p><b>Annual Bonus</b></p> <p>The maximum bonus payable is set at 100% of base salary, which is conservative compared to the Company's peers, as shown on page 100. All executive Directors who participate in the annual bonus scheme receive the same percentage bonus. In the last three years prior to 2018, the average percentage of base salary payable has been 93%. The maximum opportunity is deliberately positioned below the lower quartile maximum opportunity for FTSE 100 companies.</p>	<p>Maximum opportunity of 100% of base salary. Targets are set annually and payout is determined by the Committee after the year end based on performance against those targets. The Committee has discretion to vary the bonus payout (upwards or downwards) should any formulaic output not produce a fair result for either the individual executive Director or the Company, taking account of overall business performance.</p> <p>At least 50% of the award will be based on financial measures and the balance of the award will be based on strategic measures and/or personal objectives, as determined by the Committee.</p>	<p>Where an executive Director holds less than the minimum shareholding requirement (being 200% of base salary), up to 50% of their annual bonus will be deferred into shares, and required to be held for three years or until the minimum shareholding requirement has been met, subject to the discretion of the Committee.</p> <p>The maximum bonus opportunity under the recruitment policy for new executive Directors not participating in the 2017 Incentive Plan is 300% of base salary. In the event a bonus of above 100% of base salary is awarded, and the executive Director does not meet the minimum shareholding requirement of 200% of base salary, up to 50% of such excess bonus will be subject to deferral into shares for a period of three years.</p> <p>Clarification: see below for the Committee's proposed treatment on cessation of employment.</p>	<p>An 80/20 split between financial and strategic targets.</p> <p>See page 97 for details of the performance conditions, the targets and their level of satisfaction.</p>	<p>No change to bonus maximum of 100% of base salary.</p> <p>An 80/20 split between financial and strategic targets:</p> <ul style="list-style-type: none"> <li>• 80% based on EPS Growth including: <ul style="list-style-type: none"> <li>• threshold of 5% (20% of bonus);</li> <li>• target of 10% (40% bonus); and</li> <li>• maximum of 20% (80% of bonus), and with a linear line</li> </ul> </li> </ul> <p>for achievement between the threshold and the maximum; and</p> <ul style="list-style-type: none"> <li>• 20% based on strategic measures to be determined by the Committee.</li> </ul> <p>It is the view of the Committee that the strategic measures for the bonus are commercially sensitive and therefore their disclosure in advance is not in the interests of the Company or shareholders. The Committee will, however, provide full retrospective disclosure to enable shareholders to judge the level of award against the targets set.</p>
<p><b>Minimum Shareholding Requirement</b></p>	<p>No standard minimum shareholding requirement as a percentage of salary; but a requirement to retain 50% of the shares awarded in 2017 pursuant to the crystallisation of the 2012 Incentive Plan (the "2012 Incentive Plan Obligations"). On crystallisation of the 2017 Incentive Plan, this will be superseded by the obligation for the executive Directors to retain any ordinary shares arising from crystallisation of 2017 Incentive Shares for the two year holding period. In any event, the executive Directors already hold significant shareholdings in the Company (see page 100).</p>	<p>Introduction of a separate minimum shareholding requirement for executive Directors of 200% of salary.</p>	<p>Only the 2012 Incentive Plan Obligations operated in 2018, noting that the executive Directors all met (and exceeded) this requirement.</p>	<p>Alongside the 2012 Incentive Plan Obligations, the executive Directors will be required to retain a shareholding equal to 200% of base salary throughout their directorship.</p> <p>As at 31 December 2018, the executive Directors held shares in the Company as set out on page 100.</p>

# Directors' Remuneration report

Continued

Element	Current Directors' Remuneration Policy	Proposed adjustments to implementation for 2019	Operation in 2018	Operation in 2019
<b>Post-Cessation Minimum Shareholding Requirement</b>	<p>At the time the Directors' Remuneration Policy was approved, there was no requirement in the Code to provide for post-cessation minimum shareholding requirements beyond the obligation to hold any shares in connection with the 2017 Incentive Plan for the two-year holding period.</p> <p>In any event, the executive Directors already hold significant shareholdings in the Company (see page 100).</p>	<p>Introduction of a post cessation minimum shareholding requirement.</p>	<p>Not operated in 2018.</p>	<p>The executive Directors will be required to retain a shareholding equal to 200% of base salary for the first 12 months after cessation of employment, and 100% of base salary for the following 12 months.</p>
<b>2017 Incentive Plan</b>	<p>Options are granted over a separate class of incentive shares and may be exercised at any time up to and including 31 May 2020 (the "trigger date").</p> <p>Following the trigger date, the participants shall be entitled to 7.5% of the index-adjusted increase in value of the Company from and including 31 May 2017 to but excluding the trigger date. At the discretion of the Committee, this value is typically delivered through the conversion of the 2017 Incentive Shares into an appropriate number of ordinary shares, subject to tax requirements.</p> <p>Each executive Director is required to retain all of the ordinary shares they receive in connection with the crystallisation of the 2017 Incentive shares until 31 May 2022, other than any ordinary shares sold in order to make adequate provision for any tax liability arising in connection with the crystallisation.</p> <p>The maximum number of new ordinary shares in the Company that may be issued on conversion of the 2017 Incentive Shares is 5% of the aggregate number of ordinary shares in issue on 31 May 2017 plus 5% of any additional ordinary shares issued or created by the Company after that date and prior to the trigger date.</p>	<p>No changes.</p> <p>The 2017 Incentive Plan was designed with a three-year performance period and two-year additional holding period in anticipation of the changes to the UK Corporate Governance Code.</p> <p>Clarification: see table on page 98 for the Committee's proposed treatment on cessation of employment.</p>	<p>The first tranche of options for the executive Directors issued in respect of 2017 were:</p> <ul style="list-style-type: none"> <li>• Christopher Miller: 2,583</li> <li>• David Roper: 2,583</li> <li>• Simon Peckham: 2,833</li> <li>• Geoffrey Martin: 2,833</li> </ul> <p>On 29 June 2017, these options were exercised by each of the executive Directors and a total of 12,831 2017 Incentive Shares were issued to the executive Directors in accordance with the proportions set out above.</p> <p>The second tranche of options for the executive Directors issued on 7 June 2018 were:</p> <ul style="list-style-type: none"> <li>• Christopher Miller: 2,583</li> <li>• David Roper: 2,583</li> <li>• Simon Peckham: 2,833</li> <li>• Geoffrey Martin: 2,833</li> </ul> <p>The total number of 2017 Incentive Shares and options held by the executive Directors as at 31 December 2018 was as follows:</p> <ul style="list-style-type: none"> <li>• Christopher Miller: 5,166</li> <li>• David Roper: 5,166</li> <li>• Simon Peckham: 5,666</li> <li>• Geoffrey Martin: 5,666</li> </ul>	<p>Same as in 2018.</p> <p>The third tranche of options for the executive Directors to be issued in respect of 2019 are expected to be:</p> <ul style="list-style-type: none"> <li>• Christopher Miller: 2,584</li> <li>• David Roper: 2,584</li> <li>• Simon Peckham: 2,834</li> <li>• Geoffrey Martin: 2,834</li> </ul> <p>The total number of 2017 Incentive Shares and options expected to be held by the executive Directors as at 31 December 2019 is as follows:</p> <ul style="list-style-type: none"> <li>• Christopher Miller: 7,750</li> <li>• David Roper: 7,750</li> <li>• Simon Peckham: 8,500</li> <li>• Geoffrey Martin: 8,500</li> </ul>
<b>Malus and clawback</b>	<p>Applies to both the annual bonus and the 2017 Incentive Plan.</p>	<p>No change.</p>	<p>As described in the Directors' Remuneration Policy.</p> <p>There was no application of the malus and clawback provisions to the executive Directors in 2018.</p>	<p>As described in the Directors' Remuneration Policy.</p>

Element	Current Directors' Remuneration Policy	Proposed adjustments to implementation for 2019	Operation in 2018	Operation in 2019
<b>Cessation of employment and use of discretion (Annual Bonus)</b>	In the event of cessation of employment of an executive Director, the Committee has discretion on an individual basis as to whether or not to award a bonus in full or in part. The decision will be dependent on a number of factors, including the circumstances of the executive Director's departure and their contribution to the business during the bonus period in question. Typically the bonus amounts will be pro-rated for time in service up to termination.	<p>A good leaver is defined at cessation in the following circumstances: death; permanent ill-health; permanent disability; retirement at or over 65 years of age; resignation in connection with a "Change of Control" and at the discretion of the Committee.</p> <p><b>Bonus in year of cessation</b></p> <p><b>Good leaver reason</b> Performance conditions will be measured at the bonus measurement date. Bonus will normally be pro-rated for the period worked during the financial year and will be paid in cash.</p> <p><b>Other reason</b> No bonus will otherwise be payable for year of cessation.</p> <p><b>Bonus from prior years deferred into shares</b></p> <p><b>Good leaver reason</b> Good leavers will be entitled to retain those shares awarded in prior year's deferral of annual bonus.</p> <p><b>Other reason</b> Any shares awarded for a deferral of a prior year's annual bonus and still subject to restrictions will be forfeited.</p> <p><b>Discretion</b> The Committee will have the following elements of discretion with respect to the annual bonus and deferred share awards in the event of cessation of employment:</p> <ul style="list-style-type: none"> <li>• to determine that an executive Director is a good leaver. It is the Committee's intention to only use this discretion in circumstances where there is an appropriate business case which will be explained in full to shareholders;</li> <li>• to determine whether to pro-rate a cash bonus to time. The Committee's normal policy is that it will pro-rate for time. It is the Committee's intention to use discretion to not pro-rate in circumstances where there is an appropriate business case which will be explained in full to shareholders; and</li> <li>• to vest any annual bonus that has been deferred into shares at the end of the original deferral period or at the date of cessation. The Committee will make this determination depending on the type of good leaver reason resulting in the cessation.</li> </ul>	Not operated in 2018.	As per the adjustments described.  Note that the executive Directors all meet the minimum shareholding requirement of 200% of base salary.

# Directors' Remuneration report

Continued

## Wider workforce considerations

### Introduction

The Committee's focus is on setting the level of executive remuneration policy and practices to ensure that the incentives operated by the Company align with its culture and strategy. The Committee has oversight of workforce pay and policies and incentives at both a Melrose level and a business unit level, which enables it to ensure that the approach to executive remuneration is consistent with those workforces. The Committee has the authority to ask for additional information from the Company in order to carry out these responsibilities.

The Committee does not have responsibility for setting and managing the remuneration of Melrose senior management or divisional CEOs. The Chief Executive retains responsibility for setting and managing the remuneration of these groups; however, the terms of such remuneration are fully disclosed to the Committee to enable visibility and comparison against the remuneration of the executive Directors. The Committee has determined that such an approach is appropriate in light of Melrose's business model.

Similarly, the Committee does not directly set and manage pay policies of the business units. The structure and the business model of Melrose requires each of its business units to operate independently and to set its own pay policy guidelines, which are aligned to its culture and strategy and deemed appropriate by the business unit in light of a number of factors, including its performance and the industry in which it operates. The divisional CEOs retain responsibility for setting and managing the remuneration of their senior executive team members, subject to approval by the Chief Executive, with the terms of such remuneration being fully disclosed to the Committee to enable visibility and comparison against the remuneration of the executive Directors. Wider business unit pay is determined by the divisional CEOs and the relevant executive team within the agreed annual budgetary requirements. The Committee may provide guidance on the areas that it would expect the business units to look at in determining that the remuneration provided to their respective employees is consistent with the wider workforce of that business unit and that the incentives operated by it align with its culture and strategy.

As part of the disclosures described above, the Committee receives an annual summary setting out the key details of remuneration changes for Melrose senior management, the wider Melrose workforce, divisional CEOs and their respective executive team members. The Committee is also provided with confirmation from each business unit that the remuneration provided to its executive team is consistent with the wider workforce of that business unit and that the incentives operated by that business unit align with its culture and strategy.

Clearly, the level and type of remuneration offered will vary across employees depending on the employee's level of seniority and nature of his or her role. The Committee is not looking for a homogeneous approach to remuneration; however, when conducting its review, it pays particular attention to: whether the element of remuneration is consistent with the Company's remuneration philosophy; if there are differences, they are objectively justifiable; and whether the approach seems fair and equitable in the context of other Melrose senior management, Melrose employees, divisional CEOs or divisional executive teams, as the case may be.

In summary, based on the disclosures that have been made to it, the Committee is satisfied that the approaches to remuneration at all levels are consistent with the Company's remuneration philosophy.

### Long-term incentives

As mentioned, the Melrose remuneration philosophy is that executive remuneration should be simple and transparent, support the delivery of the value creation strategy and pay only for performance. To this end, the 2017 Incentive Plan is in place for the executive Directors and Melrose senior management, which the Committee feels aligns this group with shareholders as it is based purely on performance and on the increase in value of the Company, and has been paid in shares, not cash.

In addition, divisional long-term incentive plans have been implemented for senior managers of certain business units, to incentivise them to create value for the Company and our shareholders. Depending on the amount of value created, participants in such incentive plans will receive a cash payment on the sale of their respective business. If a sale of the relevant business has not occurred within a certain period, the incentive plan will crystallise and any payment to be made to participants will be based on the increase in value of the business during this period.

### Retirement Provisions

The Company provides retirement benefits to Melrose employees and the business units determine the retirement benefits provided to their respective employees. In the UK, the Group's commitments with regards to pension contributions, consistent with the prior year, range from 8% to 15% of an employee's salary for members of the Melrose pension scheme and from 3% to 20% across our various business unit pension schemes.

In line with Melrose's "Improve" strategy, we have continued to improve funding levels in the pension plans of our business units. As further detailed on pages 10 to 11, Melrose has a stellar record of successfully taking underfunded pension schemes under our stewardship and bringing them to full funding. In particular, as part of our acquisition of GKN, the Board made a number of commitments regarding the existing GKN pension schemes, including an agreement to make cash contributions of up to c.£1 billion to prudently fund the GKN pension schemes, and a target of full funding for the GKN 2012 Pension Scheme using a discount rate of Gilts +75bps. Payments to the GKN pension schemes will also be secured by a Melrose guarantee.

### Pay comparisons – CEO ratio

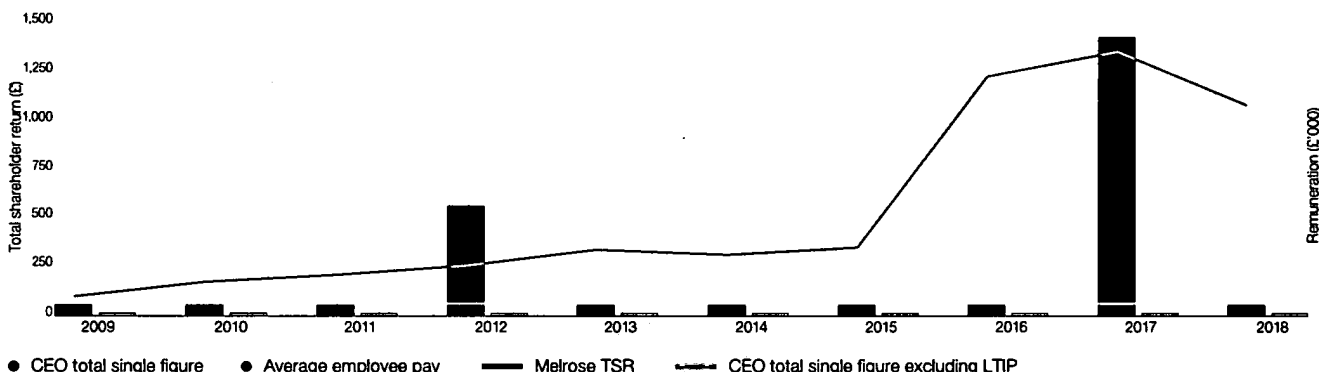
Our CEO to employee pay ratio for 2018 was **20:1**.

To calculate the average employee figure, we divided the total remuneration paid to UK employees (including basic salary and annual bonus) in 2018 by the total number of UK employees as at 31 December 2018. The CEO pay figure used is the 2018 single figure amount (which includes basic salary, annual bonus, pension contributions, and benefits).

The pay ratio across the entire Melrose executive team is consistent with that of the Chief Executive, reflecting the consistent nature of the pay structure across the executive management team at Melrose (noting that the executive Vice-Chairmen do not participate in the annual bonus plan).

2018 CEO to executive Director pay ratio	
Christopher Miller	1.8:1
David Roper	1.8:1
Geoffrey Martin	1.2:1

To give context to this ratio, we have included an illustrative chart tracking CEO pay and average employee pay alongside Melrose's TSR performance over the same period. The Committee has always been committed to ensuring that the Chief Executive's reward is commensurate with performance. The chart shows a clear alignment between shareholder returns and the Chief Executive's single figure pay.



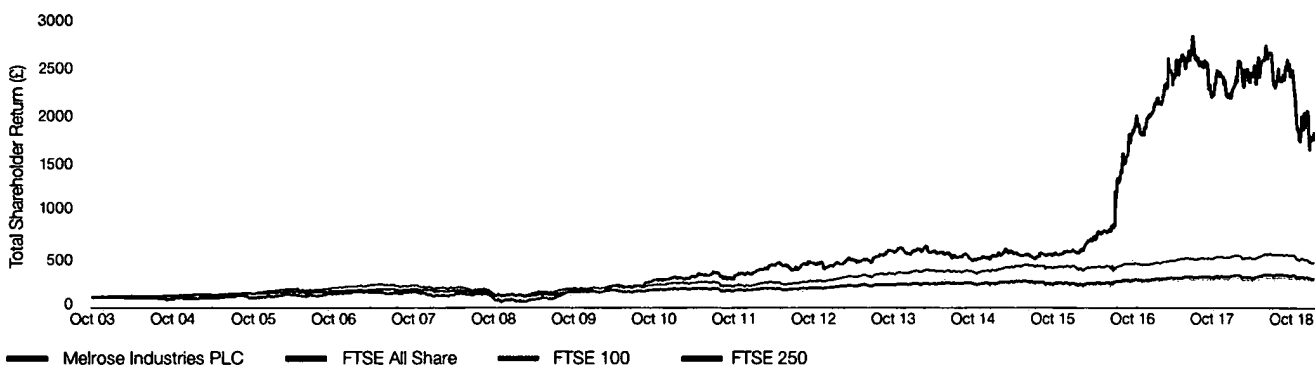
Shareholders expect the Chief Executive to have a significant proportion of his pay based on performance and paid in shares. It is this element of his package which provides the volatility in his remuneration when comparing on a year-to-year basis. The Committee is comfortable through the analysis set out above that the underlying picture is not one of a greater divergence of the Chief Executive's remuneration from employees, i.e. excluding the volatility of the LTIP, the relationship is consistent.

There is likely to be significant volatility in this ratio year-on-year, and we believe that this is likely to be caused by the following factors:

- Our Chief Executive's pay is made up of a higher proportion of incentive pay than that of our employees, in line with the expectations of our shareholders. This introduces a higher degree of variability in his pay each year, which will affect the ratio.
- The value of long-term incentives which measure performance over three years is disclosed in pay in the year it vests, which increases the Chief Executive's pay in that year, again impacting the ratio for that year.
- Long-term incentives are typically provided in shares, and therefore an increase in share price over the three years magnifies the impact of a long-term incentive award vesting in a year.
- We recognise that the ratio is driven by the different structure of the pay of our Chief Executive versus that of our employees, as well as the make-up of our workforce. This ratio varies between businesses even in the same sector. What is important from our perspective is that this ratio is influenced only by the differences in structure, and not by divergence in fixed pay between the Chief Executive and the wider workforce.
- Where the structure of remuneration is similar, as for the executive Directors and the Chief Executive, the ratio will be much more stable over time.

**Total Shareholder Return**

The total shareholder return graph below shows the value as at 31 December 2018 of £100 invested in the Company in October 2003, compared with £100 invested in the FTSE 100 Index, the FTSE 250 Index and the FTSE All-Share Index. The Committee considers the FTSE 100 Index, the FTSE 250 Index and the FTSE All-Share Index to be appropriate indices for the year ended 31 December 2018 for the purposes of this comparison because of the comparable size of the companies which comprise the FTSE 100 Index and the FTSE 250 Index and the broad nature of companies which comprise the FTSE All-Share Index. The data shown below assumes that all cash returns to shareholders made by the Company during this period are reinvested in ordinary shares.



# Directors' Remuneration report

Continued

## Chief Executive remuneration for previous nine years

In accordance with the regulations governing the reporting of Director remuneration, which came into effect in October 2013, the total figure of remuneration set out in the table below includes the value of long-term incentive vesting in respect of the financial year. This means that the full value of the crystallisation of the 2009 Incentive Plan on 11 April 2012 is shown for the year ended 31 December 2012 and that the full value of the 2012 Incentive Plan which crystallised in May 2017 is shown for 2017.

The value of each Incentive Plan was earned over a period of approximately five years. Therefore, in the view of the Committee, inclusion of these values in respect of the years ended 31 December 2012 and 31 December 2017 does not give a fair representation of the Chief Executive's yearly remuneration over each of the previous five years. Therefore, a separate column has been added showing the total remuneration with the incentives averaged over the five-year periods during which they were earned (the value used is based on their value on maturity). No other long-term incentive plan vested in favour of any executive Director in any of the other years.

The amount of that value shown in respect of David Roper and Simon Peckham for the year ended 31 December 2012 reflects the proportion of that year for which each was the Chief Executive.

Financial year	Chief Executive	Non-LTIP	LTIP	Total remuneration £	Total remuneration with average long-term incentive value <sup>(1)</sup> £	Annual bonus as a percentage of maximum opportunity	Long-term incentives as a percentage of maximum opportunity
Year ended 31 December 2018	Simon Peckham	1,049,000	0	1,049,000	– <sup>(2)</sup>	95%	–
Year ended 31 December 2017	Simon Peckham	994,000	41,770,000	42,764,000 <sup>(3)</sup>	9,348,056	90%	n/a <sup>(4)</sup>
Year ended 31 December 2016	Simon Peckham	987,725	0	987,725	9,341,781	95%	–
Year ended 31 December 2015	Simon Peckham	928,541	0	928,541	9,282,597	88%	–
Year ended 31 December 2014	Simon Peckham	773,167	0	773,167	9,127,223	58%	–
Year ended 31 December 2013	Simon Peckham	927,276	0	927,276	9,281,332	100%	–
Year ended 31 December 2012 <sup>(5)</sup>	Simon Peckham	489,372	19,791,212	20,280,584 <sup>(6)</sup>	4,447,614	64%	n/a <sup>(7)</sup>
Year ended 31 December 2011	David Roper	259,040	10,656,806	10,915,846 <sup>(6)</sup>	2,390,401	64%	n/a <sup>(7)</sup>
Year ended 31 December 2011	David Roper	811,152	0	811,152	2,942,513	84%	–
Year ended 31 December 2010	David Roper	849,341	0	849,341	2,980,702	100%	–

(1) To provide a more meaningful comparison of total remuneration year-on-year, we have added an amount equal to one-fifth of the value derived by the CEOs in 2017 and 2012 from the 2012 Incentive Shares and the 2009 Incentive Shares respectively, to the Non-LTIP remuneration, as set out in the column titled "Non-LTIP".

(2) The value of the 2017 Incentive Shares will only be known upon the crystallisation date, which is 31 May 2020.

(3) The value derived in 2017 from the 2012 Incentive Shares represents the Chief Executive's share, determined in accordance with the terms of those shares, of the shareholder value created over a period of approximately five years. This amount was paid in shares, not cash.

(4) On the crystallisation in May 2017 of the 2012 Incentive Plan, participants as a whole were entitled to 7.5% of the increase in shareholder value from 22 March 2012 to 31 May 2017. Because the value derived on the crystallisation of the Incentive Shares (2012) depended upon the shareholder value created over the relevant period, it is not possible to express the value derived as a percentage of the maximum opportunity.

(5) In the year ending 31 December 2012, David Roper was Chief Executive for the period from 1 January 2012 until 9 May 2012 and Simon Peckham was Chief Executive for the period from 9 May 2012 onwards. In the table above:

(i) the "Total remuneration" figure shows, in respect of David Roper, his total remuneration in respect of his service in the period 1 January 2012 to 9 May 2012 and in respect of Simon Peckham his total remuneration in respect of his service in the period from 9 May 2012 to 31 December 2012. Included in this figure for each of David Roper and Simon Peckham is the value of the long-term incentives vesting in the year, pro-rated to reflect the portion of the year for which he was Chief Executive; and

(ii) the "Total remuneration including average long-term incentive value" shows in respect of each of David Roper and Simon Peckham total remuneration in respect of the period for which he was Chief Executive excluding any value received on the maturity in April 2012 of the 2009 Incentive Plan.

(6) The value derived in 2012 from the 2009 Incentive Shares represents the Chief Executive's share, determined in accordance with the terms of those shares, of the shareholder value created over a period of approximately five years.

(7) On the crystallisation in April 2012 of the 2009 Incentive Plan awarded in 2009, participants as a whole were entitled to 10% of the increase in shareholder value from 18 July 2007 to 23 March 2012. Because the value derived on the crystallisation of the 2009 incentive shares depended upon the shareholder value created over the relevant period, it is not possible to express the value derived as a percentage of the maximum opportunity. The crystallisation of the 2009 Incentive Shares was satisfied by the conversion of those shares into ordinary shares.

### Percentage change in Chief Executive's remuneration

The table sets out, in relation to basic salary, taxable benefits and annual bonus, the percentage increase in pay for the Chief Executive compared to the average increase for a group consisting of the Company's senior head office employees, the divisional CEOs, managing directors and finance directors of the Group's business units and the direct senior reports of those individuals. The percentages shown opposite relate to the financial year ended 2018 as a percentage comparison to the financial year ended 2017. This group of senior management was considered an appropriate comparator group because of their level of seniority and the structure of their remuneration packages. The spread of the Company's operations across various countries and industries means that remuneration policies vary to take account of geography and industry such that the Committee considers that selecting a wider group of employees would not provide a meaningful comparison.

Element of remuneration	Chief Executive percentage change	Senior employees percentage change <sup>(1)</sup>
Basic salary	3%	5%
Benefits	-5%	-5%
Annual bonus	9%	4%

(1) In light of the Company's business model of "Buy, Improve, Sell", this group of senior management inevitably varies from year to year, and can vary significantly in acquisition and disposal years.

### Relative Importance of Spend on Pay

The following table sets out the percentage change in dividends and the overall expenditure on pay (as a whole across the Group).

Expenditure	Year ended	Year ended	Percentage change
	31 December 2017	31 December 2018	
Remuneration paid to all employees	£503 <sup>(1)</sup>	£2,192 <sup>(2)</sup>	336%
Distributions to shareholders by way of dividend and share buy back	63	129	105%

- (1) The figure for the year ended 31 December 2017 is the total staff costs as stated in note 7 to the financial statements and the figure for the year ended 31 December 2018 is the total staff costs as stated in note 7 to the financial statements.
- (2) The 2018 total staff costs include eight months of GKN staff costs as compared to the 2017 costs, which do not reflect any GKN staff costs. In light of this, and of the Company's business model of "Buy, Improve, Sell", your Board does not consider that the table is meaningful in the context of the Group's remuneration structure, which provides a strong alignment with shareholder interests.

### Non-executive Directors

#### Single figure table (audited)

The following table sets out the single figure of remuneration for 2018 in comparison with 2017 for the Company's Non-executive Directors:

Period	Total salary and fees £000	Taxable benefits £000	Bonus £000	LTIP £000	Pension £000	Total £000	
<b>Non-executive Directors</b>							
Justin Dowley	2018	85	n/a	n/a	n/a	n/a	<b>85</b>
	2017	81	n/a	n/a	n/a	n/a	<b>81</b>
Liz Hewitt	2018	80	n/a	n/a	n/a	n/a	<b>80</b>
	2017	75	n/a	n/a	n/a	n/a	<b>75</b>
David Lis	2018	72	n/a	n/a	n/a	n/a	<b>72</b>
	2017	69	n/a	n/a	n/a	n/a	<b>69</b>
Archie G. Kane	2018	69	n/a	n/a	n/a	n/a	<b>69</b>
	2017	33 <sup>(1)</sup>	n/a	n/a	n/a	n/a	<b>33</b>
Charlotte Twyning <sup>(2)</sup>	2018	17	n/a	n/a	n/a	n/a	<b>17</b>
	2017	-	-	-	-	-	<b>-</b>
<b>Total</b>	<b>2018</b>	<b>323</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>323</b>
	<b>2017</b>	<b>258</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>258</b>

(1) Archie G. Kane was appointed as a Non-executive Director of the Company with effect from 5 July 2017 and the fees referred to above for 2017 reflect his fees for the period 5 July 2017 to 31 December 2017.

(2) Charlotte Twyning was appointed as a Non-executive Director of the Company with effect from 1 October 2018 and the fees referred to above reflect her fees for the period 1 October 2018 to 31 December 2018.

### Non-executive Directors' fees (audited)

Basic fees for Non-executive Directors have been increased by 8% with effect from 1 January 2019. The Non-executive Director fee levels for 2018 and 2019 are set out in the table below. The reason for the increase in the base fee compared with last year's base fee increase is due to both (i) the benchmarking exercise undertaken with respect to Non-executive Director fees, which took into account the increase in the size and scope of the roles following the acquisition of GKN; and (ii) there being no additional base committee membership fee, whilst all Non-executive Directors serve on all of the Board's committees (other than Justin Dowley, who does not sit on the Audit Committee as a result of his role as Chairman of the Board), which has been determined to be appropriate.

Fee element	Previous fee with effect from 1 January 2018	Fee with effect from 1 January 2019
Non-executive Chairman fee	-	£350,000
Basic Non-executive Director fee	£69,715	£75,000
Additional fee for holding the Chairmanship of the Remuneration Committee	£10,000	£20,000
Additional fee for holding the Chairmanship of the Audit Committee	£10,000	£20,000
Additional fee for holding the Chairmanship of the Nomination Committee	£2,500	£10,000
Additional fee for holding the position of Senior Independent Director	£5,000	£15,000

In line with the move to appointing an inaugural Non-executive Chairman of the Board, the Chairman's fee has been set by the Board under advice and following a benchmarking exercise against the Company's peers. There was no Chairman fee for the 2018 financial year as in previous years this role was undertaken by one of the executive Directors, who was not paid a separate fee.

# Directors' Remuneration report

Continued

## Share interests (audited)

The table below sets out the subsisting interests in the equity of the Company held by the Non-executive Directors as at 31 December 2018:

Director	Ordinary shares held at 31 December 2017	Ordinary shares held at 31 December 2018
Justin Dowley	1,065,661	1,387,509
Liz Hewitt	120,877	188,377
David Lis	433,947	458,947
Archie G. Kane <sup>(1)</sup>	–	50,000
Charlotte Twynning <sup>(2)</sup>	–	36,000

- (1) Archie G. Kane was appointed as a Non-executive Director of the Company with effect from 5 July 2017.  
 (2) Charlotte Twynning was appointed as a Non-executive Director of the Company with effect from 1 October 2018.

## Service contracts and letters of appointments

Consistent with the best practice guidance provided by the UK Corporate Governance Code, the Company's policy is for executive Directors to be employed on the terms of service agreements, which may be terminated by either the executive Director or the Company on the giving of not less than 12 months' written notice (subject to certain exceptions).

Executive Directors' service contracts do not provide for pre-determined compensation in the event of termination. Any payments made would be subject to normal contractual principles, including mitigation as appropriate. The length of service for any one executive Director is not defined and is subject to the requirement for annual re-election under both the UK Corporate Governance Code and the Company's Articles of Association.

The Non-executive Directors do not have service contracts but have letters of appointment for an initial term of three years, which may be renewed by mutual agreement. Generally, a Non-executive Director may be appointed for one or two periods of three years after the initial three-year period has expired, subject to re-election by shareholders at each AGM. The terms of appointment do not contain any contractual provisions regarding a notice period or the right to receive compensation in the event of early termination.

The Company follows the UK Corporate Governance Code's recommendation that all directors of FTSE 350 companies be subject to annual re-appointment by shareholders.

Directors	Date of original appointment as a Director of Melrose
<b>Chairman</b>	
Justin Dowley <sup>(1)</sup>	1 September 2011
<b>Executive Directors<sup>(2)</sup></b>	
Christopher Miller	29 May 2003
David Roper	29 May 2003
Simon Peckham	29 May 2003
Geoff Martin	7 July 2005
<b>Non-executive Directors</b>	
Liz Hewitt <sup>(1)</sup>	8 October 2013
David Lis	12 March 2016
Archie G. Kane	5 July 2017
Charlotte Twynning	1 October 2018

- (1) Original letter of appointment novated to Melrose Industries PLC (f/k/a New Melrose Industries PLC).  
 (2) Service agreements novated from Melrose PLC to Melrose Holdings Limited (f/k/a Melrose Industries PLC) on 27 November 2012, and from Melrose Holdings Limited to Melrose Industries PLC (f/k/a New Melrose Industries PLC) on 19 November 2015.

Each executive Director's service contract and each Non-executive Director's letter of appointment are available for inspection at the Company's registered office during normal business hours.

This report was approved by the Board and signed on its behalf by:



David Lis  
 Chairman, Remuneration Committee  
 7 March 2019

# Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland". Under company law, the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing the parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

In preparing the Group financial statements, International Accounting Standard 1 requires that Directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## Directors' responsibility statement

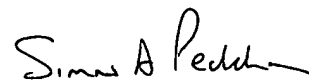
We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole;
- the Strategic Report includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face; and
- the Annual Report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company's performance, business model and strategy.

This responsibility statement was approved by the Board of Directors on 7 March 2019 and is signed on its behalf by:



**Geoffrey Martin**  
Group Finance Director  
7 March 2019



**Simon Peckham**  
Chief Executive  
7 March 2019

# Independent auditor's report to the members of Melrose Industries PLC

## Report on the audit of the financial statements

### Opinion

In our opinion:

- the financial statements of Melrose Industries PLC (the 'parent company') and its subsidiaries (the 'Group') give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2018 and of the Group's loss for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements which comprise:

- the Consolidated Income Statement;
- the Consolidated Statement of Comprehensive Income;
- the Consolidated Statement of Cash Flows;
- the Consolidated and Company Balance Sheets;
- the Consolidated and Company Statements of Changes in Equity; and
- the related notes 1 to 30 to the consolidated financial statements and the related notes 1 to 8 to the Company Balance Sheet.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and IFRSs as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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**Summary of our audit approach**
**Significant changes in our approach**

Melrose Industries plc completed the acquisition of GKN plc on 19 April 2018. As a result of the acquisition there was a significant change in the structure of the Group.

Considering the effects of the acquisition on the 2018 income statement, we changed the basis for materiality from a % of adjusted profit to a blended measure reflecting a number of relevant metrics using our professional judgement.

We have revised our audit scoping in the context of the enlarged Group. This includes the addition of 102 reporting units where either the Group audit team performed procedures or we requested component auditors to perform procedures under the Group audit team's supervision.

In addition, we have considered the significant risks to the enlarged Group. We identified a number of additional risks relating to the underlying business operations as well as risks in relation to accounting for the acquisition of the GKN group.

New key audit matters in the current year reflect changes in our risk assessment and include:



- Acquisition accounting – recognition and measurement of intangible assets, provisions and contingent liabilities acquired as part of GKN.
- Revenue recognition – this risk arises principally in the Engine Systems businesses, acquired as part of GKN Aerospace, and focuses on the valuation of revenue recognised given the increased level of estimation and judgement following the adoption of IFRS 15.
- Valuation of inventory – specifically in relation to sites where there are high levels of rework stock.

There were no key audit matters included in the prior year audit report that have not been included below.

**Key audit matters**

The key audit matters that we identified in the current year were:

- Acquisition accounting – intangible asset valuation
- Acquisition accounting – onerous contract, warranty and contingent liability provisions
- Impairment of goodwill and acquired intangibles
- Classification of adjusting items
- Revenue recognition
- Valuation of inventory

Within this report, any new key audit matters are identified with  and any key audit matters which are the same as the prior year are identified with .

**Materiality**

The materiality that we used for the group financial statements was £29 million. We considered a number of benchmarks including operating profit, adjusted profit before tax and net assets, derived a materiality from each benchmark and then selected materiality from within the range which in our professional judgement is appropriate to the enlarged group financial statements.

**Scoping**

We selected 40 reporting units representing 58% of the Group's revenue (including the group's share of joint venture revenue) where we requested component auditors to perform a full scope audit of the components' financial information.

We also requested component auditors to perform specified audit procedures on certain account balances and transactions at a further 32 reporting units. These units represented 17% of the Group's revenue.

The remaining reporting units were subject to desktop review procedures performed by the Group audit team.

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# Independent auditor's report to the members of Melrose Industries PLC

Continued

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## Conclusions relating to going concern, principal risks and viability statement

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### Going concern

We have reviewed the directors' statement in note 2 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

**We confirm that we have nothing material to report, add or draw attention to in respect of these matters.**

We considered as part of our risk assessment the nature of the Group, its business model and related risks including where relevant the impact of Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the directors' assessment of the group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the directors' plans for future actions in relation to their going concern assessment.

We are required to state whether we have anything material to add or draw attention to in relation to that statement required by Listing Rule 9.8.6R(3) and report if the statement is materially inconsistent with our knowledge obtained in the audit.

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### Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the Group's and the Company's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

**We confirm that we have nothing material to report, add or draw attention to in respect of these matters.**

- the disclosures on pages 52 to 58 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 51 that they have carried out a robust assessment of the principal risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on page 49 as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We are also required to report whether the directors' statement relating to the prospects of the Group required by Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.

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### Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key audit matter description	How the scope of our audit responded to the key audit matter	Key observations
<p><b>Intangible assets recognised on the balance sheet upon acquisition of GKN plc</b></p>		
<p>The Group completed the acquisition of GKN plc on 19 April 2018. The Group applied IFRS 3 <i>Business Combinations</i> ("IFRS 3") to identify and value the identifiable net assets of the acquisition business at this time, using the assistance of an external valuations expert.</p> <p>The valuation of certain intangible assets of £5.7 billion arising on the acquisition of GKN plc is considered to be a key audit matter. The assets driven by particularly sensitive assumptions are:</p> <ul style="list-style-type: none"> <li>• technology and customer programmes in the Aero and Auto segments; and</li> <li>• customer relationships in the Auto and Powder Metallurgy segments.</li> </ul> <p>The valuations are based on a number of assumptions that require significant judgement including:</p> <ul style="list-style-type: none"> <li>• forecast revenue and EBIT projections for the relevant acquired businesses;</li> <li>• royalty rates and discount rates applied; and</li> <li>• estimates of useful economic lives.</li> </ul> <p>Refer to pages 82 to 89 (Report of the Audit Committee) and note 12: Acquisitions.</p>	<p>We assessed management's processes and controls covering the measurement of intangible assets, in particular the key controls over the forecasts that underpin customer relationship and technology valuations.</p> <p>We assessed the competence, capability and objectivity of management's expert.</p> <p>We engaged valuation specialists to evaluate the methodology and key assumptions used by management's expert and to test the mathematical accuracy of the valuation models.</p> <p>We have challenged the key assumptions used within the valuations including:</p> <ul style="list-style-type: none"> <li>• assessment of discount, long-term growth and royalty rates against external market sources;</li> <li>• challenging revenue and earnings projections forecast by management through agreement to the approved mid-term plan, challenge of volumes against external industry consensus and customer order books, and challenge of margin trends over the forecast period compared with historical performance;</li> <li>• assessment of the methodology used to establish useful economic lives of assets with the assistance of our valuations expert;</li> <li>• agreeing data including customer attrition and contract length, which feed into the determination of useful economic lives, back to supporting documentation;</li> <li>• searching for and assessing contradictory evidence through review of programme minutes, analyst reports and industry publications; and</li> <li>• performing overall cross checks based on earnings multiples and the weighted average return on assets.</li> </ul> <p>We have tested that the intangible assets recognised were consistent with our knowledge of the business.</p>	<p>We found that the judgements formed by management were within an acceptable range, the overall position adopted was reasonable and disclosures made in the financial statements were appropriate.</p>
<p><b>Onerous contract, warranty and contingent liability provisions recognised on the balance sheet upon acquisition of GKN plc</b></p>		
<p>The Group has recognised onerous contract provisions of £629 million and provisions in respect of contractual, regulatory or legal issues of £264 million at estimated fair value upon acquisition of GKN plc in line with IFRS 3.</p> <p>In respect of onerous contract provisions there is judgement required in determining a best estimate of the unavoidable costs of fulfilling the company's obligations on such contracts.</p> <p>In respect of other provisions recognised, there is judgement required in determining the significance of any instances of:</p> <ul style="list-style-type: none"> <li>• potential non-compliance with contractual terms;</li> <li>• regulatory or legal issues; or</li> <li>• future warranty costs.</li> </ul> <p>These have been provided based on management's best estimate of the expenditure to settle the obligation.</p> <p>Because of the quantitative significance, complexity and level of judgement in both provisions, we consider the valuation of these provisions to be a key audit matter.</p> <p>Refer to pages 82 to 89 (Report of the Audit Committee), note 3: Critical accounting judgements and key sources of estimation uncertainty and note 20: Provisions.</p>	<p>We assessed management's processes and controls over legal and regulatory claims and issues and onerous contracts and assessed the design and implementation of relevant controls.</p> <p>We challenged the assumptions underlying the valuation of onerous contract and warranty provisions through:</p> <ul style="list-style-type: none"> <li>• verifying volume, price and cost inputs used to calculate the provision;</li> <li>• reviewing contracts upon which the provisions were based;</li> <li>• reviewing internal audit reports and customer correspondence;</li> <li>• visiting relevant sites and discussing the contracts with programme managers;</li> <li>• benchmarking projected volumes against market volume data;</li> <li>• assessing contract-related overhead allocations for each business;</li> <li>• testing the data and assumptions used in calculating the utilisation of the provisions in the post-acquisition period;</li> <li>• challenging the forecast margin by assessing against current performance and historical evidence on similar contracts; and</li> <li>• assessing contradictory evidence.</li> </ul> <p>In respect of contractual/legal/regulatory provisions we made direct enquiries of the Group's internal and external lawyers and commercial and operational management and reviewed relevant third party correspondence and customer files.</p> <p>In respect of warranty provisions, we challenged management's estimates of the most likely outcomes by critically evaluating the range of possible outcomes based on historical experience to determine if the amounts provided are appropriate.</p> <p>We assessed the adequacy of the Group's financial statement disclosures and adherence to accounting standards.</p>	<p>We found that the judgements formed by management were within an acceptable range, the overall position adopted was reasonable and disclosures made in the financial statements were appropriate.</p>

# Independent auditor's report to the members of Melrose Industries PLC Continued

Key audit matter description	How the scope of our audit responded to the key audit matter	Key observations
<p>⊗ <b>Impairment of goodwill and acquired intangibles</b></p>		
<p>Total goodwill on the balance sheet at 31 December 2018 is £4,052 million, and total acquired intangible assets is £7,019 million. As required by IAS 36 <i>Impairment of assets</i> management performs an impairment review for all goodwill balances on an annual basis and for other assets whenever an indication of impairment is identified. This review identified three groups of CGUs where headroom was limited:</p> <ul style="list-style-type: none"> <li>• Energy (goodwill £nil following a recorded impairment of £123 million, other intangible assets £55 million)</li> <li>• Security and Smart Technologies (goodwill £357 million, other intangible assets £141 million)</li> <li>• Ergotron (goodwill £435 million, other intangible assets £171 million)</li> </ul> <p>The impairment in the Energy CGU was recorded following deterioration in its end markets in the second half of the year.</p> <p>This has been identified as a key audit matter as a result of the quantitative significance of the balances, and the application of management judgement and estimation in performing impairment reviews for these groups of CGUs in particular. Specifically, support for the carrying value of assets relies on assumptions and judgements made by management in respect of the forecasting of future cash flows and growth rates used in the model.</p> <p>The key judgements and estimates and impairment accounting policy are described in more detail in the audit committee report and in notes 3 and 11 to the consolidated financial statements.</p>	<p>We assessed the design and implementation of relevant controls around management's preparation of the impairment models.</p> <p>We assessed management's impairment paper, underlying analysis, supporting financial model and challenged the reasonableness of the assumptions which underpin management's forecasts. Specifically, our work included, but was not limited to:</p> <ul style="list-style-type: none"> <li>• challenging management's key assumptions relating to the 2019 forecast and later forecast periods with reference to the recent and historical performance of all three businesses, our knowledge of the businesses, in particular the restructuring activity in the year and the status of end markets, as well as the current order book and external market data;</li> <li>• challenging of management's assumptions around the effects of US/China trade tariffs on the Security and Smart Technology and Ergotron businesses by comparing to the impact on performance in 2018, and performing independent research as to the probability of future tariffs being implemented;</li> <li>• considering the extent to which the possible effects of Brexit should be included in the impairment models;</li> <li>• specifically for Energy, challenging the timing of the recorded impairment by performing independent research of the generator market;</li> <li>• benchmarking long-term growth rates to applicable macro-economic and market data;</li> <li>• engaging our internal valuation specialists to challenge the discount rate applied, by obtaining the underlying data used in the calculation and benchmarking it against market data and comparable organisations, and by evaluating the underlying process used to determine the risk adjusted cash flow projections; and</li> <li>• validating the integrity of the impairment models through testing of the mathematical accuracy, verifying the application of the input assumptions and testing its compliance with IAS 36.</li> </ul> <p>We performed sensitivity analysis and have challenged management on the key assumptions such as forecasted revenues, operating margins, discount rate and long-term growth rate which would either individually or collectively impact the impairment charge whilst also considering the likelihood of such movements.</p> <p>We reviewed the disclosures in note 11 in relation to the sensitivities reflecting the risks inherent in the valuation of goodwill and other non-current assets and also in note 3 in relation to the key sources of estimation uncertainty for these businesses.</p>	<p>We determined that the assumptions applied in the impairment model were within an acceptable range, that the overall position adopted was reasonable and the disclosures are appropriate.</p>

Key audit matter description	How the scope of our audit responded to the key audit matter	Key observations
<p><b>Classification of adjusting items</b></p>		
<p>While there is no definition of adjusting items within IFRS, this is an area of focus for regulators including ESMA and the FRC. The Group continues to classify certain costs or income in accordance with its accounting policy on adjusting items. Given the acquisition and restructure of the GKN businesses, there are a significant level of adjusting items reported across the Group, including:</p> <ul style="list-style-type: none"> <li>• restructuring costs of £240 million</li> <li>• acquisition costs of £153 million</li> <li>• amortisation of £401 million</li> <li>• impairment totalling £152 million</li> <li>• reversal of the IFRS 3 inventory uplift for GKN £121 million</li> <li>• movement in derivatives £143 million</li> </ul> <p>Explanations of each adjustment are set out in note 6 to the financial statements. Refer also to pages 82 to 89 (Report of the Audit Committee).</p> <p>In total, adjustments totalling £1.3 billion have been made to the statutory loss before tax of £550 million to derive adjusted profit before tax of £703 million.</p> <p>As such, a key audit matter has been identified in respect of the classification of items recorded as adjusting. While the key measure used by management to monitor performance is adjusted operating profit, adjusted profit before tax is also a key measure used by management in communication with shareholders. There is a risk that items may be classified as adjusting which are underlying or recurring items and therefore distort the reported adjusted profit, whether due to manipulation or error. Consistency in the identification and presentation of these items is important for the comparability of year on year reporting.</p>	<p>We assessed the design and implementation of management's controls around the classification of adjusting items in the financial statements.</p> <p>We evaluated the appropriateness of the inclusion of items, both individually and in aggregate, within adjusted results. We assessed the consistency of items included year on year and the application of management's accounting policy, challenging the nature of these items against IFRS requirements, ESMA guidance and latest FRC guidance. In particular we challenged the inclusion of those items that recur annually.</p> <p>A sample of adjusting items, including all material items, were agreed to source documentation and evaluated by the component and Group audit teams as to their nature in order to assess whether they are disclosed in accordance with the Group's accounting policy, and also to assess consistency of adjusting items between periods in the financial statements.</p> <p>We agreed the amounts recorded through to underlying financial records and other audit support to test that the amounts disclosed were complete and accurate.</p> <p>Where new items were included as a result of the GKN acquisition (in particular the movement on un-hedged derivatives) we challenged whether these were consistent with the Melrose definition of adjusting items.</p> <p>We also assessed whether the disclosures within the financial statements provide sufficient detail for the reader to understand the nature of these items and how adjusted results are reconciled to statutory results.</p>	<p>We consider the disclosure of adjusting items to be in line with the Group's accounting policies and that the presentation of adjusting items is consistent between the periods presented where applicable.</p>

# Independent auditor's report to the members of Melrose Industries PLC Continued

Key audit matter description	How the scope of our audit responded to the key audit matter	Key observations
<p><b>⊗ Revenue recognition</b></p>		
<p>The group has recognised total revenue of £8,605 million in 2018.</p> <p>There are judgements taken within the revenue recognition of material Risk and Revenue Sharing Partnerships ("RRSPs") in the Aerospace division (where revenue totals £2,479 million). The risk specifically arises in the Engine Systems businesses and focuses on the timing at which performance obligations are met as well as the valuation of revenue recognised given the increased level of estimation and judgement following the adoption of IFRS 15 <i>Revenue from contracts with customers</i>. This includes the revenue recognised from those contracts identified by management where the pricing for the same parts varies across the contract. There is judgement in how the overall price is allocated across the units supplied where there is a contractual right to aftermarket revenues.</p> <p>Refer to pages 82 to 89 (Report of the Audit Committee), note 3: Critical accounting judgements and key sources of estimation uncertainty and note 4: Revenue.</p>	<p>We assessed the design and implementation of controls around the recognition of revenue for RRSP contracts.</p> <p>For each material RRSP contract with variable consideration, we recalculated the amount of revenue recognised to check that it has been calculated in accordance with IFRS 15, the contractual agreement and the latest correspondence with the customer. In particular, we have:</p> <ul style="list-style-type: none"> <li>• agreed the percentage of revenue entitlement to the customer contract;</li> <li>• reviewed correspondence with the customer in the period, in particular entitlement reports;</li> <li>• challenged estimations made by management at the year end by taking account of historical settlements and reviewing previous estimation accuracy;</li> <li>• challenged the assumptions used in arriving at the element of variable consideration recognised; and</li> <li>• performed an assessment of the timing at which control is transferred and revenue is recognised by identifying the performance obligations from the contract and verifying the recognition triggers.</li> </ul>	<p>We are satisfied that the key assumptions made in determining the fair value of revenue recognised on RRSP contracts with variable consideration were within an acceptable range and the overall position was reasonable.</p>
<p><b>⊗ Valuation of inventory</b></p>		
<p>The group has recorded inventory amounts (net of provisions) of £1,489 million.</p> <p>We have identified a key audit matter in respect of inventory valuation in those former GKN businesses (Aero and Auto divisions) where there is a history of inventory write-downs and rework stock, and judgement is required in determining provisions for obsolete items and the appropriate point at which to recognise permanent write downs. Net inventory for these sites totals £108 million.</p> <p>Refer to pages 82 to 89 (Report of the Audit Committee), note 3: Critical accounting judgements and key sources of estimation uncertainty and note 15: Inventory.</p>	<p>As part of our risk assessment we identified inventory balances that appeared to be outliers using a range of metrics including stock turn and inventory provisioning percentage.</p> <p>We have evaluated the valuation of inventory by:</p> <ul style="list-style-type: none"> <li>• assessing the design and implementation of inventory provisioning controls both at the local plant level and at the divisional and group level;</li> <li>• evaluating the appropriateness of the inventory provisioning policy with reference to stock count results and recalculating its application to the year-end inventory balance;</li> <li>• performing test counts with attendance from the audit management team, with a focus on consideration of obsolescence and defective inventory, including a sample of WIP items;</li> <li>• performing detailed sample tests of inventory identified at the stock count, making direct enquires of engineers and programme managers where applicable to understand the nature of the stock and its realisable value;</li> <li>• performing testing of net realisable value of finished goods and subsequent sales; and</li> <li>• performing an analytical review of levels of scrap year on year, relative to programme, nature of inventory and any other site specifics.</li> </ul>	<p>We consider the valuation of inventory at the sites referred to above to be within an acceptable range, the overall position was reasonable and the disclosures are appropriate.</p>

### Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
<b>Materiality</b>	£29 million (2017: £12.5 million)	£14.5 million (2017: £6.25 million)
<b>Basis for determining materiality</b>	<p>We considered a number of benchmarks including operating profit, net assets and adjusted profit before tax, and the materiality figures derived from those, then selected a materiality within that range that we considered to be appropriate.</p> <p>In 2017, materiality was determined on the basis of 5% of underlying profit before tax.</p>	<p>We calculated materiality based on net assets, which was then capped at 50% of Group materiality.</p>
<b>Rationale for the benchmark applied</b>	<p>In our professional judgement we believe that use of this blended measure is appropriate because we consider that the current year loss does not represent a long term decline in the size and scale of the business and therefore solely using a profit measure would not appropriately reflect the characteristics of the underlying business operations in particular given that GKN was owned for only part of the year.</p> <p>The selected materiality represents 4% of adjusted profit before tax (2017: 5% of underlying profit before tax) and 0.3% of net assets (2017: 0.7%)</p>	<p>In our professional judgement we believe that use of a balance sheet measure is appropriate for a holding company. Materiality has been capped at 50% of Group materiality. This is with reference to the net asset position of the parent company when compared to the net asset position of the Group.</p>

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Group performance materiality was set at 60% of group materiality (2017: 60%). In determining performance materiality we considered factors including:

- our risk assessment, including the proportion of significant audit risks versus normal audit risks in the audit;
- the historical control environment in the newly acquired GKN businesses; and
- our assessment of the complexity of the Group and the level of change during the year.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £1 million (2017: £500,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

### An overview of the scope of our audit

Melrose completed the acquisition of GKN plc on 19 April 2018. As a result of the acquisition there was a significant change in the structure of the Group from last year which had a significant impact on the scope of our audit.

Following the acquisition of the GKN group, the group reorganised to recognise five separate operating segments which reflected the industries the group operates in. The five segments are:

- Aerospace
- Automotive
- Powder Metallurgy
- Nortek Air & Security
- Other Industrial

Each division consists of a number of reporting units, and manages operations on a geographical and functional basis.

There are 338 reporting units in total, each of which is responsible for maintaining their own accounting records and controls and using an integrated consolidation system to report to UK head office.

Our Group audit scope focused on audit work at 72 components (2017: 15), of which 16 relate to components that form part of the Aerospace segment; 26 relate to components that form part of the Automotive segment; 13 relate to components that form part of the Powder Metallurgy segment; 5 relate to components that form part of the Nortek Air & Security segment; and 12 relate to components that form part of the Other Industrial segment. The change in the number of components reflects the acquisition of the GKN business by Melrose.

Each component was set a specific component materiality, considering its relative size and any component-specific risk factors such as internal audit findings and history of error. The component materialities applied were in the range £5-10 million.

# Independent auditor's report to the members of Melrose Industries PLC Continued

## General scope

Full scope audit work was completed on 40 components and the head office function, and audit procedures have also been performed over certain balances within 32 other components. In total our scope represented 75% of Group revenue, 66% of Group operating profit and 84% of Group net assets.

## Aerospace

In respect of the Aerospace division, 9 components were subject to a full audit and 7 components were subject to the audit of specified account balances. These 16 components together accounted for 81% of the Aerospace division's revenue and 70% of the Aerospace division's adjusted operating profit and divisional costs (before central costs).

## Automotive

In respect of the Automotive division, 13 components were subject to a full audit and 13 components were subject to the audit of specified account balances. These 26 components accounted for 87% of the Automotive division's revenue and 55% of the Automotive division's adjusted operating profit and divisional costs (before central costs).

## Powder Metallurgy

In respect of the Powder Metallurgy division, 4 components were subject to a full audit and 9 components were subject to the audit of specified account balances. These 13 components together accounted for 80% of the Powder Metallurgy division's revenue and 61% of the Powder Metallurgy division's adjusted operating profit and divisional costs (before central costs).

## Nortek Air & Security

In respect of the Nortek Air & Security division, 4 components were subject to a full audit and 1 component was subject to an audit of specified account balances. These 5 components together accounted for 71% of the Nortek Air & Security division's revenue and 71% of the Nortek Air & Security division's adjusted operating profit and divisional costs (before central costs).

## Other Industrial

In respect of the Other Industrial division, 10 components were subject to a full audit and 2 components were subject to the audit of specified account balances. These 12 components together accounted for 51% of the Other Industrial division's revenue and 54% of the Other Industrial division's adjusted operating profit and divisional costs (before central costs).

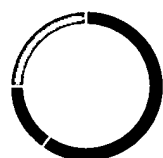
The increase in scale and complexity of the group had a direct impact on the global audit teams engaged to perform the Group audit and our supervision thereof. The Group engagement team visited 23 of the Group's largest and most complex businesses during 2018 with a particular focus on newly acquired GKN businesses as well as some legacy businesses. These visits, together with central analytics and enquiries of management, the knowledge of local auditors already in role and the output from management's advisors as they performed the fair value visits, informed our risk assessment.

In scoping the audit we were mindful of the North American balance sheet review and associated controls issues reported by GKN plc in their 2017 Annual report. We focussed on the businesses that reported material write offs in 2017 including visits from the senior statutory auditor and other members of the Group engagement team, and instructing our component audit team to apply a risk adjusted, and therefore lower, level of materiality than other components of a similar size. We also subjected other component auditors whose work was a response to a key audit matter, for instance Engine Systems, to additional supervision and direction including visits from the senior statutory auditor.

In addition to the programme of visits above, the senior statutory auditor held group-wide, divisional and individual planning and close meetings which covered all businesses. Each segment has a dedicated member of the group audit team responsible for the supervision and direction of components, including where appropriate sector-specific expertise, and for GKN components we maintained some continuity from the previous audit teams where possible and appropriate. Where we do not visit a component within our Group audit scope, we include the component audit team in our team briefing, discuss and review their risk assessment, and review documentation of the findings from their work. We also reviewed the audit work papers supporting component teams' reporting to us either in person during the visits above, or remotely using shared desktop technology.

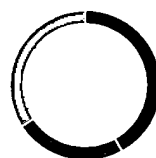
In total, as set out in the chart below we performed audit work on site at locations which together contributed 75% of Group revenue and 66% of adjusted operating profit.

### Revenue %



● Full	60%
● SAP	15%
● DTR	25%

### OP %



● Full	42%
● SAP	24%
● DTR	34%

The Group engagement team also performed central procedures on:

- post-employment benefit obligations;
- derivative financial instruments;
- UK and corporate taxation;
- goodwill and intangible asset impairment assessments; and
- self-insurance provisions and equity.

The Company was also subject to a full scope audit by the Group audit team, and we also tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

#### **Other information**

The Directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- **Fair, balanced and understandable** – the statement given by the Directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- **Audit committee reporting** – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee; or
- **Directors' statement of compliance with the UK Corporate Governance Code** – the parts of the directors' statement required under the Listing Rules relating to the company's compliance with the UK Corporate Governance Code containing provisions specified for review by the auditor in accordance with Listing Rule 9.8.10R(2) do not properly disclose a departure from a relevant provision of the UK Corporate Governance Code.

**We have nothing to report in respect of these matters.**

#### **Responsibilities of directors**

As explained more fully in the Directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

#### **Auditor's responsibilities for the audit of the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at:

**[www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities)**. This description forms part of our auditor's report.

# Independent auditor's report to the members of Melrose Industries PLC Continued

## **Extent to which the audit was considered capable of detecting irregularities, including fraud**

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

## **Identifying and assessing potential risks related to irregularities**

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of group management and local management at each component and the audit committee, including obtaining and reviewing supporting documentation, concerning the group's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations including the work of the internal audit function;
- discussing among the engagement team including significant component audit teams and involving relevant internal specialists including tax, valuations, pensions, and industry specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the following areas: classification of adjusting items, acquisition accounting (in particular intangible asset valuation and valuation of provisions) and revenue recognition. We determined that inventory valuation and impairment did not represent fraud risks; and
- obtaining an understanding of the legal and regulatory frameworks that the group operates in, focusing on those laws and regulations that had a direct effect on the financial statements. The key laws and regulations we considered in this context included the UK Companies Act and Listing Rules as well as the pensions legislation, tax legislation. In addition, we considered environmental legislation in the jurisdictions the Group operates in as having a fundamental effect on the operations of the group.

## **Audit response to risks identified**

As a result of the above, we identified the following as key audit matters: classification of adjusting items, acquisition accounting (in particular intangible asset valuation and valuation of provisions) and revenue recognition. The key audit matters section of our report describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the audit committee and in-house legal counsel concerning actual and potential litigation and claims, including through a centrally managed global fraud questionnaire sent to key management personnel at the component, divisional and group level;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance and reviewing internal audit reports;
- making direct enquiries of internal audit; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists and significant component audit teams, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

## Report on other legal and regulatory requirements

### Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the group and of the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

### Matters on which we are required to report by exception

#### Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns.

**We have nothing to report in respect of these matters.**

#### Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the directors' remuneration report to be audited is not in agreement with the accounting records and returns.

**We have nothing to report in respect of these matters.**

### Other matters

#### Auditor tenure

Following the recommendation of the audit committee, we were appointed by the Board of Directors in 2003 to audit the financial statements for the year ending 31 December 2003 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 16 years, covering the years ending 31 December 2003 to 31 December 2018.

#### Consistency of the audit report with the additional report to the audit committee

Our audit opinion is consistent with the additional report to the audit committee we are required to provide in accordance with ISAs (UK).

#### Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.



**Stephen Griggs FCA (Senior statutory auditor)**

**For and on behalf of Deloitte LLP**

Statutory Auditor

London, United Kingdom

7 March 2019

# Consolidated Income Statement

	Notes	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>			
Revenue	4, 5	8,605	2,092
Cost of sales		(6,920)	(1,439)
Gross profit		1,685	653
Share of results of equity accounted investments	14	34	-
Net operating expenses	7	(2,111)	(660)
Operating loss	5, 6	(392)	(7)
Finance costs	7	(163)	(22)
Finance income	7	5	1
Loss before tax		(550)	(28)
Tax	8	75	4
<b>Loss after tax for the year</b>		<b>(475)</b>	<b>(24)</b>
<b>Attributable to:</b>			
Owners of the parent		(475)	(24)
Non-controlling interests		-	-
		<b>(475)</b>	<b>(24)</b>
<b>Earnings per share</b>			
- Basic	10	(12.0)p	(1.2)p
- Diluted	10	(12.0)p	(1.2)p
<b>Adjusted Results</b>			
Adjusted revenue	5	9,102	2,095
Adjusted operating profit	5, 6	847	279
Adjusted profit before tax	6	703	258
Adjusted profit after tax	6	539	191
Adjusted basic earnings per share	10	13.3p	9.9p
Adjusted diluted earnings per share	10	13.3p	9.8p

# Consolidated Statement of Comprehensive Income

	Notes	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Loss for the year</b>		<b>(475)</b>	<b>(24)</b>
<b>Items that will not be reclassified subsequently to the Income Statement:</b>			
Net remeasurement (loss)/gain on retirement benefit obligations	23	<b>(36)</b>	12
Income tax credit/(charge) relating to items that will not be reclassified	8	<b>9</b>	(1)
		<b>(27)</b>	11
<b>Items that may be reclassified subsequently to the Income Statement:</b>			
Currency translation on net investments		<b>625</b>	(133)
Share of other comprehensive income from equity accounted investments		<b>9</b>	-
Transfer to Income Statement from equity of cumulative translation differences on disposal of foreign operations		-	(1)
(Losses)/gains on hedge relationships		<b>(97)</b>	9
Transfer to Income Statement on hedge relationships		<b>(2)</b>	(4)
Income tax credit/(charge) relating to items that may be reclassified	8	<b>29</b>	(1)
		<b>564</b>	(130)
<b>Other comprehensive income/(expense) for the year</b>		<b>537</b>	(119)
<b>Total comprehensive income/(expense) for the year</b>		<b>62</b>	(143)
<b>Attributable to:</b>			
Owners of the parent		<b>44</b>	(143)
Non-controlling interests		<b>18</b>	-
		<b>62</b>	(143)

# Consolidated Statement of Cash Flows

		Year ended 31 December 2018	Year ended 31 December 2017
Continuing operations	Notes	£m	£m
<b>Net cash from operating activities</b>	26	373	32
<b>Investing activities</b>			
Disposal of businesses, net of cash disposed		(4)	10
Purchase of property, plant and equipment		(344)	(48)
Proceeds from disposal of property, plant and equipment		20	2
Purchase of computer software and capitalised development costs		(35)	(3)
Dividends received from equity accounted investments	14	66	-
Equity accounted investment additions	14	(3)	-
Acquisition of subsidiaries, net of cash acquired <sup>(1)</sup>		(1,009)	(9)
Interest received		5	1
<b>Net cash used in investing activities</b>		<b>(1,304)</b>	<b>(47)</b>
<b>Financing activities</b>			
Purchase of non-controlling interests		(224)	-
Costs of issuing shares		(1)	-
Repayment of borrowings		(820)	-
New bank loans raised		2,558	56
Costs of raising debt finance		(51)	-
Repayment of finance leases		-	(1)
Dividends paid to non-controlling interests		(1)	-
Dividends paid to owners of the parent	9	(129)	(63)
<b>Net cash from/(used in) financing activities</b>		<b>1,332</b>	<b>(8)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>401</b>	<b>(23)</b>
Cash and cash equivalents at the beginning of the year	26	16	42
Effect of foreign exchange rate changes	26	(2)	(3)
<b>Cash and cash equivalents at the end of the year</b>	17, 26	<b>415</b>	<b>16</b>

(1) Comprises consideration of £1,316 million, net of cash and cash equivalents acquired of £307 million (note 12).

As at 31 December 2018, the Group had net debt of £3,482 million (31 December 2017: £572 million). A reconciliation of the movement in net debt is shown in note 26.

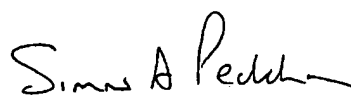
# Consolidated Balance Sheet

	Notes	31 December 2018 £m	31 December 2017 £m
<b>Non-current assets</b>			
Goodwill and other intangible assets	11	11,071	2,238
Property, plant and equipment	13	3,171	219
Interests in equity accounted investments	14	492	-
Deferred tax assets	21	149	49
Derivative financial assets	24	26	4
Trade and other receivables	16	504	2
		<b>15,413</b>	<b>2,512</b>
<b>Current assets</b>			
Inventories	15	1,489	276
Trade and other receivables	16	2,328	332
Derivative financial assets	24	15	10
Current tax assets		74	-
Cash and cash equivalents	17	415	16
		<b>4,321</b>	<b>634</b>
<b>Total assets</b>	<b>5</b>	<b>19,734</b>	<b>3,146</b>
<b>Current liabilities</b>			
Trade and other payables	18	2,583	367
Interest-bearing loans and borrowings	19	377	-
Finance lease obligations	27	5	-
Derivative financial liabilities	24	204	1
Current tax liabilities		137	7
Provisions	20	381	92
		<b>3,687</b>	<b>467</b>
<b>Net current assets</b>		<b>634</b>	<b>167</b>
<b>Non-current liabilities</b>			
Trade and other payables	18	778	2
Interest-bearing loans and borrowings	19	3,378	588
Finance lease obligations	27	52	-
Derivative financial liabilities	24	227	-
Deferred tax liabilities	21	874	69
Retirement benefit obligations	23	1,413	18
Provisions	20	1,064	117
		<b>7,786</b>	<b>794</b>
<b>Total liabilities</b>	<b>5</b>	<b>11,473</b>	<b>1,261</b>
<b>Net assets</b>		<b>8,261</b>	<b>1,885</b>
<b>Equity</b>			
Issued share capital	25	333	133
Share premium account		8,138	1,493
Merger reserve		109	109
Other reserves		(2,330)	(2,330)
Hedging reserve		(67)	8
Translation reserve		562	(66)
Retained earnings		1,492	2,538
<b>Equity attributable to owners of the parent</b>		<b>8,237</b>	<b>1,885</b>
Non-controlling interests		24	-
<b>Total equity</b>		<b>8,261</b>	<b>1,885</b>

The financial statements were approved and authorised for issue by the Board of Directors on 7 March 2019 and were signed on its behalf by:



Geoffrey Martin  
Group Finance Director  
7 March 2019



Simon Peckham  
Chief Executive  
7 March 2019

# Consolidated Statement of Changes in Equity

	Issued share capital £m	Share premium account £m	Merger reserve £m	Other reserves £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Equity attributable to owners of the parent £m	Non- controlling interests £m	Total equity £m
At 1 January 2017	129	1,493	112	(2,330)	4	68	2,686	2,162	-	2,162
Loss for the year	-	-	-	-	-	-	(24)	(24)	-	(24)
Other comprehensive income/(expense)	-	-	-	-	4	(134)	11	(119)	-	(119)
Total comprehensive income/(expense)	-	-	-	-	4	(134)	(13)	(143)	-	(143)
Dividends paid	-	-	-	-	-	-	(63)	(63)	-	(63)
Equity-settled share-based payments	-	-	-	-	-	-	10	10	-	10
Deferred tax on share-based payment transactions	-	-	-	-	-	-	34	34	-	34
Incentive scheme related	4	-	(3)	-	-	-	(116)	(115)	-	(115)
At 31 December 2017	133	1,493	109	(2,330)	8	(66)	2,538	1,885	-	1,885
Loss for the year	-	-	-	-	-	-	(475)	(475)	-	(475)
Other comprehensive (expense)/income	-	-	-	-	(75)	628	(34)	519	18	537
Total comprehensive (expense)/income	-	-	-	-	(75)	628	(509)	44	18	62
Acquisition of GKN <sup>(1)</sup>	169	5,631	-	-	-	-	-	5,800	857	6,657
Purchase of non-controlling interests	31	1,014	-	-	-	-	(419)	626	(850)	(224)
Implementation of IFRS 9 <sup>(2)</sup>	-	-	-	-	-	-	(2)	(2)	-	(2)
Dividends paid	-	-	-	-	-	-	(129)	(129)	(1)	(130)
Equity-settled share-based payments	-	-	-	-	-	-	13	13	-	13
At 31 December 2018	333	8,138	109	(2,330)	(67)	562	1,492	8,237	24	8,261

(1) Relates to the purchase of approximately 85% of the issued share capital of GKN plc. The amount recognised within the share premium account for the acquisition of GKN of £5,631 million is net of £1 million for costs associated with issuing shares.

(2) The Group adopted IFRS 9 on 1 January 2018. See note 1 for details.

# Notes to the Financial Statements

## 1. Corporate information

Melrose Industries PLC ("the Company") is a public company limited by shares. The Company is incorporated in the United Kingdom under the Companies Act 2006 and registered in England and Wales. The address of the registered office is given on the back cover. The nature of the Group's operations and its principal activities by operating segment are set out in note 5 and in the Divisional reviews on pages 20 to 39.

The Consolidated Financial Statements of the Group for the year ended 31 December 2018 were authorised in accordance with a resolution of the Directors of Melrose Industries PLC on 7 March 2019.

These Financial Statements are presented in pounds Sterling which is the currency of the primary economic environment in which the Company is based. Foreign operations are included in accordance with the policies set out in note 2.

On 19 April 2018 the Group acquired approximately 85% of the issued share capital and obtained control of GKN plc ("GKN") for consideration of £7,091 million (note 12). The remaining 15% of the issued share capital of GKN was acquired in the period from 19 April 2018 to 30 June 2018, at a cost of £1,260 million which has been treated as a purchase of a non-controlling interest.

### 1.1 New Standards and Interpretations affecting amounts, presentation or disclosure reported in the current year

In the current financial year, the Group has adopted the following new and revised Standards and Interpretations. Their adoption has not had a significant impact on the comparative amounts reported in these Financial Statements:

- IFRS 9: Financial Instruments
- IFRS 15: Revenue from Contracts with Customers (and the related clarifications)
- Amendments to IFRS 2: Classification and Measurement of Share-Based Payment Transactions
- Annual improvements to IFRSs: 2014 –16 cycle
- Amendments to IAS 7: Disclosure initiative
- Amendments to IAS 12: Recognition of deferred tax assets for unrealised losses
- IFRIC 22: Foreign currency transactions and advance consideration
- Amendments to IAS 28: Investments in associates and joint ventures

The Group adopted IFRS 15: "Revenue from Contracts with Customers" on 1 January 2018 using the full retrospective approach. Due to the immaterial impact of IFRS 15 on the Group for the year ended 31 December 2017, no further disclosure is provided on the comparative results or balance sheet position. The GKN IFRS 15 impact forms part of the acquired business and therefore is not included in the transitional impact within these Financial Statements. The impact of IFRS 15 on the enlarged Group reduced annual revenue by approximately £80 million, due to the reclassification of certain costs. There was a £15 million increase in operating profit, which principally relates to recognition of variable consideration.

The Group adopted IFRS 9: "Financial Instruments" on 1 January 2018. IFRS 9 replaces IAS 39 and the main impacts relate to; a) classification and measurement of financial assets and liabilities, b) impairment of financial assets, and c) hedge accounting. The Group has elected not to restate the comparatives but instead record any adjustments identified in retained earnings in line with the transition arrangement within the standard. Following management's review, a £2 million reduction in net assets was identified. The GKN IFRS 9 impact forms part of the acquired business and therefore is not included in the transitional impact within these Financial Statements.

The Group has reviewed the classification of its financial instruments and has concluded the following:

- There is no change in the classification of derivative financial instruments that were classified as "fair value through profit or loss", as under IFRS 9 they fail the contractual cash flow characteristics test in IFRS 9 (4.1.2(b)) and (4.1.2A(b));
- Financial instruments designated in cash flow hedge relationships under IAS 39 continue to qualify for hedge accounting under IFRS 9; and
- Financial assets previously classified within the "loans and receivables" category are classified in the "amortised cost" category.

The introduction of IFRS 9 has resulted in changes to the accounting policies in the following areas:

- Trade and other receivables;
- Derivative financial instruments;
- Amounts due from equity accounted investments; and
- Contract assets.

# Notes to the Financial Statements

Continued

## 1. Corporate information continued

### 1.2 New Standards and Interpretations in issue but not yet effective

At 31 December 2018, the following Standards and Interpretations were in issue but not yet effective (and in some cases have not been adopted by the EU):

- IFRS 16: Leases
- Amendments to IFRS 10 and IAS 28: Sale or contribution of assets between an investor and its associate or joint venture
- IFRIC 23: Uncertainty over income tax treatments
- Amendments to IFRS 9: Prepayment Features with Negative Compensation
- Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures
- Annual Improvements to IFRS Standards 2015–2017 Cycle
- Amendments to IAS 19: Employee Benefits

The Directors do not expect that the adoption of the above Standards and Interpretations, with the exception of IFRS 16, will have a material impact on the Financial Statements of the Group in future periods.

IFRS 16 is effective for accounting periods beginning on or after 1 January 2019. IFRS 16 will supersede the current lease guidance including IAS 17: "Leases" and related interpretations. It will require all leases to be recognised on the Balance Sheet. Currently, IAS 17 only requires arrangements categorised as finance leases to be recognised on the Balance Sheet, with other arrangements categorised as operating leases not recognised on the Balance Sheet but expensed through the Income Statement instead.

The impact of IFRS 16 will be to recognise a lease liability and a corresponding asset in the Balance Sheet for leases currently classified as operating leases, except for short-term leases and leases of low value assets. There will also be a specific reclassification from operating costs to finance costs.

IFRS 16 will be adopted for the year ending 31 December 2019 via a modified retrospective approach and it is anticipated that the right-of-use asset recognised on transition will be measured at an amount materially equal to the lease liability. At 31 December 2018, the Group had non-cancellable operating lease commitments of £710 million (note 27). A preliminary assessment has been undertaken involving all businesses. This entailed a review of all arrangements to identify those affected by IFRS 16. Future cash flow obligations have been collated for each identified lease and the associated lease liability has been assessed. For arrangements that meet the definition of a lease under IFRS 16, the Group will recognise a right-of-use asset and corresponding liability unless they qualify as low value or short-term leases as defined by IFRS 16. The right-of-use asset and lease liability to be recognised upon transition is expected to be in the range of £550 million to £600 million. The expected annual impact of IFRS 16 on the Income Statement in the year ended 31 December 2019 will be an increase to operating profit, expected to be in the range of £10 million to £15 million. This is expected to be more than offset by an increase in finance costs in the range of £15 million to £20 million.

For arrangements previously classified as finance leases, where the Group is a lessee, as the Group has already recognised an asset and a related finance lease liability for the lease arrangement, the Directors do not anticipate that the application of IFRS 16 will have a significant impact on the amounts recognised in the Group's Consolidated Financial Statements, at 31 December 2018.

## 2. Summary of significant accounting policies

### Basis of accounting

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs"). The Consolidated Financial Statements have also been prepared in accordance with IFRSs adopted for use in the European Union and therefore comply with Article 4 of the EU IAS Regulation.

The Consolidated Financial Statements have been prepared on an historical cost basis, except for the revaluation of certain financial instruments which are recognised at fair value at the end of each reporting period. Historical cost is generally based on the fair value of the consideration given in exchange for assets. Following the acquisition of GKN on 19 April 2018, where relevant the Group has applied certain accounting policies to align them with the enlarged business.

### Alternative Performance Measures

The Group presents Alternative Performance Measures ("APMs") in addition to the statutory results of the Group. These are presented in accordance with the Guidelines on APMs issued by the European Securities and Markets Authority ("ESMA").

APMs used by the Group are set out in the glossary to these Financial Statements on pages 193 to 196 and the reconciling items between statutory and adjusted results are listed below and described in more detail in note 6.

Adjusted revenue includes the Group's share of revenue from equity accounted investments.

Adjusted profit/(loss) excludes items which are significant in size or volatility or by nature are non-trading or non-recurring, and any item released to the Income Statement that was previously a fair value item booked on an acquisition.

## 2. Summary of significant accounting policies continued

On this basis, the following are the principal items included within adjusting items impacting operating profit:

- Amortisation of intangible assets that are acquired in a business combination, excluding computer software and development costs;
- Significant restructuring costs and other associated costs, including losses incurred following the announcement of closure for identified businesses, arising from significant strategy changes that are not considered by the Group to be part of the normal operating costs of the business;
- Acquisition and disposal costs;
- Impairment charges that are considered to be significant in nature and/or value to the trading performance of the business;
- Movement in derivative financial instruments not designated in hedging relationships, including revaluation of associated financial assets and liabilities;
- Reversal of inventory uplift in value recorded on acquisition;
- Removal of adjusting items, interest and tax on equity accounted investments to reflect operating results;
- The charge for the Melrose equity-settled compensation scheme, including its associated employer's tax charge;
- One-off costs associated with gender equalisation of guaranteed minimum pensions ("GMP") for occupational schemes; and
- The release of fair value items booked on acquisitions.

Further to the adjusting items above, adjusting items impacting profit before tax include:

- Acceleration of unamortised debt issue costs written off as a consequence of Group refinancing; and
- The fair value changes on cross-currency swaps, entered into by GKN prior to acquisition, relating to cost of hedging which are not deferred in equity.

In addition to the items above, adjusting items impacting profit after tax include:

- Net effect of significant new tax legislation changes; and
- The tax effects of adjustments to profit/(loss) before tax.

The Board considers the adjusted results to be an important measure used to monitor how the businesses are performing as this provides a meaningful reflection of how the businesses are managed and measured on a day-to-day basis and achieves consistency and comparability between reporting periods, when all businesses are held for a complete reporting period.

The adjusted measures are used to partly determine the variable element of remuneration of senior management throughout the Group and are also in alignment with performance measures used by certain external stakeholders. The adjusted measures are also taken into account when valuing individual businesses as part of the "Buy, Improve, Sell" Group strategy model.

Adjusted profit is not a defined term under IFRS and may not be comparable with similarly titled profit measures reported by other companies. It is not intended to be a substitute for, or superior to, GAAP measures. All APMs relate to the current year results and comparative periods where provided.

### Basis of consolidation

The Group's Financial Statements include the results of the parent undertaking and all of its subsidiary undertakings. In addition, the Group's share of the results and equity of joint ventures and associated undertakings (together "equity accounted investments") are included. The results of businesses acquired during the period are included from the effective date of acquisition and, for those sold during the period, to the effective date of disposal. Where necessary, adjustments are made to the Financial Statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All intra-Group balances and transactions, including unrealised profits arising from intra-Group transactions, have been eliminated in full.

Non-controlling interests in subsidiaries are identified separately from the Group's equity therein. The interest of non-controlling shareholders is initially measured at the non-controlling interests' proportion of the share of the fair value of the acquiree's identifiable net assets. Subsequent to acquisition, the carrying amount of non-controlling interests is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity. Total comprehensive income is attributed to non-controlling interests even if this results in the non-controlling interests having a deficit balance.

### Going concern

The Directors have, at the time of approving the Financial Statements, a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the Financial Statements. Further detail is contained on page 48 of the Finance Director's review.

# Notes to the Financial Statements

Continued

## 2. Summary of significant accounting policies continued

### Business combinations and goodwill

The acquisition of subsidiaries is accounted for using the acquisition method. The cost of acquisition is measured at the fair value of assets transferred, the liabilities incurred or assumed at the date of exchange of control and equity instruments issued by the Group in exchange for control of the acquiree. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. Costs directly attributable to business combinations are recognised as an expense in the Income Statement as incurred.

The acquired identifiable assets and liabilities are measured at their fair value at the date of acquisition except those where specific guidance is provided by IFRSs. Non-current assets and directly attributable liabilities that are classified as held for sale in accordance with IFRS 5: "Non-current assets held for sale and discontinued operations", are recognised and measured at fair value less costs to sell. Also, deferred tax assets and liabilities are recognised and measured in accordance with IAS 12: "Income taxes", liabilities and assets related to employee benefit arrangements are recognised and measured in accordance with IAS 19 (revised): "Employee benefits" and liabilities or equity instruments related to the replacement by the Group of an acquiree's share-based payments awards are measured in accordance with IFRS 2: "Share-based payment". Any excess of the cost of the acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts where appropriate. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities recognised, to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the amounts recognised at that date.

The measurement period is the period from the date of acquisition to the date the Group obtains complete information about facts and circumstances that existed as of the acquisition date and is subject to a maximum period of one year.

Goodwill on acquisition is initially measured at cost, being the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

If, after reassessment, the Group's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquiree and the fair value of the acquirer's previously held equity interest in the acquiree, the excess is recognised immediately in profit or loss as a bargain purchase gain.

As at the acquisition date, any goodwill acquired is allocated to the cash-generating units acquired. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised in the Income Statement and is not subsequently reversed. When there is a disposal of a cash-generating unit, goodwill relating to the operation disposed of is taken into account in determining the gain or loss on disposal of that operation. The amount of goodwill allocated to a partial disposal is measured on the basis of the relative values of the operation disposed of and the operation retained.

### Equity accounted investments

A joint venture is an entity which is not a subsidiary undertaking but where the interest of the Group is that of a partner in a business over which the Group exercises joint control with its partners over the financial and operating policies. In all cases voting rights are 50% or lower.

Associated undertakings are entities that are neither a subsidiary nor a joint venture, but where the Group has a significant influence. The results, assets and liabilities of equity accounted investments are accounted for using the equity method of accounting. The Group's share of equity includes goodwill arising on acquisition.

When a group entity transacts with an equity accounted investment of the Group, profits and losses resulting from the transactions with the equity accounted investments are recognised in the Group's Consolidated Financial Statements only to the extent of interests in equity accounted investments that are not related to the Group.

### Revenue

Revenues are recognised either at the point of transfer of control of goods and services, or recognised over time on an activity basis using the costs incurred as the measure of the activity. Costs are recognised as they are incurred.

The nature of agreements into which the Group enters means that certain of the Group's arrangements with its customers have multiple elements that can include any combination of:

- Sale of products and services;
- Risk and revenue sharing partnerships ("RRSPs");
- Design and build; and
- Construction contracts.

Contracts are reviewed to identify each performance obligation relating to a distinct good or service and the associated consideration. The Group allocates revenue to multiple element arrangements based on the identified performance obligations within the contracts in line with the policies below. A performance obligation is identified if the customer can benefit from the good or service on its own or together with other readily available resources, and it can be separately identified within the contract. This review is performed by reference to the specific contract terms.

## 2. Summary of significant accounting policies continued

### Sale of products and services

This revenue stream accounts for the majority of Group sales. Contracts in the Automotive, Powder Metallurgy, Nortek Air & Security and Other Industrial segments operate almost exclusively on this basis, and it also covers a high proportion of the Aerospace segment's revenues.

Invoices for goods are raised and revenue is recognised when control of the goods is transferred to the customer. Dependent upon contractual terms this may be at the point of despatch, acceptance by the customer or, in Aerospace, certification by the customer. The revenue recognised is the transaction price as it is the observable selling price per product.

Cash discounts, volume rebates and other customer incentive programmes are based on certain percentages agreed with the Group's customers, which are typically earned by the customer over an annual period. These are allocated to performance obligations and are recorded as a reduction in revenue at the point of sale based on the estimated future outcome. Due to the nature of these arrangements an estimate is made based on historical results to date, estimated future results across the contract period and the contractual provisions of the customer agreement.

Many businesses in the Powder Metallurgy and Automotive segments recognise an element of revenue via a surcharge or similar raw material cost recovery mechanism. The surcharge is generally based on prior period movement in raw material price indices applied to current period deliveries.

### Risk and revenue sharing partnerships ("RRSPs")

This revenue stream affects a small number of businesses, exclusively in the Aerospace segment. Revenue is recognised under RRSPs for both the sale of product as detailed above and sales of services, which are recognised by reference to the stage of completion based on the performance obligations in the contract. In most RRSP contracts, there are two separate phases where the Group earns revenue; sale of products principally to engine manufacturers and aftermarket support.

The assessment of the stage of completion is dependent on the nature of the contract and the performance obligations within it.

The value of revenue is based on the standalone selling price for each element of the contract.

Revenue is recognised at the point control passes to the customer. For products and services, this has been identified as the point of despatch, acceptance by the customer or certification by the customer. Where the amount of revenue recognised is not yet due for collection under the terms of the contract, it will be recognised as variable consideration within contract assets. Revenue is not recognised where recovery is not probable due to potential significant reversals in the future. This can be affected by assessment of future volumes including aftermarket expectations which are impacted by technology development, fuel price and competition.

Participation fees are payments made to engine manufacturers and original equipment manufacturers relating to RRSPs and long-term agreements. They are recognised as contract assets to the extent they can be recovered from future sales. Where participation fees have been paid under the RRSP, the amortisation is recognised as a revenue reduction under IFRS 15, as performance obligations are satisfied.

### Design and build

This revenue stream affects a discrete number of businesses, primarily in the Aerospace segment but also on a smaller scale in the Automotive segment. Generally, revenue is only recognised on the sale of product as detailed above, however, on occasions cash is received in advance of work performed to compensate the Group for costs incurred in design and development activities. The Group performs an assessment of its performance obligations to understand multiple elements. Where it is determined there is only one type of performance obligation, being the delivery of product, any cash advance is factored into the revenue allocated across the deliveries required under the contract. Where the performance obligation has not been satisfied amounts received are recognised as a contract liability. If there is more than one performance obligation, revenue is allocated to each one based on a standalone selling price for each element of the contract.

Due to the nature of design and build contracts, there can be significant 'learning curves' while the Group optimises its production processes. During the early phase of these contracts, all costs including any start-up losses are taken directly to the Income Statement, as they do not meet the criteria for fulfilment costs.

### Construction contracts

Where multiple performance obligations are identified, revenue is recognised as each performance obligation is met. This requires an assessment of total revenue to identify the allocation across the performance obligations, based on the standalone selling price for each obligation.

In cases where one of the following criteria is met, revenue is recognised over time:

- The customer simultaneously receives and consumes the benefits provided by the Group's performance;
- The Group's performance creates or enhances an asset that the customer controls as the asset is created or enhanced; or
- The Group's performance does not create an asset with an alternative use to the Group and it has an enforceable right to payment for performance completed to date.

# Notes to the Financial Statements

Continued

## 2. Summary of significant accounting policies continued

Due to the nature of the criteria above, only certain contracts in the Group qualify for over time recognition. On this basis revenue is recognised using the input method, which uses costs incurred and the assessed margin across the contract. The input method is used to measure progress as it best depicts the transfer of control to the customer. The margin and associated revenue are calculated based on the estimated transaction price and expected total costs, with considerations made for the associated contract risks.

If the above criteria are not met, revenue is recognised at a point in time when control transfers to the customer which, in line with the sale of goods and services above, is the point of delivery or customer acceptance dependent on the terms of the contract.

Variable consideration, such as price or scope amendments, is included based on the expected value or most likely amount. A constraint is included unless it is highly probable that the revenue will not significantly reverse in the future. This constraint is calculated based on a cautious expectation of the life of certain RRSPs and by assessing the impact of a 10% reduction in expected spares sales. Variations in contract work, claims and incentive payments are included in revenue from construction contracts based on an estimate of the expected value the Group expects to receive. Variations are included when the customer has agreed to the variation or acknowledged liability for the variation in principle. Claims are included when negotiations with the customer have reached an advanced stage such that it is virtually certain that the customer will accept the claim.

### Finance income

Finance income is recognised when it is probable that the economic benefits will flow to the Group and the amount of income can be measured reliably. Finance income is accrued on a time basis, by reference to the principal outstanding and the effective interest rate applicable.

### Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in the Income Statement in the period in which they are incurred.

### Issue costs of loans

The finance cost recognised in the Income Statement in respect of the issue costs of borrowings is allocated to periods over the terms of the instrument using the effective interest rate method.

### Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any impairment in value.

The initial cost of an asset comprises its purchase price or construction cost, any costs directly attributable to bring the asset into operation, and any borrowing costs on qualifying assets. Qualifying assets are defined as an asset or programme where the period of capitalisation is more than 12 months. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

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, at which point depreciation commences.

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

Freehold land	nil
Freehold buildings and long leasehold property	over expected economic life not exceeding 50 years
Short leasehold property	over the term of the lease
Plant and equipment	3-15 years

The estimated useful lives of property, plant and equipment are reviewed on an annual basis and, if necessary, changes in useful lives are accounted for prospectively.

The carrying values of property, plant and equipment are reviewed annually for indicators of impairment, or if events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists an impairment test is performed and, where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount. The recoverable amount of property, plant and equipment is the greater of net selling price and value in use. In assessing value in use, estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds or costs and the carrying amount of the item) is included in the Income Statement in the period that the item is derecognised.

## 2. Summary of significant accounting policies continued

### Intangible assets

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses.

On acquisition of businesses, separately identifiable intangible assets are initially recorded at their fair value at the acquisition date.

Access to the use of brands and intellectual property are valued using a "relief from royalty" method which determines the net present value of future additional cash flows arising from the use of the intangible asset.

Customer relationships and contracts are valued on the basis of the net present value of the future additional cash flows arising from customer relationships with appropriate allowance for attrition of customers.

Technology assets are valued using a replacement cost approach, or a "relief from royalty" method.

Amortisation of intangible assets is recorded in administration expenses in the Income Statement and is calculated on a straight-line basis over the estimated useful lives of the asset as follows:

Customer relationships and contracts	20 years or less
Brands and intellectual property	20 years or less
Technology	20 years or less
Computer software	5 years or less
Development costs	20 years or less

Where computer software is not integral to an item of property, plant or equipment, its costs are capitalised and categorised as intangible assets. Computer software is initially recorded at cost. Where these assets have been acquired through a business combination, this will be the fair value allocated in the acquisition accounting. Where these have been acquired other than through a business combination, the initial cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Intangible assets (other than computer software and development costs) are tested for impairment annually or more frequently whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Impairment losses are measured on a similar basis to property, plant and equipment. Useful lives are also examined on an annual basis and adjustments, where applicable, are made on a prospective basis.

### Research and development costs

Research costs are expensed as incurred.

Costs relating to clearly defined and identifiable development projects are capitalised when there is a technical degree of exploitation, adequacy of resources and a potential market or development possibility in the undertaking that are recognisable; and where it is the intention to produce, market or execute the project. A correlation must also exist between the costs incurred and future benefits and those costs can be measured reliably. Capitalised costs are expensed on a straight-line basis over their useful lives of 20 years or less. Costs not meeting such criteria are expensed as incurred.

### Inventories

Inventories are valued at the lower of cost and net realisable value and are measured using a first in, first out or weighted average cost basis. Cost includes all direct expenditure and appropriate production overhead expenditure incurred in bringing goods to their current state under normal operating conditions. Net realisable value is based on estimated selling price less costs expected to be incurred to completion and disposal. Provisions are made for obsolescence or other expected losses where necessary.

### Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, current balances with banks and similar institutions, and short-term deposits which are readily convertible to cash and are subject to insignificant risks of changes in value.

For the purpose of the Consolidated Statement of Cash Flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

### Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at fair value of the consideration received net of issue costs associated with the borrowings.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

Gains and losses are recognised in the Income Statement when the liabilities are derecognised or impaired, as well as through the amortisation process.

### Government refundable advances

Government refundable advances are reported in "Trade and other payables" in the Balance Sheet. Refundable advances include amounts advanced by a government, accrued interest and directly attributable costs. Refundable advances are provided to the Group to part-finance expenditures on specific development programmes. The advances are provided on a risk sharing basis, i.e. repayment levels are determined subject to the success of the related programme. Balances are held at amortised cost and interest is calculated using the effective interest rate method.

# Notes to the Financial Statements

Continued

## 2. Summary of significant accounting policies continued

### Leases

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the Balance Sheet as a finance lease obligation. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

Finance charges are charged directly against income. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Operating lease payments are recognised as an expense in the Income Statement on a straight-line basis over the lease term. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease.

### Financial instruments – assets

#### Classification and measurement

All financial assets are classified as either those which are measured at fair value, through profit or loss or Other Comprehensive Income, and those measured at amortised cost.

Financial assets are initially recognised at fair value. For those which are not subsequently measured at fair value through profit or loss, this includes directly attributable transaction costs. Trade and other receivables, contract assets and amounts due from equity accounted investments are subsequently measured at amortised cost.

#### Recognition and derecognition of financial assets

Financial assets are recognised in the Group's Balance Sheet when the Group becomes a party to the contractual provisions of the instrument. The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity.

#### Impairment of financial assets

For trade and other receivables, contract assets and amounts due from equity accounted investments, the simplified approach permitted under IFRS 9 is applied. The simplified approach requires that at the point of initial recognition the expected credit loss across the life of the receivable must be recognised. As these balances do not contain a significant financing element, the simplified approach relating to expected lifetime losses is applicable under IFRS 9. Cash and cash equivalents are also subject to impairment requirements.

#### Trade and other receivables

Trade receivables and other receivables are measured and carried at amortised cost using the effective interest method, less any impairment. The carrying amount of other receivables is reduced by the impairment loss directly and a charge is recorded in the Income Statement. For trade receivables, the carrying amount is reduced by the expected lifetime losses. Subsequent recoveries of amounts previously written off are credited against the allowance account and changes in the carrying amount of the allowance account are recognised in the Income Statement.

Trade receivables that are assessed not to be impaired individually are also assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting receipts, an increase in the number of delayed receipts in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with default on receivables.

### Financial instruments – liabilities

Financial liabilities are recognised in the Group's Balance Sheet when the Group becomes a party to the contractual provisions of the instruments and are initially measured at fair value, net of transaction costs. Non-derivative financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant periods. The effective interest rate is the rate that discounts estimated future cash payments throughout the expected life of the financial liability, or, where appropriate, a shorter period to the net carrying amount on initial recognition. The Group derecognises financial liabilities when the Group's obligations are discharged, cancelled or they expire.

### Derivative financial instruments and hedging

The Group uses derivative financial instruments to manage its exposure to interest rate, foreign exchange rate and commodity risks, arising from operating and financing activities. The Group does not hold or issue derivative financial instruments for trading purposes. Details of derivative financial instruments are disclosed in note 24 of the Financial Statements.

Derivative financial instruments are recognised and stated at fair value in the Group's Balance Sheet. Their fair value is recalculated at each reporting date. The accounting treatment for the resulting gain or loss will depend on whether the derivative meets the criteria to qualify for hedge accounting.

Where derivatives do not meet the criteria to qualify for hedge accounting, any gains or losses on the revaluation to fair value at the period end are recognised immediately in the Income Statement. Where derivatives do meet the criteria to qualify for hedge accounting, recognition of any resulting gain or loss on revaluation depends on the nature of the hedge relationship and the item being hedged.

Derivative financial instruments with maturity dates of less than one year from the period end date are classified as current in the Balance Sheet.

Derivatives embedded in non-derivative host contracts are recognised at their fair value in the Group's Balance Sheet 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 recognised in the Income Statement.

## 2. Summary of significant accounting policies continued

### Hedge accounting

In order to qualify for hedge accounting, the Group is required to document from inception the relationship between the item being hedged and the hedging instrument, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents that the hedge will be highly effective, which is when the hedging relationships meet all of the following hedge effectiveness requirements:

- there is an economic relationship between the hedged item and the hedging instrument;
- the effect of credit risk does not dominate the value changes that result from that economic relationship; and
- the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Group actually hedges and the quantity of the hedging instrument that the Group actually uses to hedge that quantity of hedged item.

The Group discontinues hedge accounting only when the hedging relationship (or a part thereof) ceases to meet the qualifying criteria (after rebalancing, if applicable). This includes instances when the hedging instrument expires or is sold, terminated or exercised. The discontinuation is accounted for prospectively.

The Group designates certain hedging instruments as either fair value hedges, cash flow hedges or hedges of net investments in foreign operations.

### Fair value hedge

Derivative financial instruments are classified as fair value hedges when they hedge the Group's exposure to changes in the fair value of a recognised asset or liability. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement immediately, together with any changes in the fair value of the hedged item that is attributable to the hedged risk.

### Cash flow hedge

Derivative financial instruments are classified as cash flow hedges when they hedge the Group's exposure to the variability in cash flows that are either attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecasted cash flow.

The Group designates the full change in the fair value of a foreign exchange forward contract (i.e. including the forward elements) as the hedging instrument for all of its hedging relationships involving foreign exchange forward contracts.

The effective portion of any gain or loss from revaluing the derivative financial instrument is recognised in the Statement of Comprehensive Income and accumulated in equity. The gain or loss relating to the ineffective portion is recognised immediately in the Income Statement.

Amounts previously recognised in the Statement of Comprehensive Income and accumulated in equity are recycled to the Income Statement in the periods when the hedged item is recognised in the Income Statement or when the forecast transaction is no longer expected to occur. However, when the forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the non-financial asset or non-financial liability.

### Hedges of net investments in foreign operations

Derivative financial instruments are classified as net investment hedges when they hedge the Group's net investment in foreign operations. The effective element of any foreign exchange gain or loss from revaluing the derivative at a reporting period end is recognised in the Statement of Comprehensive Income. Any ineffective element is recognised immediately in the Income Statement.

The Group designates only the spot rate component of cross-currency swaps in net investment hedges. The changes in the fair value of the aligned forward and currency basis elements are recognised in Other Comprehensive Income and accumulated in the cost of hedging reserve. If the hedged item is transaction-related, the time value is reclassified to profit or loss when the hedged item affects profit or loss. If the hedged item is time-period related, then the amount accumulated in the cost of hedging reserve is reclassified to profit or loss on a rational basis.

Gains and losses accumulated in equity are recognised immediately in the Income Statement when the foreign operation is disposed of or when the hedge is no longer expected to occur.

### Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a rate that reflects the current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

### Contingent liabilities acquired in a business combination

Contingent liabilities acquired in a business combination are initially measured at fair value at the acquisition date. At the end of subsequent reporting periods, such contingent liabilities are measured at the higher of the amount that would be recognised in accordance with IAS 37: "Provisions, contingent liabilities and contingent assets" and the amount initially recognised less cumulative amount of revenue recognised in accordance with the principles of IFRS 15.

# Notes to the Financial Statements

Continued

## 2. Summary of significant accounting policies continued

### Pensions and other retirement benefits

The Group operates defined benefit pension plans and defined contribution plans, some of which require contributions to be made to administered funds separate from the Group.

For the defined benefit pension and retirement benefit plans, plan assets are measured at fair value and plan liabilities are measured on an actuarial basis and discounted at an interest rate equivalent to the current rate of return on a high-quality corporate bond of equivalent currency and term to the plan liabilities. Any assets resulting from this calculation are limited to past service cost plus the present value of available refunds and reductions in future contributions to the plan. The present value of the defined benefit obligation, and the related current service cost and past service cost, are measured using the projected unit credit method.

The service cost of providing pension and other retirement benefits to employees for the period is charged to the Income Statement.

Net interest expense on net defined benefit obligations is determined by applying discount rates used to measure defined benefit obligations at the beginning of the year to net defined benefit obligations at the beginning of the year. The net interest expense is recognised within finance costs.

Remeasurement gains and losses comprise actuarial gains and losses, the effect of the asset ceiling (if applicable) and the return on plan assets (excluding interest). Remeasurement gains and losses, and taxation thereon, are recognised in full in the Statement of Comprehensive Income in the period in which they occur and are not subsequently recycled.

Actuarial gains and losses may result from differences between the actuarial assumptions underlying the plan obligations and actual experience during the period or changes in the actuarial assumptions used in the valuation of the plan obligations.

For defined contribution plans, contributions payable are charged to the Income Statement as an operating expense when employees have rendered services entitling them to the contributions.

### Foreign currencies

The individual Financial Statements of each Group company are presented in the currency of the primary economic environment in which it operates (its functional currency). For the purpose of the Consolidated Financial Statements, the results and financial position of each Group company are expressed in pounds Sterling, which is the functional currency of the Company, and the presentation currency for the Consolidated Financial Statements.

In preparing the Financial Statements of the individual companies, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in the Income Statement for the period. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in the Income Statement for the period except for differences arising on the retranslation of non-monetary items in respect of which gains and losses are recognised directly in equity. For such non-monetary items, any exchange component of that gain or loss is also recognised directly in equity.

For the purpose of presenting Consolidated Financial Statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the date of transactions are used. Exchange differences arising, if any, are recognised in the Statement of Comprehensive Income and accumulated in equity (attributed to non-controlling interests as appropriate). Such translation differences are recognised as income or as expenses in the period in which the related operation is disposed of. Any exchange differences that have previously been attributed to non-controlling interests are derecognised but they are not reclassified to the Income Statement.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the rate prevailing at the balance sheet date.

### Taxation

The tax expense is based on the taxable profits for the period and represents the sum of the tax paid or currently payable and deferred tax.

Taxable profit differs from net profit as reported in the Income Statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

A tax provision is recognised for those matters for which the tax determination is uncertain but it is considered probable that there will be a future outflow of funds to a tax authority. The provisions are measured at the best estimate of the amount expected to become payable. The assessment is based on the judgement of tax professionals within the Company supported by previous experience in respect of such activities and in certain cases based on specialist independent advice.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

## 2. Summary of significant accounting policies continued

Deferred tax liabilities are recognised for all taxable temporary differences except:

- where the deferred tax liability arises on the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- where the timing of the reversal of the temporary differences associated with investments in subsidiaries and interests in equity accounted investments can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and carry-forward of unused tax assets and unused tax losses can be utilised except:

- where the deferred tax asset arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and interests in equity accounted investments, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the relevant balance sheet date.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

Tax relating to items recognised directly in other comprehensive income is recognised in the Statement of Comprehensive Income and not in the Income Statement.

Revenues, expenses and assets are recognised net of the amount of sales tax except:

- where the sales tax incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the sales tax is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- where receivables and payables are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the Balance Sheet.

### Share-based payments

The Group has applied the requirements of IFRS 2: "Share-based payment". The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value of the equity instrument excluding the effect of non-market based vesting conditions at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest and adjusted for the effect of non-market based vesting conditions.

Fair value is measured by use of the Black Scholes pricing model. The expected life used in the model has been adjusted, based on the Directors' best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

### Non-current assets and businesses held for sale

Non-current assets and businesses classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non-current assets and businesses are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as having been met only when the sale is highly probable and the asset or business is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

# Notes to the Financial Statements

Continued

## 3. Critical accounting judgements and key sources of estimation uncertainty

In the application of the Group's accounting policies, which are described in note 2, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experiences and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of revision and future periods if the revision affects both current and future periods.

There are critical judgements to disclose within the scope of paragraph 122 of IAS 1: "Presentation of Financial Statements", as well as those involving estimations.

### Key sources of estimation uncertainty

Assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

#### a) Assumptions used to determine the carrying amount of goodwill and other assets

The carrying value of goodwill in the Group at 31 December 2018 was £4,052 million (2017: £1,432 million).

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units ("CGUs") to which the goodwill has been allocated. The value in use calculation requires the Directors to estimate the future cash flows expected to arise from the CGU and a suitable discount rate in order to calculate present value.

#### Brush group of CGUs

During the year ended 31 December 2018, an impairment charge of £123 million has been recorded in respect of the goodwill held in the Brush group of CGUs. At 31 December 2018, goodwill in the Brush group of CGUs had a carrying value of £nil, and therefore there is no further estimation uncertainty in this balance. Total remaining assets at 31 December 2018 are £103 million. Should the business experience further unforeseen deterioration of results a future impairment may be required for these assets. Further details and sensitivity disclosure is included in note 11.

#### Security & Smart Technology and Ergotron groups of CGUs

The determination of the recoverable amount, including goodwill, in respect of the Security & Smart Technology and Ergotron groups of CGUs involved management estimation of the impact of highly uncertain matters, particularly with respect to the possible increase in tariffs in the US for goods being imported from China; the level of competition and technological change in the market; the timing and quantity of forecast unit sales; long-term growth rates and discount factors.

The carrying amount of goodwill and other intangible assets (not including computer software and development costs) at the balance sheet date was £505 million (31 December 2017: £470 million) for Security & Smart Technology.

The carrying amount of goodwill and other intangible assets (not including computer software and development costs) at the balance sheet date was £606 million (31 December 2017: £589 million) for Ergotron.

At 31 December 2018 and 2017, the Group recognised no impairment loss in respect of these assets. Further information including a sensitivity analysis on the key assumptions, is provided in note 11.

#### b) Valuation of warranty liabilities

The warranty related costs provision in the Financial Statements at 31 December 2018 was £387 million (2017: £73 million), as shown in note 20.

The increase in the year was predominantly from the acquisition of GKN and the £295 million provision recorded at the acquisition date. To quantify the fair value of the warranty provision estimates have been made based on historical failure rates, volumes and cost of rectification based on the most up to date information available. As investigations into warranty claims continue, methods and costs of rectification could change materially, giving a variety of ranges of possible outcomes, which could result in a change in the provision. The warranty terms of the Group are, on average, between one and five years, and at 31 December 2018 is equivalent to 1% of the previous three years' total revenue. If the percentage were to increase or decrease by 0.1 percentage points the provision would move by £29 million.

#### c) Assumptions used to determine the carrying amount of the Group's retirement benefit obligations

The Group's pension plans are significant in size. The defined benefit obligations in respect of the plans are discounted at rates set by reference to market yields on high quality corporate bonds. Significant estimation is required when setting the criteria for bonds to be included in the population from which the yield curve is derived. The most significant criteria considered for the selection of bonds to include are the issue size of the corporate bonds, quality of the bonds and the identification of outliers which are excluded. In addition, assumptions are made in determining mortality rates to be used when valuing the plan's defined benefit obligations. At 31 December 2018, the Group's retirement benefit obligation was a deficit of £1,413 million (31 December 2017: £18 million).

Further details of the assumptions applied and a sensitivity analysis on the principal assumptions used to determine the defined benefit obligations of the Group's pension plans are shown in note 23.

### 3. Critical accounting judgements and key sources of estimation uncertainty continued

#### d) Loss-making contracts

On acquisition of GKN, loss-making contract provisions were recorded, which represented the forecast unavoidable costs required to meet the obligations of long-term agreements, in excess of the contractual inflow expected to be generated in respect of these agreements. In assessing the unavoidable costs, management has considered the possibility that future actions could impact the profitability of the contracts. Calculation of the liability includes estimations of volumes, price and costs to be incurred over the life of the contract, which are discounted to a current value. Future changes within these estimates could have a material impact on the provision in future periods. At 31 December 2018, the carrying value of the loss-making contract provision in the Group was £616 million (2017: £3 million). If the margin of these contracts were to improve by one percentage point, the impact on the loss-making contract provision would be £49 million.

#### e) Inventory provisioning

The calculation of inventory provisions requires judgement by management of the expected value of future sales. If the carrying value of inventory is higher than the expected recoverable value, the Group makes provisions writing inventory down to its net recoverable value. The inventory is initially assessed for impairment by comparing inventory levels to recent utilisation rates and carrying values to historical selling prices. A detailed review is completed for inventory lines identified in the initial assessment considering sales activity, order flow, customer contracts and current selling price.

At 31 December 2018, there were provisions of £358 million (31 December 2017: £33 million) against gross inventory of £1,847 million (31 December 2017: £309 million). A one percentage point increase in the proportion of gross inventory provided would increase the provision by £18 million. See note 15 for an analysis of inventory.

#### f) IFRS 15 – Estimates of future revenues and costs of long-term contractual arrangements

During the financial year, the Group has adopted IFRS 15: "Revenue from Contracts with Customers". IFRS 15 required contracts to be reviewed to identify each performance obligation and the associated consideration. Whilst the impact on the Group was immaterial at 1 January 2018, following the acquisition of GKN on 19 April 2018, the Group now has a number of large, complex contracts where significant judgements and estimates are required in order to identify the performance obligations, the associated consideration and the timing of revenue recognition.

A key judgement is the timing of revenue recognition and the associated quantum of variable consideration, in particular relating to risk and revenue sharing partnerships ("RRSPs"). A detailed review has been performed of the Group's RRSP contracts where terms and conditions result in variable consideration. The estimated revenue and costs in respect of these contracts are inherently imprecise and significant estimates are required to assess the pattern of future maintenance activity and the costs to be incurred and escalation of revenue and costs. The estimates take account of the inherent uncertainties, constraining the expected level of revenue as appropriate. Whilst the acquisition of GKN has impacted the Group during the year, due to the maturity profile of certain RRSP contract judgements, beyond initial adoption, IFRS 15 could have a far greater impact in future periods.

#### Key Judgement

##### Allocation of goodwill on acquisition of GKN

The purchase consideration on acquisition of GKN has been allocated to each of the group of CGUs monitored for impairment purposes. Judgement is applied in the basis of allocation which has been completed on an income approach using the proportion of the forecast discounted cash flows of each of the group of CGUs as a percentage of the total as calculated by an external advisor. A validation of the allocation was completed based on market multiples.

### 4. Revenue

An analysis of the Group's revenue, as defined by IFRS 15: "Revenue from Contracts with Customers", is as follows:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>		
Revenue recognised at a point in time	7,602	2,087
Revenue recognised over time	1,003	5
<b>Revenue</b>	<b>8,605</b>	<b>2,092</b>

The Group has approximately £9 billion in respect of contractual transaction prices including a constrained estimate of variable consideration, on four engine programmes, out of a wider population of such programmes, which has been allocated to contracted performance obligations not satisfied at 31 December 2018. These performance obligations will be satisfied and revenue will be recognised over a period of up to 30 years.

As permitted under the transitional provisions in IFRS 15, the comparable amount for the year ended 31 December 2017 is not disclosed. As a practical expedient, performance obligations within a contract that had an original expectation of less than one year in duration have been excluded.

There was no revenue recognised in the current reporting period that related to performance obligations satisfied by the Group in the prior year.

# Notes to the Financial Statements

Continued

## 5. Segment information

Segment information is presented in accordance with IFRS 8: "Operating Segments" which requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reported to the Group's Chief Operating Decision Maker ("CODM"), which has been deemed to be the Group's Board, in order to allocate resources to the segments and assess their performance.

The Group's reportable operating segments were reconsidered following the acquisition of GKN in April 2018. The Group now reports under a revised segment structure and comparative results have been restated accordingly. The operating segments are as follows:

**Aerospace** – comprises GKN's aerospace operations: a multi-technology tier one supplier of air frame and engine structures, including Aerostructures, Engine Systems and Special Technologies.

**Automotive** – comprises GKN's Driveline, All-Wheel Drive and eDrive (together ePowertrain), and Cylinder Liners businesses; a global technology and systems engineer which designs, develops, manufactures and integrates an extensive range of driveline technologies.

**Powder Metallurgy** – a global leader in the manufacture of precision powder metal parts for the automotive and industrial sectors, as well as the production of powder metal.

**Nortek Air & Security** – comprises the Group's Air Management and Security & Smart Technology businesses, previously reported as separate segments. The Air Management and Security & Smart Technology segments have been aggregated based on commonality of economic characteristics, including manufacturing footprint. Air Management includes the Air Quality & Home Solutions business ("AQH") and the Global Heating, Ventilation & Air Conditioning business ("HVAC"). AQH is a leading manufacturer of ventilation products for the professional remodelling and replacement markets, residential new construction market and DIY market. Global HVAC manufactures and sells split-system and packaged air conditioners, heat pumps, furnaces, air handlers and parts for the residential replacement and new construction markets along with custom designed and engineered products and systems for non-residential applications. Security & Smart Technology manufactures and distributes products designed to provide convenience and security primarily for residential applications and audio-visual equipment for the residential audio video and professional video market.

**Other Industrial** – comprises the Group's Ergotron and Brush businesses, previously reported separately as the Ergonomics and Energy segments respectively, as well as GKN's Wheels & Structures and the Walterscheid Powertrain Group (formerly Off-Highway Powertrain) businesses. Further details are provided in the Divisional review.

In addition, there are central cost centres which are also reported to the Board. The central corporate cost centres contain the Melrose Group head office costs, the remaining GKN central costs and charges related to the divisional management long-term incentive plans.

Prior year comparatives have been restated following the change in the Group's segment structure. Reportable segment results include items directly attributable to a segment as well as those which can be allocated on a reasonable basis. Inter-segment pricing is determined on an arm's length basis in a manner similar to transactions with third parties.

The Group's geographical segments are determined by the location of the Group's non-current assets and, for revenue, the location of external customers. Inter-segment sales are not material and have not been disclosed.

The following tables present the results and certain asset and liability information regarding the Group's operating segments and central cost centres for the year ended 31 December 2018.

### a) Segment revenues

The Group derives its revenue from the transfer of goods and services over time and at a point in time. The Group has assessed that the disaggregation of revenue recognised from contracts with customers by operating segments is appropriate as this is the information regularly reviewed by the CODM in evaluating financial performance. The Group also believes that presenting this disaggregation of revenue based on the timing of transfer of goods or services provides useful information as to the nature and timing of revenue from contracts with customers.

Year ended 31 December 2018						
Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Total £m
<b>Adjusted revenue</b>	<b>2,521</b>	<b>3,382</b>	<b>851</b>	<b>1,458</b>	<b>890</b>	<b>9,102</b>
Equity accounted investments	(42)	(446)	(5)	–	(4)	(497)
<b>Revenue</b>	<b>2,479</b>	<b>2,936</b>	<b>846</b>	<b>1,458</b>	<b>886</b>	<b>8,605</b>
<b>Timing of revenue recognition</b>						
At a point in time	1,483	2,936	846	1,458	879	7,602
Over time	996	–	–	–	7	1,003
<b>Revenue</b>	<b>2,479</b>	<b>2,936</b>	<b>846</b>	<b>1,458</b>	<b>886</b>	<b>8,605</b>
<b>Year ended 31 December 2017 – restated</b>						
Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Total £m
<b>Adjusted revenue</b>	–	–	–	<b>1,600</b>	<b>495</b>	<b>2,095</b>
Equity accounted investments	–	–	–	–	(3)	(3)
<b>Revenue</b>	–	–	–	<b>1,600</b>	<b>492</b>	<b>2,092</b>

## 5. Segment information continued

## b) Segment operating profit

Year ended 31 December 2018							
Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate <sup>2</sup> £m	Total £m
<b>Adjusted operating profit/(loss)</b>	<b>250</b>	<b>231</b>	<b>98</b>	<b>198</b>	<b>98</b>	<b>(28)</b>	<b>847</b>
Items not included in adjusted operating profit <sup>(1)</sup> :							
Amortisation of intangible assets acquired in business combinations	(176)	(103)	(34)	(54)	(34)	–	(401)
Restructuring costs	(56)	(46)	(11)	(22)	(73)	(32)	(240)
Acquisition and disposal costs	(7)	–	(1)	–	–	(145)	(153)
Impairment of assets	(17)	–	(3)	–	(132)	–	(152)
Movement in derivatives and associated financial assets and liabilities	–	–	–	–	–	(143)	(143)
Reversal of uplift in value of inventory	(50)	(42)	(11)	–	(18)	–	(121)
Equity accounted investments adjustments	(1)	(24)	–	–	–	–	(25)
Melrose equity-settled compensation scheme charges	–	–	–	–	–	(13)	(13)
Impact of GMP equalisation on UK pension schemes	(2)	(1)	–	–	(1)	(7)	(11)
Release of fair value items	15	–	–	4	1	–	20
<b>Operating (loss)/profit</b>	<b>(44)</b>	<b>15</b>	<b>38</b>	<b>126</b>	<b>(159)</b>	<b>(368)</b>	<b>(392)</b>
Finance costs							(163)
Finance income							5
<b>Loss before tax</b>							<b>(550)</b>
Tax							75
<b>Loss for the year</b>							<b>(475)</b>

Year ended 31 December 2017 – restated							
Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate <sup>2</sup> £m	Total £m
<b>Adjusted operating profit/(loss)</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>215</b>	<b>87</b>	<b>(23)</b>	<b>279</b>
Items not included in adjusted operating profit <sup>(1)</sup> :							
Impairment of assets	–	–	–	–	(145)	–	(145)
Amortisation of intangible assets acquired in business combinations	–	–	–	(56)	(26)	–	(82)
Restructuring costs	–	–	–	(27)	(8)	–	(35)
Melrose equity-settled compensation scheme charges	–	–	–	–	–	(24)	(24)
Acquisition and disposal costs	–	–	–	–	–	(6)	(6)
Release of fair value items	–	–	–	5	1	–	6
<b>Operating profit/(loss)</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>137</b>	<b>(91)</b>	<b>(53)</b>	<b>(7)</b>
Finance costs							(22)
Finance income							1
<b>Loss before tax</b>							<b>(28)</b>
Tax							4
<b>Loss for the year</b>							<b>(24)</b>

(1) Further details on adjusting items are discussed in note 6.

(2) Corporate adjusted operating loss of £28 million (2017: £23 million), includes £6 million in respect of remaining GKN central costs (2017: £nil) and £2 million (2017: £8 million) of costs in respect of divisional long-term incentive plans.

# Notes to the Financial Statements

Continued

## 5. Segment information continued

### c) Segment total assets and liabilities

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate £m	Total £m
<b>At 31 December 2018</b>							
<b>Total assets</b>	7,738	5,675	2,070	2,142	1,494	615	<b>19,734</b>
<b>Total liabilities</b>	(3,053)	(2,320)	(521)	(492)	(499)	(4,588)	<b>(11,473)</b>
<b>At 31 December 2017 – restated</b>							
Total assets	–	–	–	2,030	1,047	69	3,146
Total liabilities	–	–	–	(484)	(173)	(604)	(1,261)

### d) Segment capital expenditure and depreciation

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate £m	Total £m
<b>Year ended 31 December 2018</b>							
<b>Capital expenditure<sup>(1)</sup></b>	105	198	53	44	22	–	<b>422</b>
<b>Depreciation<sup>(1)</sup></b>	88	116	37	24	17	–	<b>282</b>
<b>Year ended 31 December 2017 – restated</b>							
Capital expenditure <sup>(1)</sup>	–	–	–	48	4	–	52
Depreciation <sup>(1)</sup>	–	–	–	23	12	–	35

(1) Including computer software and development costs. Capital expenditure excludes finance lease additions.

### e) Geographical information

The Group operates in various geographical areas around the world. The parent company's country of domicile is the UK and the Group's revenues and non-current assets in Europe and North America are also considered to be material.

The Group's revenue from external customers and information about its segment assets (non-current assets excluding deferred tax assets; non-current trade and other receivables; and non-current derivative financial assets) by geographical location are detailed below:

	Revenue <sup>(1)</sup> from external customers		Segment assets	
	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m	31 December 2018 £m	31 December 2017 £m
<b>Continuing operations</b>				
UK	852	105	2,432	130
Rest of Europe	2,043	124	3,609	109
North America	4,602	1,768	7,241	2,207
Other	1,108	95	1,452	11
<b>Total</b>	<b>8,605</b>	<b>2,092</b>	<b>14,734</b>	<b>2,457</b>

(1) Revenue is presented by destination.

## 6. Reconciliation of adjusted profit measures

As described in note 2, adjusted profit measures are an alternative performance measure used by the Board to monitor the operating performance of the Group.

### a) Operating profit

Continuing operations	Notes	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Operating loss		(392)	(7)
Amortisation of intangible assets acquired in business combinations	a	401	82
Restructuring costs	b	240	35
Acquisition and disposal costs	c	153	6
Impairment of assets	d	152	145
Movement in derivatives and associated financial assets and liabilities	e	143	–
Reversal of uplift in value of inventory	f	121	–
Equity accounted investments adjustments	g	25	–
Melrose equity-settled compensation scheme charges	h	13	24
Impact of GMP equalisation on UK pension schemes	i	11	–
Release of fair value items	j	(20)	(6)
Total adjustments to operating loss		1,239	286
<b>Adjusted operating profit</b>		<b>847</b>	<b>279</b>

- a. The value of intangible assets acquired in business combinations has significantly increased during the year following the acquisition of GKN. As a result, the amortisation charge in the year was £401 million (2017: £82 million) and included eight months of amortisation of intangible assets acquired with GKN. This is excluded from adjusted results due to its non-trading nature and to enable comparison with companies that grow organically. Where intangible assets are trading in nature, such as computer software and development costs, the amortisation is not adjusted.
- b. Restructuring and other associated costs totalled £240 million (2017: £35 million), including £7 million (2017: £1 million) of losses incurred following the announcement of the closure of certain businesses within the Group. Restructuring costs are adjusting items due to their size and non-trading nature and during the year ended 31 December 2018 they included:
- A charge of £156 million in respect of the GKN businesses. Within this, £56 million related to the Aerospace division, predominantly in North America, with key focus on improving quality and delivery for customers. Within the Automotive business £46 million of costs have been incurred restructuring and enhancing the future performance of the business under new leadership. In addition, £54 million of restructuring costs were incurred in respect of early actions within other GKN businesses, including the ceasing of GKN head office functions.
  - A charge of £59 million (2017: £6 million) in respect of the closure of the Dutch turbogenerator facility in Brush and the restructuring of its turbogenerator production in the UK following the announcement on 1 February 2018.
  - A charge of £22 million (2017: £27 million) within Nortek Air & Security, which mostly related to footprint rationalisation within the HVAC business.
- c. Acquisition and disposal costs of £153 million (2017: £6 million) were incurred in the year and included general transaction fees and associated transaction taxes, predominantly in respect of the acquisition of GKN. These costs also included a small amount of fees relating to the £26 million bolt-on acquisition of IntelliVision Inc., by the Security & Smart Technology business and the cost of certain other corporate deal activities in the year. These items are excluded from adjusted results due to their non-trading nature.
- d. An impairment charge totalling £152 million (2017: £145 million) was incurred in the year ended 31 December 2018. This included £132 million in respect of the carrying value of assets held within the Brush business of which £123 million related to goodwill and £9 million to property, plant and equipment. In addition, £15 million of intangible assets and £5 million of property, plant and equipment were impaired in respect of assets held within the GKN businesses. The impairment charges are shown as an adjusting item due to their non-trading nature and size.
- e. Melrose policy is to hedge account where possible, however, hedge accounting has not historically been applied in the GKN businesses for transactional foreign exchange exposure. For consistency, the movement in the value of derivative financial instruments (primarily forward foreign currency exchange contracts) entered into to mitigate the potential volatility of future cash flows on long-term foreign currency customer and supplier contracts, along with foreign exchange movements on the associated financial assets and liabilities, totalling a charge of £143 million (2017: £nil), is shown as an adjusting item because of its volatility and size.
- f. Finished goods and work in progress inventory which are present in a business when acquired, in accordance with IFRS 3, are required to be uplifted in value to closer to their selling price. As a result, in the early months of an acquisition, reduced profits are generated as this inventory is sold. The one-off effect in the year, relating to GKN acquired inventory, was a charge of £121 million (2017: £nil) and is excluded from adjusted results due to its size and non-recurring nature.

# Notes to the Financial Statements

Continued

## 6. Reconciliation of adjusted profit measures continued

g. The Group has a number of equity accounted investments ("EAls") in which it does not hold full control, the largest of which is a 50% interest in Shanghai GKN HUAYU Driveline Systems ("SDS"), within the Automotive business. The EAls generated £497 million of revenue in 2018, which is not included in the statutory results but is shown within adjusted revenue so as not to distort the operating margins reported in the businesses when the adjusted operating profit earned from these EAls is included.

In addition, the profits and losses of EAls, which are shown after amortisation of acquired intangible assets, interest and tax in the statutory results, are adjusted to show adjusted operating profit consistent with the adjusted operating profits of the subsidiaries of the Group. The revenue and profit of EAls are adjusted because they are considered to be significant in size and are important in assessing the performance of the business.

- h. The charge for the Melrose equity-settled Incentive Scheme, including its associated employer's tax charge, of £13 million (2017: £24 million), is excluded from adjusted results due to its volatility. The shares that would be issued, based on the Scheme's current value at the end of the reporting period, are included in the calculation of the adjusted diluted earnings per share, which the Board considers to be a key measure of performance.
- i. On 26 October 2018, a High Court judgement was made in respect of the gender equalisation of guaranteed minimum pensions for occupational pension schemes. The judgement concluded the schemes should be amended to equalise pension benefits for men and women in relation to guaranteed minimum pension benefits, an issue which affects many UK defined benefit pension schemes. The impact of this amendment on the pension schemes within the Group resulted in a specific £11 million increase in the pension deficit with a corresponding past service cost in the Income Statement. This cost is excluded from adjusted results due to its non-trading and non-recurring nature.
- j. Certain items recognised as fair value items on an acquisition totalling £20 million (2017: £6 million), which have been resolved for more favourable amounts than first anticipated, were released as an adjusting item to avoid positively distorting adjusted results.

### b) Profit before tax

	Notes	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>			
Loss before tax		(550)	(28)
Adjustments to operating loss per above		1,239	286
Write-off previous debt facility unamortised fees	k	7	-
Fair value changes on cross-currency swaps	l	8	-
Equity accounted investments – interest	m	(1)	-
Total adjustments to loss before tax		1,253	286
<b>Adjusted profit before tax</b>		<b>703</b>	<b>258</b>

- k. To enable the acquisition of GKN, a new bank facility was negotiated which replaced the old Group bank facility. As a result, the amortisation of the remaining £7 million of debt fees relating to the old facility was accelerated and written off in the year. This charge is shown as an adjusting item because of its one-off, non-trading nature.
- l. The fair value changes on cross-currency swaps relating to cost of hedging which are not deferred in equity, are shown as an adjusting item because of its volatility and non-trading nature.
- m. As explained in paragraph g above, the profits and losses of EAls are shown after interest and tax in the statutory results. They are adjusted to show the profit before tax and the profit after tax, consistent with the subsidiaries of the Group.

### c) Profit after tax

	Notes	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>			
Loss after tax		(475)	(24)
Adjustments to loss before tax per above		1,253	286
Equity accounted investments – tax	m, 8	(9)	-
Net effect of new tax legislation in the US	n	-	(27)
Tax effect of adjustments to loss before tax	8	(230)	(44)
Total adjustments to loss after tax		1,014	215
<b>Adjusted profit after tax</b>		<b>539</b>	<b>191</b>

- n. The net tax credit arising from US tax legislation enacted in December 2017, including an estimated repatriation charge and changes to closing deferred tax items due to a reduction in the Federal tax rate from 35% to 21%, was included as an adjusting item because of its size and nature.

## 7. Revenues and expenses

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>		
<b>Net operating expenses comprise:</b>		
Selling and distribution costs	(240)	(168)
Administration expenses <sup>(1)</sup>	(1,871)	(492)
<b>Total net operating expenses</b>	<b>(2,111)</b>	<b>(660)</b>

(1) Includes £1,093 million (2017: £286 million) of adjusting items (note 6).

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>		
<b>Operating loss is stated after charging/(crediting):</b>		
Cost of inventories	6,920	1,439
Amortisation of intangible assets acquired in business combinations (note 11)	401	82
Depreciation and impairment of property, plant and equipment (note 13)	252	75
Impairment of goodwill (note 11)	123	96
Amortisation and impairment of computer software and development costs (note 11)	59	4
Operating lease expense	68	20
Staff costs	2,192	503
Research and development costs <sup>(1)</sup>	203	63
(Profit)/loss on disposal of property, plant and equipment	(5)	2
Expense of writing down inventory to net realisable value (note 15)	65	12
Reversals of previous write-downs of inventory (note 15)	(20)	(3)
Impairment recognised on trade receivables	35	5
Impairment reversed on trade receivables	(12)	(5)

(1) Includes staff costs totalling £161 million (2017: £44 million).

The analysis of auditor's remuneration is as follows:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Fees payable to the Company's auditor for the audit of the Company's annual accounts	7	2
Fees payable to the Company's auditor for the audit of the GKN acquisition Balance Sheet	2	–
<b>Total fees payable for the audit of the Company's annual accounts</b>	<b>9</b>	<b>2</b>
Fees payable to the Company's auditor and their associates for other audit services to the Group:		
The audit of the Company's subsidiaries pursuant to legislation	1	1
<b>Total audit fees</b>	<b>10</b>	<b>3</b>
Audit-related assurance services:		
Review of the half year interim statement	–	–
Non-statutory audit of certain of the Company's businesses	1	1
<b>Total audit-related assurance services</b>	<b>1</b>	<b>1</b>
<b>Total audit and audit-related assurance services</b>	<b>11</b>	<b>4</b>
Tax compliance services	–	–
Other tax advisory services	–	–
Corporate finance services	–	–
<b>Total audit and non-audit fees</b>	<b>11</b>	<b>4</b>

# Notes to the Financial Statements

Continued

## 7. Revenues and expenses continued

Details of the Company's policy on the use of the auditors for non-audit services and how auditor's independence and objectivity were safeguarded are set out in the Audit Committee report on page 88. No services were provided pursuant to contingent fee arrangements.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>		
<b>Staff costs during the year (including executive Directors)</b>		
Wages and salaries	1,808	434
Social security costs <sup>(1)</sup>	283	52
Pension costs (note 23)		
– defined benefit plans <sup>(2)</sup>	21	–
– defined contribution plans	67	7
Share based compensation expense <sup>(3)</sup> (note 22)	13	10
<b>Total staff costs</b>	<b>2,192</b>	<b>503</b>

- (1) Includes the employer's tax charge on the change in value of the Melrose equity-settled Incentive Scheme, shown as an adjusting item (note 6).  
(2) Includes past service cost of £11 million (2017: £nil) in respect of GMP equalisation on UK pension schemes, shown as an adjusting item (note 6).  
(3) Shown as an adjusting item (note 6).

	Year ended <sup>(1)</sup> 31 December 2018 Number	Year ended <sup>(2)</sup> 31 December 2017 Number
<b>Continuing operations</b>		
<b>Average monthly number of persons employed (including executive Directors)</b>		
Aerospace	16,302	–
Automotive	24,365	–
Powder Metallurgy	7,369	–
Nortek Air & Security	7,827	8,714
Other Industrial	6,418	3,216
Corporate – Melrose	37	30
Corporate – GKN <sup>(3)</sup>	32	–
<b>Total average number of persons employed</b>	<b>62,350</b>	<b>11,960</b>

- (1) For GKN businesses the average monthly number of persons employed in the year ended 31 December 2018 reflects the average for the eight-month period from the date of acquisition.  
(2) Restated to show average monthly number of persons employed in line with the revised segment structure, following the acquisition of GKN.  
(3) At 31 December 2018, two GKN central employees remained within the Group.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>		
<b>Finance costs and income</b>		
Interest on bank loans and overdrafts	(103)	(17)
Amortisation of costs of raising finance <sup>(1)</sup>	(18)	(2)
Net interest cost on pensions	(24)	(1)
Unwind of discount on provisions	(10)	(2)
Fair value changes on cross-currency swaps <sup>(2)</sup>	(8)	–
Total finance costs	(163)	(22)
Finance income	5	1
<b>Total net finance costs</b>	<b>(158)</b>	<b>(21)</b>

- (1) Includes £7 million (2017: £nil) in respect of accelerated future year charges following the repayment of debt facilities as a result of the acquisition of GKN. This cost is excluded from adjusted finance costs (note 6).  
(2) These costs are excluded from adjusted finance costs (note 6).

## 8. Tax

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>		
<b>Analysis of tax credit in year:</b>		
<b>Current tax</b>		
Current year tax charge	55	13
Adjustments in respect of prior years	(21)	–
<b>Total current tax charge</b>	<b>34</b>	<b>13</b>
<b>Deferred tax</b>		
Origination and reversal of temporary differences	(33)	6
Adjustments in respect of prior years	(6)	–
Tax on the change in value of derivative financial instruments	(31)	–
Adjustments to deferred tax attributable to changes in tax rates	(34)	(39)
Loss utilisation against US repatriation charge	–	16
Recognition of previously unrecognised deferred tax assets	(5)	–
<b>Total deferred tax credit</b>	<b>(109)</b>	<b>(17)</b>
<b>Total tax credit</b>	<b>(75)</b>	<b>(4)</b>
<b>Analysis of credit in year:</b>		
	£m	£m
Tax charge in respect of adjusted profit before tax	164	67
Tax credit in respect of adjusting items	(239)	(71)
<b>Total tax credit</b>	<b>(75)</b>	<b>(4)</b>

The tax charge of £164 million (2017: £67 million) arising on adjusted profit before tax of £703 million (2017: £258 million), results in an effective tax rate of 23% (2017: 26%).

Tax in respect of adjusting items includes a credit of £230 million (2017: £44 million) arising on adjusting items of £1,253 million (2017: £286 million), £nil (2017: £27 million) arising from the impact of the US tax measures enacted in December 2017 and £9 million (2017: £nil) in respect of tax on equity accounted investments.

The tax credit for the year for continuing operations can be reconciled to the loss before tax per the Income Statement as follows:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Loss before tax	(550)	(28)
Tax credit on loss before tax at the weighted average rate of 20% (2017: 14%)	(110)	(4)
Tax effect of:		
Disallowable expenses and other permanent differences within adjusted profit	10	5
Disallowable items included within adjusting items	57	22
Temporary differences not recognised in deferred tax	14	11
Recognition of previously unrecognised deferred tax assets	(5)	–
Withholding taxes	10	–
Adjustments in respect of prior years	(27)	(10)
Tax charge/(credit) classified within adjusting items	10	(27)
Effect of changes in tax rates	(34)	(1)
<b>Total tax credit for the year</b>	<b>(75)</b>	<b>(4)</b>

The reconciliation has been performed at a blended Group tax rate of 20% (2017: 14%) which represents the weighted average of the tax rates applying to profits and losses in the jurisdictions in which those results arose.

# Notes to the Financial Statements

Continued

## 8. Tax continued

Tax credits included in Other Comprehensive Income are as follows:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Deferred tax on retirement benefit obligations	(9)	1
Deferred tax on hedge relationship gains and losses	(24)	1
Deferred tax on foreign currency gains and losses	(5)	–
<b>Total (credit)/charge for the year</b>	<b>(38)</b>	<b>2</b>

In addition to the amounts recognised in Other Comprehensive Income in 2017, a deferred tax credit of £34 million in respect of share-based payments was recognised directly in retained earnings.

### Franked investment income – litigation

Since 2003, the GKN Group has been involved in litigation with HMRC in respect of various advance corporate tax payments and corporate tax paid on certain foreign dividends which, in its view, were levied by HMRC in breach of the Group's EU community law rights. The most recent Court of Appeal judgement in the case was published in November 2016. This judgement was broadly positive but HMRC have sought leave to appeal.

The continuing complexity of the remaining case and uncertainty over the issues raised (and in particular which points HMRC may seek to appeal) means that it is not possible to predict the final outcome of the litigation with any reasonable degree of certainty. A successful outcome could result in the Group being able to recognise additional deferred tax assets in the UK and receiving cash payments from HMRC.

## 9. Dividends

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Final dividend for the year ended 31 December 2016 paid of 1.9p	–	36
Interim dividend for the year ended 31 December 2017 paid of 1.4p	–	27
Final dividend for the year ended 31 December 2017 paid of 2.8p	54	–
Interim dividend for the year ended 31 December 2018 paid of 1.55p	75	–
	<b>129</b>	<b>63</b>

Proposed final dividend for the year ended 31 December 2018 of 3.05p per share (2017: 2.8p per share) totalling £148 million (2017: £54 million).

The final dividend of 3.05p was proposed by the Board on 7 March 2019 and, in accordance with IAS 10: "Events after the reporting period", has not been included as a liability in these Consolidated Financial Statements.

## 10. Earnings per share

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Earnings attributable to owners of the parent</b>		
Earnings for basis of earnings per share from continuing operations	(475)	(24)

	Year ended 31 December 2018 Number	Year ended 31 December 2017 Number
Weighted average number of ordinary shares for the purposes of basic earnings per share (million)	3,959	1,919
Further shares for the purposes of diluted earnings per share (million)	–	22
Weighted average number of ordinary shares for the purposes of diluted earnings per share (million)	3,959	1,941

On 19 April 2018, 2,469 million ordinary shares were issued as a result of the acquisition of GKN. Further issues of share capital totalling 448 million took place between 19 April 2018 and 30 June 2018 in order to purchase the remaining non-controlling interests of GKN. The total number of ordinary shares in issue therefore increased from 1,941 million at 31 December 2017 to 4,858 million at 31 December 2018.

	Year ended 31 December 2018	Year ended 31 December 2017
<b>Earnings per share</b>		
Basic earnings per share	(12.0)p	(1.2)p
Diluted earnings per share	(12.0)p	(1.2)p

## 10. Earnings per share continued

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Adjusted earnings</b>		
Adjusted earnings for the basis of adjusted earnings per share <sup>(1)</sup>	<b>526</b>	<b>191</b>

(1) Adjusted earnings for the year ended 31 December 2018 comprises adjusted profit after tax of £539 million (note 6), net of an allocation to non-controlling interest of £13 million.

## Adjusted earnings per share

	Year ended 31 December 2018	Year ended 31 December 2017
<b>Continuing operations</b>		
Adjusted basic earnings per share	<b>13.3p</b>	<b>9.9p</b>
Adjusted diluted earnings per share	<b>13.3p</b>	<b>9.8p</b>

## 11. Goodwill and other intangible assets

	Goodwill £m	Customer relationships and contracts £m	Brands and Intellectual property £m	Other <sup>(1)</sup> £m	Computer <sup>(2)</sup> software £m	Development <sup>(2)</sup> costs £m	Total £m
<b>Cost</b>							
At 1 January 2017	1,648	623	398	32	22	–	2,723
Additions	–	–	–	–	–	4	4
Disposals	–	–	–	–	(1)	–	(1)
Exchange adjustments	(120)	(52)	(23)	(3)	(1)	(1)	(200)
At 31 December 2017	1,528	571	375	29	20	3	2,526
Acquisition of businesses	2,538	4,268	473	999	24	444	8,746
Additions	–	–	–	–	11	24	35
Disposals	–	–	–	–	(5)	(1)	(6)
Exchange adjustments	205	366	23	29	3	26	652
<b>At 31 December 2018</b>	<b>4,271</b>	<b>5,205</b>	<b>871</b>	<b>1,057</b>	<b>53</b>	<b>496</b>	<b>11,953</b>
<b>Amortisation and impairment</b>							
At 1 January 2017	–	(41)	(55)	(6)	(11)	–	(113)
Charge for the year:							
Adjusted operating profit	–	–	–	–	(4)	–	(4)
Adjusting items	–	(50)	(23)	(9)	–	–	(82)
Impairments <sup>(3)</sup>	(96)	–	–	–	–	–	(96)
Disposals	–	–	–	–	1	–	1
Exchange adjustments	–	4	1	1	–	–	6
At 31 December 2017	(96)	(87)	(77)	(14)	(14)	–	(288)
Charge for the year:							
Adjusted operating profit	–	–	–	–	(11)	(33)	(44)
Adjusting items	–	(275)	(44)	(82)	–	–	(401)
Impairments <sup>(4)</sup>	(123)	–	–	–	–	(15)	(138)
Disposals	–	–	–	–	4	1	5
Exchange adjustments	–	(10)	(3)	(2)	(1)	–	(16)
<b>At 31 December 2018</b>	<b>(219)</b>	<b>(372)</b>	<b>(124)</b>	<b>(98)</b>	<b>(22)</b>	<b>(47)</b>	<b>(882)</b>
<b>Net book value</b>							
<b>At 31 December 2018</b>	<b>4,052</b>	<b>4,833</b>	<b>747</b>	<b>959</b>	<b>31</b>	<b>449</b>	<b>11,071</b>
At 31 December 2017	1,432	484	298	15	6	3	2,238

(1) Other includes technology and order backlog intangible assets acquired with the Nortek and GKN businesses.

(2) Computer software and development costs were shown aggregated in 2017.

(3) The impairment in 2017 relates to an impairment recognised in Brush.

(4) The impairments in 2018 relate to goodwill in Brush and development costs in Aerospace.

The goodwill generated as a result of major acquisitions represents the premium paid in excess of the fair value of all net assets, including intangible assets, identified at the point of acquisition. The carrying value of goodwill includes a premium, paid in order to secure shareholder agreement to the business combination, that is less than the value that the Directors believed could be added to the acquired businesses through the application of their specialist turnaround experience.

The goodwill arising on bolt-on acquisitions is attributable to the anticipated profitability and cash flows arising from the businesses acquired, synergies as a result of the complementary nature of the business with existing Melrose businesses, the assembled workforce, technical expertise, know-how, market share and geographical advantages afforded to the Group.

# Notes to the Financial Statements

Continued

## 11. Goodwill and other intangible assets continued

The future improvements applied to the acquired businesses, achieved through a combination of revised strategic direction, operational improvements and investment, are expected to result in improved profitability of the acquired businesses during the period of ownership and are also expected to result in enhanced disposal proceeds when the acquired businesses are ultimately disposed. The combined value achieved from these improvements is expected to be in excess of the value of goodwill acquired.

Goodwill acquired in business combinations, net of impairment, has been allocated to the businesses, each of which comprises several cash-generating units ("CGUs"). Goodwill in respect of GKN businesses remains provisional at 31 December 2018.

Goodwill	31 December 2018 £m	31 December 2017 £m
Brush	-	122
<b>Nortek businesses:</b>		
AQH	370	348
HVAC	246	232
Security & Smart Technology	357	320
Ergotron	435	410
<b>GKN businesses:</b>		
Aerostructures	576	-
Aerospace Engine Systems	347	-
Aerospace Special Technologies	51	-
Automotive Driveline	704	-
Automotive ePowertrain	345	-
Powder Metallurgy	529	-
The Walterscheid Powertrain Group	92	-
	<b>4,052</b>	<b>1,432</b>

### Impairment Testing

The Group tests goodwill annually or more frequently if there are indications that goodwill might be impaired. In accordance with IAS 36: "Impairment of assets" the Group values goodwill at the recoverable amount, being the higher of the value in use basis and the fair value less costs to sell basis.

Value in use calculations have been used to determine the recoverable amount of goodwill allocated to each group of CGUs. The calculation uses the latest approved forecast extrapolated to perpetuity using growth rates shown below, which do not exceed the long-term growth rate for the relevant market.

Based on impairment testing completed at the year end, no impairment was identified in respect of the Nortek businesses or the GKN businesses. No reasonably possible change in key assumptions would result in an impairment in the AQH and HVAC groups and GKN groups of CGUs. The recoverable amount of the GKN groups of CGUs at 31 December 2018 are higher than the recent acquisition date fair values. As a result, no sensitivity analysis has been disclosed for these businesses.

Both Security & Smart Technology and Ergotron have manufacturing facilities located in China that export to the US and their results in 2018, and the ongoing market environment, have been negatively impacted by the increase in US tariffs placed on Chinese goods. The intention is to pass any increased tariffs through to customers, but the uncertainty around how customers will react and/or a further escalation of US tariffs on Chinese goods and the impact that this could have on the behaviour of competitors means that there is a risk that future forecasts could be negatively impacted. No impairment of goodwill is required within these businesses, but sensitivity analysis has been provided.

An impairment charge of £123 million in respect of goodwill recorded in the Brush group of CGUs has been recorded in the Consolidated Income Statement and is shown as an adjusting item (note 6).

## 11. Goodwill and other intangible assets continued

### Significant assumptions and estimates

Each group of CGUs has been assessed through a value in use methodology, using the following significant assumptions.

The basis of these impairment tests and the key assumptions are set out in the table below:

Group of CGUs	31 December 2018			31 December 2017		
	Pre-tax discount rates	Long-term growth rates	Period of forecast	Pre-tax discount rates	Long-term growth rates	Period of forecast
Brush	10.8%	1.5%	5	11.9%	2.2%	5
AQH	11.8%	3.3%	3	12.6%	3.0%	4
HVAC	11.8%	3.1%	3	12.6%	3.0%	4
Security & Smart Technology	12.0%	3.3%	3	12.6%	3.0%	4
Ergotron	11.8%	3.3%	3	12.6%	3.0%	4
Aerostructures	10.2%	2.0%	5	-	-	-
Aerospace Engine Systems	10.1%	2.5%	5	-	-	-
Aerospace Special Technologies	9.7%	2.5%	5	-	-	-
Automotive Driveline	11.6%	0.0%	5	-	-	-
Automotive ePowertrain	12.0%	3.0%	5	-	-	-
Powder Metallurgy	12.0%	2.0%	5	-	-	-
The Walterscheid Powertrain Group	14.5%	2.0%	5	-	-	-

### Pre-tax risk adjusted discount rates

Cash flows are discounted using a pre-tax discount rate specific to each group of CGUs. Discount rates reflect the current market assessments of the time value of money and the territories in which the CGU operates. In determining the cost of equity, the Capital Asset Pricing Model ("CAPM") has been used. Under CAPM, the cost of equity is determined by adding a risk premium, based on an industry adjustment ("Beta"), to the expected return of the equity market above the risk-free return. The relative risk adjustment reflects the risk inherent in each group of CGUs relative to all other sectors and geographies on average.

The cost of debt is determined using a risk-free rate based on the cost of government bonds, and an interest rate premium equivalent to a corporate bond with a similar credit rating to Melrose.

### Assumptions applied in financial forecasts

The Group prepares cash flow forecasts derived from financial budgets and medium-term forecasts. Each forecast has been prepared using a cash flow period deemed most appropriate by management, considering the nature of each group of CGUs. The key assumptions used in forecasting pre-tax cash flows relate to future budgeted revenue and operating margins likely to be achieved and the expected rates of long-term growth by market sector. Underlying factors in determining the values assigned to each key assumption are shown below:

#### Revenue growth and operating margins:

Revenue growth assumptions in the forecast period are based on financial budgets and medium-term forecasts by management, taking into account industry growth rates and management's historical experience in the context of wider industry and economic conditions. Projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates, projections of developments in key markets, secured orders and orders forecast to be achieved in the short to medium term given trends in the relevant market sector.

Operating margins have been forecast based on historical levels achieved considering the likely impact of changing economic environments and competitive landscapes on volumes and revenues and the impact of management actions on costs. Projected margins reflect the impact of all initiated projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed. Forecasts for other operating costs are based on inflation forecasts and supply and demand factors.

**Aerospace** – The key drivers for growth in revenue and operating margins are global demand for commercial and military aircraft. Consumer spending, passenger load factors, raw material input costs, market expectations for aircraft production requirements, technological advancements, and other macroeconomic factors influence demand for these products.

**Automotive** – The key drivers for growth in revenue and operating margins are global demand for a large range of cars including smaller low-cost to larger premium vehicles. Demand is influenced by technological advancements particularly in electric and full hybrid vehicles, market expectations for global vehicle production requirements, fuel prices, raw material input costs, consumer spending, credit availability, and other macroeconomic factors.

**Powder Metallurgy** – The key drivers for growth in revenue and operating margins are trends in the automotive and industrial markets. Market expectations for global light vehicle production requirements, raw material input costs, technological advancements, particularly in additive manufacturing, influence demand for these products along with other macroeconomic factors.

**The Walterscheid Powertrain Group** – The key drivers for growth in revenue and operating margins are the global demand in the agricultural, construction, mining, utility and industrial markets. Demand for these products is impacted by raw material input costs, consumer spending, market expectations on future production requirements, particularly in the agricultural and industrial sectors, and other macroeconomic factors.

# Notes to the Financial Statements

Continued

## 11. Goodwill and other intangible assets continued

**HVAC and AQH** – The key drivers for growth in revenue and operating margins are the levels of residential remodelling and replacement activity and the levels of residential and non-residential new construction in the markets in which these businesses operate. New residential and non-residential construction activity and, to a lesser extent, residential remodelling and replacement activity are affected by seasonality and cyclical factors such as interest rates, credit availability, inflation, consumer spending, employment levels and other macroeconomic factors.

**Security & Smart Technology** – The key driver for growth in revenue and operating margins is global demand for security and home automation products. Consumer spending, employment levels, regulation, technological advancements and the evolution of the traditional security market towards home automation and other macroeconomic factors influence demand for these products.

**Ergotron** – The key driver for growth in revenue and operating margins is demand for technology and wellness products in the markets in which Ergotron operates. Seasonal factors, public authority spending, corporate and consumer spending, employment levels, the public awareness of wellness, regulation, technological advancements and other macroeconomic factors influence demand for these products.

**Brush** – The key drivers for growth in revenues and operating margins are: i) original equipment investments in the global power market, both new capacity (mainly emerging markets) and replacement capacity (mainly in mature markets); ii) growth in service requirements of the installed base; and iii) new product introduction. Independent forecasts of growth in these power generation markets have been used to derive revenue growth assumptions. Forecasts for other operating costs are based on inflation forecasts and supply and demand factors.

### Long-term growth rates:

Long-term growth rates are based on long-term forecasts for growth in the sectors and geography in which the CGU operates. Long-term growth rates are determined using a blend of publicly available data and a long-term growth rate forecast that takes into account the international presence and the markets in which each business operates.

### Brush group of CGUs

In the previous year, the assets of the Brush business were impaired by £145 million to a value of £300 million, using the fair value less costs to sell basis. This method of valuation, at the time, was higher than the value in use method, because the latter excluded the benefits of the restructuring announced in February 2018, and would have given a value of £178 million.

The restructuring of the Brush business that was announced in February 2018 followed a full review of the power generation industry and highlighted the surplus generator manufacturing capacity existing in the market. The restructuring programme has been implemented in line with plan.

However, in 2018 the conditions in the generator services business have also become more challenging as the year has progressed, with competitors taking a decision to look to service opportunities to offset surplus capacity issues in the generator manufacturing market. Alongside this, customers and competitors in the power generation sector have continued to reorganise and restructure in the second half of 2018.

These newly developed generator services market conditions and the decisions from significant market participants have had a direct impact on the trading of Brush and reduced forecasts in the Brush generator servicing business.

At 31 December 2018, the recoverable amount of the Brush assets, using the reduced forecasts and the value in use method, was £103 million, resulting in a further impairment to Brush goodwill of £123 million in the year.

### Sensitivity analysis

Further sensitivity analysis has been carried out on the Brush group of CGUs. For illustration purposes, a further 0.1 percentage point increase in the discount rate or a further five per cent reduction in the annual and terminal value of operating profit could result in a reduction in the value in use of £1 million and £5 million respectively. A further 0.1 percentage point decrease in the long-term growth rate could result in a reduction in the value in use of £1 million.

### Security & Smart Technology group of CGUs

The goodwill related to the Security & Smart Technology (“SST”) group of CGUs is tested for impairment by comparing the carrying amount of the SST group against recoverable amounts of the SST CGUs. As disclosed within note 3, determination of the recoverable amount involved management judgement on highly uncertain matters, particularly with respect to the possible increase in tariffs in the US for goods being imported from China; the level of competition and technological change in the market; the timing and quantity of forecast unit sales; long-term growth rates and discount factors. The value in use model prepared for the SST group was prepared using latest cash flow projections for the period 2019-2021 followed by an assumed long-term growth rate of 3.3%. These cash flow projections were discounted at a pre-tax discount rate of 12.0% and used sale price and cost inflation data from available market sources.

### Sensitivity analysis

The forecasts, prepared using a methodology required by IAS 36, show headroom of £88 million above the carrying amount for the SST group of CGUs. In accordance with IAS 36 a sensitivity analysis has been undertaken and a reasonably possible increase in the discount rate from 12.0% to 13.4% would reduce headroom to £nil. A reasonably possible decrease in the long-term growth rate from 3.3% to 1.7% would reduce headroom to £nil. In relation to a possible increase in US tariffs, it is difficult to model the precise impact on business performance at this time but this would likely lead to reduced sales and margins in the short term. A five per cent reduction in the annual and terminal value of operating profit could result in a reduction in the value in use of £34 million.

## 11. Goodwill and other intangible assets continued

### Ergotron group of CGUs

The goodwill related to the Ergotron group of CGUs is tested for impairment by comparing the carrying amount of the Ergotron group against recoverable amounts of the Ergotron CGUs. As disclosed within note 3, determination of the recoverable amount involved management judgement on highly uncertain matters, particularly with respect to the possible increase in tariffs in the US for goods being imported from China as well as long-term growth rates. The value in use model prepared for the Ergotron group used the latest cash flow projections for the period 2019-2021 followed by an assumed long-term growth rate of 3.3%. These cash flow projections were discounted at a pre-tax discount rate of 11.8% and used sale price and cost inflation data from available market sources.

### Sensitivity analysis

The forecasts, prepared using a methodology required by IAS 36, show headroom of £198 million above the carrying amount for the Ergotron group of CGUs. In accordance with IAS 36 a sensitivity analysis has been undertaken and a reasonably possible decrease in the long-term growth rate from 3.3% to 0.2% would reduce headroom to £nil. In relation to a possible increase in US tariffs, it is difficult to model the precise impact on business performance at this time but this would likely lead to reduced sales and margins in the short term. A five per cent reduction in the annual and terminal value of operating profit could result in a reduction in the value in use of £42 million.

### Allocation of significant intangible assets

The allocation of significant customer relationships, brands, intellectual property and technology is as follows:

	Customer relationships				Brands, intellectual property and technology			
	Remaining amortisation period		Net book value		Remaining amortisation period		Net book value	
	31 December 2018 years	31 December 2017 years	31 December 2018 £m	31 December 2017 £m	31 December 2018 years	31 December 2017 years	31 December 2018 £m	31 December 2017 £m
Brush	-	1	-	2	10	11	55	61
AQH	12	13	176	180	13	14	55	56
HVAC	9	10	93	97	13	14	71	72
Security & Smart Technology <sup>(1)</sup>	12	13	108	110	13	14	40	40
Ergotron	8	9	88	95	16	17	83	84
Aerostructures	10	-	604	-	20	-	529	-
Aerospace Engine Systems	20	-	1,960	-	20	-	203	-
Aerospace Special Technologies	10	-	53	-	20	-	61	-
Automotive Driveline	12	-	693	-	20	-	122	-
Automotive ePowertrain	9	-	334	-	20	-	329	-
Powder Metallurgy	17	-	651	-	20	-	85	-
The Walterscheid Powertrain Group	15	-	63	-	8	-	62	-
Wheels & Structures	20	-	10	-	20	-	11	-
			4,833	484			1,706	313

(1) The Security & Smart Technology brands, intellectual property and technology balance at 31 December 2018 includes £9 million in relation to IntelliVision, acquired in the year.

# Notes to the Financial Statements

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## 12. Acquisitions

### GKN

On 19 April 2018 the Group acquired approximately 85% of the issued share capital and obtained control of GKN plc for consideration of £7,091 million. The remaining 15% of share capital was acquired subsequently, at a cost of £1,260 million which has been treated as a purchase of a non-controlling interest.

GKN is a global engineering business which designs, manufactures and services systems and components for original equipment manufacturers, specialising in the aerospace and automotive markets.

The Group has reviewed the assets and liabilities acquired. Due to the size of the acquired business, the assessment of the fair value of the assets and liabilities acquired has not yet been finalised. In accordance with IFRS 3: "Business combinations", the acquisition Balance Sheet of GKN at 19 April 2018 remains provisional as of 31 December 2018 as there could be further adjustment to the fair values recognised in the table below, if additional information comes to light.

	GKN £m	IntelliVision £m	Provisional fair value £m
Property, plant and equipment	2,619	–	2,619
Intangible assets	6,199	9	6,208
Interests in equity accounted investments	512	–	512
Inventories	1,173	–	1,173
Trade and other receivables, excluding contract assets <sup>(1)</sup>	1,973	1	1,974
Contract assets	524	–	524
Cash and cash equivalents	307	–	307
Trade and other payables	(2,915)	–	(2,915)
Derivative financial instruments	(137)	–	(137)
Provisions and contingent liabilities	(1,180)	–	(1,180)
Deferred tax	(761)	–	(761)
Retirement benefit obligations	(1,369)	–	(1,369)
Current tax liabilities	(89)	–	(89)
Interest-bearing loans and borrowings	(1,430)	–	(1,430)
Non-controlling interests <sup>(2)</sup>	(857)	–	(857)
<b>Net assets attributable to the parent</b>	<b>4,569</b>	<b>10</b>	<b>4,579</b>
Total consideration	7,091	26	7,117
Provisional goodwill	2,522	16	2,538
Total consideration satisfied by:			
Cash consideration	1,290	26	1,316
Shares issued to GKN shareholders	5,801	–	5,801

(1) The fair value of financial assets includes gross trade and other receivables of £1,994 million. The best estimate at the acquisition date of the contractual cash flows not to be collected is £20 million.

(2) Non-controlling interests include an amount of £830 million in respect of approximately 15% of the issued share capital of GKN not acquired on 19 April 2018, but subsequently purchased in the period 19 April 2018 to 30 June 2018.

## 12. Acquisitions continued

GKN contributed £7,212 million to adjusted revenue and £607 million to adjusted operating profit for the period between the date of acquisition and the balance sheet date. The amounts recognised in relation to GKN for the period from 19 April to 31 December 2018 include revenue and profit and the associated impact on working capital, based on an estimate of activity from 19 April to 30 April 2018. If the acquisition of GKN had been completed on the first day of the financial year, Group adjusted revenues would have been £12,247 million and Group adjusted operating profit would have been £1,095 million.

The goodwill arising on acquisition of GKN is attributable to the anticipated profitability and cash flows arising from the businesses acquired, the assembled workforce, technical expertise, know-how, market share and geographical advantages afforded to the Group, and which, the Group expects to realise through a combination of revised strategic direction, operational improvements and investment. None of the goodwill is expected to be deductible for income tax purposes.

Contingent liabilities acquired in respect of legal claims of £15 million have been recognised within provisions, none of which were utilised in the period. The majority of expenditure is expected to be incurred over the next five years.

In determining the fair value of assets acquired in the GKN business combination, a number of estimates and judgements have been made. The fair value exercise was carried out in conjunction with independent experts and considered the existence and valuation of the acquired assets and liabilities, and the goodwill which has arisen.

### Intangible assets

Intangible assets inherent in GKN's customer relationships/contracts were valued using an excess earnings method. This methodology places a value on the asset as a function of (a) management's estimate of the expected cash flows arising from the customer contracts; (b) discount rates reflective of the risks inherent in the cash flows; and (c) a contributory charge attributable to assets needed to generate the operating cash flows. An after-tax discount rate of 8.5% to 10.8% was applied to the forecast cash flows.

The tradenames within the GKN business were deemed to have measurable value as they are well recognised in their industries. They have been valued using a relief from royalty methodology based on projected cash flows attributable to the tradename and an assumed royalty rate that would be charged if the name were subject to licence within a comparable trade situation and an appropriate discount rate reflecting inherent risk in the projected cash flows. A total fair value of £473 million has been recognised for tradenames and intellectual property.

The proprietary technology and know-how has been valued using a relief from royalty methodology, consistent with the Group accounting policy. The cash flow forecasts supporting this valuation reflect the future sales to be generated in conjunction with the technology. The fair value is attributed to the proprietary technology and represents the theoretical costs avoided by GKN from not having to pay a licence fee for the technology. The royalty rates used in the valuation were 3.0% to 4.5% based on review of licence agreements for comparable technologies in a similar segment. After-tax discount rates of 9.5% to 10.5% were applied to the forecast cash flows, rates that reflect the inherent risk within cash flows and are comparable with the weighted average cost of capital for the acquisition.

The valuation of all intangible assets reflects the tax benefit of amortisation, which has been assessed with reference to country tax laws.

### IntelliVision Inc. ("IntelliVision")

On 27 April 2018, the Group's Security & Smart Technology business acquired 100% of the issued share capital and obtained control of IntelliVision, a leader in artificial intelligence, smart cameras and video analytics software, for consideration of £26 million. The amounts recognised in respect of the identifiable assets acquired and liabilities assumed are set out in the table above. Fair values remain provisional as at 31 December 2018 in case additional information comes to light that would require adjustment to the fair values recognised in the table above.

Transaction costs incurred on all acquisition and disposal activities during the year and charged through the Income Statement totalled £153 million (note 6).

# Notes to the Financial Statements

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## 13. Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Total £m
<b>Cost</b>			
At 1 January 2017	139	186	325
Additions	9	39	48
Disposals	(3)	(11)	(14)
Transfer to held for sale	(12)	(6)	(18)
Exchange adjustments	(3)	(6)	(9)
At 31 December 2017	130	202	332
Acquisition of businesses	715	1,904	2,619
Additions <sup>(1)</sup>	57	369	426
Disposals	(10)	(41)	(51)
Disposal of businesses	–	(8)	(8)
Exchange adjustments	51	145	196
<b>At 31 December 2018</b>	<b>943</b>	<b>2,571</b>	<b>3,514</b>
<b>Accumulated depreciation and impairment</b>			
At 1 January 2017	(11)	(42)	(53)
Charge for the year	(6)	(25)	(31)
Disposals	–	10	10
Transfer to held for sale	1	2	3
Impairments	(16)	(28)	(44)
Exchange adjustments	1	1	2
At 31 December 2017	(31)	(82)	(113)
Charge for the year	(26)	(212)	(238)
Disposals	–	36	36
Impairments <sup>(2)</sup>	(3)	(11)	(14)
Exchange adjustments	(2)	(12)	(14)
<b>At 31 December 2018</b>	<b>(62)</b>	<b>(281)</b>	<b>(343)</b>
<b>Net book value</b>			
<b>At 31 December 2018</b>	<b>881</b>	<b>2,290</b>	<b>3,171</b>
At 31 December 2017	99	120	219

(1) Additions include £39 million (2017: £nil) in relation to assets acquired under finance leases.

(2) Treated as an adjusting item (note 6).

## 14. Equity accounted investments

	31 December 2018 £m	31 December 2017 £m
Aggregated amounts relating to equity accounted investments:		
Share of current assets	382	3
Share of non-current assets	420	–
Share of current liabilities	(231)	(3)
Share of non-current liabilities	(79)	–
<b>Interests in equity accounted investments</b>	<b>492</b>	<b>–</b>

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Group share of results</b>		
Revenue	497	3
Operating costs	(438)	(3)
Adjusted operating profit	59	–
Adjusting items	(15)	–
Net finance costs	(1)	–
Profit before tax	43	–
Tax	(9)	–
<b>Share of results of equity accounted investments</b>	<b>34</b>	<b>–</b>

## 14. Equity accounted investments continued

	Year ended	Year ended
	31 December	31 December
	2018	2017
	£m	£m
<b>Group share of equity accounted investments</b>		
At 1 January	-	-
Acquisition of businesses	512	-
Share of results of equity accounted investments	34	-
Additions	3	-
Dividends paid to the Group	(66)	-
Exchange adjustments	9	-
<b>At 31 December</b>	<b>492</b>	<b>-</b>

Within the Group's share of equity accounted investments the Group has one significant joint venture, held within the Automotive segment, Shanghai GKN HUAYU Driveline Systems Co Limited ("SDS"). SDS had total sales in the post-acquisition period of £839 million, adjusted operating profit of £108 million, adjusting items of £30 million, an interest charge of £nil and a tax charge of £16 million, leaving retained profit of £62 million.

Total net assets of SDS at 31 December 2018 were £937 million. These comprised non-current assets of £805 million, current assets of £464 million, current liabilities of £319 million and non-current liabilities of £13 million. During 2018, SDS paid a dividend to the Group of £58 million. Further information about SDS can be found in note 3 to the Melrose Industries PLC Company Financial Statements.

## 15. Inventories

	31 December	31 December
	2018	2017
	£m	£m
Raw materials	659	79
Work in progress	328	55
Finished goods	502	142
	<b>1,489</b>	<b>276</b>

In 2018 the write-down of inventories to net realisable value amounted to £65 million (2017: £12 million), of this, £18 million (2017: £4 million) related to restructuring activities and is included within adjusting items. The reversal of write-downs amounted to £20 million (2017: £3 million). Write-downs and reversals in both years relate to ongoing assessments of inventory obsolescence, excess inventory holding and inventory resale values across all of the Group's businesses.

The Directors consider that there is no material difference between the Balance Sheet value of inventories and their replacement cost.

## 16. Trade and other receivables

	31 December	31 December
	2018	2017
	£m	£m
<b>Current</b>		
Trade receivables	1,877	313
Allowance for doubtful receivables	(42)	(15)
Other receivables	256	21
Prepayments	37	13
Contract assets	200	-
	<b>2,328</b>	<b>332</b>

Trade receivables are non interest-bearing. Credit terms offered to customers vary upon the country of operation but are generally between 30 and 90 days.

	31 December	31 December
	2018	2017
	£m	£m
<b>Non-current</b>		
Other receivables	108	2
Contract assets	396	-
	<b>504</b>	<b>2</b>

As described in note 24, certain businesses participate in receivables working capital programmes and have the ability to choose whether to receive payment earlier than the normal due date, for specific customers on a non-recourse basis. As at 31 December 2018, all eligible receivables under these programmes have been factored and derecognised in line with the derecognition criteria of IFRS 9. There are no amounts due under such schemes at the year end.

# Notes to the Financial Statements

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## 16. Trade and other receivables continued

An allowance has been made for expected lifetime credit losses with reference to past default experience and management's assessment of credit worthiness over trade receivables, other receivables and contract assets, an analysis of which is as follows:

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Total £m
At 1 January 2017	-	-	-	17	1	18
Income Statement charge	-	-	-	-	-	-
Utilised	-	-	-	(1)	-	(1)
Transfer to held for sale	-	-	-	(1)	-	(1)
Exchange adjustments	-	-	-	(1)	-	(1)
At 31 December 2017	-	-	-	14	1	15
Adoption of IFRS 9	-	-	-	2	-	2
Income Statement charge/(credit)	13	6	3	(4)	5	23
Utilised	-	-	-	(2)	(1)	(3)
Exchange adjustments	2	-	-	2	1	5
<b>At 31 December 2018</b>	<b>15</b>	<b>6</b>	<b>3</b>	<b>12</b>	<b>6</b>	<b>42</b>

The concentration of credit risk is limited due to the large number of unrelated customers. Credit control procedures are implemented to ensure that sales are only made to organisations that are willing and able to pay for them. Such procedures include the establishment and review of customer credit limits and terms. The Group does not hold any collateral or any other credit enhancements over any of its trade receivables nor does it have a legal right of offset against any amounts owed by the Group to the counterparty.

The ageing of impaired trade receivables past due is as follows:

	31 December 2018 £m	31 December 2017 £m
0 – 30 days	12	11
31 – 60 days	1	-
60+ days	29	4
	<b>42</b>	<b>15</b>

Included in the Group's trade receivables balance are overdue trade receivables with a carrying amount of £208 million (31 December 2017: £55 million) against which a provision of £42 million (31 December 2017: £15 million) is held.

The balance deemed recoverable of £166 million (31 December 2017: £40 million) is past due as follows:

	31 December 2018 £m	31 December 2017 £m
0 – 30 days	124	28
31 – 60 days	33	6
60+ days	9	6
	<b>166</b>	<b>40</b>

The Directors consider that the carrying amount of trade and other receivables, including amounts not past due and not impaired, approximates to their fair value.

## 16. Trade and other receivables continued

The Group's contract assets comprise the following:

	Participation fees £m	Unbilled receivables £m	Variable consideration £m	Other £m	Total £m
At 1 January 2018	–	–	–	–	–
Acquisition of businesses	173	164	171	16	524
Additions	25	145	28	15	213
Utilised	(6)	(164)	(12)	–	(182)
Exchange adjustments	21	–	19	1	41
<b>At 31 December 2018</b>	<b>213</b>	<b>145</b>	<b>206</b>	<b>32</b>	<b>596</b>

### Participation fees

Participation fees are described in the accounting policies (note 2) and under IFRS 15 they are considered to be a reduction in revenue for the related customer contract. Amounts are capitalised and 'amortised' to match to the related performance obligation.

### Unbilled receivables for over time recognition

Unbilled receivables for over time recognition represent amounts previously recorded in inventory along with associated margins where contracts contain a legal right to compensation for work completed, including a margin, and there is no alternative use for the customer's asset.

### Variable consideration

Variable consideration only impacts a small number of businesses in the Group, exclusively in the Aerospace reporting segment. Due to the nature of risk and revenue sharing partnerships, covered in detail in the accounting policies (note 2), original equipment ("OE") products sold to engine manufacturers are at a lower margin with more favourable pricing in the aftermarket phase. Where the Group has a contractual right to this aftermarket revenue, IFRS 15 requires that the total contract revenue is allocated to the performance obligations based on their standalone selling price and recognised as control is transferred to the customer. Whilst this has resulted in a material value, attributable to previously delivered OE components, being recognised ahead of cash recovery during the aftermarket phase, risk adjustments as well as a constraint applied to revenue recognised in the year, have been applied due to future uncertainty. Any constraint applied to variable consideration will only unwind when uncertainties are resolved. This could lead to additional revenue recognition in future periods.

A contract asset of £524 million was recognised on acquisition of GKN (note 12) and the movement up to 31 December 2018 is shown in the table above.

## 17. Cash and cash equivalents

	31 December 2018 £m	31 December 2017 £m
Cash and cash equivalents	415	16

Cash and cash equivalents comprises cash at bank and in hand which earns interest at floating rates based on daily bank deposit rates and short-term deposits which are made for varying periods of between one day and one month. The carrying amount of these assets is considered to be equal to their fair value.

# Notes to the Financial Statements

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## 18. Trade and other payables

	31 December 2018 £m	31 December 2017 £m
<b>Current</b>		
Trade payables	1,307	210
Other payables	568	18
Customer advances and contract liabilities	190	–
Other taxes and social security	64	7
Government refundable advances	8	–
Accruals	434	132
Deferred government grants	12	–
	<b>2,583</b>	<b>367</b>

As at 31 December 2018, and as described in note 24, included within trade payables were drawings on supplier finance facilities of £94 million (2017: £nil).

Trade payables are non interest-bearing. Normal settlement terms vary by country and the average credit period taken for trade and other payables is 81 days (2017: 66 days).

	31 December 2018 £m	31 December 2017 £m
<b>Non-current</b>		
Other payables	94	1
Customer advances and contract liabilities	552	–
Other taxes and social security	23	–
Government refundable advances	73	–
Deferred government grants	8	–
Accruals	28	1
	<b>778</b>	<b>2</b>

The Directors consider that the carrying amount of trade and other payables approximates to their fair value.

Non-current amounts owed to suppliers fall due within two years. Government refundable advances are forecast to fall due for repayment between 2019 and 2055.

Customer advances and contract liabilities increased significantly on acquisition of GKN. The balance includes cash receipts from customers in advance of the Group completing its performance obligations and is generally utilised as product is delivered. Non-current amounts in respect of customer advances and contract liabilities will be utilised as follows: one to two years £241 million, two to five years £136 million and over five years £175 million.

## 19. Interest-bearing loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings. Details of the Group's exposure to credit, liquidity, interest rate and foreign currency risk are included in note 24.

	Current		Non-current		Total	
	31 December 2018 £m	31 December 2017 £m	31 December 2018 £m	31 December 2017 £m	31 December 2018 £m	31 December 2017 £m
<b>Floating rate obligations</b>						
Bank borrowings – US Dollar loan	–	–	1,118	462	1,118	462
Bank borrowings – Sterling loan	–	–	1,139	134	1,139	134
Bank borrowings – Euro loan	–	–	363	–	363	–
<b>Fixed rate obligations</b>						
2019 £350 million bond	350	–	–	–	350	–
2022 £450 million bond	–	–	450	–	450	–
2032 £300 million bond	–	–	300	–	300	–
Other loans	13	–	6	–	19	–
	<b>363</b>	<b>–</b>	<b>3,376</b>	<b>596</b>	<b>3,739</b>	<b>596</b>
Unamortised finance costs	–	–	(41)	(8)	(41)	(8)
Non-cash acquisition fair value adjustment	14	–	43	–	57	–
<b>Total interest-bearing loans and borrowings</b>	<b>377</b>	<b>–</b>	<b>3,378</b>	<b>588</b>	<b>3,755</b>	<b>588</b>

A new multi-currency committed bank facility was entered into on 17 January 2018 to assist with the acquisition of GKN, which replaced the previous bank facility of US\$1.25 billion. The US\$1.25 billion facility was repaid and cancelled on 30 April 2018. The new facility included a £1.5 billion multi-currency term loan with a duration of three years and six months. In addition, the new facility included a five-year multi-currency revolving credit facility, denominated £1.1 billion, US\$2.0 billion and €0.5 billion.

### 19. Interest-bearing loans and borrowings continued

On 29 October 2018, £663 million of the new term loan was surplus to requirements, and therefore cancelled, because potential change of control clauses on the bonds were not exercised by the relevant bondholders.

At 31 December 2018 the drawings on the term loan were £100 million and US\$960 million. There was a significant amount of headroom on the multi-currency committed revolving credit facility, as at 31 December 2018. Applying the exchange rates at 31 December 2018 the headroom equated to £1,352 million, which includes an amount available to replace the 2019 bond when it matures, or before. There are also a number of uncommitted overdraft, guarantee and borrowing facilities made available to the Group. These uncommitted facilities have been lightly used.

Throughout the year, the Group remained compliant with all covenants under the facilities disclosed above. A number of Group companies continue to be guarantors under the bank facilities.

Drawdowns under the existing facilities bear interest at interbank rates plus a margin determined by reference to the Group's performance under its debt cover ratio, ranging between 0.75% to 2.0% on the term loan, and 0.95% to 2.25% on the revolving credit facility. As at 31 December 2018 the margin was 1.4% on the term loan and 1.65% on the revolving credit facility (31 December 2017: 1.35% on the Melrose committed bank debt).

The GKN net debt at acquisition included three capital market borrowings totalling £1.1 billion. The bonds maturing in 2019 and 2022 have cross-currency swaps associated with them. Details are in the table below:

Maturity date	Notional amount £m	Coupon % p.a.	Cross-currency swaps million	Interest rate on swaps % p.a.
October 2019	350	6.75%	US\$578	6.80%
September 2022	450	5.375%	US\$373 €284	5.70% 3.87%
May 2032	300	3.375%	n/a	n/a

The coupon rate on the £300 million bond, maturing in 2032, is expected to increase to 4.625% from May 2019.

#### Maturity of financial liabilities (excluding currency contracts)

The table below shows the maturity profile of anticipated future cash flows, including interest, on an undiscounted basis in relation to the Group's financial liabilities (other than those associated with currency risk, which are shown in note 24, and finance lease obligations which are shown in note 27). The amounts shown therefore differ from the carrying value and fair value of the Group's financial liabilities.

	Interest-bearing loans and borrowings £m	Interest rate derivative financial liabilities £m	Other financial liabilities £m	Total financial liabilities £m
Within one year	502	1	2,317	2,820
In one to two years	122	3	122	247
In two to five years	3,285	14	18	3,317
After five years	425	-	55	480
Effect of financing rates	(579)	(4)	-	(583)
<b>31 December 2018</b>	<b>3,755</b>	<b>14</b>	<b>2,512</b>	<b>6,281</b>
Within one year	18	-	360	378
In one to two years	20	-	2	22
In two to five years	626	-	-	626
After five years	-	-	-	-
Effect of financing rates	(76)	-	-	(76)
31 December 2017	588	-	362	950

# Notes to the Financial Statements

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## 20. Provisions

	Loss-making contracts £m	Property related costs £m	Environmental and litigation £m	Warranty related costs £m	Restructuring £m	Other £m	Total £m
At 1 January 2018	3	14	88	73	20	11	209
Acquisition of businesses	629	62	123	295	24	47	1,180
Utilised <sup>(1)</sup>	(63)	(5)	(60)	(36)	(111)	(9)	(284)
Net charge to operating profit <sup>(2)</sup>	(1)	–	43	37	181	(3)	257
Unwind of discount	9	–	–	–	–	1	10
Disposal of businesses	(8)	–	–	–	–	–	(8)
Exchange adjustments	47	3	8	18	2	3	81
<b>At 31 December 2018</b>	<b>616</b>	<b>74</b>	<b>202</b>	<b>387</b>	<b>116</b>	<b>50</b>	<b>1,445</b>
Current	65	15	58	130	108	5	381
Non-current	551	59	144	257	8	45	1,064
	616	74	202	387	116	50	1,445

(1) Includes £63 million of non-cash unwind of loss-making contracts provisions, positively impacting operating profit in 2018.

(2) Includes restructuring charges and other adjusting items of £168 million, along with £89 million relating to items charged through adjusted operating profit.

The Group's provision categories have been reconsidered following the acquisition of GKN which has resulted in certain reclassifications between provision categories.

### Loss-making contracts

Provisions for loss-making contracts are considered to exist where the Group has a contract under which the unavoidable costs of meeting the obligations exceed the economic benefits expected to be received under it. This obligation has been discounted and will be utilised over the period of the respective contracts, which is up to 15 years.

Calculation of loss-making contract provisions is based on contract documentation and delivery expectations, along with an estimate of directly attributable costs and represents management's best estimate of the unavoidable costs of fulfilling the contract.

### Property related costs

The provision for property related costs represents the estimated net payments for surplus property or off-market lease contracts on acquisition, due over the term of the leases and any dilapidation costs for ongoing leases. This is expected to result in cash expenditure over the next eight years. Calculations of surplus leasehold property costs and dilapidations are based on lease agreements with landlords and external quotes, or in the absence of specific documentation, management's best estimate of the costs required to fulfil obligations.

### Environmental and litigation

Environmental and litigation provisions relate to the estimated remediation costs of pollution, soil and groundwater contamination at certain sites and estimated future costs and settlements in relation to legal claims and associated insurance obligations. Liabilities for environmental costs are recognised when environmental assessments are probable and the associated costs can be reasonably estimated.

Provisions are recorded for product and general liability claims which are probable and for which the cost can be reliably estimated. These liabilities include an estimate of claims incurred but not yet reported and are based on actuarial valuations using claim data. Due to their nature, it is not possible to predict precisely when these provisions will be utilised.

The Group has on occasion been required to take legal or other actions to defend itself against proceedings brought by other parties. Provisions are made for the expected costs associated with such matters, based on past experience of similar items and other known factors, considering professional advice received. This represents management's best estimate of the likely outcome. The timing of utilisation of these provisions is frequently uncertain, reflecting the complexity of issues and the outcome of various court proceedings and negotiations. Contractual and other provisions represent management's best estimate of the cost of settling future obligations and reflect management's assessment of the likely settlement method, which may change over time. However, no provision is made for proceedings which have been, or might be, brought by other parties against Group companies unless management, considering professional advice received, assess that it is more likely than not that such proceedings may be successful.

### Warranty related costs

Provisions for the expected cost of warranty obligations under local sale of goods legislation are recognised at the date of sale of the relevant products and subsequently updated for changes in estimates as necessary. The provision for warranty related costs represents the best estimate of the expenditure required to settle the Group's obligations, based on past experience, recent claims and current estimates of costs relating to specific claims. Warranty terms are, on average, between one and five years.

## 20. Provisions continued

### Restructuring

Restructuring provisions relate to committed costs in respect of restructuring programmes, usually resulting in cash spend within one year. A restructuring provision is recognised when the Group has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by either starting to implement the plan or by announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are necessarily entailed by the restructuring programmes.

### Other

Other provisions include long-term incentive plans for divisional senior management and the employer tax on equity-settled Incentive Schemes which are expected to result in cash expenditure over the next two to five years.

Where appropriate, provisions have been discounted using discount rates between 0% and 9% (31 December 2017: 3%) depending on the territory in which the provision resides and the length of its expected utilisation.

## 21. Deferred tax

The following are the major deferred tax assets and liabilities recognised by the Group and movements thereon during the current and prior reporting period.

	Deferred tax assets		Deferred tax liabilities		Total net deferred tax £m
	Tax losses and other assets £m	Accelerated capital allowances and other liabilities £m	Deferred tax on intangible assets £m	Total deferred tax liabilities £m	
At 1 January 2017	50	(12)	(118)	(130)	(80)
(Charge)/credit to income	(108)	(5)	130	125	17
Credit to equity	30	2	–	2	32
Exchange adjustments	(16)	–	27	27	11
Movement in set off of assets and liabilities <sup>(1)</sup>	93	3	(96)	(93)	–
At 31 December 2017	49	(12)	(57)	(69)	(20)
Acquisition of businesses	712	(188)	(1,285)	(1,473)	(761)
(Charge)/credit to income	(64)	42	131	173	109
Credit to equity	37	1	–	1	38
Exchange adjustments	20	(17)	(94)	(111)	(91)
Movement in set off of assets and liabilities <sup>(1)</sup>	(605)	8	597	605	–
<b>At 31 December 2018</b>	<b>149</b>	<b>(166)</b>	<b>(708)</b>	<b>(874)</b>	<b>(725)</b>

(1) Set off of deferred tax assets and liabilities in accordance with IAS 12 within territories with a right of set off.

As at 31 December 2018, the Group had gross unused corporate income tax losses of £1,991 million (31 December 2017: £497 million) available for offset against future profits. A deferred tax asset of £192 million (31 December 2017: £62 million) has been recognised in respect of £978 million (31 December 2017: £346 million) of these gross losses. No asset has been recognised in respect of the remaining losses due to the divisional and geographic split of anticipated future profit streams. Most of these losses may be carried forward indefinitely subject to certain continuity of business requirements. Where losses are subject to time expiry, a deferred tax asset is recognised to the extent that sufficient future profits are anticipated to utilise these losses. In addition to the corporate income tax losses included above, a deferred tax asset of £42 million (31 December 2017: £33 million) has been recognised on US tax credits and US state tax losses.

Deferred tax assets have also been recognised on Group retirement benefit obligations at £170 million (31 December 2017: £4 million) and on other temporary differences at £494 million (31 December 2017: £94 million). The gross deferred tax assets therefore amount to £898 million (31 December 2017: £193 million).

Deferred tax liabilities have been recognised on intangible assets at £1,446 million (31 December 2017: £198 million) and accelerated capital allowances and other temporary differences at £177 million (31 December 2017: £15 million). The gross deferred tax liabilities therefore amount to £1,623 million (31 December 2017: £213 million).

There are no material unrecognised deferred tax assets at 31 December 2018, other than the losses referred to above.

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries except where the distribution of such profits is planned. If these earnings were remitted in full, tax of £59 million (31 December 2017: £3 million) would be payable. This figure could increase significantly if, as a result of Brexit, the Group had to rely on withholding tax rates as set out in Double Taxation Conventions agreed between the UK and other countries, rather than the EU Parent-Subsidiary Directive. Due to the ongoing uncertainty around the UK's exit from the EU, this amount has not been quantified at the current time.

# Notes to the Financial Statements

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## 22. Share-based payments

### Melrose Incentive Plan

The 2017 Melrose Incentive Plan was established on 11 May 2017 and comprised 50,000 2017 options which enable the holders to subscribe for 2017 Melrose Incentive Shares. These options are to be issued to Directors and Senior Management in three annual tranches and 31,203 options had been issued at 31 December 2018 (31 December 2017: 16,542). For accounting purposes the IFRS 2 charge has been calculated as if all three tranches had been granted on day one because of a common expectation, established at that date, between employees and the Company that the options will be allocated annually over the three-year performance period. It is expected that the remaining options will be issued prior to the crystallisation of the Plan in May 2020. Further details of the 2017 Melrose Incentive Plan are set out in the Directors' Remuneration Report on page 98.

During 2017, 12,831 of the incentive plan options were converted to incentive shares with a nominal value of £1 each. The number of incentive plan options in issue as at 31 December 2018 is therefore 37,169 (31 December 2017: 37,169).

The estimated value of the 2017 Melrose Incentive Plan at 31 December 2018 was £nil (31 December 2017: £nil). Using a Black Scholes option pricing model, the projected value of this plan at 31 May 2020 will be £13 million (31 December 2017: projected value of £25 million).

The annual IFRS 2 charge to be recognised in respect of the 2017 Melrose Incentive Plan is £13 million. The inputs into the Black Scholes valuation model that were used to fair value the plan at the point of establishment in May 2017 were as follows:

	Valuation assumptions
Weighted average share price	£2.41
Weighted average exercise price	£2.77
Expected volatility	27%
Expected life as at inception	3.05 years
Risk free interest	0.2%

Expected volatility was determined by calculating the historical volatility of the Company's share price.

The Group recognised an IFRS 2 charge of £13 million (2017: £10 million) in the year ended 31 December 2018. £13 million (2017: £8 million) was in respect of the 2017 Melrose Incentive Plan and £nil (2017: £2 million) was in respect of the 2012 Melrose Incentive Plan.

## 23. Retirement benefit obligations

### Defined contribution plans

The Group operates defined contribution plans for qualifying employees across several jurisdictions. The assets of the plans are held separately from those of the Group in funds under the control of trustees.

The total costs charged in relation to the continuing businesses during the year of £67 million (2017: £7 million) represent contributions payable to these plans by the Group at rates specified in the rules of the plans.

### Defined benefit plans

The Group sponsors defined benefit plans for qualifying employees of certain subsidiaries. The funded defined benefit plans are administered by separate funds that are legally separated from the Group. The Trustees of the funds are required by law to act in the interest of the fund and of all relevant stakeholders in the plans. The Trustees of the pension funds are responsible for the investment policy with regard to the assets of the fund.

The most significant defined benefit pension plans in the Group at 31 December 2018 were:

#### GKN UK 2012 Pension Plan

The GKN UK 2012 Pension Plan is a funded plan, closed to new members and was closed to future accrual in 2017. The valuation of the plan was based on a full actuarial valuation as of 5 April 2016, updated at 31 December 2018 by independent actuaries.

#### GKN UK 2016 Pension Plan

The GKN UK 2016 Pension Plan is a funded plan, closed to new members with no active members, containing assets and liabilities in respect of the pension schemes from various legacy GKN businesses. The valuation of the plan was based on a full actuarial valuation as of 5 April 2016, updated to 31 December 2018 by independent actuaries.

#### GKN US Consolidated Pension Plan

The GKN US Consolidated Pension Plan is a funded plan, closed to new members and closed to future accrual. The US Pension Plan valuation was based on a full actuarial valuation as of 1 January 2018, updated to 31 December 2018 by independent actuaries.

#### GKN Germany Pension Plans

The GKN Germany Pension Plans provide benefits dependent on final salary and service with the Company. The plans are generally unfunded and closed to new members.

## 23. Retirement benefit obligations continued

### Brush UK Pension Plan

The Brush Group (2013) ("Brush UK") Pension Plan is a funded plan, closed to new members and closed to future accrual. The valuation of the Brush UK Pension Plan was based on a full actuarial valuation as of 31 December 2016, updated to 31 December 2018 by independent actuaries.

Other plans include a number of funded and unfunded defined benefit arrangements and retiree medical insurance plans, predominantly in the US and Europe.

The cost of the Group's defined benefit plans is determined in accordance with IAS 19 (revised): "Employee benefits" using the advice of independent professionally qualified actuaries on the basis of formal actuarial valuations and using the projected unit credit method. In line with normal practice, these valuations are undertaken triennially in the UK and annually in the US and Germany.

### Contributions

The Group committed to contribute £150 million in total to the GKN UK 2012 and 2016 plans in the first 12 months of ownership, as well as ongoing annual contributions of £60 million. In addition, the Group has committed to contribute £270 million upon the disposal of Powder Metallurgy, 10% of the proceeds from disposal of other GKN businesses and 5% of the proceeds from disposal of non-GKN businesses to the GKN UK pension plans. These commitments cease when the funding target which has been agreed with Trustees is achieved, being gilts plus 25 basis points for the GKN UK 2016 plan and gilts plus 75 basis points for the GKN UK 2012 plan.

The Group contributed £102 million (2017: £4 million) to defined benefit pension plans and post-employment plans in the year ended 31 December 2018, including £56 million of the Melrose commitment to contribute £150 million to the GKN UK 2012 and 2016 plans within the first 12 months of GKN ownership.

The Group expects to contribute £192 million to defined benefit pension plans and post-employment plans in 2019, consisting of £94 million of one-off special payments, being the balance of the £150 million upfront commitment, and £98 million of ongoing commitments.

### Actuarial assumptions

The major assumptions used by the actuaries in calculating the Group's pension liabilities are as set out below:

	Rate of increase of pensions in payment % per annum	Discount rate % per annum	Price inflation % per annum
<b>31 December 2018</b>			
GKN UK – 2012 plan	3.1	2.9	2.1
GKN UK – 2016 plan	3.1	2.9	2.1
GKN US plans	n/a	4.1	2.5
GKN Europe plans	2.5	1.9	1.8
Brush UK plan	3.2	2.9	2.1
<b>31 December 2017</b>			
Brush UK plan	3.2	2.5	2.1

### Mortality

#### GKN UK 2012 Pension Plan, GKN UK 2016 Pension Plan and the Brush UK Pension Plan

Mortality assumptions for all UK pension plans as at 31 December 2018 were based on the Self-Administered Pension Scheme ("SAPS") "S2" base tables. The Brush UK Pension Plan uses a scaling factor of 110%. The GKN UK 2012 scheme (and the small post-retirement medical plan) use scaling factors of 96% for male and 85% for females. The GKN UK 2016 scheme uses scaling factors of 100% for male and 91% for females.

Future improvements for all UK plans are in line with the 2017 Continuous Mortality Investigation ("CMI") improvement model with a long-term rate of improvement of 1.25% p.a. for both males and females.

#### GKN US Consolidated Pension Plan

The GKN US Consolidated Pension Plan uses RP2006 mortality tables, consistent with the plan's most recent formal valuation (1 January 2018). Other US plans also use RP2006 but in some cases the base table is adjusted to reflect scheme experience. Future improvements for all US plans are in line with MP2018.

#### GKN Germany Pension Plan

All German plans use the Richttafel 2018 G tables, with no adjustment.

The following table shows the future life expectancy of individuals age 65 at the year-end and the future life expectancy of individuals aged 65 in 20 years' time.

	GKN UK 2012 Pension Plan years	GKN UK 2016 Pension Plan years	GKN US Consolidated Pension Plan years	GKN Germany Pension Plan years	Brush UK Pension Plan years
Male today	22.3	22.0	19.7	20.0	21.3
Female today	25.1	24.6	21.7	23.6	23.2
Male in 20 years' time	23.7	23.4	21.3	22.8	22.7
Female in 20 years' time	26.6	26.1	23.3	25.8	24.7

# Notes to the Financial Statements

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## 23. Retirement benefit obligations continued

### Balance Sheet disclosures

The amount recognised in the Consolidated Balance Sheet arising from net liabilities in respect of defined benefit plans was as follows:

	31 December 2018 £m	31 December 2017 £m
Present value of funded defined benefit obligations	(3,937)	(538)
Fair value of plan assets	3,273	524
Funded status	(664)	(14)
Present value of unfunded defined benefit obligations	(749)	(4)
<b>Net liabilities</b>	<b>(1,413)</b>	<b>(18)</b>

The plan liabilities and assets at 31 December 2018 were as follows:

	UK Plans <sup>(1)</sup> £m	US Plans £m	European Plans £m	Other Plans £m	Total £m
Plan assets	2,791	412	29	41	3,273
Plan liabilities	(3,378)	(565)	(690)	(53)	(4,686)
<b>Net liabilities</b>	<b>(587)</b>	<b>(153)</b>	<b>(661)</b>	<b>(12)</b>	<b>(1,413)</b>

(1) Includes a net deficit in respect of the GKN UK 2012 plan, GKN post-employment medical plans, and the Nortek UK plan and a surplus in respect of the Brush UK plan and the GKN UK 2016 plan.

The major categories and fair values of plan assets at the end of the reporting period for each category were as follows:

	31 December 2018 £m	31 December 2017 £m
Equities	639	231
Government bonds	802	138
Corporate bonds	524	114
Property	147	10
Insurance contracts	181	-
Multi-strategy/Diversified Growth Funds	781	-
Private equity	140	-
Other	59	31
<b>Total</b>	<b>3,273</b>	<b>524</b>

The assets were well diversified and the majority of plan assets had quoted prices in active markets. All government bonds were issued by reputable governments and were generally AA rated or higher. Interest rate and inflation rate swaps were also employed to complement the role of fixed and index-linked bond holdings for liability risk management.

The Trustees continually review whether the chosen investment strategy is appropriate with a view to providing the pension benefits and to ensure appropriate matching of risk and return profiles. The main strategic policies included maintaining an appropriate asset mix, managing interest rate sensitivity and maintaining an appropriate equity buffer. Investment results are regularly reviewed.

### 23. Retirement benefit obligations continued

Movements in the present value of defined benefit obligations during the year:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
At 1 January	542	556
Acquisition of businesses	4,216	–
Transfer to held for sale	–	(1)
Current service cost	10	–
Past service cost <sup>(1)</sup>	11	–
Interest cost on obligations	96	17
Remeasurement gains – demographic	(7)	(6)
Remeasurement (gains)/losses – financial	(77)	24
Remeasurement (gains)/losses – experience <sup>1</sup>	(1)	10
Benefits paid out of plan assets	(159)	(33)
Benefits paid out of Group assets for unfunded plans	(17)	(1)
Settlements	(1)	–
Exchange adjustments	73	(24)
<b>At 31 December</b>	<b>4,686</b>	<b>542</b>

(1) An expense of £11 million has been recorded in the year ended 31 December 2018 as a past service cost in respect of the equalisation of guaranteed minimum pension ("GMP") benefits in the UK. This has been treated as an adjusting item (note 6).

The defined benefit plan liabilities were 31% (31 December 2017: 2%) in respect of active plan participants, 23% (31 December 2017: 47%) in respect of deferred plan participants and 46% (31 December 2017: 51%) in respect of pensioners.

The weighted average duration of the defined benefit plan liabilities at 31 December 2018 was 16.6 years (31 December 2017: 14.8 years).

Movements in the fair value of plan assets during the year:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
At 1 January	524	522
Acquisition of businesses	2,847	–
Interest income on plan assets	72	16
Return on plan assets, excluding interest income	(121)	40
Contributions	85	3
Benefits paid out of plan assets	(159)	(33)
Plan administrative costs	(12)	(2)
Settlements	(1)	–
Exchange adjustments	38	(22)
<b>At 31 December</b>	<b>3,273</b>	<b>524</b>

The actual return on plan assets was a loss of £49 million (2017: gain of £56 million).

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## 23. Retirement benefit obligations continued

### Income Statement disclosures

Amounts recognised in the Consolidated Income Statement in respect of these defined benefit plans were as follows:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Continuing operations</b>		
Included within operating profit:		
– current service cost	10	–
– past service cost <sup>(1)</sup>	11	–
– plan administrative costs	12	2
Included within net finance costs:		
– interest cost on defined benefit obligations	96	17
– interest income on plan assets	(72)	(16)

(1) An expense of £11 million has been recorded in the year ended 31 December 2018 as a past service cost in respect of the equalisation of guaranteed minimum pension ("GMP") benefits in the UK. This has been treated as an adjusting item (note 6).

### Statement of Comprehensive Income disclosures

Amounts recognised in the Consolidated Statement of Comprehensive Income in respect of these defined benefit plans were as follows:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Return on plan assets, excluding interest income	(121)	40
Remeasurement gains arising from changes in demographic assumptions	7	6
Remeasurement gains/(losses) arising from changes in financial assumptions	77	(24)
Remeasurement gains/(losses) arising from experience adjustments	1	(10)
<b>Net remeasurement (loss)/gain on retirement benefit obligations</b>	<b>(36)</b>	<b>12</b>

### Risks and sensitivities

The defined benefit plans expose the Group to actuarial risks, such as longevity risk, inflation risk, interest rate risk and market (investment) risk. The Group is not exposed to any unusual, entity specific or plan specific risks.

A sensitivity analysis on the principal assumptions used to measure the plan liabilities at the year-end was as follows:

	Change in assumption	Decrease/ (increase) to plan liabilities £m	Increase/ (decrease) to profit before tax £m
Discount rate	Increase by 0.1 ppts	68	1
	Decrease by 0.1 ppts	(73)	(1)
Inflation assumption <sup>(1)</sup>	Increase by 0.1 ppts	(52)	n/a
	Decrease by 0.1 ppts	51	n/a
Assumed life expectancy at age 65 (rate of mortality)	Increase by 1 year	(163)	n/a
	Decrease by 1 year	159	n/a

(1) The inflation sensitivity encompasses the impact on pension increases, where applicable.

The sensitivity analysis above was determined based on reasonable possible changes to the respective assumptions, while holding all other assumptions constant. There has been no change in the methods and assumptions used in preparing the sensitivity analysis from prior years.

The sensitivities are based on the relevant assumptions and membership profile as at 31 December 2018 and are applied to the obligations at the end of the reporting period. Whilst the analysis does not take account of the full distribution of cash flows expected, it does provide an approximation to the sensitivity of the assumptions shown. Extrapolation of these results beyond the sensitivity figures shown may not be appropriate and the sensitivity analysis presented may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

## 24. Financial instruments and risk management

The table below sets out the Group's accounting classification of each category of financial assets and liabilities and their carrying values at 31 December 2018 and 31 December 2017:

	Aerospace £m	Automotive £m	Powder Metallurgy £m	North Air & Security £m	Other Industrial £m	Corporate £m	Total £m
<b>31 December 2018</b>							
<b>Financial assets</b>							
<b>Classified as amortised cost:</b>							
Cash and cash equivalents	-	-	-	-	-	415	<b>415</b>
Net trade receivables	837	458	177	193	170	-	<b>1,835</b>
Contract assets	584	12	-	-	-	-	<b>596</b>
<b>Classified as fair value:</b>							
<b>Derivative financial assets</b>							
Foreign currency forward contracts	-	-	-	2	1	12	<b>15</b>
Interest rate swaps	-	-	-	-	-	8	<b>8</b>
Embedded derivatives	18	-	-	-	-	-	<b>18</b>
<b>Financial liabilities</b>							
<b>Classified as amortised cost:</b>							
Interest-bearing loans and borrowings	-	-	-	-	-	(3,755)	<b>(3,755)</b>
Government refundable advances	(81)	-	-	-	-	-	<b>(81)</b>
Finance lease obligations	(21)	(35)	-	(1)	-	-	<b>(57)</b>
Other financial liabilities	(842)	(913)	(155)	(217)	(224)	(80)	<b>(2,431)</b>
<b>Classified as fair value:</b>							
<b>Derivative financial liabilities</b>							
Foreign currency forward contracts	-	-	-	(3)	(1)	(205)	<b>(209)</b>
Interest rate swaps	-	-	-	-	-	(14)	<b>(14)</b>
Cross-currency swaps	-	-	-	-	-	(199)	<b>(199)</b>
Embedded derivatives	(9)	-	-	-	-	-	<b>(9)</b>
<b>31 December 2017</b>							
<b>Financial assets</b>							
<b>Classified as amortised cost:</b>							
Cash and cash equivalents	-	-	-	-	-	16	<b>16</b>
Net trade receivables	-	-	-	208	90	-	<b>298</b>
<b>Classified as fair value:</b>							
<b>Derivative financial assets</b>							
Foreign currency forward contracts	-	-	-	1	1	4	<b>6</b>
Interest rate swaps	-	-	-	-	-	8	<b>8</b>
<b>Financial liabilities</b>							
<b>Classified as amortised cost:</b>							
Interest-bearing loans and borrowings	-	-	-	(1)	-	(587)	<b>(588)</b>
Other financial liabilities	-	-	-	(246)	(105)	(11)	<b>(362)</b>
<b>Classified as fair value:</b>							
<b>Derivative financial liabilities</b>							
Foreign currency forward contracts	-	-	-	-	(1)	-	<b>(1)</b>

# Notes to the Financial Statements

Continued

## 24. Financial instruments and risk management continued

### Fair values

The Directors consider that the financial assets and liabilities have fair values not materially different to the carrying values.

### Credit risk

The Group's principal financial assets were cash and cash equivalents, trade receivables, contract assets and derivative financial assets which represented the Group's maximum exposure to credit risk in relation to financial assets.

The Group's credit risk on cash and cash equivalents and derivative financial assets was limited because the counterparties were banks with strong credit ratings assigned by international credit rating agencies. Exposure is managed on the basis of risk rating and counterparty limits. The value of credit risk in derivative assets has been modelled using publicly available inputs as part of their fair value.

The Group's credit risk was therefore primarily attributable to its trade receivables and contract assets. The amounts presented in the Consolidated Balance Sheet were net of allowances for doubtful receivables, estimated by the Group's management based on prior experience and their assessment of the current economic environment. Note 16 provides further details regarding the recovery of trade receivables.

### Capital risk

The Group manages its capital to ensure that entities in the Group will be able to continue as a going concern.

The capital structure of the Group as at 31 December 2018 consists of net debt, as disclosed in note 26, and equity attributable to the owners of the parent, comprising issued share capital, reserves and retained earnings as disclosed in the Consolidated Statement of Changes in Equity.

### Liquidity risk management

#### Overview of banking facilities

A new multi-currency committed bank facility was entered into on 17 January 2018 to assist with the acquisition of GKN, which replaced the previous bank facility of US\$1.25 billion. The US\$1.25 billion facility was repaid and cancelled on 30 April 2018. The new facility included a £1.5 billion multi-currency term loan with a duration of three years and six months. In addition, the new facility included a five-year multi-currency revolving credit facility, denominated £1.1 billion, US\$2.0 billion and €0.5 billion.

On 29 October 2018, £663 million of the new term loan was surplus to requirements, and therefore cancelled, because change of control clauses on the bonds were not exercised by the relevant bondholders.

At 31 December 2018 the drawings on the term loan were £100 million and US\$960 million. There was a significant amount of headroom on the multi-currency committed revolving credit facility, as at 31 December 2018. Applying the exchange rates at 31 December 2018 the headroom equated to £1,352 million, which includes an amount available to replace the 2019 bond when it matures, or before. There are also a number of uncommitted overdraft, guarantee and borrowing facilities made available to the Group. These uncommitted facilities have been lightly used.

Cash, deposits and marketable securities amounted to £415 million at 31 December 2018 (31 December 2017: £16 million) and are considered together with loans and borrowings to arrive at the Group net debt position of £3,482 million (31 December 2017: £572 million), shown in note 26. The combination of this cash and the headroom on the new facility allows the Directors to consider that the Group has sufficient access to liquidity for its current needs. The Board takes careful consideration of counterparty risk with banks when deciding where to place cash on deposit.

### Covenants

As with previous facilities the new facility has two financial covenants being a net debt to adjusted EBITDA covenant and an interest cover covenant, both of which are tested half yearly in June and December.

The EBITDA covenant test is set at 3.5x leverage for each of the half yearly measurement dates for the remainder of the term of the facility. For the year ended 31 December 2018 it was 2.3x (31 December 2017: 1.9x), showing reasonable headroom compared to the covenant test.

The interest cover covenant is set at 4.0x throughout the life of the facility and was 11.6x at 31 December 2018 (31 December 2017: 19.6x), affording comfortable headroom compared to the covenant test.

## 24. Financial instruments and risk management continued

### Bonds

The GKN net debt at acquisition included three capital market borrowings totalling £1.1 billion. The bonds maturing in 2019 and 2022 have cross-currency swaps associated with them. Details are in the table below:

Maturity date	Notional amount £m	Coupon % p.a.	Cross-currency swaps million	Interest rate on swaps % p.a.
October 2019	350	6.75%	US\$578	6.80%
September 2022	450	5.375%	US\$373 €284	5.70% 3.87%
May 2032	300	3.375%	n/a	n/a

The series of cross-currency swaps which were acquired with GKN had a fair value liability at the date of acquisition of £109 million. At 31 December 2018 they were valued at a liability of £199 million, the rise being predominantly due to the change in foreign exchange rates.

The bonds remain within the Group at 31 December 2018, but to simplify the corporate reporting requirements of the Group, the 2019 bonds were transferred onto the Professional Securities Market in September 2018 and the 2022 and 2032 bonds will transfer during March 2019. Bond holders and rating agencies no longer require Consolidated Financial Statements for GKN Holdings Limited, but instead will receive the detailed information they require from the Melrose Group Consolidated Financial Statements. The 2022 and 2032 bond holders will have the same guarantees from the Melrose Group companies as those provided to the banks lending in the new bank facility.

The cross-currency swaps are designated as net investment hedges. The critical terms of the hedges are not perfectly matched against the hedged item in terms of the cost of hedging; this gives rise to ineffectiveness through the Income Statement for the year ended 31 December 2018, and could also do so in future reporting periods.

In respect of the cross-currency swaps, for the year ended 31 December 2018, £16 million (31 December 2017: £nil) was booked through the Income Statement in finance costs, of which £8 million has been treated as an adjusting item (note 6). In addition, there is an £84 million charge in losses/gains on hedge relationships within Other Comprehensive Income in respect of hedge accounting relationships. The cross-currency swaps are designated in a net investment hedge accounting relationship against US Dollar and Euro net assets of certain subsidiaries. The hedged risk of spot rate represents the significant component of the movement and therefore has been recorded in the hedging reserve.

### Currency derivatives

The following table shows the maturity profile of undiscounted contracted gross cash outflows of derivative financial liabilities used to manage currency risk, being both the cross-currency swaps above and foreign exchange forward contracts used to manage transaction exchange rate risk:

	0-1 years £m	1-2 years £m	2-5 years £m	5+ years £m	Total £m
<b>Year ended 31 December 2018</b>					
Foreign exchange forward contracts – payments	1,203	624	918	43	2,788
Cross-currency swaps	511	27	603	–	1,141
<b>Year ended 31 December 2017</b>					
Foreign exchange forward contracts – payments	51	–	–	–	51

### Working capital

The Group has a small number of uncommitted working capital programmes, which predominantly relate to the programmes inherited as part of the GKN acquisition. These programmes provide favourable financing terms on eligible customer receipts and competitive financing terms to suppliers on eligible supplier payments.

Businesses which participate in the receivables working capital programme have the ability to choose whether to receive payment earlier than the normal due date, for specific customers on a non-recourse basis. Due to the short-term nature of the financing, the interest cost to the Group for this beneficial cash flow is favourable compared to the interest cost of the Group's committed bank facilities. As at 31 December 2018, the drawings on these facilities were £139 million, compared to £189 million by GKN as at 31 December 2017.

In addition, some suppliers have access to utilise the Group's supplier finance programmes, which are provided by a small number of the Group's banks. There is no cost to the Group for providing these programmes to its suppliers. These arrangements do not change the date suppliers are due to be paid by the Group, and therefore there is no additional impact on the Group's liquidity. These programmes allow suppliers to choose whether they want to accelerate the payment of their invoices, by the financing banks, for an interest cost which is competitive, based off the rating of the Group as determined by the financing banks. The amounts owed to the banks are presented in trade payables on the Balance Sheet and the cash flows are presented in cash flows from operating activities. As at 31 December 2018, total facilities were £204 million with drawings of £97 million.

# Notes to the Financial Statements

Continued

## 24. Financial instruments and risk management continued

### Hedge of net investments in foreign entities using loans

Included in interest-bearing loans and borrowings at 31 December 2018, were the following amounts which were designated as hedges of net investments in the Group's subsidiaries in the US and Europe and were being used to reduce the exposure to the foreign exchange risks.

Borrowings in local currency designated as hedges of net investments:

	31 December 2018 £m	31 December 2017 £m
US Dollar	1,118	462
Euro	363	-

The foreign exchange movement on these borrowings, which is recorded in currency translation on net investments within Other Comprehensive Income was £54 million.

### Finance cost risk management

The bank margin on the bank facility depends on the Group leverage, and ranges from 0.75% to 2.0% on the term loan, and 0.95% to 2.25% on the revolving credit facility. As at 31 December 2018 the margin was 1.4% on the term loan and 1.65% on the revolving credit facility (31 December 2017: 1.35% on the Melrose committed bank debt).

The Group holds interest rate swap instruments to fix the cost of LIBOR. The policy of the Board is to hedge approximately 70% of the interest rate exposure of the Group. Given the recent restructuring of the bonds and noting that the 2019 bonds mature this year, the Group is in the process of increasing the interest rate swaps to be in line with Group policy from the current position of approximately 50%. Under the terms of the existing swap arrangements and excluding the bank margin, the Group will pay a weighted average fixed cost of approximately 2% until the swaps terminate on 17 January 2023.

The average cost of the debt for the new enlarged Group is expected to be approximately 3.8% over the next 12 months.

The interest rate swaps are designated as cash flow hedges and were highly effective throughout 2018. The fair value of the contracts as at 31 December 2018 was a liability of £6 million (31 December 2017: asset of £8 million). The net charge of £14 million for the year ended 31 December 2018 (2017: credit of £1 million) being the movement in the year, was booked to gains/losses on hedge relationships within Other Comprehensive Income.

Due to some of the minor critical terms of the interest rate swaps and the hedged items not being perfectly matched, this could give rise to ineffectiveness through the Income Statement in future periods. This is not expected to be material and no ineffectiveness was booked through the Income Statement in the year ended 31 December 2018 (2017: £nil).

### Interest rate sensitivity analysis

Assuming the net debt, inclusive of interest rate swaps, held as at the balance sheet date was outstanding for the whole year, a one percentage point rise in market interest rates for all currencies would decrease profit before tax by the following amounts:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Sterling	(10)	-
US Dollar	(4)	(1)
Euro	(1)	-

### Exchange rate risk management

The Group trades in various countries around the world and is exposed to movements in a number of foreign currencies. The Group therefore carries exchange rate risk that can be categorised into three types, transaction, translation and disposal related risk as described in the paragraphs below. The Melrose policy is designed to protect against the majority of the cash risks but not the non-cash risks.

The most common exchange rate risk is the transaction risk the Group takes when it invoices a customer or purchases from suppliers in a different currency to the underlying functional currency of the business. The Melrose policy is to review transactional foreign exchange exposures and place contracts quarterly on a rolling basis. To the extent the cash flows associated with a transactional foreign exchange risk are committed Melrose will hedge 100%. For forecast cash flows, Melrose hedges a proportion of the expected cash flows with the percentage being hedged lowering as the time horizon lengthens. The average time horizons are longer for GKN Aerospace, GKN Automotive and GKN Powder Metallurgy to reflect the long-term nature of the contracts within these divisions. Typically the Group hedges around 90% of foreign exchange exposures expected over the next year, and approximately 60% to 70% of exposures between one and two years. This policy does not eliminate the cash risk but does bring some certainty to it.

The translation rate risk is the effect on the Group results in the period due to the movement of exchange rates used to translate foreign results into Sterling from one period to the next. No specific exchange instruments are used to protect against the translation risk because it is a non-cash risk to the Group, unless foreign currency is converted to Sterling. However, the Group has debt drawn in Euros and US Dollars, and the hedge of having debt drawn in these currencies funding the trading units with US Dollars or Euro functional currencies protects against some of the Balance Sheet and banking covenant translation risk.

## 24. Financial instruments and risk management continued

Lastly, and potentially most significantly for Melrose, exchange rate risk arises when a business that is predominantly based in a foreign currency is sold. The proceeds for those businesses may be received in a foreign currency and therefore an exchange rate risk may arise on conversion of foreign currency proceeds into Sterling, for instance to pay a dividend or Capital Return to shareholders. Protection against this risk is considered on a case-by-case basis.

As at 31 December 2018, the Group held foreign exchange forward contracts to mitigate expected exchange rate fluctuations on future cash flows from sales to customers and purchases from suppliers. A small proportion of these contracts have been designated as cash flow hedges within the Nortek Air & Security and Other Industrial reporting segments. Contracts where hedge accounting was applied had a fair value liability as at 31 December 2018 of £2 million (31 December 2017: asset of £5 million). These contracts all mature between January 2019 and December 2019. The fair value of all foreign exchange forward contracts across the Group was a liability at 31 December 2018 of £194 million (31 December 2017: asset of £5 million).

The change in fair value of foreign exchange forward contracts recognised in losses/gains on hedging relationships, net of recycling, within Other Comprehensive Income was a charge of £1 million (2017: credit of £4 million).

### Foreign currency sensitivity analysis

Currency risks are defined by IFRS 7: "Financial instruments: Disclosures" as the risk that the fair value or future cash flows of a financial asset or liability will fluctuate because of changes in foreign exchange rates.

The following table details the transactional impact of hypothetical changes in foreign exchange rates on financial assets and liabilities at the balance sheet date, illustrating the increase/(decrease) in Group operating profit caused by a 10% strengthening of the US Dollar and Euro against Sterling compared to the year-end spot rate. The analysis assumes that all other variables, in particular other foreign currency exchange rates, remain constant. The Group operates in a range of different currencies, and those with a notable impact are noted here:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
US Dollar	10	(2)
Euro	6	1

The following table details the impact of hypothetical changes in foreign exchange rates on financial assets and liabilities at the balance sheet date, illustrating the increase/(decrease) in Group equity caused by a 10% strengthening of the US Dollar and Euro against Sterling. The analysis assumes that all other variables, in particular other foreign currency exchange rates, remain constant.

	31 December 2018 £m	31 December 2017 £m
US Dollar	32	10
Euro	1	(2)

In addition, the change in equity due to a 10% strengthening of the US Dollar against Sterling for the translation of net investment hedging instruments would be a decrease of £186 million (2017: decrease £51 million) and for Euro, a decrease of £62 million (2017: £nil). However, there would be no overall effect on equity because there would be an offset in the currency translation of the foreign operation.

### Fair value measurements recognised in the Balance Sheet

Foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching the maturities of the contracts.

Interest rate swap and cross-currency swap contracts are measured using yield curves derived from quoted interest and foreign exchange rates.

# Notes to the Financial Statements

Continued

## 24. Financial instruments and risk management continued

### Hedge accounted derivatives

The following table sets out details of the Group's material hedging instruments where hedge accounting is applied at the balance sheet date:

Hedging instruments	Average fixed rate		Notional principal		Fair value assets/(liabilities)	
	2018 %	2017 %	2018 £m	2017 £m	2018 £m	2017 £m
<b>Pay fixed, receive floating interest rate swaps – assets</b>						
Within one year	0.96%	0.94%	393	428	6	4
In one to two years	0.99%	0.95%	303	376	2	2
In two to five years	0.93%	0.96%	228	256	–	2
After five years	–	–	–	–	–	–
<b>Total</b>					<b>8</b>	<b>8</b>
<b>Pay fixed, receive floating interest rate swaps – liabilities</b>						
Within one year	1.81%	–	379	–	(1)	–
In one to two years	2.37%	–	946	–	(3)	–
In two to five years	2.27%	–	1,301	–	(10)	–
After five years	–	–	–	–	–	–
<b>Total</b>					<b>(14)</b>	<b>–</b>
<b>Pay fixed, receive fixed cross-currency swaps</b>						
Within one year	5.65%	–	1,001	–	(101)	–
In one to two years	4.85%	–	548	–	(3)	–
In two to five years	4.85%	–	548	–	(95)	–
After five years	–	–	–	–	–	–
<b>Total</b>					<b>(199)</b>	<b>–</b>

Derivative and financial assets and liabilities are presented within the Balance Sheet as:

	31 December 2018 £m	31 December 2017 £m
Non-current assets	26	4
Current assets	15	10
Non-current liabilities	(227)	–
Current liabilities	(204)	(1)

The change in fair value of interest rate swaps was a £14 million charge (2017: £1 million credit) which is discussed in the finance cost risk management section.

All hedging instruments are booked in the Balance Sheet as derivative financial assets or derivative financial liabilities.

The fair value of derivative financial instruments is derived from inputs other than quoted prices that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) and they are therefore categorised within Level 2 of the fair value hierarchy set out in IFRS 13: "Fair value measurement". The Group's policy is to recognise transfers into and out of the different fair value hierarchy levels at the date the event or change in circumstances that caused the transfer to occur. There have been no transfers between levels in the year.

The following table sets out details of the Group's material hedged items at the balance sheet date where hedge accounting is applied:

Hedged items	Change in fair value for calculating ineffectiveness		Balance in hedging reserve for continuing hedges	
	2018 £m	2017 £m	2018 £m	2017 £m
Floating rate borrowings – interest risk	14	(1)	6	(8)
Net assets of designated investments	237	–	84	–

There is no balance held in the cash flow hedge reserve from hedging relationships for which hedge accounting is no longer applied.

## 25. Issued capital and reserves

Share Capital	31 December 2018 £m	31 December 2017 £m
<b>Allotted, called-up and fully paid</b>		
4,858,254,963 (31 December 2017: 1,941,200,503) Ordinary Shares of 48/7p each (31 December 2017: 48/7p each)	333	133
12,831 (31 December 2017: 12,831) 2017 Melrose Incentive Plan Shares of £1 each	–	–
	<b>333</b>	<b>133</b>

The rights of each class of share are described in the Directors' Report.

On 19 April 2018, 2,469 million ordinary shares were issued as a result of the acquisition of GKN. Further issues of share capital totalling 448 million took place between 19 April 2018 and 30 June 2018 in order to purchase the remaining non-controlling interest of GKN. The total number of ordinary shares in issue therefore increased from 1,941 million at 31 December 2017 to 4,858 million at 31 December 2018.

### Translation reserve

The Translation reserve contains exchange differences on the translation of subsidiaries with a functional currency other than Sterling and exchange gains or losses on the translation of liabilities that hedge the Company's net investment in foreign subsidiaries.

### Hedging reserve

The Hedging reserve represents the cumulative fair value gains and losses on derivative financial instruments for which cash flow hedge and net investment hedge accounting has been applied.

### Merger reserve and Other reserves

The Merger reserve represents the excess of fair value over nominal value of shares issued in consideration for the acquisition of subsidiaries. Other reserves comprise accumulated adjustments in respect of Group reconstructions.

## 26. Cash flow statement

	Note	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Reconciliation of adjusted operating profit to cash generated by continuing operations</b>			
Adjusted operating profit <sup>(1)</sup>	6	847	279
Adjustments for:			
Depreciation of property, plant and equipment		238	31
Amortisation of computer software and development costs		44	4
Share of adjusted operating profit of equity accounted investments		(59)	–
Restructuring costs paid and movements in provisions		(207)	(74)
Defined benefit pension contributions paid		(102)	(4)
Increase in inventories		(108)	(8)
Decrease in receivables		181	8
Decrease in payables		(159)	(16)
Acquisition costs and associated transaction taxes		(125)	(8)
Tax paid		(66)	(16)
Interest paid		(111)	(16)
Incentive scheme tax related payments		–	(148)
<b>Net cash from operating activities</b>		<b>373</b>	<b>32</b>

(1) See note 6 for reconciliation of operating loss to adjusted operating profit.

### Net debt reconciliation

Net debt consists of interest-bearing loans and borrowings (excluding any acquisition related fair value adjustments), cross-currency swaps and cash and cash equivalents. Currency denominated balances within net debt are translated to Sterling at swapped rates where hedged by cross-currency swaps.

Net debt is considered to be an alternative performance measure as it is not defined in IFRS. The most directly comparable IFRS measure is the aggregate of interest-bearing loans and borrowings (current and non-current) and cash and cash equivalents.

# Notes to the Financial Statements

Continued

## 26. Cash flow statement continued

A reconciliation from the most directly comparable IFRS measure to net debt is given below:

	31 December 2018 £m	31 December 2017 £m
Interest-bearing loans and borrowings – due within one year	(377)	–
Interest-bearing loans and borrowings – due after one year	(3,378)	(588)
External debt	(3,755)	(588)
Less:		
Cash and cash equivalents	415	16
	(3,340)	(572)
Adjustments:		
Impact of cross-currency swaps	(199)	–
Non-cash acquisition fair value adjustments	57	–
<b>Net debt</b>	<b>(3,482)</b>	<b>(572)</b>

The table below shows the key components of the movement in net debt:

	At 31 December 2017 £m	Cash flow £m	Acquisitions £m	Other non-cash movements £m	Effect of foreign exchange £m	At 31 December 2018 £m
External debt	(588)	(1,732)	(1,430)	49	(54)	(3,755)
Impact of cross-currency swaps	–	10	(109)	(16)	(84)	(199)
Non-cash acquisition fair value adjustments	–	–	73	(16)	–	57
	(588)	(1,722)	(1,466)	17	(138)	(3,897)
Cash and cash equivalents	16	1,802	(1,401)	–	(2)	415
<b>Net debt</b>	<b>(572)</b>	<b>80</b>	<b>(2,867)</b>	<b>17</b>	<b>(140)</b>	<b>(3,482)</b>

## 27. Commitments and contingencies

Amounts payable under finance leases:

	31 December 2018 £m	31 December 2017 £m
<b>Present value of minimum lease payments</b>		
Amounts payable:		
Within one year	5	–
After one year but within five years	22	–
Over five years	30	–
<b>Present value of lease obligations</b>	<b>57</b>	<b>–</b>

	31 December 2018 £m	31 December 2017 £m
<b>Minimum lease payments</b>		
Amounts payable:		
Within one year	8	–
After one year but within five years	28	–
Over five years	48	–
Less: future finance charges	(27)	–
<b>Present value of lease obligations</b>	<b>57</b>	<b>–</b>
Analysed as:		
Amounts due for settlement within one year (shown within current liabilities)	5	–
Amount due for settlement after one year	52	–
<b>Present value of lease obligations</b>	<b>57</b>	<b>–</b>

It is the Group's policy to lease certain of its property, plant and equipment under finance leases. The average lease term is ten years. Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

## 27. Commitments and contingencies continued

The Group's obligations under finance leases are secured by the lessors' rights over the leased assets.

Future total minimum rentals payable under non-cancellable operating leases were as follows:

	31 December 2018 £m	31 December 2017 £m
Amounts payable:		
Within one year	94	18
After one year but within five years	296	48
Over five years	320	31
	<b>710</b>	<b>97</b>

The Group leases properties, plant, machinery and vehicles for operational purposes. Property leases vary in length. Plant, machinery and vehicle leases typically run for periods of up to five years.

### Capital commitments

At 31 December 2018, there were commitments of £137 million (31 December 2017: £9 million) relating to the acquisition of new plant and machinery.

## 28. Related parties

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

In the ordinary course of business sales and purchases of goods take place between subsidiaries and equity accounted investment companies priced on an arm's length basis. Sales by subsidiaries to equity accounted investments in the year ended 31 December 2018 totalled £28 million (2017: £nil). Purchases by subsidiaries from equity accounted investments in the year ended 31 December 2018 totalled £14 million (2017: £nil). At 31 December 2018, amounts receivable from equity accounted investments totalled £6 million (31 December 2017: £nil) and amounts payable to equity accounted investments totalled £2 million (31 December 2017: £nil).

Sales to and purchases from Group companies are priced on an arm's length basis and generally are settled on 30-day terms.

### Remuneration of key management personnel

The remuneration of the Directors, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24: "Related party disclosures". Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration Report on page 96.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Short-term employee benefits	3	3
Share-based payments	9	7
	<b>12</b>	<b>10</b>

## 29. Post Balance Sheet events

On 6 March 2019 the Group announced the agreement to sell the Walterscheid Powertrain Group to One Equity Partners, a US-based private equity firm. In addition the Group announced the completion of the sale of the minority 43.57% interest in Société Anonyme Belge de Constructions Aéronautiques ("SABCA"), previously held within the Aerospace reporting segment, to SABCA's majority shareholder, Dassault Belgique Aviation S.A. The sale of the Walterscheid Powertrain Group is subject to the customary regulatory conditions and is expected to complete in the first half of this year. The combined net proceeds of the sales are approximately £200 million.

## 30. Contingent liabilities

As a result of acquisitions made by the Group, certain contingent legal and warranty liabilities have been identified as part of the fair value review of these acquisition Balance Sheets. Whilst it is difficult to reasonably estimate the timing and ultimate outcome of these claims, the Directors' best estimate has been included in the Balance Sheet where they existed at the time of acquisition and hence were recognised in accordance with IFRS 3: "Business combinations". Where a provision has been recognised, information regarding the different categories of such liabilities and the amount and timing of outflows is included within note 20.

Given the nature of the Group's business many of the Group's products have a large installed base, and any recalls or reworks related to such products could be particularly costly. The costs of product recalls or reworks are not always covered by insurance. Recalls or reworks may have a material adverse effect on the Group's financial condition, results of operations and cash flows.

The Group has contingent liabilities representing guarantees and contract bonds given in the ordinary course of business on behalf of trading subsidiaries. No losses are anticipated to arise on these contingent liabilities. The Group does not have any other significant contingent liabilities.

# Company Balance Sheet for Melrose Industries PLC

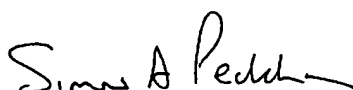
	Notes	31 December 2018 £m	31 December 2017 £m
<b>Fixed assets</b>			
Investment in subsidiaries	3	10,569	2,213
Debtors:			
Amounts falling due within one year	4	400	-
Amounts falling due after one year	4	25	25
Creditors: amounts falling due within one year	5	(1,773)	(192)
<b>Net current liabilities</b>		<b>(1,348)</b>	<b>(167)</b>
<b>Total assets less current liabilities</b>		<b>9,221</b>	<b>2,046</b>
Provisions	6	(1)	-
<b>Net assets</b>		<b>9,220</b>	<b>2,046</b>
<b>Capital and reserves</b>			
Issued share capital	7	333	133
Share premium account		8,138	1,493
Merger reserve		109	109
Retained earnings		640	311
<b>Shareholders' funds</b>		<b>9,220</b>	<b>2,046</b>

The Company reported a profit for the financial year ended 31 December 2018 of £445 million (2017: loss of £21 million).

The financial statements were approved by the Board of Directors on 7 March 2019 and were signed on its behalf by:



Geoffrey Martin  
Group Finance Director  
7 March 2019



Simon Peckham  
Chief Executive  
7 March 2019

Registered number: 09800044

## Company Statement of Changes in Equity

	Issued share capital £m	Share premium account £m	Merger reserve £m	Retained earnings £m	Shareholders' funds £m
At 1 January 2017	129	1,493	112	476	2,210
Loss for the year (note 2)	-	-	-	(21)	(21)
Total comprehensive expense	-	-	-	(21)	(21)
Dividends paid	-	-	-	(63)	(63)
Equity-settled share-based payments	-	-	-	10	10
Incentive scheme related	4	-	(3)	(116)	(115)
Deferred tax on share-based payment transactions	-	-	-	25	25
At 31 December 2017	133	1,493	109	311	2,046
Profit for the year (note 2)	-	-	-	445	445
Total comprehensive income	-	-	-	445	445
Dividends paid	-	-	-	(129)	(129)
Acquisition of GKN <sup>(1)</sup>	200	6,645	-	-	6,845
Equity-settled share-based payments	-	-	-	13	13
<b>At 31 December 2018</b>	<b>333</b>	<b>8,138</b>	<b>109</b>	<b>640</b>	<b>9,220</b>

(1) Relates to purchase of the issued share capital of GKN plc. The amount recognised within the share premium account for the acquisition of GKN of £6,645 million is net of £1 million for costs associated with issuing shares.

# Notes to the Company Balance Sheet

## 1. Significant accounting policies

### Basis of accounting

Melrose Industries PLC ("the Company") is a public company limited by shares. The Company is incorporated in the United Kingdom under the Companies Act 2006 and registered in England and Wales. The address of the registered office is given on the back cover. The nature of the Group's operations and its principal activities are set out in the strategic report on pages 10 to 69.

The Financial Statements have been prepared under the historical cost convention and in accordance with Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council.

The functional currency of Melrose Industries PLC is considered to be pounds Sterling because that is the currency of the primary economic environment in which the Company operates.

Melrose Industries PLC meets the definition of a qualifying entity under FRS 102 and has therefore taken advantage of the disclosure exemptions available to it in respect of its separate Financial Statements. Melrose Industries PLC is consolidated in its Group Financial Statements. Exemptions have been taken in these separate Company Financial Statements in relation to share-based payments, presentation of a cash flow statement, the remuneration of key management personnel and financial instruments.

The principal accounting policies are consistent with the prior period and are summarised below.

### Going concern

The Directors have, at the time of approving the Financial Statements, a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the Financial Statements. Further detail is contained in the Directors' statement of going concern on page 48 of the Finance Director's review.

### Investments

Investments in subsidiaries are measured at cost less impairment.

For investments in subsidiaries acquired for consideration including the issue of shares qualifying for merger relief, cost is measured by reference to the nominal value of the shares issued plus fair value of other consideration. Any premium is ignored.

### Impairment of assets

Assets are assessed for indicators of impairment at each balance sheet date. If there is objective evidence of impairment, an impairment loss is recognised in profit or loss as described below.

### Non-financial assets

An asset is impaired where there is objective evidence that, as a result of one or more events that occurred after initial recognition, the estimated recoverable value of the asset has been reduced. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use.

Where indicators exist for a decrease in impairment loss, the prior impairment loss is tested to determine reversal. An impairment loss is reversed on an individual impaired asset to the extent that the revised recoverable value does not lead to a revised carrying amount higher than the carrying value had no impairment been recognised.

### Financial instruments

Financial assets and financial liabilities are recognised when the Company becomes a party to the contractual provisions of the instrument. Financial liabilities are classified according to the substance of the contractual arrangements entered into.

### Financial assets and liabilities

All financial assets and liabilities are initially measured at transaction price (including transaction costs).

Financial assets and liabilities are only offset in the Balance Sheet when, and only when, there exists a legally enforceable right to set off the recognised amounts and the Company intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Financial assets are derecognised when, and only when, a) the contractual rights to the cash flows from the financial asset expire or are settled, b) the Company transfers to another party substantially all of the risks and rewards of ownership of the financial asset, or c) the Company, despite having retained some, but not all, significant risks and rewards of ownership, has transferred control of the asset to another party.

Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

# Notes to the Company Balance Sheet

Continued

## 1. Significant accounting policies continued

### Share-based payments

The Company issues equity-settled share-based payments to certain employees. The required disclosures are included in the Group Consolidated Financial Statements.

Equity-settled share-based payments are measured at fair value (excluding the effect of non-market based vesting conditions) at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the shares that will eventually vest and adjusted for the effect of non-market based vesting conditions.

Fair value is measured by use of the Black Scholes pricing model. The expected life used in the model has been adjusted, based on the Directors' best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

Where equity-settled share-based payments are made available to employees of the Company's subsidiaries, these are treated as increases in equity over the vesting period of the award with a corresponding increase in the Company's investment in subsidiaries.

### Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the Financial Statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the Financial Statements.

### Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a rate that reflects the current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

### Critical accounting judgements and key sources of estimation uncertainty

There were no critical accounting judgements that would have a significant effect on the amounts recognised in the parent Company Financial Statements or key sources of estimation uncertainty at the balance sheet date that would have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

## 2. Profit for the year

As permitted by section 408 of the Companies Act 2006 the Company has elected not to present its own Profit and Loss Account for the year. Melrose Industries PLC reported a profit for the financial year ended 31 December 2018 of £445 million (2017: loss of £21 million).

The auditor's remuneration for audit services to the Company is disclosed in note 7 to the Group Consolidated Financial Statements.

Directors' remuneration is disclosed in the Directors' Remuneration Report on pages 92 to 112. There were no other employees of the Company in the year.

## 3. Investment in subsidiaries

	£m
At 1 January 2018	2,213
Additions	8,356
<b>At 31 December 2018</b>	<b>10,569</b>

During the year, the Company acquired 100% of the issued share capital of GKN plc resulting in an increase in investments of £8,351 million. In addition, a £5 million investment from equity-settled share-based payments for subsidiaries is included in investment in subsidiaries at 31 December 2018.

### 3. Investment in subsidiaries continued

The following subsidiaries and significant holdings were owned by the Company as at 31 December 2018:

	Equity interest %	Class of Share held		Equity interest %	Class of Share held
<b>Argentina</b>					
<b>Corrientes Avenue 311, 7, Capital Federal, 1043</b>					
Nordyne Argentina SRL	100	Ordinary			
<b>Avenida Del Libertador 602, 4' Piso, Buenos Aires</b>					
Transmisiones Homocineticas Argentinas SA (in liquidation)	49	Ordinary B <sup>(n)</sup>			
<b>Australia</b>					
<b>2 Fawley Avenue, Narangba, Queensland, 4504</b>					
Bristol Meci Australasia Pty Limited	100	Ordinary			
Hawker Siddeley Switchgear Pty Limited	100	Ordinary			
<b>45-49 McNaughton Road, Clayton Victoria 3168</b>					
Unidrive Pty Ltd	100	Ordinary			
<b>c/o Baker &amp; McKenzie, Level 27, AMP Centre, 50 Bridge Street, Sydney, NSW 2000</b>					
Ergotron Australia Pty Ltd	100	Ordinary			
<b>Austria</b>					
<b>Slamastrasse 32, Postfach 36, 1230 Wien</b>					
GKN Service Austria GmbH	100	Ordinary			
<b>Belgium</b>					
<b>Robert Klingstraat 96A, 8940 Wervik</b>					
Nortek Global HVAC Belgium NV	100	Ordinary			
<b>Chaussée de Haecht 1470, B – 1130 Brussels</b>					
Société Anonyme Belge de Constructions Aéronautiques	43.57	Ordinary			
<b>Brazil</b>					
<b>Cicada de Vitoria, Estado do Espiriot Santo, na Av. Nossa, Senhora da Penha, 520, Sala 404, Praia do Canto, 29055-131</b>					
Nordyne do Brasil Distribuidora de Ar Condicionado Ltda	100	Quota capital			
<b>Av. Alfredo Ignácio Noqueira Penido, 335 – Sala 1103 – Edifício Madison Power, São José dos Campos, SP, 12246-000</b>					
GKN Aerospace Transparency Systems do Brasil Ltda	100	Quota capital			
<b>Rua Joaquim Silveira 557, Parque Sao Sebastiao, 91060-320 Porto Alegre, RS</b>					
GKN do Brasil Ltda	100	Quota capital			
<b>Av. da Emancipacao no. 4.500, CEP 13.184-542, Bairro Santa Esmeralda, Hortolandia, Sao Paulo</b>					
GKN Sinter Metals Ltda	99.99	Quota capital			
<b>Av. Sargento Geraldo Santana, 154, 04674-225, Sao Paulo, SP</b>					
GKN Brasil Equipamentos Ltda	100	Quota capital			
<b>British Virgin Islands</b>					
<b>Wickhams Cay 1, P.O. Box 3140, Road Town, Tortola</b>					
Nortek Trading Limited	100	Ordinary			
<b>Canada</b>					
<b>19 rue des Mésanges, Montréal, Québec H3E 1W2</b>					
Brush Canada Services Inc./Services Brush Canada Inc.	100	Common Stock			
<b>44 Chipman Hill, Suite 100, Saint John, New Brunswick E2L 2A9</b>					
2GIG Technologies Canada, Inc.	100	Ordinary			
<b>1300 – 1969 Upper Water Street, Purdy's Wharf Tower II, Halifax Nova Scotia, B3J 2V1</b>					
Ergotron Canada Corporation	100	Ordinary			
<b>605 Rue Rocheleau, Drummondville, Quebec, J2C 6L8</b>					
Innergy Tech, Inc.	100	Ordinary			
<b>1502D Quebec Avenue, Saskatoon, Saskatchewan, S7K 1V7</b>					
Nortek Air Solutions Canada, Inc.	100	Ordinary			
<b>9100 Rue du Parcours, Montreal, Quebec, H1J 2Z1</b>					
Nortek Air Solutions Quebec, Inc.	100	Ordinary			
<b>1900, 520 3rd Avenue, Calgary, AB t2P 0R3</b>					
Venmar Ventilation ULC	100	Ordinary			
<b>1635 rue Blueberry Forest, Saint-Lazare Québec, J7T2J9</b>					
Fokker Elmo Canada Inc	100	Common stock			
<b>7 Michigan Boulevard, St. Thomas, Ontario, Canada</b>					
GKN Sinter Metals – St. Thomas, Ltd.	100	Common stock			
<b>China</b>					
<b>8 Changhong Road, Changshu Economic Development Zone, Jiangsu Province, 215500</b>					
Brush Electrical Machines (Changshu) Co. Limited	100	Registered investment			
<b>2025, 2031, 1st Floor, Building C, No.155 West Fute Road One, Shanghai Waigaoqiao Bonded Area, China (Shanghai) Free Trade Pilot Zone</b>					
FKI Engineering Shanghai Limited	100	Ordinary			
<b>Zone 6, Daxin Jituan, Chenjiang Town, Huicheng District, Guangdong, 516229</b>					
Guangdong Broan IAQ Systems Co. Limited	100	Ordinary			
<b>The 3rd Industry Area, Juzhou Shijie, Dongguan, Guangdong</b>					
Dongguan Ergotron Precision Technology Co Limited	100	Ordinary			
<b>Room 2913&amp;2914 TaiShang Building, Dongguan Road 11#, Dongcheng, Guangdong</b>					
Dongguan Ergotron Precision Technology Design Services Co Limited	100	Ordinary			
<b>3/F, Building A5, Anle Industrial Zone, Hangcheng Ave, Baoan District, Shenzhen City, China</b>					
Linear Electronics (Shenzhen) Co Limited	100	Ordinary			
<b>Room 28D2, 895 Yan'an West Road, Changning District, Shanghai</b>					
Nortek (Shanghai) Trading Co Limited	100	Ordinary			
<b>No 71 Xiangyun Road, Langfang Economic &amp; Technical Development Zone, Langfang</b>					
Fokker Elmo (Langfang) Electrical Systems Co. Ltd	100	Registered investment			
<b>On the north of 1500 meters, Wuping Dong Road, Shengfang Town, Bazhou City, Hebei Province</b>					
GKN (Bazhou) Metal Powder Company Limited	40	Registered investment			
<b>Unit A, 6/F, Building A1#, No. 2555 Xiupu Road, Pudong New Area, Shanghai, 201315, China</b>					
GKN China Holding Co Ltd	100	Registered investment			
<b>18 North Shitan Road, North Industrial Park, Development Zone, Danyang, Jiangsu 212310, China</b>					
GKN Danyang Industries Company Limited	100	Registered investment			

# Notes to the Company Balance Sheet

Continued

## 3. Investment in subsidiaries continued

	Equity Interest %	Class of Share held		Equity Interest %	Class of Share held
<b>No. 1 Cuigu, Northern New Zone, Chongqing, 401122</b>			<b>100 Avenue Vanderbilt, 78955 Carrieres-sous-Poissy</b>		
GKN HUAYU Driveline Systems (Chongqing) Co. Ltd	9	Registered investment <sup>2</sup>	GKN Automotive SAS	100	Ordinary
<b>928 JingDu Road, Donghai Economic Development Zone, Jiangsu, 222300 China</b>			GKN Driveline SA	99.99	Ordinary
GKN (Lianyungang) Company Limited	100	Registered investment	GKN Freight Services EURL	100	Ordinary
<b>No. 7 Liutai Road, Liuzhou, Guangxi, 545007</b>			<b>8 rue Panhard et Levassor, Ecoparc des Cettons, 78570, Chanteloup-les-Vignes</b>		
GKN Power Solutions (Liuzhou) Company Limited	100	Registered investment	GKN Service France SAS	100	Ordinary
<b>No. 8 Kangming Road, Industrial Automotive Park, Yizhenb City, Jiangsu 21400, China</b>			<b>765 rue Albert Einstein, CS 70402, 13591 Aix-en-Provence Cedex 3</b>		
GKN Sinter Metals Yizheng Co Ltd	100	Registered investment	NH Industries SAS	5.5	Ordinary
<b>188 East Guangzhou Road, Taicang Economic Development Area, Jiangsu Province</b>			<b>Germany</b>		
GKN (Taicang) Co Ltd	100	Registered investment	<b>Teichhorn 4-6, 24119, Kronshagen</b>		
<b>Xiguo Industrial Zone, Mengzhou City, Henan Province, 454750</b>			Ergotron Deutschland GmbH	100	Ordinary
GKN Zhongyuan Cylinder Liner Company Limited	59	Registered investment	<b>Brunhamstr. 21, 81249, Munich</b>		
<b>17 Zhongshan Road, Yong Yang County, Lishui District, Nanjing</b>			GKN Aerospace Deutschland GmbH	100	Ordinary
Nanjing FAYN Piston Ring Company Limited	19.79	Registered investment	<b>Carl-Legien-Strasse 10, 63073 Offenbach am Main</b>		
<b>898 Kangshen Road, Pudong, Shanghai</b>			GKN Driveline Deutschland GmbH	100	Ordinary
Shanghai GKN Driveline Sales Co Ltd	49	Registered investment	<b>Hauptstrasse 130, 53797 Lohmar</b>		
<b>950 KangQiao Road, Pudong New Area, Shanghai</b>			GKN Driveline International GmbH	100	Ordinary
Shanghai GKN HUAYU Driveline Systems Company Limited	50	Registered investment	<b>Hafenstrasse 41, 54293 Trier</b>		
<b>Building 48, 128 Dieqiao Road, Kangqiao Industrial Zone, Pudong, Shanghai, 201315</b>			GKN Driveline Trier GmbH	100	Ordinary
Shanghai GKN HUAYU Driveline Systems Torque Technology Company Limited	100	Registered investment	<b>Nussbaumweg 19-21 51503, Rösraath, Germany</b>		
<b>Suite 805, Block 2, BaoWu Plaza, 1859 Shibo Avenue, Shanghai, 200126, China</b>			GKN Driveline Service GmbH	100	Ordinary
GKN Aerospace (Shanghai) Co., Ltd	100	Registered investment	<b>Opelkreisel 1-9, 67663 Kaiserslautern</b>		
<b>Colombia</b>			GKN Gelenkwellenwerk Kaiserslautern GmbH	100	Ordinary
<b>1301, 13/F Bank of America Tower, 12 Harcourt Road, Central</b>			<b>Krebsoege 10, 42477 Radevormwald</b>		
MiOS Colombia	42	Ordinary	GKN Powder Metallurgy Holding GmbH	100	Ordinary
<b>Calle 32 No. 15 – 23 Barrio Rincon de Girón, Girón Santander</b>			<b>Nussbaumweg 19-21, 51503 Roesrath</b>		
Transejes Transmisiones Homocineticas de Colombia SA	49	Ordinary	GKN Service International GmbH	100	Ordinary
<b>Czech Republic</b>			<b>Pennfeldsweg 11-15, 53177, Bonn</b>		
<b>Edvarda Beneše 564/39, Doudlevice, 301 00 Pízen</b>			GKN Sinter Metals Components GmbH	100	Ordinary
Brush SEM s.r.o.	100	Ordinary	<b>Krebsoege 10, 42477 Radevormwald</b>		
<b>Denmark</b>			GKN Sinter Metals Engineering GmbH	100	Ordinary
<b>Baldershøj 11, 2635 Ishøj</b>			<b>Dahlienstrasse 43, 42477 Radevormwald</b>		
GKN Walterscheid Service & Distribution A/S	100	Ordinary	GKN Sinter Metals Filters GmbH Radevormwald	100	Ordinary
<b>Nagbølvej 31, 6640 Lunderskov</b>			<b>Industriestr. 1, 97769 Bad Brückenau</b>		
GKN Wheels Nagbol A/S	100	Ordinary	GKN Sinter Metals & Forge Operations GmbH	100	Ordinary
<b>France</b>			<b>Am Fliegerhorst 9, 99947 Bad Langensalza</b>		
<b>Boulevard De L Europe, 91000 Evry, France</b>			GKN Sinter Metals GmbH, Bad Langensalza	100	Ordinary
Arianespace Participation S.A.	1.6110	Ordinary	<b>Alte Bautzener Strasse 1-3, 02689 Sohland/Spree</b>		
<b>12 Quai du Commerce 69009 Lyon</b>			GKN Walterscheid Getriebe GmbH	100	Ordinary
Ergotron France SARL	100	Ordinary	<b>Hauptstrasse 150, 53797 Lohmar</b>		
<b>Z.I. de Rosarge, 230, rue de la Dombes, Les Echets, 01706 Miribel Cedex, Lyon</b>			GKN Walterscheid GmbH	100	Ordinary
Nortek Global HVAC France SAS	100	Ordinary	<b>Peterstrasse 69, 42499 Hueckeswagen</b>		
<b>20 rue Lavoisier, 95300 Pontoise</b>			Hoeganaes Corporation Europe GmbH	100	Ordinary
Automotive Group Services SARL	100	Ordinary	<b>Nymphenburger Str. 3c, D-80335, München</b>		
<b>7 rue de la Briqueterie, 02240 Ribemont</b>			Gefen Europe GmbH	100	Ordinary
GKN Driveline Ribemont SARL	100	Ordinary	<b>Hong Kong</b>		
			<b>28/F Bank of East Asia Harbour View Center, 56 Gloucester Road, Wanchai</b>		
			Broan-NuTone (HK) Limited	100	Ordinary
			<b>19F Hounor Industrial Centre, 6 Sun Yip Street, Chai Wan, Hong Kong</b>		
			Linear HK Manufacturing Limited	100	Ordinary
			<b>Citicorp Centre, STE 1607-8, 18 Whitfield Road, Causeway Bay, Hong Kong</b>		
			MiOS Limited	42	Ordinary

## 3. Investment in subsidiaries continued

	Equity Interest %	Class of Share held		Equity Interest %	Class of Share held
<b>India</b>					
<b>Block 2A No. 311, NPR Complex. Survey No 197, Hoody Village, K R Puram Hobli, Whitefield Road, Bangalore – 560048, Karnataka</b>					
Fokker Elmo SASMOS Interconnection Systems Limited	49	Ordinary	<b>21-15 Azusawa 2-chome, Itabashi-ku, Tokyo 174 (4)</b>		Common stock
<b>270, Sector-24, Faridabad 121 005, Haryana</b>			Matsui-Walterscheid Ltd	40	
GKN Driveline (India) Limited	97.03	Ordinary	<b>Senri Life Science Centre Building. 12F, 1-4-2 Shin Senri Higashi-machi, Toyonaka-shi, Osaka</b>		
<b>146 Mumbai Pune Road, Pimpri, Pune 411 018</b>			GKN Powder Metallurgy Japan K.K.	100	Ordinary
GKN Sinter Metals Private Limited	100	Ordinary	<b>Jersey</b>		
<b>Shop No. 002, Lumkad Sky Vista, S. No. 230/AViman Naga/3/2, Viman Nagar, Pune, Maharashtra, 411014</b>			<b>13 Castle Street, St Helier, JE4 5UT</b>		
GKN Fokker Elmo India Private Limited	100	Ordinary	GKN Finance Limited	100	Ordinary
<b>135, 2nd Floor, RMZ Titanium, Old Airport Road, Bengaluru, 560 017</b>			<b>Korea</b>		
GKN Aerospace Engine Systems India Private Limited	100	Ordinary	<b>Foreign Investors Industrial Park, 2 Ro, 3 Kongdan, Subuk-gu, Choongnam-do, 330-220</b>		Common stock
<b>214 Navi Peth (Sadashiv Peth), L.B.S. Marg, Tal Haveli District, Pune, 411030, India</b>			GKN Driveline Korea Limited	100	
IntelliVision Technologies	100	Ordinary	<b>Malaysia</b>		
<b>Iran</b>					
<b>N° 9, Yas Alley Fath St, Sadr Express Way, 1939753151 Tehran, Iran</b>			<b>Boardroom Corporate Services (KL) SDN. BHD. LOT 6.05, Level 6 KPMG Tower 8 First Avenue, Bandar Utama, 47800 Petaling Jaya, Selangor</b>		
GKN Driveline Beshel Private Joint Stock Company	59.995	Ordinary	GKN Engine Systems Component Repair Sdn Bhd.	100	Ordinary
<b>Ireland</b>					
<b>3rd Floor, Kilmore House, Park Lane, Spencer Dock, Dublin, Ireland</b>			<b>2445 Lorong Perusahaan Enam B, Kawasan Perindustrian Prai 13600 Prai, Penang</b>		
Nortek Air Solutions (Ireland) Limited	100	Ordinary	GKN Driveline Malaysia Sdn Bhd	68.42	Ordinary
<b>Isle of Man</b>					
<b>Tower House, Loch Promenade, Douglas, IM1 2LZ</b>			<b>Malta</b>		
Ipsley Insurance Limited	100	Ordinary	<b>Marsa Industrial Estate, Marsa, MRS 3000</b>		
<b>Italy</b>					
<b>Via dei Campi della Rienza 8, 39031 Brunico, BZ, Italy</b>			Mediterranean Power Electric Company Limited	26	Ordinary
GKN Driveline Brunico SpA	100	Ordinary	<b>Mexico</b>		
<b>Via Fratelli Cervi 1, 50013 Campi Bisenzio, FI, Italy</b>			<b>Avenue de los Olivos 100-A, Parque Industrial El Pajio, Tecata, Baja California, 21438</b>		
GKN Driveline Firenze SpA	100	Ordinary	Broan Building Products-Mexico S de RL de CV	100	Ordinary
<b>Via dei Campi della Rienza 8, 39031 Brunico, BZ, Italy</b>			<b>Rodolfo González #100, Col. Jardines La Victoria, Guadalupe, Nuevo Leon, Mexico, Zip Code 67119</b>		
GKN Italia SpA	100	Ordinary	Nortek Global HVAC Mexico S. de RL de CV	100	Ordinary
<b>Via G. Ferraris 125/C 20021 Bollate, MI, Italy</b>			<b>Tabalaopa #8301, Parque Industrial, Chihuahua</b>		
GKN Service Italia SpA	100	Ordinary	FAE Aerostructures SA de CV	100	Ordinary
<b>Via Delle Fabbriche 5, 39031 Brunico, BZ, Italy</b>			<b>Av. CFE No. 709, Parque Industrial Millennium, San Luis Potosi S.L.P 78395</b>		
GKN Sinter Metals SpA	100	Ordinary	GKN Aerospace San Luis Potosi S. de R.L. de C.V. (in liquidation)	100	Fixed equity
<b>Viale Santa Maria 76, 25013 Carpenedolo, BS, Italy</b>			<b>Carretera Panamericana km 284, Celaya, Guanajuato, C.P. 38110</b>		
GKN Wheels Carpenedolo SpA	100	Ordinary	GKN Driveline Celaya SA de CV	99.68	Ordinary
<b>Zona industriale Est 1 39035 Monguelfo BZ, Italy</b>			GKN Driveline Mexico Services SA de CV	98	Ordinary
Walterscheid Monguelfo SpA	100	Ordinary	GKN Driveline Mexico Trading SA de CV	98	Ordinary
<b>Japan</b>					
<b>Shiroyama Trust Tower, 4-3-1, Toranomon, Minatuo-ku, Tokyo</b>			<b>Carretera Alterna Celaya Villagrán Km 11, Col. El Pintor, Villagrán, Guanajuato, C.P. 38260</b>		
Ergotron Japan KK	100	Ordinary	GKN Driveline Villagran SA de CV	98	Ordinary
<b>2388 Ohmiya-cho, Tochigi City, 328-8502 Tochigi</b>			<b>Av. Constituyentes Pte. 206, El Jacal, Queretaro, C.P. 76187</b>		
GKN Driveline Japan Ltd	100	Ordinary	GKN Sinter Metals Mexico S. De. R.L. De. C.V.	100	Ordinary
<b>2388 Ohmiya-cho, Tochigi City, 328-8502 Tochigi</b>			GKN Sinter Metals Mexico (Services)		
GKN Driveline Tochigi Holdings KK	100	Ordinary	S. De. R.L. De. C.V.	100	Ordinary
			<b>Calle Profesor Rodolfo Gonzalez 100, Colonia Jardines de la Victoria, Guadalupe, Nuevo Leon, C.P. 67119</b>		
			Manufactura e Innovacion Monterrey, S. de R.L. de C.V.	100	Membership interest
			<b>Herminia Castro de Aguirre 1805-8, Parque Industrial Amistad Aeropuerto, Ramos Arizpe, Coahila, 25900</b>		
			Manufacturas Avanzadas Ramsal, S. de. R.L. de C.V.	100	Membership interest

# Notes to the Company Balance Sheet

Continued

## 3. Investment in subsidiaries continued

	Equity interest %	Class of Share held		Equity interest %	Class of Share held
<b>The Netherlands</b>			<b>Al. Katowicka 33, 05-830, Nadarzyn</b>		
<b>Beeldschermweg 3, 3821 AH Amersfoort</b>			GKN Service Polska Sp. z o.o (in liquidation)	100	Ordinary
Ergotron Nederland BV	100	Ordinary	<b>Romania</b>		
<b>Ringdijk 390B, 2983 GS, Postbus 3007, 2980 DA, Ridderkerk</b>			<b>Str. Condonilor 9, 600302, Bacau</b>		
Brush HMA BV	100	Ordinary	FOAR S.R.L.	49	Ordinary
<b>Strawinskylaan 3127 8e Verdiepin, Amsterdam, Noord-Holland, 1077 ZX</b>			<b>Hermes Business Campus, Dimitrie Pompeiu Blvd 5-7, Building 2, 3rd floor Bucharest 020337 RO, București 077190</b>		
Nortek Holding BV	100	Ordinary	Fokker Engineering Romania S.R.L.	100	Ordinary
Nortek International Holdings BV	100	Ordinary	<b>33 Urziceni Street, Buzau 120226 Romania</b>		
<b>Aviolandalaan 37, 4631 RP, Hoogerheide</b>			Hoeganaes Corporation Europe SA	100	Ordinary
Business Park Aviolanda B.V.	20	Ordinary	<b>Russian Federation</b>		
<b>Industrieweg 4, 3351 LB, Papendrecht</b>			<b>The Land Plot No.3, Building No.4, Roadway No.2, Territory of OEZ IPT, Podstepki Village, Stavropolsky District, Samara Region, Podstepki Village, 445143</b>		
Cooperative Delivery of Retrokits (CDR) V.O.F.	50	Registered investment	GKN Driveline Togliatti LLC	100	Ordinary
<b>Markt 22, 3351 PB, Papendrecht, Netherlands</b>			<b>Office 21K, Building 19, Leninskaya Sloboda Street, 115280, Moscow</b>		
Fabriek Slobbengors Beheer B.V.	49	Ordinary	GKN Engineering (RUS) LLC	100	Ordinary
Fabriek Slobbengors C.V.	49	Registered investment	<b>Nizhniy Novgorod, 77 Ulitsa Gorkogo, Premises P6, Russian Federation</b>		
Hoofdkantoor Slobbengors Beheer B.V.	49	Ordinary	IntelliVision Limited	100	Ordinary
Kantoor Industrieweg C.V.	49	Registered investment	<b>Saudi Arabia</b>		
<b>Aviolandalaan 31, 4631 RP, Hoogerheide, Netherlands</b>			<b>P.O. Box 2091, Riyadh 11451</b>		
Fokker Aircraft Services B.V.	100	Ordinary	Huntair Arabia	49	Ordinary
Fokker Techniek BV	100	Ordinary	<b>Singapore</b>		
<b>Aviolandalaan 33, Hoogerheide, 4631 RP, Netherlands</b>			<b>1800 West Camp Road, Seletar Aerospace Park</b>		
Fokker Elmo B.V.	100	Ordinary	Fokker Services Asia Pte Ltd	100	Ordinary
<b>Grasbeemd 28, 5705 DG, Helmond, Netherlands</b>			<b>10 Eunon Road 8, #13-06, Singapore Post Centre, 408600</b>		
Fokker Landing Gear B.V.	100	Ordinary	GKN Driveline Singapore Pte Ltd	100	Ordinary
<b>Industrieweg 4, 3351 LB, Papendrecht, Netherlands</b>			<b>38 Beach Road #29-11, South Beach Tower, Singapore 189767</b>		
Fokker Procurement Combination B.V.	100	Ordinary	Nortek Air Solutions Pte. Ltd	100	Ordinary
Structural Laminates Industries B.V.	100	Ordinary	<b>Slovenia</b>		
Fokker Technologies Group B.V.	100	Ordinary	<b>Rudniska cesta 20, Zreče 3214</b>		
Fokker Technologies Holding B.V.	100	Ordinary	GKN Driveline Slovenija d o o	100	Ordinary
Fokker Technology B.V.	100	Ordinary	<b>Spain</b>		
GKN Aerospace Netherlands B.V.	100	Ordinary	<b>Pol. Ind. Can Salvatella, Avenida Arrahona 54-56, 08210 Barbera del Valles, Barcelona</b>		
Fokker Engineers & Contractors B.V.	100	Ordinary	GKN Ayra Servicio, SA	100	Ordinary
Fokker Aerospace B.V.	100	Ordinary	<b>Avenida de Citroen s/n, 36210 Vigo</b>		
Fokker Aerostructures B.V.	100	Ordinary	GKN Driveline Vigo, SA	100	Ordinary
Fokker (CDR) B.V.	100	Ordinary	<b>Sagarbidea 2, 20750 Zumaia</b>		
<b>Hoeksteen 40, 2132 MS, Hoofddorp, Netherlands</b>			GKN Driveline Zumaia, SA	100	Ordinary
Fokker Services B.V.	100	Ordinary	<b>Polígono Industrial s/n, Maçanet de la Selva, 17412 Girona</b>		
<b>Haarlemmerstraatweg 153-157, 1165 MK Halfweg, Netherlands</b>			Stork Prints Iberia SA	100	Ordinary
GKN Service Benelux BV	100	Ordinary	<b>C/ Garzas 10, Apinto 28 Madrid</b>		
<b>PO BOX 55 Ipsley House, Ipsley Church Lane, Redditch, Worcestershire, United Kingdom, B98 0TL</b>			Off-Highway Powertrain Service Spain SL	100	Ordinary
GKN UK Holdings BV	100	Ordinary	<b>Sweden</b>		
<b>Norway</b>			<b>SE - 461 81, Trollhättan</b>		
<b>Kirkegårdsveien 45, 3616 Kongsberg</b>			GKN Aerospace Sweden AB	100	Ordinary
GKN Aerospace Norway AS	100	Ordinary	GKN Sweden Holdings AB	100	Ordinary
Kongsberg Technology Training Centre AS	33.33	Ordinary	<b>SE - 731 36, Köping</b>		
Kongsberg Terotech AS	50	Ordinary	GKN Driveline Köping AB	100	Ordinary
<b>Poland</b>			<b>Alfred Nobels allé 110, 14621, Tullinge</b>		
<b>Ul. B. Krzywoustego 31 G, 56-400 Oleśnica,</b>			GKN Driveline Service Scandinavia AB	100	Ordinary
GKN Driveline Polska Sp z o o	100	Ordinary	GKN Shafts and Services AB	100	Ordinary

## 3. Investment in subsidiaries continued

	Equity Interest %	Class of Share held		Equity Interest %	Class of Share held
<b>581 88 Linköping</b>			FAD (UK) Limited	100	Ordinary
Industrigruppen JAS AB	20	Ordinary	Firth Cleveland Limited	100	Ordinary
<b>Taiwan</b>			FKI Plan Trustees Limited	100	Ordinary
<b>14 Kwang Fu Road, Hsin-Chu Industrial Park, Hukou, Hsin Chu 30351</b>		Common Stock	GKN Aerospace Transparency Systems (Luton) Limited	100	Ordinary
Taiway Limited	36.25		GKN Birfield Extrusions Limited	100	Ordinary
<b>Thailand</b>			GKN Bound Brook Limited	100	Ordinary
<b>9/21 Moo 5, Phaholyothin Road Klong 1, Klong Luang, Patumthanee, 12120</b>			GKN Building Services Europe Limited	100	Ordinary
GKN Aerospace Transparency Systems (Thailand) Limited	100	Ordinary	GKN CEDU Limited	100	Ordinary
<b>Eastern Seaboard Industrial Estate, 64/9 Moo 4, Tambon Pluakdaeng, Amphur Pluakdaeng, Rayong 21140</b>			GKN Composites Limited	100	Ordinary
GKN Driveline (Thailand) Limited	100	Ordinary	GKN Computer Services Limited	100	Ordinary
<b>Turkey</b>			GKN Countertrade Limited	100	Ordinary
<b>Ege Serbest Bölgesi, SADI Sok. No:10, 35410 Gazimir, Izmir</b>			GKN Defence Holdings Limited	100	Ordinary
Fokker Elmo Havacilik Sanayi Ve Ticaret Limited Sirketi	100	Ordinary	GKN Defence Limited	100	Ordinary
<b>Organize Sanayi Bölgesi 20, Cadde No: 17, 26110, Eskisehir</b>			GKN Enterprise Limited	100	Ordinary
GKN Eskisehir Automotive Products Manufacture and Sales A.S.	100	Ordinary	GKN Euro Investments Limited	100	Ordinary
<b>Istanbul AHL Serbest Bölgesi, Yesilkoy SB Mah. Havalimani Cd. L2 Blok Sokak No:1, 34149 Yesilkoy, Bakirkoy, Istanbul, Turkey</b>			GKN Export Services Limited	100	Ordinary
GKN Sinter Istanbul Metal Sanayi Ve Ticaret Anonim Sirketi	100	Ordinary	GKN Fasteners Limited	100	Ordinary
<b>United Kingdom</b>			GKN Finance (UK) Limited	100	Ordinary
<b>11th Floor, The Colmore Building, 20 Colmore Circus Queensway, Birmingham, B4 6AT</b>			GKN Firth Cleveland Limited	100	Ordinary
Alcester Capricorn	100	Ordinary	GKN Group Services Limited	100	Ordinary and redeemable preference
Alcester EP1 Limited	100	Ordinary	GKN Hardy Spicer Limited	100	Ordinary
Alcester Number 1 Limited	100	Ordinary	GKN Holdings Limited	100	Ordinary
Alder Miles Druce Limited	100	Ordinary	GKN Industries Limited	100	Ordinary
Ambi-Rad Group Limited	100	Ordinary	G.K.N. International Trading (Holdings) Limited	100	Ordinary
Ball Components Limited	100	Ordinary	GKN Limited	100	Ordinary
Birfield Limited	100	Ordinary	GKN Marks Limited	100	Ordinary
British Hovercraft Corporation Limited	100	Ordinary	GKN Overseas Holdings Limited	100	Ordinary
Brush Electrical Engineering Company Limited	100	Ordinary	GKN Pistons Limited	100	Ordinary
Brush Electrical Machines Limited	100	Ordinary	G.K.N. Powder Met. Limited	100	Ordinary
Brush Holdings Limited	100	Ordinary	GKN Sankey Finance Limited	100	Ordinary and deferred
Brush Properties Limited	100	Ordinary	GKN SEK Investments Limited	100	Ordinary
Brush Scheme Trustees Limited	100	Ordinary	GKN Service UK Limited	100	Ordinary
Brush Switchgear Limited	100	Ordinary	GKN Sheepbridge Limited	100	Ordinary
Brush Transformers Limited	100	Ordinary	GKN Sheepbridge Stokes Limited	100	Ordinary
Colmore Lifting Limited	100	Ordinary	GKN Sinter Metals Limited	100	Ordinary
Colmore Overseas Holdings Limited	100	Ordinary	GKN Technology Limited	100	Ordinary
Danks Holdings Limited	100	Ordinary	GKN Thompson Chassis Limited	100	Ordinary
Eachairn Aerospace Holdings Limited	100	Ordinary	GKN Trading Limited	100	Ordinary
Eaton-Williams (Millbank) Limited	100	Ordinary	GKN UK Investments Limited	100	Ordinary
Eaton-Williams Exports Limited	100	Ordinary	GKN U.S. Investments Limited	100	Ordinary
Eaton-Williams Group Limited	100	Ordinary	GKN USD Investments Limited	100	Ordinary
Eaton-Williams Holdings Limited	100	Ordinary	GKN Ventures Limited	100	Ordinary
Eaton-Williams Limited	100	Ordinary	GKN Westland Aerospace (Avonmouth) Limited	100	Ordinary
Eaton-Williams Products Limited	100	Ordinary	GKN Westland Aerospace Advanced Materials Limited	100	Ordinary and convertible preference
Eaton-Williams Service Limited	100	Ordinary	GKN Westland Aerospace Aviation Support Limited	100	Ordinary
Edenaire Limited	100	Ordinary	GKN Westland Aerospace Holdings Limited	100	Ordinary
Electro Dynamic Limited	100	Ordinary	GKN Westland Design Services Limited	100	Ordinary
Ergotron UK Limited	100	Ordinary	GKN Westland Limited	100	Ordinary
			GKN Westland Overseas Holdings Limited	100	Ordinary
			GKN Westland Services Limited	100	Ordinary
			GKN 1 Trustee 2018 Limited	100	Ordinary
			GKN 2 Trustee 2018 Limited	100	Ordinary
			GKN 3 Trustee 2018 Limited	100	Ordinary
			GKN 4 Trustee 2018 Limited	100	Ordinary

# Notes to the Company Balance Sheet

Continued

## 3. Investment in subsidiaries continued

	Equity Interest %	Class of Share held		Equity Interest %	Class of Share held
Guest, Keen and Nettlefolds, Limited	100	Ordinary	<b>Hadley Castle Works, Telford, Shropshire, TF1 6AA</b>		
Harrington Generators International Limited	100	Ordinary	GKN Sankey Limited	100	Ordinary
Hawker Siddeley Switchgear Limited	100	Ordinary	GKN AutoStructures Limited	100	Ordinary
Laycock Engineering Limited	100	Ordinary	GKN Wheels Limited	100	Ordinary
McKechnie 2005 Pension Scheme Trustee Limited	100	Ordinary	<b>Chester Road, Erdington, Birmingham, B24 0RB</b>		
Melrose Holdings Limited	100	Ordinary	GKN Driveline Birmingham Limited	100	Ordinary
Melrose Intermediate Limited	100	Ordinary	<b>Unit 5, Kingsbury Business Park, Kingsbury Road, Minworth, Sutton Coldfield, B76 9DL</b>		
Melrose PLC	100	Ordinary	GKN Driveline Service Limited	100	Ordinary
Melrose UK 4 Limited	100	Ordinary	<b>30 Milbank, London, SW1P 4WY</b>		
Melrose UK Holdings Limited	100	Ordinary	Hadfields Holdings Limited	37.5	Ordinary
Melrose USD 1 Limited	100	Ordinary	<b>Uruguay</b>		
Nortek (UK) Limited	100	Ordinary	<b>Arq. Baldomiro, 2408, Montevideo</b>		
Nortek Global HVAC (UK) Limited	100	Ordinary	GKN Driveline Uruguay SA (in liquidation)	100	Ordinary
P.F.D. Limited	100	Ordinary	<b>USA</b>		
Powertrain Services UK Limited	100	Ordinary	<b>601 Braddock Avenue, Turtle Creek, Pittsburgh, Pennsylvania, 15145</b>		
Powertrain Services (UK Newco) Limited	100	Ordinary	Brush Aftermarket North America Inc.	100	Common Stock
Precision Air Control Limited	100	Ordinary	Generator and Motor Services of Pennsylvania, LLC	100	Membership Interest
Precision House Management Services Limited	100	Ordinary	<b>456 Aerotron Parkway, LaGrange, 30240 GA</b>		
Raingear Limited	100	Ordinary	Aerotron AirPower, Inc.	100	Common Stock
Reznor (UK) Limited	100	Ordinary	<b>421 West Main Street, Franklin, Frankfort, Kentucky, 40601</b>		
Rzeppa Limited	100	Ordinary and redeemable preference	Barcom Asia Holdings, LLC	100	Membership Interest
Rigby Metal Components Limited	100	Ordinary	<b>2711 Centerville Road, Suite 400, New Castle, Wilmington, Delaware</b>		
Sageford UK Limited	100	Ordinary	BNSS LP, Inc.	100	Ordinary
Sheepbridge Stokes Limited	100	Ordinary	<b>926 West State Street, Hartford, Wisconsin, 53027</b>		
Vapac Humidity Control Limited	100	Ordinary	Broan-NuTone, LLC	100	Membership Interest
Westland Group Services Limited	100	Ordinary	<b>1181 Trapp Road, Eagan, Minnesota, 55121</b>		
Westland System Assessment Limited	100	Ordinary	Ergotron, Inc.	100	Ordinary
Whipp & Bourne Limited	100	Ordinary	<b>19855 South West 124th Avenue, Tualatin, Oregon, 97062</b>		
<b>15 Atholl Crescent, Edinburgh, Scotland, EH3 8HA</b>			Huntair Middle East Holdings, Inc.	100	Ordinary
A. P. Newall & Company Limited	100	Ordinary	<b>c/o Nortek, Inc., 50 Kennedy Plaza, Providence, RI 02903</b>		
GKN Investments LP	100	Ordinary	Linear HK, LLC	100	Membership Interest
<b>26-28 Goodall Street, Walsall, West Midlands, WS1 1QL</b>			<b>1180 Peachtree Street NE, Suite 2450, Atlanta, Georgia, 30309</b>		
Chassis Systems Limited (in liquidation)	50	Ordinary	Melrose North America, Inc.	100	Ordinary
<b>PO BOX 55 Ipsley House, Ipsley Church Lane, Redditch, Worcestershire, United Kingdom, B98 0TL</b>			Nevada Holdco Corp.	100	Ordinary
F.P.T. Industries Limited	100	Ordinary	Nortek Global HVAC de Puerto Rico, LLC	100	Membership Interest
GKN Aerospace Limited	100	Ordinary	Nortek Global HVAC, Latin America, Inc.	100	Ordinary
GKN Aerospace Services Limited	100	Ordinary	Nortek, Inc.	100	Ordinary
GKN Aerospace Transparency Systems (Kings Norton) Limited	100	Ordinary	Nortek International, Inc.	100	Ordinary
GKN EVO eDrive Systems Limited	100	Ordinary	<b>5919 Sea Otter Place, Ste 100, Carlsbad, CA 92010</b>		
GKN Freight Services Limited	100	Ordinary and cumulative preference	Nortek Security & Control LLC	100	Membership Interest
GKN Group Pension Trustee (No.2) Limited	100	Ordinary	<b>601 Abbott Road, East Lansing, Michigan 48823</b>		
GKN Group Pension Trustee Limited	100	Ordinary	Operator Specialty Company, Inc.	100	Ordinary
GKN Hybrid Power Limited	100	Ordinary	<b>2277 Harbor Bay Parkway, Alameda, California, 94502</b>		
GKN Quest Trustee Limited	100	Ordinary	Zephyr Ventilation, LLC	100	Membership Interest
GKN Powder Metallurgy Holdings Limited	100	Ordinary			
Westland Group plc	100	Ordinary			
<b>PO Box 4128, Ipsley House, Ipsley Church Lane, Redditch, Worcestershire, B98 0WR</b>					
GKN Automotive Limited	100	Ordinary and preference			
GKN Driveline UK Limited	100	Ordinary			
GKN Driveline Mexico (UK) Limited	100	Ordinary			

## 3. Investment in subsidiaries continued

	Equity interest %	Class of Share held		Equity interest %	Class of Share held
<b>8000 Phoenix Parkway, O'Fallon, Missouri, 63368</b>			<b>Corporation Service Company, 80 State Street, Albany New York 12207</b>		
Nortek Air Solutions, LLC	100	Membership Interest	GKN Aerospace Monitor, Inc.	100	Ordinary
Nortek Global HVAC, LLC	100	Membership Interest	<b>Corporation Service Company, 251 East Ohio Street, Suite 500, Indianapolis Indiana 46204</b>		
<b>Corporation Service Company, 300 Deschutes Way SW, Suite 304, Tumwater WA 98501</b>			GKN Aerospace Muncie, Inc.	100	Ordinary
Fokker Aerostructures Inc.	100	Common Stock	<b>Illinois Corporation Service Company, 801 Adlai Stevenson Drive, Springfield Illinois 62703</b>		
<b>Corporation Service Company, 40 Technology Pkwy South, #300, Norcross GA 30092</b>			GKN Waterscheid, Inc.	100	Ordinary
Fokker Elmo Inc.	100	Common Stock	<b>6203 San Ignacio Avenue, Suite 112, San Jose, CA 95119</b>		
<b>CSC – Lawyers Incorporating Service, 2710 Gateway Oaks Drive, Suite 150 N, Sacramento CA 95833</b>			IntelliVision Technologies Corp.	100	Ordinary
GENIL, Inc.	100	Ordinary	<b>c/o 3PL – 1144 65th Unit F, Oakland, CA 94608</b>		
GKN Aerospace Camarillo, Inc.	100	Ordinary	MiOS Limited	42	Ordinary
GKN Aerospace Chem-tronics Inc.	100	Ordinary			
<b>Corporation Service Company, 251 Little Falls Drive, Wilmington Delaware 19808</b>					
GKN Aerospace Aerostructures, Inc	100	Ordinary			
GKN Aerospace Florida LLC	100	Membership Interest			
GKN Aerospace, Inc.	100	Common Stock			
GKN Aerospace New England, Inc.	100	Ordinary			
GKN Aerospace Newington LLC	100	Membership Interest			
GKN Aerospace St. Louis LLC	100	Membership Interest			
GKN Aerospace Transparency Systems, Inc.	100	Membership Unit			
GKN Aerospace Precision Machining, Inc.	100	Ordinary			
GKN Aerospace Services Structures LLC	100	Membership Interest			
GKN Aerospace South Carolina, Inc.	100	Common Stock			
GKN Aerospace US Holdings LLC	100	Membership Interest			
GKN America Corp	100	Common Stock			
GKN Armstrong Wheels, Inc.	100	Ordinary			
GKN Cylinder Liners, LLC	100	Membership Interest			
GKN Driveline Newton LLC	100	Membership Interest			
GKN Driveline North America, Inc.	100	Common Stock			
GKN Freight Services, Inc.	100	Common Stock			
GKN North America Investments Inc.	100	Ordinary			
GKN Rockford, Inc.	100	Ordinary			
GKN Sinter Metals LLC	100	Membership Interest			
GKN Westland Aerospace, Inc.	100	Common Stock			
Hoeganaes Corporation	100	Common Stock			
Hoeganaes Specialty Metal Powders LLC	70	Membership Interest			
XIK, LLC	100	Membership Interest			
<b>CSC-Lawyers Incorporating Service, 50 West Broad Street, Suite 1300, Columbus Ohio 43215</b>					
GKN Driveline Bowling Green, Inc.	100	Common Stock			
GKN Ohio, Inc.	100	Common Stock			

Each of the subsidiaries and significant holdings listed are included in the Consolidated Financial Statements of the Company and are held in each case by a subsidiary undertaking, except for Melrose Holdings Limited and GKN Limited which are held directly by Melrose Industries PLC.

(1) The Group owns 100% of the Ordinary Class B shares with a total ownership of 49% in the company.

(2) The Group owns 9% directly with a total effective ownership of 34.5%.

# Notes to the Company Balance Sheet

Continued

## 4. Debtors

	31 December 2018 £m	31 December 2017 £m
<b>Amounts falling due within one year:</b>		
Amounts owed by Group undertakings	400	–
<b>Amounts falling due after one year:</b>		
Deferred tax	25	25
	<b>425</b>	<b>25</b>

Amounts owed by Group undertakings are either interest-bearing or non interest-bearing depending on the type and duration of the receivable relationship.

The Directors consider that amounts owed by Group undertakings approximate to their fair value.

The deferred tax included in the Balance Sheet is as follows:

	31 December 2018 £m	31 December 2017 £m
Tax losses available for carry forward	25	25
	<b>25</b>	<b>25</b>

The tax losses may be carried forward indefinitely.

## 5. Creditors

	31 December 2018 £m	31 December 2017 £m
<b>Amounts falling due within one year:</b>		
Amounts owed to Group undertakings	1,772	191
Accruals and other creditors	1	1
	<b>1,773</b>	<b>192</b>

Amounts owed to Group undertakings are repayable on demand and are either interest-bearing or non interest-bearing depending on the type and duration of the payable relationship.

The Directors consider that amounts owed to Group undertakings approximate to their fair value.

## 6. Provisions

	Incentive plan related £m	Total £m
At 1 January 2018	–	–
Charge to profit and loss account	1	1
<b>At 31 December 2018</b>	<b>1</b>	<b>1</b>

The provision for incentive plan related costs relates to employer national insurance costs which are expected to be incurred when the Melrose incentive plan matures. Further details of this plan are set out in the Directors' Remuneration Report. The costs are expected to be incurred within two years.

## 7. Issued share capital

	31 December 2018 £m	31 December 2017 £m
<b>Share Capital</b>		
<b>Allotted, called-up and fully paid</b>		
4,858,254,963 (31 December 2017: 1,941,200,503) Ordinary Shares of 48/7p each (31 December 2017: 48/7p each)	333	133
12,831 (31 December 2017: 12,831) 2017 Melrose Incentive Plan Shares of £1 each	–	–
	<b>333</b>	<b>133</b>

The rights of each class of share are described in the Directors' Report.

On 19 April 2018, 2,469 million ordinary shares were issued as a result of the acquisition of GKN. Further issues of share capital totalling 448 million took place between 19 April 2018 and 30 June 2018 in order to purchase the remaining non-controlling interest of GKN. The total number of ordinary shares in issue therefore increased from 1,941 million at 31 December 2017 to 4,858 million at 31 December 2018.

## 8. Related party transactions

The Company has taken the exemption in FRS 102.33: "Related party information" not to disclose intercompany balances and transactions in the year with fully owned subsidiary undertakings.

# Glossary

## Alternative Performance Measures ("APMs")

In accordance with the Guidelines on APMs issued by the European Securities and Markets Authority ("ESMA"), additional information is provided on the APMs used by the Group below.

In the reporting of financial information, the Group uses certain measures that are not required under IFRS. These additional measures (commonly referred to as APMs) provide additional information on the performance of the business and trends to stakeholders. These measures are consistent with those used internally, and are considered important to understanding the financial performance and financial health of the Group. APMs are considered to be an important measure to monitor how the businesses are performing because this provides a meaningful comparison of how the business is managed and measured on a day-to-day basis and achieves consistency and comparability between reporting periods.

These APMs may not be directly comparable with similarly titled profit measures reported by other companies and they are not intended to be a substitute for, or superior to, IFRS measures.

## Income Statement Measures

APM		
Adjusted revenue and Annualised adjusted revenue		
<b>Closest equivalent statutory measure</b>		
Revenue.		
<b>Reconciling items to statutory measure</b>		
Share of revenue of equity accounted investments (note 5) and full period impact of acquisitions.		
<b>Definition and purpose</b>		
Adjusted revenue includes the Group's share of revenue of equity accounted investments. Annualised adjusted revenue reflects the Group's adjusted revenue as if all acquisitions in the period had occurred on the first day of the financial year.		
This enables comparability between reporting periods.		
	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Revenue	8,605	2,092
Share of revenue of equity accounted investments	497	3
<b>Adjusted revenue</b>	<b>9,102</b>	2,095
Full year impact of acquisitions	3,145	–
<b>Annualised adjusted revenue</b>	<b>12,247</b>	2,095

APM		
Adjusting items		
<b>Closest equivalent statutory measure</b>		
None.		
<b>Reconciling items to statutory measure</b>		
Adjusting items (note 6).		
<b>Definition and purpose</b>		
Those items which the Group excludes from its adjusted profit metrics in order to present a further measure of the Group's performance.		
These include items which are significant in size or volatility or by nature are non-trading or non-recurring, and any item released to the Income Statement that was previously a fair value item booked on an acquisition.		
This provides a meaningful comparison of how the business is managed and measured on a day-to-day basis and provides consistency and comparability between reporting periods.		

APM		
Adjusted operating profit and Annualised adjusted operating profit		
<b>Closest equivalent statutory measure</b>		
Operating profit/(loss) <sup>(1)</sup> .		
<b>Reconciling items to statutory measure</b>		
Adjusting items (note 6) and full period impact of acquisitions.		
<b>Definition and purpose</b>		
The Group uses adjusted profit measures to provide a useful and more comparable measure of the ongoing performance of the Group. Adjusted measures are reconciled to statutory measures by removing adjusting items, the nature of which are disclosed above and further detailed in note 6.		
Annualised adjusted operating profit reflects the Group adjusted operating profit as if all acquisitions in the period had occurred on the first day of the financial year.		
	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Operating profit</b>		
Operating loss	(392)	(7)
Adjusting items (note 6)	1,239	286
<b>Adjusted operating profit</b>	<b>847</b>	279
Full year impact of acquisitions	248	–
<b>Annualised adjusted operating profit</b>	<b>1,095</b>	279

APM		
Adjusted operating margin and Annualised adjusted operating margin		
<b>Closest equivalent statutory measure</b>		
Operating margin <sup>(2)</sup> .		
<b>Reconciling items to statutory measure</b>		
Share of revenue of equity accounted investments (note 5), adjusting items (note 6) and full period impact of acquisitions.		
<b>Definition and purpose</b>		
Adjusted operating margin represents Adjusted operating profit as a percentage of Adjusted revenue. Annualised adjusted operating margin represents Annualised adjusted operating profit as a percentage of Annualised adjusted revenue.		

# Glossary

Continued

## Income Statement Measures continued

**APM**  
**Adjusted EBITDA, Annualised adjusted EBITDA and Annualised adjusted EBITDA for covenant purposes**

**Closest equivalent statutory measure**  
 Operating profit/(loss)<sup>(1)</sup>.

**Reconciling items to statutory measure**

Adjusting items (note 6), depreciation of property, plant and equipment (note 13) and amortisation of computer software and development costs (note 11), share of depreciation of property, plant and equipment and amortisation of computer software and development costs of equity accounted investments, as well as full period impact of acquisitions and adjustments for covenant purposes.

**Definition and purpose**

Adjusted operating profit before depreciation and impairment of property, plant and equipment and before the amortisation and impairment of computer software and development costs.

Adjusted EBITDA and Annualised adjusted EBITDA are measures used to value individual businesses as part of the "Buy, Improve, Sell" Melrose strategy model and by certain external stakeholders to measure performance.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Adjusted EBITDA</b>		
Adjusted operating profit	847	279
Depreciation of property, plant and equipment (note 13)	238	31
Amortisation of computer software and development costs (note 11)	44	4
Share of depreciation and amortisation of equity accounted investments	18	-
<b>Adjusted EBITDA</b>	<b>1,147</b>	<b>314</b>
Full year impact of acquisitions	378	-
<b>Annualised adjusted EBITDA</b>	<b>1,525</b>	<b>314</b>
Other adjustments required for covenant purposes	(33)	-
<b>Annualised adjusted EBITDA for covenant purposes</b>	<b>1,492</b>	<b>314</b>

**APM**  
**Adjusted profit before tax and Annualised adjusted profit before tax**

**Closest equivalent statutory measure**  
 Profit/(loss) before tax.

**Reconciling items to statutory measure**

Adjusting items (note 6) and full period impact of acquisitions.

**Definition and purpose**

Profit before the impact of adjusting items and tax. As discussed above, adjusted profit measures are used to provide a useful and more comparable measure of the ongoing performance of the Group. Adjusted measures are reconciled to statutory measures by removing adjusting items, the nature of which are disclosed above and further detailed in note 6.

As discussed above, the Group uses adjusted profit measures to provide a useful and comparable measure of the ongoing performance of the Group.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Profit before tax</b>		
Loss before tax	(550)	(28)
Adjusting items (note 6)	1,253	286
<b>Adjusted profit before tax</b>	<b>703</b>	<b>258</b>
Full year impact of acquisitions	183	-
<b>Annualised adjusted profit before tax</b>	<b>886</b>	<b>258</b>

**APM**  
**Adjusted profit after tax and Annualised adjusted profit after tax**

**Closest equivalent statutory measure**  
 Profit/(loss) after tax.

**Reconciling items to statutory measure**

Adjusting items (note 6) and full period impact of acquisitions.

**Definition and purpose**

Profit after tax but before the impact of the adjusting items. As discussed above, adjusted profit measures are used to provide a useful and more comparable measure of the ongoing performance of the Group. Adjusted measures are reconciled to statutory measures by removing adjusting items, the nature of which are disclosed above and further detailed in note 6.

As discussed above, the Group uses adjusted profit measures to provide a useful and comparable measure of the ongoing performance of the Group.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Profit after tax</b>		
Loss after tax	(475)	(24)
Adjusting items (note 6)	1,014	215
<b>Adjusted profit after tax</b>	<b>539</b>	<b>191</b>
Full year impact of acquisitions	141	-
<b>Annualised adjusted profit after tax</b>	<b>680</b>	<b>191</b>

**APM**  
**Adjusted tax rate**

**Closest equivalent statutory measure**  
 Effective tax rate.

**Reconciling items to statutory measure**

Adjusting items, adjusting tax items and the tax impact of adjusting items (note 6 and note 8).

**Definition and purpose**

The income tax charge for the Group excluding adjusting tax, the net effect of new tax legislation in the US enacted in December 2017 and the tax impact of adjusting items, divided by adjusted profit before tax.

This measure is a useful indicator of the ongoing tax rate for the Group.

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
<b>Adjusted tax rate</b>		
Tax credit per Income Statement	75	4
Adjusting tax items	-	(27)
Tax impact of adjusting items	(239)	(44)
<b>Adjusted tax charge</b>	<b>(164)</b>	<b>(67)</b>
<b>Adjusted profit before tax</b>	<b>703</b>	<b>258</b>
<b>Adjusted tax rate</b>	<b>23.3%</b>	<b>25.9%</b>

**APM**  
**Adjusted basic earnings per share**

**Closest equivalent statutory measure**  
 Basic earnings per share.

**Reconciling items to statutory measure**

Adjusting items (notes 6 and 10).

**Definition and purpose**

Profit after tax attributable to owners of the Parent and before the impact of adjusting items, divided by the weighted average number of ordinary shares in issue during the financial year.

## Income Statement Measures continued

APM  
Adjusted diluted earnings per share

Closest equivalent statutory measure  
Diluted earnings per share.

Reconciling items to statutory measure  
Adjusting items (notes 6 and 10).

**Definition and purpose**  
Profit after tax attributable to owners of the Parent and before the impact of adjusting items, divided by the weighted average number of ordinary shares in issue during the financial year adjusted for the effects of any potentially dilutive options.

The Board considers this to be a key measure of performance when all businesses are held for the complete reporting period.

APM  
Annualised adjusted diluted earnings per share

Closest equivalent statutory measure  
Diluted earnings per share.

Reconciling items to statutory measure  
Adjusting items (notes 6 and 10) and full period impact of acquisitions.

**Definition and purpose**  
Annualised profit after tax attributable to owners of the Parent and before the impact of adjusting items, divided by the number of ordinary shares in issue at 31 December 2018 adjusted for the effects of any potentially dilutive options.

The Board considers this to be a key measure of performance when adjusted results include businesses owned for part of a period.

	Year ended 31 December 2018 £m
Annualised adjusted diluted earnings per share	
Annualised adjusted profit after tax	680
Attributable to:	
Owners of the parent	670
Non-controlling interests	10
Diluted number of shares at 31 December 2018 (million)	4,858
<b>Annualised adjusted diluted earnings per share</b>	<b>13.8p</b>

APM  
Interest cover

Closest equivalent statutory measure  
None.

Reconciling items to statutory measure  
Not applicable.

**Definition and purpose**  
Adjusted EBITDA as a multiple of net interest payable on bank loans and overdrafts, being 11.6x in year ended 31 December 2018 (2017: 19.6x).  
This measure is used for bank covenant testing.

## Balance Sheet Measures

APM  
Working capital

Closest equivalent statutory measure  
Inventories, trade and other receivables less trade and other payables.

Reconciling items to statutory measure  
Not applicable.

**Definition and purpose**  
Working capital comprises inventories, current and non-current trade and other receivables and current and non-current trade and other payables.

APM  
Net debt

Closest equivalent statutory measure  
Cash and cash equivalents less interest-bearing loans and borrowings and finance related derivative instruments.

Reconciling items to statutory measure  
Reconciliation of net debt (note 26).

**Definition and purpose**  
Net debt comprises cash and cash equivalents, interest-bearing loans and borrowings and cross-currency swaps but excludes non-cash acquisition fair value adjustments.

Net debt is one measure that could be used to indicate the strength of the Group's Balance Sheet position and is a useful measure of the indebtedness of the Group.

APM  
Leverage of net debt to Annualised adjusted EBITDA

Closest equivalent statutory measure  
None.

Reconciling items to statutory measure  
Not applicable.

**Definition and purpose**  
Bank covenant definition of net debt divided by Annualised adjusted EBITDA for bank covenant purposes.

This measure is used for bank covenant testing.

# Glossary

Continued

## Balance Sheet Measures continued

APM		
Bank covenant definition of net debt at average rates		
Closest equivalent statutory measure		
Cash and cash equivalents less interest-bearing loans and borrowings and finance related derivative instruments.		
Reconciling items to statutory measure		
Impact of foreign exchange and adjustments for bank covenant purposes.		
Definition and purpose		
Net debt (as above) is presented in the Balance Sheet translated at year end exchange rates.		
For bank covenant testing purposes net debt is converted using average exchange rates for the year.		
	31 December 2018	31 December 2017
	£m	£m
Net debt		
Net debt at closing rates (note 26)	3,482	572
Impact of foreign exchange	(86)	23
<b>Net debt at average rates</b>	<b>3,396</b>	<b>595</b>
Other adjustments required for covenant purposes	11	–
<b>Bank covenant definition of net debt at average rates</b>	<b>3,407</b>	<b>595</b>
<b>Leverage</b>	<b>2.3x</b>	<b>1.9x</b>

## Cash flow measures

APM		
Adjusted operating cash flow (pre-capex) and Adjusted operating cash flow conversion		
Closest equivalent statutory measure		
Net cash from operating activities.		
Reconciling items to statutory measure		
Non-working capital items (note 26).		
Definition and purpose		
Adjusted operating cash flow (pre-capex) is calculated as adjusted EBITDA attributable to subsidiaries less movements in working capital.		
Adjusted operating cash flow (pre-capex) conversion is adjusted operating cash flow (pre-capex) divided by adjusted EBITDA attributable to subsidiaries.		
This measure provides additional useful information in respect of cash generation and is consistent with how business performance is measured internally.		
	31 December 2018	31 December 2017
	£m	£m
Adjusted operating cash flow		
Adjusted EBITDA	1,147	314
Share of depreciation and amortisation of equity accounted investments	(18)	–
Share of adjusted operating profit of equity accounted investments	(59)	–
<b>Adjusted EBITDA attributable to subsidiaries</b>	<b>1,070</b>	<b>314</b>
Change in inventories	(108)	(8)
Change in receivables	181	8
Change in payables	(159)	(16)
Positive non-cash impact from loss-making contracts	(63)	–
<b>Adjusted operating cash flow (pre-capex)</b>	<b>921</b>	<b>298</b>
<b>Adjusted operating cash flow conversion</b>	<b>86%</b>	<b>95%</b>

## Cash flow measures continued

APM	
Free cash flow	
Closest equivalent statutory measure	
Net increase/decrease in cash and cash equivalents.	
Reconciling items to statutory measure	
Acquisition related cash flows, dividends paid to owners of the parent, foreign exchange and other non-cash movements.	
Definition and purpose	
Free cash flow represents cash generated from trading after all costs including restructuring, pension contributions, tax and interest payments.	
APM	
Capital expenditure (capex)	
Closest equivalent statutory measure	
None.	
Reconciling items to statutory measure	
Not applicable.	
Definition and purpose	
Calculated as the purchase of property, plant and equipment and computer software and expenditure on capitalised development costs during the year, excluding any assets acquired as part of a business combination.	
APM	
Capital expenditure to depreciation ratio	
Closest equivalent statutory measure	
None.	
Reconciling items to statutory measure	
Not applicable.	
Definition and purpose	
Capital expenditure divided by depreciation of property, plant and equipment and amortisation of computer software and development costs.	
APM	
Dividend per share	
Closest equivalent statutory measure	
Dividend per share.	
Reconciling items to statutory measure	
Not applicable.	
Definition and purpose	
Amounts payable by way of dividends in terms of pence per share.	

- (1) Operating profit/(loss) is not defined within IFRS but is a widely accepted profit measure being profit/(loss) before finance costs, finance income and tax.
- (2) Operating margin is not defined within IFRS but is a widely accepted profit measure being derived from operating profit/loss<sup>(1)</sup> divided by revenue.

# Notice of Annual General Meeting

**This document is important and requires your immediate attention. If you are in any doubt as to the action you should take, you should consult your stockbroker, bank, solicitor, accountant, fund manager or other independent financial adviser authorised under the Financial Services and Markets Act 2000 if you are resident in the United Kingdom or, if not, another appropriately authorised independent financial adviser.**

If you have sold or otherwise transferred or sell or otherwise transfer all of your shares in Melrose Industries PLC (the "Company"), please send this document, together with the accompanying form of proxy, as soon as possible to the purchaser or transferee or to the agent through whom the sale or transfer was effected for delivery to the purchaser or transferee.

Notice is given that the Annual General Meeting of the Company will be held at Barber-Surgeons' Hall, Monkwell Square, Wood Street, London EC2Y 5BL at 11.00 am on 9 May 2019 for the purposes set out below. Resolutions 1 to 15 (inclusive) will be proposed as ordinary resolutions and resolutions 16 to 19 (inclusive) as special resolutions.

## Ordinary resolutions

1. To receive the Company's audited financial statements for the financial year ended 31 December 2018, together with the Directors' Report, Strategic Report and the Auditor's Report on those financial statements.
2. To approve the Directors' Remuneration Report for the year ended 31 December 2018, as set out on pages 92 to 112 of the Company's 2018 Annual Report.
3. To declare a final dividend of 3.05 pence per ordinary share for the year ended 31 December 2018.
4. To re-elect Christopher Miller as a Director of the Company.
5. To re-elect David Roper as a Director of the Company.
6. To re-elect Simon Peckham as a Director of the Company.
7. To re-elect Geoffrey Martin as a Director of the Company.
8. To re-elect Justin Dowley as a Director of the Company.
9. To re-elect Liz Hewitt as a Director of the Company.
10. To re-elect David Lis as a Director of the Company.
11. To re-elect Archie G. Kane as a Director of the Company.
12. To elect Charlotte Twyning as a Director of the Company.
13. To re-appoint Deloitte LLP as auditor of the Company to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting of the Company at which accounts are laid.
14. To authorise the Audit Committee to determine the remuneration of the auditor of the Company.

15. That, in accordance with section 551 of the Companies Act 2006 (the "Act"), the directors of the Company (the "Directors") be and are generally and unconditionally authorised to allot shares in the Company, or to grant rights to subscribe for or to convert any security into shares in the Company ("Rights"):

- (A) up to an aggregate nominal amount of £111,045,827; and
- (B) comprising equity securities (as defined in section 560 of the Act) up to an aggregate nominal amount of £222,091,655 (such amount to be reduced by the aggregate nominal amount of any allotments or grants made under paragraph (A) of this resolution) in connection with an offer by way of a rights issue:
  - (i) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and
  - (ii) to holders of other equity securities as required by the rights of those securities or, subject to such rights, as the Directors otherwise consider necessary,

and so that the Directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or under the laws of any territory or any other matter, such authorities to expire at the conclusion of the Company's next Annual General Meeting after this resolution is passed or, if earlier, at the close of business on 30 June 2020, but, in each case, so that the Company may make offers or agreements before the authority expires which would or might require shares to be allotted or Rights to be granted after the authority expires, and so that the Directors may allot shares or grant Rights in pursuance of any such offer or agreement notwithstanding that the authority conferred by this resolution has expired.

## Special resolutions

16. That, subject to the passing of resolution 15, the Directors be and are generally empowered to allot equity securities (as defined in section 560 of the Act) for cash pursuant to the authorities granted by resolution 15 and/or to sell ordinary shares held by the Company as treasury shares for cash, in each case as if section 561 of the Act did not apply to any such allotment or sale, provided that this power shall be limited:
- (A) to the allotment of equity securities in connection with an offer of equity securities (but in the case of an allotment pursuant to the authority granted under paragraph (B) of resolution 15, such power shall be limited to the allotment of equity securities in connection with an offer by way of a rights issue only):
    - (i) to ordinary shareholders in proportion (as nearly as may be practicable) to their existing holdings; and
    - (ii) to holders of other equity securities, as required by the rights of those securities or, subject to such rights, as the Directors otherwise consider necessary, and so that the Directors may impose any limits or restrictions and make any arrangements which they consider necessary or appropriate to deal with treasury shares, fractional entitlements, record dates, legal, regulatory or practical problems in, or under the laws of, any territory or any other matter; and

# Notice of Annual General Meeting

Continued

(B) to the allotment (otherwise than in circumstances set out in paragraph (A) of this resolution) of equity securities pursuant to the authority granted by paragraph (A) of resolution 15 or sale of treasury shares up to a nominal amount of £16,656,874,

such powers to expire at the conclusion of the Company's next Annual General Meeting after this resolution is passed or, if earlier, at the close of business on 30 June 2020, but, in each case, so that the Company may make offers or agreements before the power expires which would or might require equity securities to be allotted (and/or treasury shares sold) after the power expires and so that the Directors may allot equity securities (and/or sell treasury shares) in pursuance of any such offer or agreement notwithstanding that the power conferred by this authority has expired.

17. That, subject to the passing of resolution 15 and in addition to any power granted under resolution 16, the Directors be and are generally empowered to allot equity securities (as defined in section 560 of the Act) for cash pursuant to the authorities granted by resolution 15 and/or to sell ordinary shares held by the Company as treasury shares for cash, in each case as if section 561 of the Act did not apply to any such allotment or sale, provided that this power shall be:

(A) limited to the allotment of equity securities pursuant to the authority granted by sub-paragraph (A) of resolution 15 or sale of treasury shares up to a nominal amount of £16,656,874; and

(B) used only for the purposes of financing (or refinancing, if the authority is to be used within six months of the original transaction) a transaction which the Directors determine to be an acquisition or other capital investment of a kind contemplated by the Statement of Principles on Disapplying Pre-Emption Rights most recently published by the Pre-Emption Group prior to the date of this notice of the Annual General Meeting,

such powers to expire at the conclusion of the Company's next Annual General Meeting after this resolution is passed or, if earlier, at the close of business on 30 June 2020, but, in each case, so that the Company may make offers or agreements before the power expires which would or might require equity securities to be allotted (and/or treasury shares sold) after the power expires and so that the Directors may allot equity securities (and/or sell treasury shares) in pursuance of any such offer or agreement notwithstanding that the power conferred by this authority has expired.

18. That the Company be and is generally and unconditionally authorised to make one or more market purchases (within the meaning of section 693 of the Act) of ordinary shares in the capital of the Company provided that:

(A) the maximum aggregate number of ordinary shares authorised to be purchased is 485,825,496;

(B) the minimum price which may be paid for an ordinary share is the nominal value of an ordinary share at the time of such purchase;

(C) the maximum price which may be paid for an ordinary share is not more than the higher of:

- (i) 105% of the average of the middle-market quotation for an ordinary share as derived from the Daily Official List of the London Stock Exchange for the five business days immediately preceding the day on which the ordinary share is purchased; and
- (ii) the higher of the price of the last independent trade and the highest current independent bid on the trading venue where the purchase is carried out, in each case, exclusive of expenses;

(D) this authority shall expire at the conclusion of the Company's next Annual General Meeting after this resolution is passed or, if earlier, at the close of business on 30 June 2020;

(E) the Company may make a contract of purchase of ordinary shares under this authority which would or might be executed wholly or partly after the expiry of this authority, and may make a purchase of ordinary shares in pursuance of any such contract; and

(F) any ordinary shares purchased pursuant to this authority may either be held as treasury shares or cancelled by the Company, depending on which course of action is considered by the Directors to be in the best interests of shareholders at the time.

19. That a general meeting other than an Annual General Meeting may be called on not less than 14 clear days' notice.

## Recommendation

The Board believes that each of the resolutions to be proposed at the Annual General Meeting is in the best interests of the Company and its shareholders as a whole. Accordingly, the Directors unanimously recommend that ordinary shareholders vote in favour of all of the resolutions proposed, as the Directors intend to do in respect of their own beneficial holdings.

## By order of the Board



Jonathon Crawford  
Company Secretary  
5 April 2019

Registered Office:  
11th Floor The Colmore Building  
20 Colmore Circus Queensway  
Birmingham  
West Midlands  
B4 6AT

### Explanatory notes to the proposed resolutions

Resolutions 1 to 15 (inclusive) are proposed as ordinary resolutions, which means that for each of those resolutions to be passed, more than half the votes cast must be cast in favour of the resolution. Resolutions 16 to 19 (inclusive) are proposed as special resolutions, which means that for each of those resolutions to be passed, at least three-quarters of the votes cast must be cast in favour of the resolution.

#### Resolution 1 – Receipt of 2018 Annual Report and financial statements

The Directors are required to lay the Company's financial statements, the Strategic Report and the Directors' and auditor's reports on those financial statements (collectively, the "2018 Annual Report") before shareholders each year at the Annual General Meeting ("AGM").

#### Resolution 2 – Approval of Directors' remuneration report

The Directors' remuneration report (the "Directors' Remuneration Report") is presented in three sections:

- the introduction to the Directors' Remuneration report;
- the annual statement from the Chairman of the Remuneration Committee; and
- the Annual Report on Remuneration.

The introduction to the Directors' Remuneration report, set out on page 92 of the 2018 Annual Report, provides an introduction to, and an overview of, the remainder of the Directors' Remuneration report.

The annual statement from the Chairman of the Remuneration Committee, set out on pages 93 to 95 of the 2018 Annual Report, summarises, for the year ended 31 December 2018, the major decisions taken on Directors' remuneration, any substantial changes relating to Directors' remuneration made during the year and the context in which those changes occurred and decisions that have been taken.

The Annual Report on Remuneration, set out on pages 92 to 112 of the 2018 Annual Report, provides details of the remuneration paid to Directors in respect of the year ended 31 December 2018, including base salary, taxable benefits, short-term incentives, long-term incentives vested in the year, pension-related benefits, any other items in the nature of remuneration and any sum(s) recovered or withheld during the year in respect of amounts paid in earlier years.

The Directors' Remuneration Report is subject to an annual advisory shareholder vote by way of an ordinary resolution. Resolution 2 is to approve the Directors' Remuneration Report.

#### Resolution 3 – Declaration of final dividend

The Board is recommending, and shareholders are being asked to approve, the declaration of a final dividend of 3.05p per ordinary share for the year ended 31 December 2018. The final dividend will, subject to shareholder approval, be paid on 20 May 2019 to the holders of ordinary shares whose names are recorded on the register of members of the Company at the close of business on 5 April 2019.

#### Resolutions 4 to 11 (inclusive) – Re-election of Directors

In accordance with the UK Corporate Governance Code (the "Code") and the Company's Articles of Association (the "Articles"), every Director will stand for re-election at the AGM (with the exception of Charlotte Twyning, who is standing for election). Biographical details of each Director can be found on pages 72 to 73 of the 2018 Annual Report. All of the Non-executive Directors standing for re-election are currently considered independent under the Code.

#### Resolution 12 – Election of Director

In accordance with the Articles, Charlotte Twyning is standing for election as a Director of the Company following her appointment to the Board with effect from 1 October 2018. Biographical details for Charlotte Twyning can be found on page 73 of the 2018 Annual Report.

#### Resolution 13 – Re-Appointment of Auditor

The Company is required to appoint auditors at each general meeting at which accounts are laid before shareholders, to hold office until the next such meeting.

The Audit Committee has reviewed the effectiveness, performance, independence and objectivity of the existing external auditor, Deloitte LLP, on behalf of the Board, and concluded that the external auditor was in all respects effective.

This resolution proposes the re-appointment of Deloitte LLP until the conclusion of the next AGM.

#### Resolution 14 – Authority to agree auditor's remuneration

This resolution seeks authority for the Audit Committee to determine the level of the auditor's remuneration.

#### Resolution 15 – Authority to allot shares

This resolution seeks shareholder approval to grant the Directors the authority to allot shares in the Company, or to grant rights to subscribe for or convert any securities into shares in the Company ("Rights"), pursuant to section 551 of the Act ("Section 551 authority"). The authority contained in paragraph (A) of the resolution will be limited to an aggregate nominal amount of £111,045,827, being approximately one-third of the Company's issued ordinary share capital as at 4 April 2019 (being the last business day prior to the publication of this notice).

In line with guidance issued by the Investment Association, paragraph (B) of this resolution would give the Directors authority to allot shares in the Company or grant Rights in connection with a rights issue up to aggregate nominal amount of £222,091,655, representing approximately two-thirds of the Company's issued ordinary share capital as at 4 April 2019. This resolution provides that such amount shall be reduced by the aggregate nominal amount of any allotments or grants under paragraph (A).

The Company does not hold any shares in treasury.

If approved, the Section 551 authority shall, unless renewed, revoked or varied by the Company, expire at the end of the Company's next AGM after the resolution is passed or, if earlier, at the close of business on 30 June 2020. The exception to this is that the Directors may allot shares or grant Rights after the authority has expired in connection with an offer or agreement made or entered into before the authority expired. The Directors have no present intention to exercise the Section 551 authority.

#### Resolutions 16 to 17 – Partial disapplication of pre-emption rights

These resolutions seek shareholder approval to grant the Directors the power to allot equity securities of the Company pursuant to sections 570 and 573 of the Act (the "Section 570 and 573 power") without first offering them to existing shareholders in proportion to their existing shareholdings.

The power is limited to allotments for cash in connection with pre-emptive offers, subject to any arrangements that the Directors consider appropriate to deal with fractions and overseas requirements and otherwise for cash up to a maximum nominal value of £33,313,748, representing approximately 10% of the Company's issued ordinary share capital as at 4 April 2019 (being the last business day prior to the publication of this notice).

# Notice of Annual General Meeting

Continued

The Directors intend to adhere to the guidelines set out in the Pre-Emption Group's Statement of Principles (as updated in March 2015) and not to allot shares for cash on a non-pre-emptive basis pursuant to a relevant authority in resolutions 16 or 17:

- in excess of an amount equal to 5% of the Company's issued ordinary share capital (excluding treasury shares) in any one-year period, whether or not in connection with an acquisition or specified capital investment; or
- in excess of an amount equal to 7.5% of the Company's issued ordinary share capital in a rolling three-year period,

in each case other than in connection with an acquisition or specified capital investment which is announced contemporaneously with the allotment or which has taken place in the preceding six-month period and is disclosed in the announcement of the allotment.

If approved, the Section 570 and 573 power shall apply until the end of the Company's next AGM after the resolution is passed or, if earlier, until the close of business on 30 June 2020. The exception to this is that the Directors may allot equity securities after the power has expired in connection with an offer or agreement made or entered into before the power expired. The Directors have no present intention to exercise the Section 570 and 573 power.

## Resolution 18 – Authority to purchase own shares

This resolution seeks shareholder approval to grant the Company the authority to purchase its own shares pursuant to sections 693 and 701 of the Act.

This authority is limited to an aggregate maximum number of 485,825,496 ordinary shares, representing 10% of the Company's issued ordinary share capital as at 4 April 2019.

The maximum price which may be paid for an ordinary share will be an amount which is not more than the higher of: (i) 5% above the average of the middle market quotation for an ordinary share as derived from the Daily Official List of the London Stock Exchange for the five business days immediately preceding the day on which the ordinary share is purchased; and (ii) the higher of the price of the last independent trade and the highest current independent bid on the trading venue where the purchase is carried out (in each case, exclusive of expenses).

If approved, the authority shall, unless varied, revoked or renewed, expire at the end of the Company's next AGM after the resolution is passed or, if earlier, at the close of business on 30 June 2020. The Directors have no present intention of exercising all or any of the powers conferred by this resolution and will only exercise their authority if it is in the interests of shareholders generally.

## Resolution 19 – Notice period for general meetings other than AGMs

This resolution seeks shareholder approval to allow the Company to continue to call general meetings (other than AGMs) on 14 clear days' notice. In accordance with the Act, as amended by the Companies (Shareholders' Rights) Regulations 2009, the notice period required for general meetings of the Company is 21 days unless shareholders approve a shorter notice period (subject to a minimum period of 14 clear days). In accordance with the Act, the Company must make a means of electronic voting available to all shareholders for that meeting in order to be able to call a general meeting on less than 21 clear days' notice.

The Company intends to only use the shorter notice period where this flexibility is merited by the purpose of the meeting and is considered to be in the interests of shareholders generally, and not as a matter of routine. AGMs will continue to be held on at least 21 clear days' notice.

The approval will be effective until the Company's next AGM, when it is intended that a similar resolution will be proposed.

## Explanatory notes as to the proxy, voting and attendance procedures at the Annual General Meeting (AGM)

1. The holders of ordinary shares in the Company are entitled to attend the AGM and are entitled to vote. A member entitled to attend, speak and vote at the AGM is also entitled to appoint a proxy to exercise all or any of his/her rights to attend, speak and vote at the AGM in his/her place. Such a member may appoint more than one proxy, provided that each proxy is appointed to exercise the rights attached to different shares. A proxy need not be a member of the Company.
2. A form of proxy is enclosed with this notice. To be effective, a form of proxy must be completed and returned, together with any power of attorney or authority under which it is completed or a certified copy of such power or authority, so that it is received by the Company's registrars at the address specified on the form of proxy not less than 48 hours (excluding any part of a day that is not a working day) before the stated time for holding the meeting (or, in the event of an adjournment, not less than 48 hours before the stated time of the adjourned meeting (excluding any part of a day which is not a working day)). Returning a completed form of proxy will not preclude a member from attending the meeting and voting in person.
3. Any person to whom this notice is sent who is a person nominated under section 146 of the Act to enjoy information rights (a "Nominated Person") may, under an agreement between him/her and the shareholder by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the AGM. If a Nominated Person has no such proxy appointment right or does not wish to exercise it, he/she may, under any such agreement, have a right to give instructions to the shareholder as to the exercise of voting rights. The statement of the rights of shareholders in relation to the appointment of proxies in notes 1 and 2 above does not apply to Nominated Persons. The rights described in paragraphs 1 and 2 can only be exercised by the holders of ordinary shares in the Company.
4. To be entitled to attend and vote at the AGM (and for the purposes of the determination by the Company of the number of votes they may cast), members must be entered on the Company's register of members by 6.30pm on 8 May 2019 (or, in the event of an adjournment, on the date which is two days, excluding any day which is not a working day, before the time of the adjourned meeting). Changes to entries on the register of members after this time shall be disregarded in determining the rights of any person to attend or vote at the meeting.
5. As at 4 April 2019 (being the last business day prior to the publication of this notice), the Company's issued share capital consists of 4,858,254,963 ordinary shares of 48/7p each, carrying one vote each.

**Explanatory notes as to the proxy, voting and attendance procedures at the Annual General Meeting (AGM) continued**

6. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST Manual (available at [www.euroclear.com](http://www.euroclear.com)). CREST Personal Members or other CREST sponsored members, and those CREST members who have appointed a service provider(s), should refer to their CREST sponsor or voting service provider(s), who will be able to take the appropriate action on their behalf.
7. In order for a proxy appointment or instruction made using the CREST service to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with Euroclear UK & Ireland Limited's specifications, and must contain the information required for such instruction, as described in the CREST Manual. The message, regardless of whether it constitutes the appointment of a proxy or is an amendment to the instruction given to a previously appointed proxy, must, in order to be valid, be transmitted so as to be received by the issuer's agent (ID RA19) by 11.00 am on 8 May 2019. For this purpose, the time of receipt will be taken to be the time (as determined by the time stamp applied to the message by the CREST Application Host) from which the issuer's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST. After this time any change of instructions to proxies appointed through CREST should be communicated to the appointee through other means.
8. CREST members and, where applicable, their CREST sponsors, or voting service providers should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular message. Normal system timings and limitations will, therefore, apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST Personal Member, or sponsored member, or has appointed a voting service provider, to procure that his/her CREST sponsor or voting service provider(s) take(s)) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsors or voting system providers are referred, in particular, to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.
9. The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5) (a) of the Uncertificated Securities Regulations 2001.
10. Any corporation which is a member can appoint one or more corporate representatives who may exercise on its behalf all of its powers as a member provided that they do not do so in relation to the same shares.
11. Under section 527 of the Act, members meeting the threshold requirements set out in that section have the right to require the Company to publish on a website a statement setting out any matter relating to: (i) the audit of the Company's accounts (including the auditor's report and the conduct of the audit) that are to be laid before the AGM; or (ii) any circumstance connected with an auditor of the Company ceasing to hold office since the previous meeting at which annual accounts and reports were laid in accordance with section 437 of the Act. The Company may not require the shareholders requesting any such website publication to pay its expenses in complying with sections 527 or 528 of the Act. Where the Company is required to place a statement on a website under section 527 of the Act, it must forward the statement to the Company's auditor not later than the time when it makes the statement available on the website. The business which may be dealt with at the AGM includes any statement that the Company has been required under section 527 of the Act to publish on a website.
12. Any member holding ordinary shares attending the meeting has the right to ask questions. The Company must answer any such questions relating to the business being dealt with at the meeting but no such answer need be given if: (i) to do so would interfere unduly with the preparation for the meeting or involve the disclosure of confidential information; (ii) the answer has already been given on a website in the form of an answer to a question; and/or (iii) it is undesirable in the interests of the Company or the good order of the meeting that the question be answered.
13. Voting at the AGM will be by poll. The Chairman will invite each shareholder, corporate representative and proxy present at the meeting to complete a poll card indicating how they wish to cast their votes in respect of each resolution. In addition, the Chairman will cast the votes for which he has been appointed as proxy. Poll cards will be collected during the meeting. Once the results have been verified by the Company's registrar, Equiniti, they will be notified to the UK Listing Authority, announced through a Regulatory Information Service and will be available to view on the Company's website.
14. A copy of this notice, and other information required by section 311A of the Act, can be found at [www.melroseplc.net](http://www.melroseplc.net).
15. You may not use an electronic address provided in either this Notice of AGM or any related documents (including the form of proxy) to communicate with the Company for any purposes other than those expressly stated.
16. The following documents will be available for inspection at the Company's registered office during normal business hours (Saturdays, Sundays and public holidays excepted) from the date of this notice until the date of the AGM and at the place of the AGM for 15 minutes prior to and during the meeting:
  - (A) copies of all service agreements under which Directors of the Company are employed by the Company or any subsidiaries; and
  - (B) a copy of the terms of appointment of the Non-executive Directors of the Company.
17. You may register your vote online by visiting Equiniti's website at [www.sharevote.co.uk](http://www.sharevote.co.uk). In order to register your vote online, you will need to enter the Voting ID, Task ID and Shareholder Reference Number which are set out on the enclosed form of proxy. The return of the form of proxy by post or registering your vote online will not prevent you from attending the AGM and voting in person, should you wish. Alternatively, shareholders who have already registered with Equiniti's online portfolio service, Shareview, can appoint their proxy electronically by logging on to their portfolio at [www.shareview.co.uk](http://www.shareview.co.uk) using your usual user ID and password. Once logged in simply click "View" on the "My Investments" page, click on the link to vote then follow the on screen instructions. A proxy appointment made electronically will not be valid if sent to any address other than those provided or if received after 11.00am on 8 May 2019.

# Company and shareholder information

As at 31 December 2018, there were 18,405 holders of ordinary shares of 48/7 pence each in the Company. An analysis of these shareholdings as at 31 December 2018 is set out in the table below.

## Shareholder analysis

Balance Ranges	Total number of holdings	Percentage of holders	Total number of shares	Percentage issued capital
1–5,000	13,875	75.39%	18,706,523	0.39%
5,001–50,000	3,546	19.27%	46,545,041	0.96%
50,001–500,000	522	2.83%	90,691,687	1.86%
Over 500,000	462	2.51%	4,702,311,712	96.79%
<b>Total</b>	<b>18,405</b>	<b>100.00%</b>	<b>4,858,254,963</b>	<b>100.00%</b>

Held by	Total number of holdings	Percentage of holders	Total number of shares	Percentage issued capital
Individuals	15,207	82.62%	58,941,326	1.21%
Institutions	3,198	17.38%	4,799,313,637	98.79%
	18,405	100.00%	4,858,254,963	100.00%

## Financial calendar 2019

Ex-dividend date for final dividend	4 April 2019
Record date for final dividend	5 April 2019
Annual General Meeting	9 May 2019
Payment date of final dividend	20 May 2019
Announcement of interim results	September 2019
Intended payment of interim dividend	October 2019
Preliminary announcement of 2019 results	March 2020

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E14 5JP

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London Branch  
  
Bank of America Merrill Lynch  
International Limited  
  
Bank of China Limited,  
London Branch  
  
Barclays Bank plc  
  
Bayerische Landesbank  
  
BNP Paribas Fortis SA/NV  
Caixabank SA, UK Branch

Citizens Bank, N.A.

Commerzbank AG,  
London Branch

Crédit Agricole Corporate  
and Investment Bank

Crédit Industriel et Commercial

Deutsche Bank Luxembourg S.A.

HSBC Bank plc

Industrial and Commercial Bank  
of China Limited, London Branch

ING Bank N.V., London Branch

J.P. Morgan Chase Bank N.A.,  
London Branch

Lloyds Bank plc

Mediobanca International  
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National Westminster  
Bank plc

Royal Bank of Canada

ICBC

Santander UK plc

Skandinaviska Enskilda  
Banken AB (publ)

Standard Chartered Bank

The Governor and Company  
of the Bank of Ireland

Unicredit Bank AG

Wells Fargo Bank, N.A.,  
London Branch

A range of shareholder information is available at Equiniti's online portfolio service [www.shareview.co.uk](http://www.shareview.co.uk), where you can register for a Shareview Portfolio to access information about your holding and undertake a number of activities, including appointing a proxy, changing a dividend mandate and updating your address. To register, you will need your 11 digit Shareholder Reference Number (SRN), which can be found on your proxy form or dividend voucher.

### Gifting your shares

If you have a small number of shares and the dealing costs or minimum fee make it uneconomical to sell them, you may like to donate them to benefit charities through ShareGift, a registered charity. Further information is available on the ShareGift website at [www.sharegift.org](http://www.sharegift.org) or call +44 (0) 20 7930 3737.

### Share fraud warning

Many companies have become aware that their shareholders have received unsolicited telephone calls or correspondence concerning investment matters. Fraudsters use persuasive and high-pressure tactics to lure investors into scams. They may offer to sell shares that turn out to be worthless or non-existent, or to buy shares at an inflated price in return for an upfront payment. For more detailed information on this kind of activity or to report a scam, please call the Financial Conduct Authority's Consumer Helpline on 0800 111 6768 or visit [www.fca.org.uk/consumers/scams](http://www.fca.org.uk/consumers/scams).

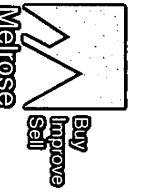






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