Melrose

Buy
Improve
Sell

Annual Report 2019

Melrose Industries PLC

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 being founded in 2003.

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For more information visit
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.

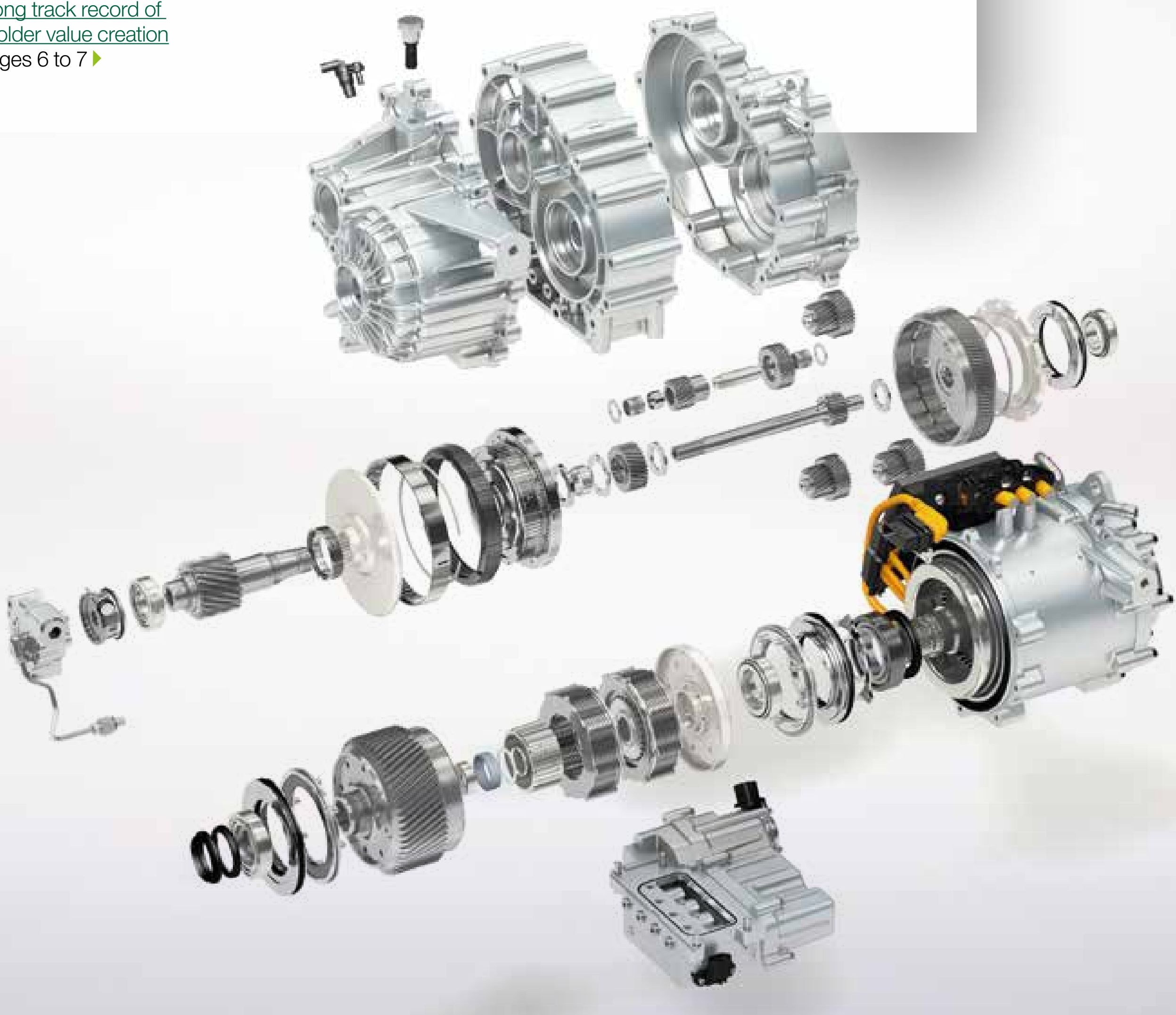
The Strategic Report has been prepared solely to provide additional information to shareholders to assess the Company's strategies and the potential for those strategies to succeed. Some financial and other numerical data in this Annual Report and financial statements have been rounded and, as a result,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

Unlocking substantial value

"We are delighted with the Melrose performance in 2019 and the substantial value that is being unlocked. Notwithstanding any implications of the COVID-19 outbreak, the bedrock has now been built for the GKN businesses to attain results which were not previously achievable, and, in addition, the shareholder value built up in our longer held assets is closer to being realised. This shows, once more, that the Melrose model thrives by investing properly in businesses and giving management the entrepreneurial freedom to succeed. This is just the start of what is possible for GKN."

Justin Dowley
Non-executive Chairman

For more information about our strong track record of shareholder value creation
See pages 6 to 7



Highlights for 2019

The results for 2019 include the first full year of ownership of GKN(1) which were comfortably ahead of the Board's expectations for both profit and cash generation.

Headline figures

13%
Increase in adjusted(2) diluted earnings per share, which was 14.3 pence.

72%(4)
Increase in adjusted free cash flow(5) on an annualised like-for-like basis.

£591m
Adjusted free cash flow(5), up 72% on last year.

2.25x
The bank covenant leverage ratio(7) has reduced to 2.25x, ahead of the previous year (2.28x).

£240m(3)
Of cash contributions to the GKN UK defined benefit pension schemes from the Group so far during Melrose ownership, making them significantly better funded.

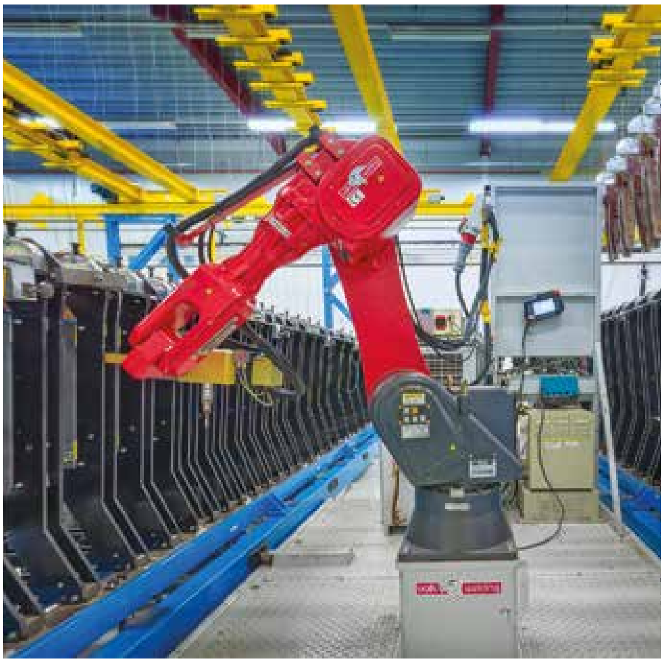
104%
Adjusted profit conversion to cash.(2)

c.25%
Of the remaining provision for loss-making contracts has been released(6) due to improvements implemented by management this year.

30%
Reduction in emissions achieved by GKN facilities over the past two years.

(1) Results for 2018 include GKN for eight months only and have been restated for discontinued operations.
(2) Considered by the Board to be a key measure of performance. Described in the glossary to the financial statements on pages 191 to 195.
(3) Including the contribution paid on 6 January 2020.
(4) Calculated compared to 2018 annualised adjusted free cash flow, excluding the previously announced £150 million cash outflow from unwinding creditor stretch in 2018. 2018 annualised adjusted free cash flow includes 12 months of GKN ownership.
(5) Adjusted free cash flow excludes the special one-off pension contributions and restructuring spend.
(6) As previously published, this is not included in adjusted(2) operating profit.
(7) Described in the glossary to the financial statements on pages 191 to 195.

Shareholder value creation
See pages 6 to 7



Group revenue and operating profit

£11.6bn
Adjusted[1] revenue.

£11.0bn
Statutory revenue.

£1.1bn
Adjusted[1] operating profit.

£318m
Statutory operating profit.

Divisional performance summary

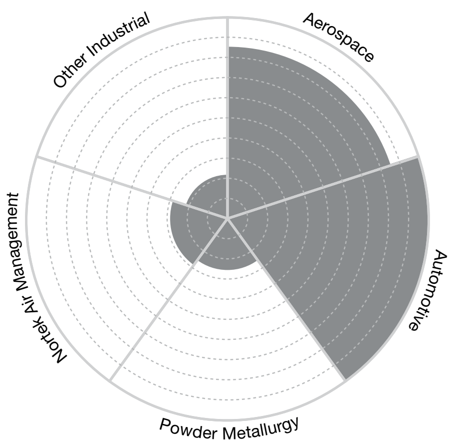
Divisional results

(figures up to 31 December 2019)

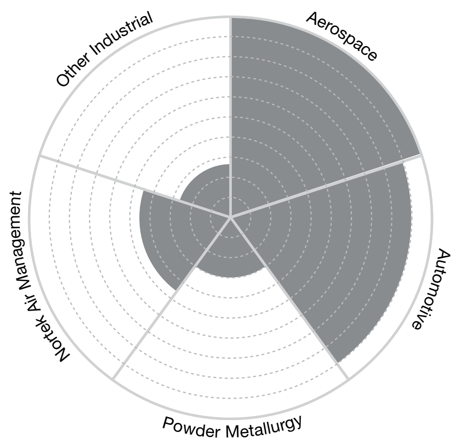
	Adjusted[1] revenue £m	Adjusted[1] operating profit/(loss) £m	Statutory revenue £m	Statutory operating profit/(loss) £m
Aerospace	3,852	409	3,836	104
Automotive	4,739	367	4,146	186
Powder Metallurgy	1,115	117	1,099	77
Nortek Air Management	1,178	175	1,178	139
Other Industrial	708	86	708	(170)
Corporate	–	(52)	–	(18)

Proportional split between divisions

Adjusted[1] revenue £m



Adjusted[1] operating profit £m



(1) Described in the glossary to the financial statements on pages 191 to 195.

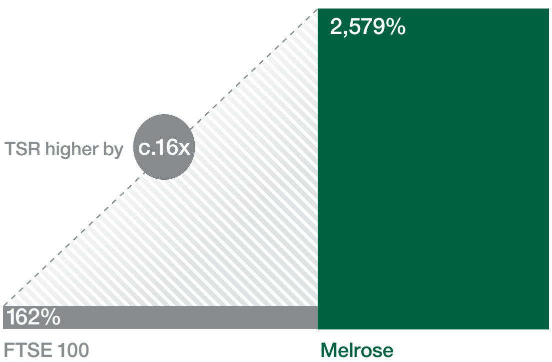
Shareholder value creation

Melrose has delivered significant returns to shareholders since floating on AIM in 2003.

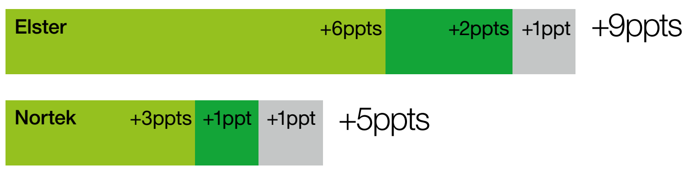
Shareholder investment and gain (figures up to 31 December 2019)

£4.7bn	2.6x	17%	2nd highest FTSE 350 performer
Cash return to shareholders since establishment	Average return for a shareholder since the first acquisition	CAGR in ordinary dividends. £1.1bn ordinary dividends since our first acquisition in 2005, in line with our progressive dividend policy	For total shareholder return over the past decade

Total shareholder return (TSR)[(1)(3)]



How Elster and Nortek operating margin improved[(2)]

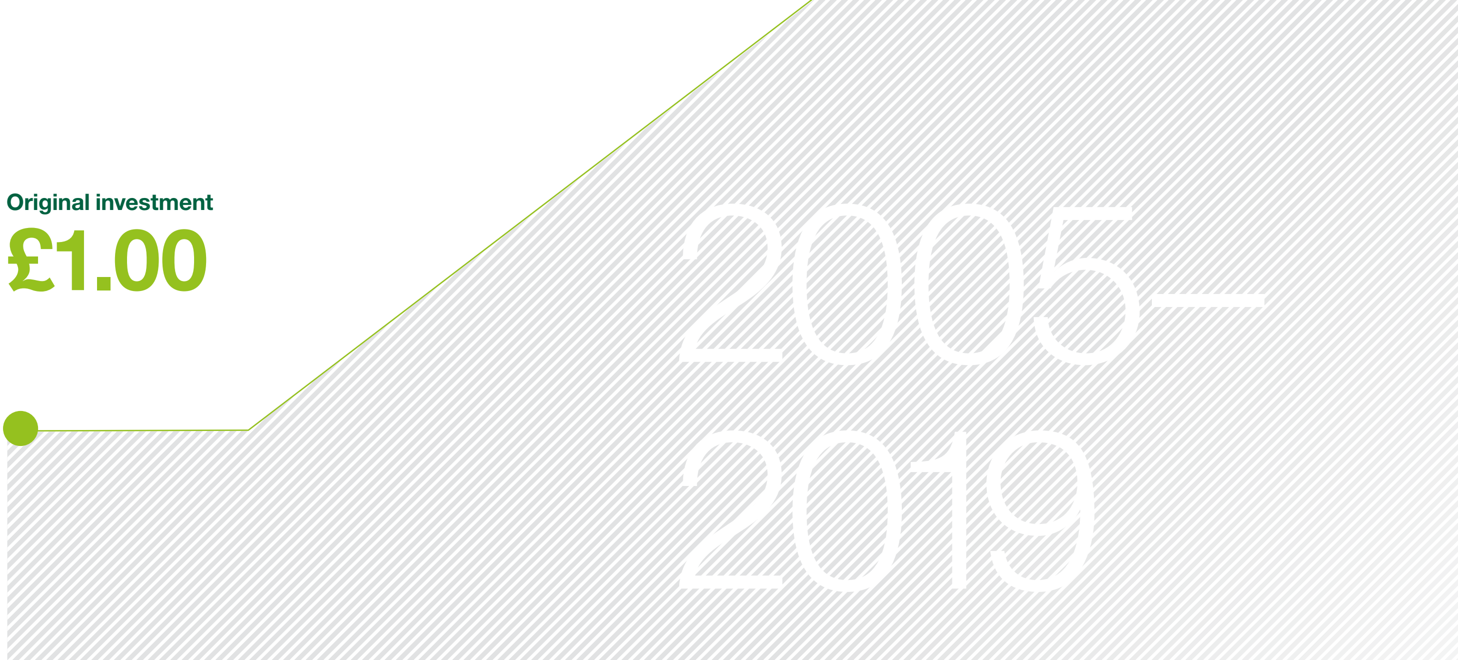


- Returns on capex and restructuring and other commercial actions.
- Central cost savings.
- Exit of low margin sales channels.

(1) Since Melrose's first acquisition (May 2005).
(2) Nortek adjusted operating margin up to 31 December 2019.
(3) Source: Datastream Total Shareholder Return Index.

Track record for £1 invested in Melrose
As at 31 December 2019

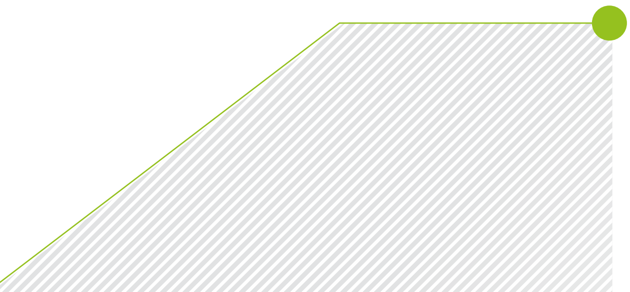
Investment in May 2005 with all dividends reinvested since (Total shareholder return)[(3)]



Gross return

£26.79

on original £1 investment



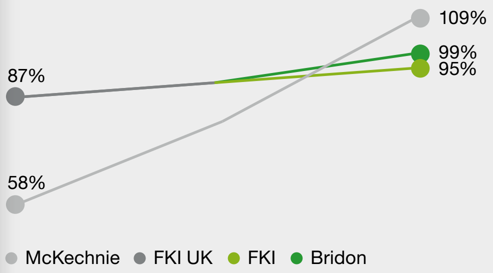
Second highest performer for total shareholder return in the FTSE 350 over the past decade.

Melrose is very pleased with the track record achieved over its 16-year history since floating on AIM in 2003. It has achieved an average annual return on equity investment of 25% since making the first acquisition in 2005, with an increase in operating margins between four and nine percentage points across the businesses sold to date.

Responsible approach to investing

Substantial improvements for all the UK pensions schemes under ownership

Whilst under Melrose ownership we improve contributions and provide better security to our businesses' pension schemes towards fully funded upon departure from the Group.

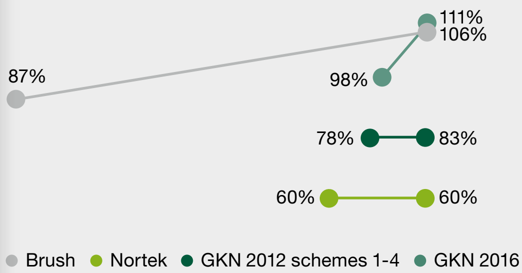


Responsible stewardship (figures up to 31 December 2019)

- For the GKN schemes, we were proactive, transparent and constructive in agreeing commitments with pension trustees during the acquisition of GKN. We committed to providing up to £1 billion of funding contributions; doubling annual contributions to £60 million and £150 million upfront contributions.

So far we have:

- Delivered £150 million upfront contributions.
- Doubled annual contributions to £60 million.
- Applied more secure funding targets of Gilts +25 basis points (GKN 2016) and Gilts +75 basis points (GKN 2012 schemes 1-4) to achieve more prudent funding levels towards fully funded.
- Funded the GKN 2016 scheme to £55 million surplus.
- Rebalanced the GKN schemes across the divisions, to avoid overburdening any one business and provide stability and better security for members.



Promoting strong ESG principles

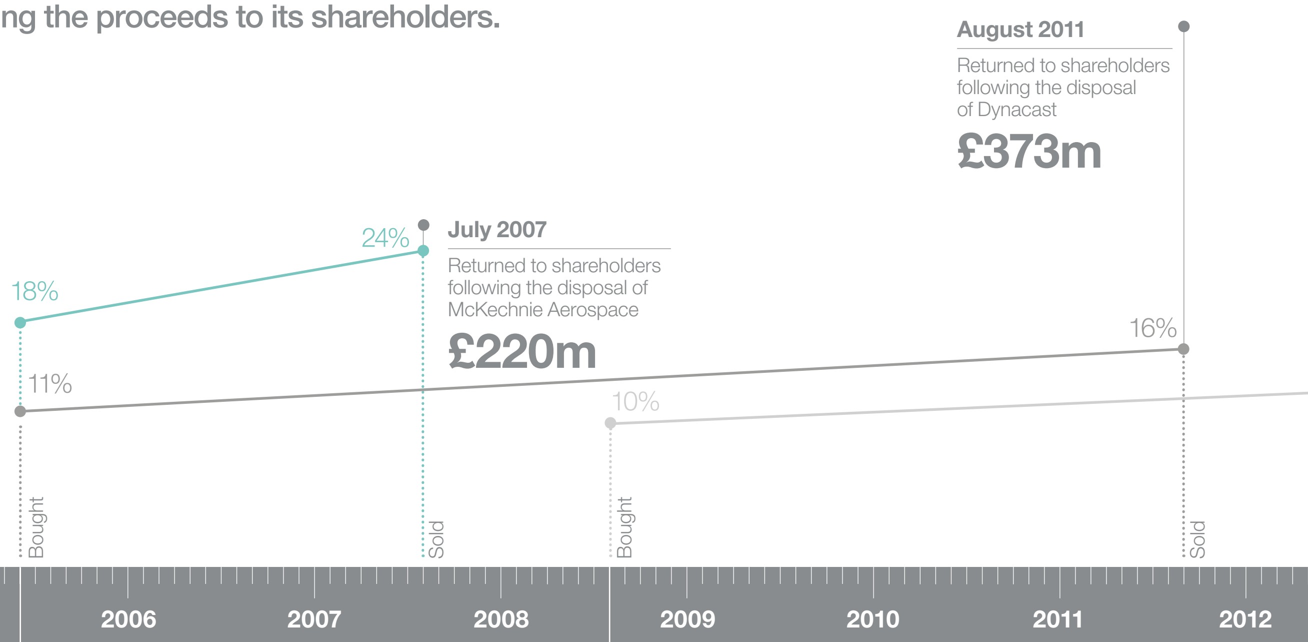
This year we have produced a standalone ESG report (see pages 58 to 69), to highlight the investment, support and encouragement we provide to our businesses to enable them to pursue relevant improvements in relation to environmental, social and governance matters.

£719m
spent on research and development for Nortek, Elster and GKN acquisitions

2.8%
of revenue for the equivalent period

"Buy, Improve, Sell" — A history of success

Melrose continues to build on its 16-year track record of increasing and realising the value in its businesses and returning the proceeds to its shareholders.



	May 2005	July 2008
Acquisition	**May 2005**	**July 2008**
Company details	**McKechnie/Dynacast**	**FKI**

McKechnie/Dynacast

Bought for	£0.4bn
Equity raised on acquisition	£243m
Follow-on investment	£124m
Sold for	£0.8bn
Investment in business	51%
Equity rate of return	30%

FKI

Bought for	£1.0bn
Equity raised on acquisition	£499m
Follow-on investment	£328m
Sold for	£1.4bn
Investment in business	66%
Equity rate of return	29%

Shareholder return on original equity

McKechnie/Dynacast: 3.0x

FKI: 2.6x

Commentary

McKechnie was a global supplier of specialist engineered components to the global aerospace industry. During our ownership we improved operating margins from 18% to 24% by optimising its cost base and focusing on profitable business.

Dynacast was a global provider of precision die cast components for a wide variety of industries. During our ownership we improved operating margins from 11% to 16% by successfully aligning capacity with customers and installing a success-driven organisational culture.

Overall we generated over £700 million in cash from the businesses versus an equity investment of approximately £240 million, resulting in a return of 3.0x on shareholders' investment. This includes direct returns to shareholders after disposals of £220 million in 2007 and £373 million in 2011.

FKI comprised a number of diverse businesses, and our improvement initiatives were centred around refocusing the FKI conglomerate to allow each of its businesses to stand alone, and making necessary investments to strengthen their market positions. We improved operating margins from 10% to 14% under our ownership and have since sold all of the businesses with the exception of Brush.

Overall we generated over £1.3 billion in cash from the businesses versus an equity investment of approximately £500 million, resulting in a return of 2.6x on shareholders' investment. This includes direct returns to shareholders after disposals of £595 million in 2014 and £200 million in 2015.

Adjusted(1) operating margin improvement

Company	Entry	Current	Exit	Improvement	
McKechnie	18%	•	24%	>30%	+6ppts
Elster	13%	•	22%	>70%	+9ppts
Dynacast	11%	•	16%	>40%	+5ppts
FKI	10%	•	14%	>40%	+4ppts
Nortek	9%	14%	•	>50%	+5ppts
GKN	8%	9%	•	>10%	+1ppt

(1) Described in the glossary to the financial statements on pages 191 to 195.

February 2014

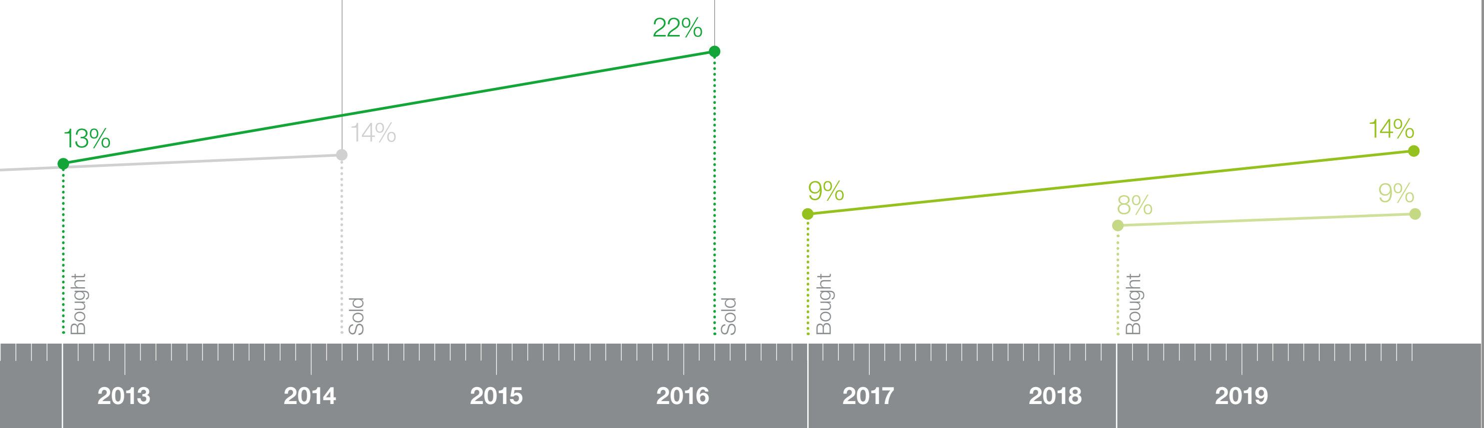
Returned to shareholders following the disposal of various FKI businesses during 2013

£595m

February 2016

Returned to shareholders following the disposal of Elster

£2.4bn



August 2012

Elster

Bought for	£1.8bn
Equity raised on acquisition	£1.2bn
Follow-on investment	£287bn
Sold for	£3.3bn
Investment in business	25%
Equity rate of return	33%

2.3x

Elster was a US publicly-listed German-based manufacturer of meters operating through three separate divisions with different markets and drivers (Gas, Electricity, Water).

Under our ownership we oversaw operating profit margins increase 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. We significantly expanded on an optimisation programme announced by Elster before our acquisition and significantly exceeded expectations.

Overall we 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. This includes direct returns to shareholders after a disposal of all three businesses to Honeywell for £3.3 billion in 2015.

August 2016

Nortek

Bought for	£2.2bn
Equity raised on acquisition	£1.6bn
Follow-on investment(1)	£0.3bn
Investment(1) as % of initial equity	14%

(1) Up to 31 December 2019.

Nortek, upon our acquisition, was a global diversified group, manufacturing innovative air management, security, home automation and ergonomic and productivity solutions. Whilst we identified strong brands and products within each of the Nortek businesses, as a group the operations were fragmented and management was underperforming. Each business has undergone a significant transformation, freed from the restrictions of the formerly centralised group structure, material investment from Melrose in research and development, and productivity improvements. The full benefits of our ongoing investments to implement the necessary improvement programmes are still unfolding alongside further improvements planned for 2020, as we look to maintain the pace of change in order to deliver further value for shareholders.

April 2018

GKN

GKN, upon our acquisition, was a multinational group of businesses making predominantly aerospace and automotive components. Upon taking control we immediately set about decentralising the businesses, and refocusing them on profitable sales rather than solely on growth. The GKN businesses now make up three distinct divisions within Melrose: Aerospace, Automotive and Powder Metallurgy. See pages 16 to 27 to find out more about our progress in improving the GKN businesses so far, and our plans for 2020.

Our purpose and strategy

Melrose was founded in 2003 to empower businesses to unlock their full potential for the collective benefit of stakeholders, whilst providing shareholders with a superior return on their investment.

We have achieved this through the implementation of our "Buy, Improve, Sell" 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.

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 £4.7 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 4 and 9 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

[1] In respect of the McKechnie, Dynacast, FKI and Elster acquisitions.

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.

ESG

The Melrose "Buy, Improve, Sell" model necessarily means that we inherit businesses that are underperforming in a number of different areas, including their environmental, social and governance performance.

We implement stronger operational and financial foundations to build better businesses, for the collective benefit of stakeholders. In doing this, we encourage them to improve on historic ESG underperformance, and make sustained, positive contributions to the environment and communities in which they operate.

Implementing Melrose ESG values – our decentralised approach

We encourage, support and invest in our businesses to implement the following Melrose ESG principles and contribute to a sustainable future, as further detailed in our ESG report on pages 58 to 69:

- Respect and protect the environment.
- Purposefully engage with key stakeholders to better understand and deliver on their expectations.
- Prioritise and nurture the wellbeing and skills development of employees and the communities that they are part of.
- Exercise robust governance, risk management, and compliance.

- Invest in the business and support research and development.
- Focus on profitability and operating cash generation – not growth for the sake of growth.
- Improve products and customer relationships.

- Engage closely and often with key external stakeholders.
- Invest in the workforce, closely monitor health and safety, and secure the financial health of workplace pension schemes.
- Prudent management of debt levels.

Sell

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

Value creation

Businesses under improvement

Aerospace

p.16

Automotive

p.20

Powder Metallurgy

p.24

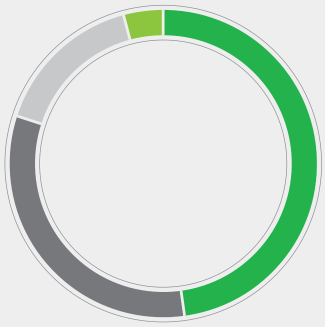
Nortek Air Management

p.28

Other Industrial

p.32

How has Melrose created value?[1]



Margin improvement	48%
Multiple arbitrage	32%
Cash generation	16%
Sales growth	4%

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

Outputs

Shareholder investment and gain

(figures up to 31 December 2019):

Average return on equity across all businesses sold

2.6x

Cash return to shareholders since establishment

£4.7bn

Reinvestment

£719m

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

2.8%

of revenue for the equivalent period

Capital expenditure in 2019

£519m

We implement secure pension scheme funding, operational and financial best practice, and lead in promoting diversity and neutralising our carbon footprint.

We invest in our businesses to bolster their research and development capabilities, to enable them to help their customers meet their environmental objectives, and help ensure the safety of their end-users.

We encourage our businesses to champion the interests, safety and skills development of their employees.

We instil our values through best practice policies, training, and internal controls, supported by renewed management and governance structures.

Our businesses' executive management teams are empowered to implement the necessary measures to improve ESG performance, by leveraging their understanding of what their respective stakeholders require.

Sustained, positive ESG performance

The success of our "Buy, Improve, Sell" model relies on building better businesses that are positioned to prosper over the longer term. The ESG improvements that we promote and encourage among our businesses benefit from our long-term view, and are underpinned by our focus on conducting business with the highest standards of integrity, honesty, and transparency.

By implementing a stronger culture of operational and financial improvement, we rebuild our businesses' resources and capabilities, and enable them to pursue commercially attuned ESG improvement initiatives.

Unlocking the full potential of our businesses

Justin Dowley
Chairman

Calendar year 2019[1]

The past year has seen us take some important steps towards unlocking the full potential of the GKN businesses and this is showing through in these results. We achieved statutory revenue for the Melrose Group of £10,967 million (2018: £8,152 million), with an adjusted operating profit of £1,102 million (2018: £813 million) based on a statutory operating profit of £318 million (2018: loss of £387 million). Importantly, adjusted free cash flow improved by 72% to £591 million on an annualised like-for-like basis, thus reducing leverage in the Group to 2.25x EBITDA.

While there remains plenty to do, this clearly demonstrates that the improvements we are making to the GKN businesses are starting to deliver the performance that we believe is achievable. Nortek Global HVAC ("HVAC") has enjoyed another strong year as the installations of its cutting edge sustainable StatePoint Technology® in large scale data centres gain momentum across the globe. With the appointment of advisors to consider strategic options for Nortek Air Management, the business is reported in these accounts as a stand-alone division and Security & Smart Technology ("Security") has been moved to the Other Industrial division.

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

In line with our progressive dividend policy, the Board proposes to pay a final dividend of 3.4 pence per share (2018: 3.05 pence), making a total dividend for the year of 5.1 pence per share (2018: 4.6 pence), an increase of 11% from last year. The final dividend will be paid on 20 May 2020 to those shareholders on the register at 3 April 2020, subject to approval at the Annual General Meeting ("AGM") on 7 May 2020.

Pensions

We are very proud of our track record in improving the funding of pension schemes under our stewardship. We were proactive, transparent and constructive in agreeing commitments with pension trustees during the acquisition of GKN to provide comfort that the improvements we had planned for the businesses included greater security for their members. We continue to deliver on our promises, increasing the prudence of their funding targets, while over £240 million of cash contributions so far have helped to significantly improve the funding position.

This improvement in funding has been matched by structural enhancements. In line with plans agreed with the trustees, we have rebalanced the pension liabilities more evenly across the supporting businesses. Stronger, better funded and more secure GKN pension schemes are the latest example in our good track record for responsible stewardship.

(1) Results for 2018 include GKN businesses for the eight months of ownership and have been restated for discontinued operations.

The Melrose model has always been focused on performance improvement rather than end-market growth and it is in uncertain and volatile markets that this shines through most clearly.

Board matters

As announced last year, co-founder and Executive Vice Chairman Mr David Roper will retire at the end of May. His period of service, first as inaugural Chief Executive and then as Executive Vice Chairman, has been one of great success for the business he helped found in 2003. It is a testament to his leadership that he leaves Melrose in such good health. We thank him for his long and successful service and wish him all the best in his retirement. David's departure is part of the ongoing succession planning for the Board that has also seen us welcome Ms Funmi Adegoke as a Non-executive Director last October.

Although I have only served as independent Non-executive Chairman for a short period, I will have served as a Director for nine years in September 2020, which is a key date for independent directors under the guidance of the new UK Corporate Governance Code (the "Code") that came into force after my appointment had been announced. The Company therefore conducted an engagement exercise with its key shareholders regarding the possible extension of my tenure past the nine year guidance. I am pleased to say that the feedback was unanimously supportive and accordingly, the Board proposes that my appointment as Chairman continues for up to a further three years, subject to annual re-election, to provide stability and certainty following the acquisition of GKN, as well as to oversee smooth succession and increasing diversity for the Board.

Purpose and strategy

Melrose was founded in 2003 to empower businesses to unlock their full potential for the collective benefit of stakeholders, whilst providing shareholders with a superior return on their investment. This has been delivered through Melrose's "Buy, Improve, Sell" strategy, which means we buy good quality but underperforming manufacturing businesses and then invest heavily to improve performance and productivity as they become stronger, better businesses under our responsible stewardship. At the appropriate time, we find them a new home for the next stage of their development and return the proceeds to shareholders. This current set of results is a strong demonstration of this strategy in action, and a continuation of the achievements that have seen Melrose ranked as the second highest performer for total shareholder return in the FTSE 350 over the past decade.

Outlook 2020

2019 was a year of significant progress but encouragingly much remains to be done and our divisional teams are delivering. As such, we expect 2020 to be another year of good progress driven by each of the key businesses with a dual focus on efficiency programmes to deliver operational improvements, as well as record investment in research and development, to maintain technological market leadership. The Melrose model has always been focused on performance improvement rather than end-market growth and it is in uncertain and volatile markets that this shines through most clearly. While it is too early to be precise on the impact of COVID-19 on our businesses or on wider economic conditions, we remain focused on what we can control. Longer term, we continue to see significant value in the Group and the foundations to realise this are stronger than ever.

J Dowley

Justin Dowley
Chairman
5 March 2020

Environmental, social and governance ("ESG") disclosure

You will see that we have produced our first standalone ESG report as part of our Annual Report. This ESG report draws together the key actions, programmes and performance on ESG matters for us and our businesses, to aid the understanding of our investors and other stakeholders.

Consistent with our "Buy, Improve, Sell" strategy, some of the businesses we acquire may be underdeveloped in one or more areas of ESG focus. While we set a good example centrally through strong governance practices and responsible stewardship, a key part of our improvement strategy is providing the investment, support and encouragement that our businesses need to make meaningful, continuous ESG improvements. This delivers material production efficiencies, such as the 30% reduction in emissions achieved by GKN facilities over the past two years, and sustainability breakthroughs on product developments such as the composite *Wing of Tomorrow* and electric aircraft initiatives of GKN Aerospace, GKN Automotive's P4 eDrive system which enables reductions in CO_2 emissions by up to 100%, and HVAC's cutting-edge StatePoint Technology®, which enables savings of up to 30% for energy consumption and up to 90% for water usage on cooling systems in the fast-growing hyperscale data centre market.

These are all long-term programmes requiring significant investment that will continue to deliver sustainable benefits long after our ownership, and demonstrate the strength of our commitment. We welcome the evolving focus and clarity on ESG matters as yet another opportunity to demonstrate how we build better, stronger businesses for the benefit of all stakeholders whilst producing excellent returns for shareholders. We see these as entirely compatible and I refer you to the ESG report for full details.

ESG report
See page 58 to 69

Our businesses continue to focus on improving their performance and delivery, particularly in critical supply chains.

A strong year of driving value

After a busy eight months following the acquisition of GKN, our first full year of ownership has proved to be equally significant as our investments and improvement plans have gained momentum. Having legally separated all the GKN businesses and with motivated executive teams, we were able to increase the focus on performance, with pleasing results.

Although benefiting from a strong sector, GKN Aerospace was successful in both growing its sales as well as improving adjusted operating margins to approximately 11% in the second half of the year. Continued record investment in technology supported a number of advances, including the first composite components for the *Wing of Tomorrow* programme for Airbus, while continuing efficiency and productivity programmes saw a return to profitability for the previously troubled North American sites. Good progress has been made on the "One Aerospace" reorganisation announced last September. This has reshaped the division into three business lines – Civil Airframe, Defense and Engines – to align with its customer base and centralise the global control of operations under the Chief Operating Officer. It is a key focus for 2020 to evolve the management structure of this business.

With the global downturn in the automotive sector continuing into 2019, GKN Automotive was quick to take corrective action that limited its impact on profitability. Although sales declined 6% over the year in line with the market, the business was able to improve adjusted operating margins in the second half to just under 8% and adjusted operating profit for the same period rose by 14% compared with the prior year. These actions are part of GKN Automotive's ambitious plan to achieve the margin target announced last year and are matched by ongoing record investment in research and development. The exciting new collaboration with Delta Electronics Inc. announced in January 2020 to jointly produce 3-in-1 eDrive systems builds on a strong existing relationship and will enable both parties to build on their respective positions in this dynamic market.

Being predominantly an automotive component manufacturer, GKN Powder Metallurgy also felt the challenges of the automotive sector downturn in 2019. This was accentuated by its exposure to the General Motors strike in the second half which drove sales down by 10% and adjusted operating margins to 10.5%. Accordingly, it is implementing a plan to rebalance its cost base and a focus for this year is on improving its Sinter Large division. There is now a strong focus on improving this business and the recent acquisition of FORECAST 3D is an exciting opportunity for GKN Powder Metallurgy to be a market leader in additive manufacturing.

All of our businesses are keeping the unfolding events surrounding the COVID-19 outbreak under review. To provide some context of the impact to date, approximately 10% of Group sales are manufactured in China, of which only 5% is sold in China. GKN Automotive has the largest exposure through its SDS joint venture, but all except one site are operational after the new year break. Whilst there is clearly going to be a material impact on the Chinese economy, at the time of writing there are increasing signs of a return to normal levels of production.

The working capital improvement programme is building momentum across the Group, which delivered significant progress towards the targeted £400 million of ultimate savings through a 5% reduction in trade working capital. Group cash conversion was strong at 104%. Each of GKN Aerospace and GKN Automotive have continued their focus on procurement, delivering significant savings year-on-year.

The GKN businesses are also making good progress in addressing the £629 million of loss-making contracts we inherited on acquisition. Through a mixture of operational improvements, productivity, procurement initiatives and commercial discussions, they have achieved sufficient improvements in the long-term positions of these contracts to enable a release of approximately 25% of the remaining provision (as previously indicated, not included in adjusted operating profit). GKN Automotive has been particularly effective in making progress, but we are confident there are significant further improvements available to all businesses.

Last year saw a number of important milestones for Nortek Air Management's game-changing data centre climate control technology StatePoint Technology®, with the business initiating roll out in two mega-scale facilities for a global technology company, and developing a strong pipeline of new opportunities to gain further market share. Elsewhere, the Nortek Air Solutions business continues to go from strength to strength, while the Air Quality and Home Solutions business overcame some headwinds in its Canadian market and delivered a number of important new product launches.

Security has been moved to the Other Industrial division, with the impairment unchanged from the interim results, and has a new management team as it looks to finalise the transition of its production away from China to minimise tariff exposure. These results indicate that the new management team at Ergotron look to have put recent challenges from tariffs behind them as they further develop their product portfolio and clarify their best routes to market. Brush has emerged from its restructuring programme better shaped and well positioned to serve its growing markets.

Simon Peckham
Chief Executive
5 March 2020

For further details about the performance of our businesses, please see the following sections:

Aerospace
p.16

Automotive
p.20

Powder Metallurgy
p.24

Nortek Air Management
p.28

Other Industrial
p.32


Aerospace

GKN AEROSPACE

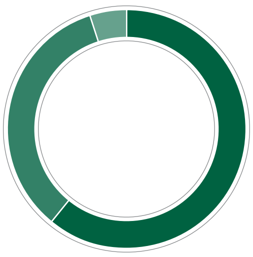
Key information

GKN Aerospace is a global tier 1 aerospace partner with market leading positions driven by technological innovation, advanced processes and engineering excellence.

Revenue by business

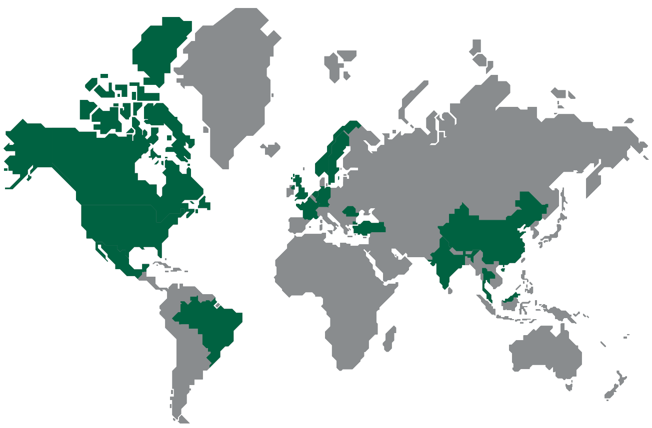
Civil Airframe	47%
Engines	32%
Defense	21%

Revenue by destination



North America	61%
Europe	34%
Rest of the world	5%

Operational geographies



Global Technology Centres
Netherlands, Sweden, UK, US

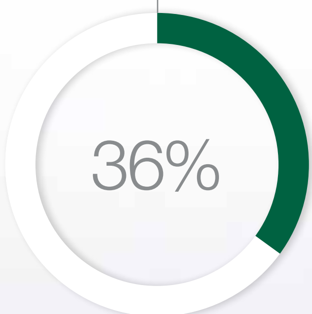
(1) All growth metrics are calculated at constant currency against 2018 annualised results, excluding the impact of loss-making contracts in both periods for consistency. 2018 annualised results included 12 months of GKN ownership.
(2) Described in the glossary to the financial statements on pages 191 to 195.

gknaerospace.com

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

£3.9bn
Adjusted[2] revenue

£104m
Statutory operating profit



Proportion of Melrose

Based on adjusted[2] 2019 operating profit for all continuing trading businesses

Highlights

- GKN Aerospace sales grew by 7% in 2019 and the adjusted(2) operating margin rose to 10.6%, up from 9.9% in 2018. The second half margin was 11.1%, already close to the target previously set.
- GKN Aerospace is implementing its extensive restructuring project, "One Aerospace", to improve performance further and is investing heavily in new technology to improve aeroplane efficiency in the future.
- North American Aerostructures became profitable in 2019; only two years ago this part of GKN Aerospace made a £43 million loss.

£409m

Adjusted(2) operating profit

£3.8bn

Statutory revenue

Divisional review[1]

Continued

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 technologies help aircrafts fly faster, further and greener.

During 2019, GKN Aerospace consolidated on the early gains made since our acquisition and continued to take the required actions to increase customer confidence and improve operational delivery. Those measures have resulted in good progress being made in addressing loss-making contracts identified in the opening Balance Sheet review, although this remains a work in progress with significant further opportunities available. The business has also kept its exposure to Boeing 737 MAX under close review and, in discussion with Boeing, is taking the necessary mitigating action. The exposure of GKN Aerospace to the Boeing 737 MAX is approximately a shipset value of up to £400,000 for each aircraft.

The business also sharpened its focus on commercial performance improvement, supported by operational efficiency measures and significant investment from Melrose. These have been particularly noticeable in the North American transformation programme in 2019 that has enabled this group of sites to move from a £43 million loss in 2017 to a small profit in 2019. This contributed to a stronger second half performance for GKN Aerospace, with operating margins for that period reaching 11% and operating margin growth across the year of more than one percentage point.

GKN Aerospace commenced a wholesale reorganisation during the second half of the year to create a stronger, simpler, more competitive business, based on a fully integrated global operating model and organised around three business lines: Civil Airframe, Defense and Engines as well as a regional network of operational sites supported by global functions. Over the next 18 months full deployment of the "One Aerospace" operating model will refocus the business to better serve its customers by placing accountability for customer relationships and product lines at the heart of the commercial organisation.

The refreshed organisation will better enable the business to unlock its full potential by supporting and directing its key improvement measures including continued investment in new facilities, centralised control of operations, further investment in technology, and improvements to delivery, quality and customer relationships. It will also result in a more streamlined and nimble management structure. Implementation of the reorganisation will remain a key focus for the business in 2020 and into 2021.

GKN Aerospace's continued investment in technology led to several landmark achievements in 2019, strengthening its position as a key partner to several major blue-chip customers. In the Civil Airframe market, GKN Aerospace's advanced composite leadership saw it manufacture and deliver the first components for Airbus' *Wing of Tomorrow* programme, including a revolutionary four-metre demonstrator tool to accelerate future progress. In Engines, GKN Aerospace's world-leading additive manufacturing capability accelerated the production of a Fan Case Mount Ring component. This is the largest purely additive aerospace part ever produced, while reducing titanium waste, CO_2 emissions, and production time and costs, and providing opportunities for expansion into key engine platforms.

GKN Aerospace also strengthened its additive manufacturing leadership position within Civil Airframe and Defense, winning key roles on collaborative research and development programmes in the UK and announcing a new world-leading additive pilot production cell at Oak Ridge National Laboratory in the US. These advances in additive manufacturing technology continue to target untapped productivity and profitability improvements, as well as secure new business opportunities.

(1) All growth metrics are calculated at constant currency against 2018 annualised results, excluding the impact of loss-making contracts in both periods for consistency. 2018 annualised results include 12 months of GKN ownership.

15

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

4

Global technology centres

£50m

Investment to strengthen previously underinvested sites in UK and US

Throughout the year, GKN Aerospace continued its strategic repositioning in the emerging Asia market, announcing a new facility in China and starting production in its new wiring site in Pune, India, while closing two loss-making sites. With Melrose support, over £50 million was committed to new investment in productivity across key European and US facilities, including Cowes, Luton and Portsmouth in the UK, and Garden Grove in the US.

Outlook

Despite some challenges, overall the long-term civil aerospace market remains in line with our acquisition assumptions, with order backlog and predicted aircraft requirements supporting a positive long-term outlook for GKN Aerospace globally. An increase in international defence spending is driving strong demand expectations in the aerospace defence market.

While the Boeing 737 MAX has made headlines over the past 12 months, the full extent of the impact on the market still remains unclear for 2020 and, whilst relatively less significant for GKN Aerospace, the business is taking appropriate mitigating actions. GKN Aerospace's strong relationships with major OEMs and good exposure to the growing Asian market, world-leading technology and a renewed focus on operational efficiencies driven centrally across its global footprint, is expected to enable a reshaped GKN Aerospace to continue to deliver further improvements towards achieving its margin targets and again perform strongly in 2020.

Market trends
Aerospace

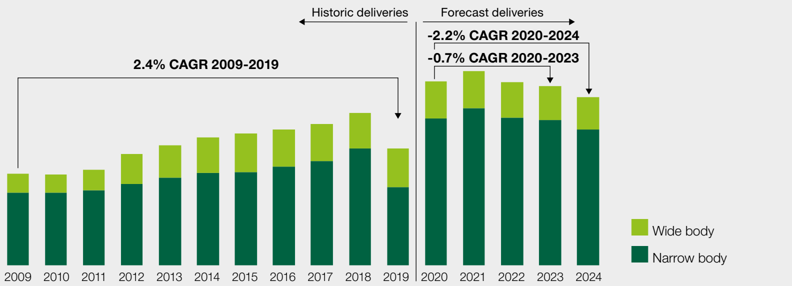
The global aerospace market remained healthy in 2019 with growth in both the civil and defense sectors, supported by the following market factors:

- Continued growth in global air passenger traffic of 4.2%.
- Continued high backlog held by the major OEMs.
- Lower delivery levels of commercial aircraft in 2019, propagated by the Boeing 737 MAX production halt.
- Continued strong growth in the defense market, driven by increased spending and new platform developments.
- Business jet output reaching its highest level for a decade, due to the introduction and production ramp-up of new aircraft models and renewed confidence in the market.
- 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 by reorganising along three business lines; Civil Airframe, Defense and Engines, investing in key sites to drive improved productivity and to meet customer ramp-up targets, continuing to establish its footprint in the growing Asia market, and streamlining its footprint elsewhere, where sites do not have a long-term, sustainable future. GKN Aerospace also placed increased focus on technology investment in additive manufacturing to further enhance productivity and ensure continual alignment of its customer offering with expected future demand. In the longer term, GKN Aerospace's globally integrated structure is anticipated to enhance the benefits that are expected to flow from each of these improvement initiatives, to accelerate its prospects of outperforming the market.

Number of commercial aircraft deliveries (historic & forecast)[1]

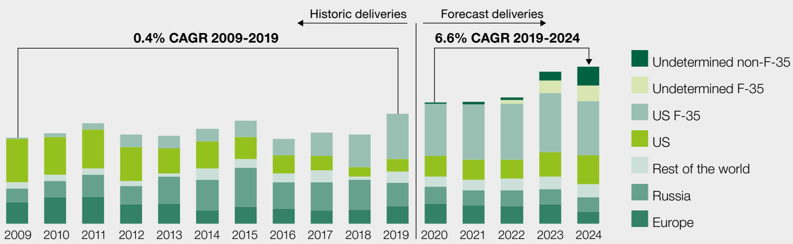
Long-term forecast deliveries underpinned by strong orderbook



(1) Source: Teal Group, Aircraft Market Forecasts & History, Commercial Aircraft, December 2019

World fighter production in number of deliveries[2]

Fighter market shows strongest growth, driven by F-35 ramp-up



(2) Source: Teal Group, Aircraft Market Forecasts & History, Fighter Aircraft, December 2019 (US F-35 deliveries incl. Partner country delivery numbers)

Automotive

GKN Automotive is a leading supplier of driveline technologies to the global automotive industry and a trusted partner to over 90% of the world's car manufacturers.

Highlights

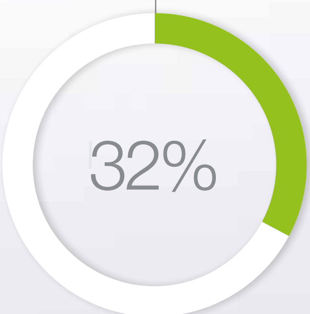
- GKN Automotive sales reduced by 6% over the full year 2019 in line with the market, but saw an improved trend in the second half, being 4% down, despite the General Motors strike in the autumn.
- An exciting new commercial partnership in eDrive has been signed with Delta Electronics Inc. to accelerate the development of electric vehicles.
- GKN Automotive's adjusted[2] operating margin in the full year was 7.7% with the second half margin rising to 7.9% up from 6.8% in 2018. This meant the adjusted[2] operating profit actually rose by 14% in the second half compared to the same period in 2018 despite the macro automotive sector headwinds.

£186m
Statutory operating profit

£4.1bn
Statutory revenue

£367m
Adjusted[(2)] operating profit

£4.7bn
Adjusted[(2)] revenue



Proportion of Melrose

Based on adjusted[(2)] 2019 operating profit for all continuing trading businesses

GKN AUTOMOTIVE

Key information

GKN Automotive is a world leading supplier of automotive driveline technology and systems used across the automotive industry, from the smallest ultra-low-cost cars to the most sophisticated premium vehicles demanding the most complex driving dynamics.

Revenue by business

Driveline	72%
ePowertrain	28%

Revenue by destination

Europe	35%
North America	34%
Rest of the world	31%

Operational geographies

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

(1) All growth metrics are calculated at constant currency against 2018 annualised results, excluding the impact of loss-making contracts in both periods for consistency. 2018 annualised results include 12 months of GKN ownership.

(2) Described in the glossary to the financial statements on pages 191 to 195.

gknautomotive.com

Divisional review[1]

Continued

GKN Automotive has global operations in 21 countries and is principally organised around its two key core competencies: (i) Driveline, which is the world's pre-eminent global driveshaft manufacturer; and (ii) ePowertrain, an industry leader in electric powertrains ("eDrive") and intelligent all-wheel drive ("AWD") systems.

The Driveline business is an industry leader, supplying to more than 90% of global vehicle manufacturers, with more than 50% of the 80 million new cars sold each year running on GKN Automotive parts. The business provides a comprehensive range of sideshafts, propshafts and constant velocity joints, offering a simple, reliable solution for every type of hybrid, electric or combustion passenger vehicle. Despite the global automotive downturn in 2019, the Driveline pipeline has expanded throughout the year, bolstering the division's market leading position as it moves into 2020.

GKN Automotive also has an unparalleled 17 years of eDrive development and integration expertise and has produced more than one million eDrive systems to date, with a rapidly expanding order book. The business has pioneered the advancement of eDrive technologies, developing its systems integration and production capabilities. GKN Automotive recently announced a strategic collaboration with Delta Electronics Inc., a global power electronics specialist, for the joint development of advanced eDrive technology, with GKN Automotive acting as system integrator.

1 million

One millionth eDrive system was delivered in 2019

£76m

In powertrain research and development

21

Countries in the global production footprint

5

Global technology centres

This partnership will further GKN Automotive's technical capabilities and accelerate time to market for scalable, next generation semi integrated 2-in-1 and fully integrated 3-in-1 eDrive systems of power classes from 80kW to 155kW. This important development milestone has been matched by commercial success, with four successful programme launches and £2.4 billion of lifetime value ePowertrain programmes secured, and the delivery of GKN Automotive's millionth eDrive system. This milestone underlines GKN Automotive's early technology position in the fast-growing and competitive eDrive market, which is projected to be worth more than £12 billion by 2030.

China continues to be an important market for GKN Automotive. A long-standing excellent relationship with local partner HASCO through GKN Automotive's 50% equity investment in the strong joint venture, Shanghai GKN HUAYU Driveline Systems ("SDS"), continues to generate impressive returns. The business in this region experienced a healthy evolution of its eDrive pipeline in 2019 and executed three major eDrive programme launches during the year. GKN Automotive is closely monitoring the situation surrounding the COVID-19 outbreak, both in China and elsewhere, and is working to mitigate the potential impact. It will be quick to take action where required. Whilst COVID-19 is very likely to have a negative effect on the Chinese economy this year, the market position of the joint venture makes us confident that China will be a very successful market for GKN Automotive in the future.

Despite facing challenging global market conditions, 2019 was a strong year for GKN Automotive. An inevitable market-driven sales decline was offset by the disciplined operational focus of the refreshed and settled management team and targeted cost control measures, resulting in an increase in operating profit margins that were just short of 8% in the second half. This margin performance is benefiting from the implementation of an ambitious improvement programme based on six main levers, including procurement optimisation, fixed cost reduction, commercial improvement and operational excellence.

(1) All growth metrics are calculated at constant currency against 2018 annualised results, excluding the impact of loss-making contracts in both periods for consistency. 2018 annualised results include 12 months of GKN ownership.

The improvement programme has a very healthy pipeline of value creation initiatives, some of which have already contributed to the margin improvement witnessed in 2019. Procurement delivered over £40 million of savings from both direct and indirect material purchasing and value engineering, while centralising the function has improved costing intelligence and diversified supply sources. Strategic footprint rationalisation opportunities continue to be assessed, with the business building greater discipline around its investment in its core manufacturing capabilities, driven by smart automation and insourcing of essential, core GKN Automotive capabilities, as well as targeted footprint expansion in best cost locations supported by rationalisation elsewhere.

The business also made significant progress in addressing loss-making contracts, taking an integrated approach to driving efficiencies while improving commercial terms and performance delivery, enabling a £60 million release from the opening Balance Sheet provision and making a distinct impact on current programme profitability. Through a better allocation of resources and increased focus on working capital management throughout 2019, GKN Automotive was also able to make significant improvements in cash flow, with a conversion rate of greater than 100% for the full year.

Outlook

GKN Automotive's performance in 2019 has set strong foundations for further performance improvements. While global production volumes are expected to remain soft and the full impact of the COVID-19 outbreak is not yet known, continued focus on cost management initiatives in its improvement plan are expected to have a further positive impact on underlying operating profit margins.

Driveline has over 60 programme launches planned for 2020 and is pushing hard to drive productivity gains through smart automation and execution of operational excellence and industrial strategy initiatives approved and deployed in 2019. For ePowertrain, market growth is expected to continue in 2020, which is expected to accelerate GKN Automotive's delivery of next generation semi integrated 2-in-1 and fully integrated 3-in-1 eDrive systems, further strengthening the business's position in the sizeable and rapidly expanding eDrive market.

With a positive underlying operating margin trajectory, improved cash position, and the strategic investments that the business made during 2019, we believe 2020 is set to be another year of transformation for GKN Automotive irrespective of market conditions.

Market trends
Automotive

The global automotive sector has endured continued challenges in 2019 which impacted sales performance at GKN Automotive during the year. The most significant factors impacting GKN Automotive's business environment are:

- **Market headwinds:** Global light vehicle production was down 6% year-on-year, driven by China (-11%), Western Europe (-7%) and North America (-4%)[(2)].
- **Evolving technological landscape:** Accelerated adoption of electrification and new mobility solutions is impacting GKN Automotive's supply chain, product mix and competitive landscape.
- **Political turbulence:** Uncertainty around trade tariffs (particularly between the US and China), legislative changes associated with Brexit, OEM employee industrial action, and the full impact of COVID-19.
- **Sociodemographic behaviours:** Shift in demand for vehicle/platform types (including the decline of diesel due to environmental concerns) and the emergence of new mobility solutions (such as ride sharing).

GKN Automotive has responded to these trends through investment in its leading eDrive technologies, a focus on operational performance across the business, close development and collaboration with OEMs, and the adoption of a leaner, more agile business model, which is set to continue. Review of the business's cost structure and targeted restructuring initiatives shall also continue at certain sites during 2020.

(2) Source: January 2020 IHS Light Vehicle Production.

Powder Metallurgy

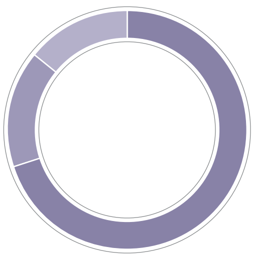
GKN Powder Metallurgy is a global leader in both precision powder metal parts for the automotive and industrial sectors, and the production of metal powder.

GKN POWDER METALLURGY

Key information

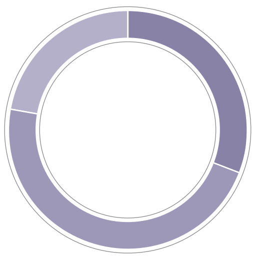
We combine advanced powder metals with innovative production technologies to create unique metal products – smart, reliable and precise.

Revenue by market type



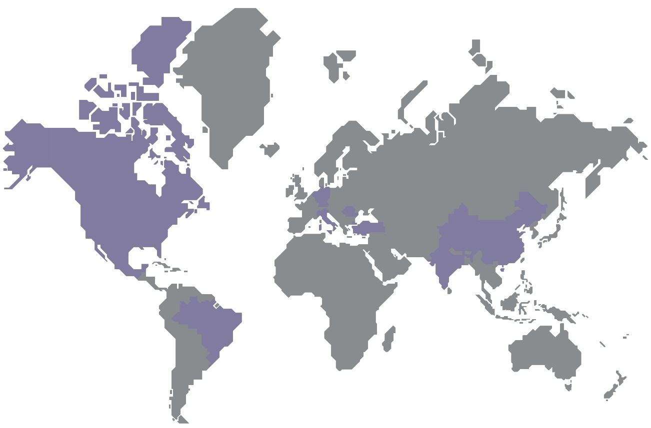
Automotive	70%
Industrial	16%
Hoeganaes Metal Powder	14%

Revenue by destination



Europe	31%
North America	47%
Rest of the world	22%

Operational geographies



Global Technology Centres
Germany, Italy, US

(1) Described in the glossary to the financial statements on pages 191 to 195.

gknpm.com

£1.1bn
Adjusted[(1)] revenue

Proportion of Melrose

Based on adjusted[(1)] 2019 operating profit for all continuing trading businesses

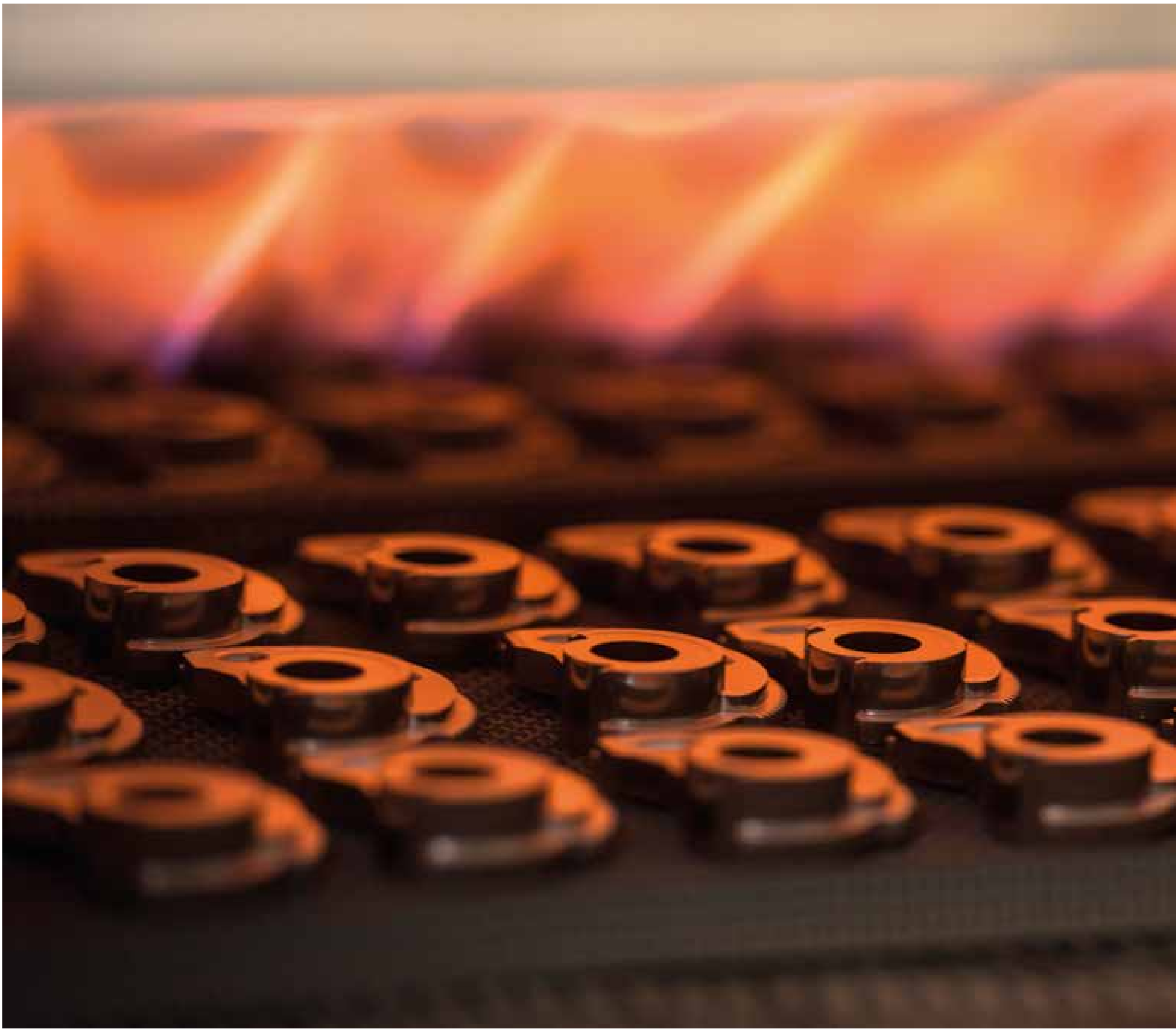
£1.1bn
Statutory revenue

£77m
Statutory operating profit

£117m
Adjusted[1] operating profit

Divisional review

Continued



GKN Powder Metallurgy comprises (i) Sinter Metals – the world's leading manufacturer of precision automotive components and components for industrial and consumer applications spread across its Small and Large segments; (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 additive manufacturing parts, both metals and polymer, and materials for prototypes, manufactured through a global, digitally connected print-network.

During 2019, GKN Powder Metallurgy faced its most challenging market conditions for some years, most notably in the automotive sector, that most significantly impacted the Sinter Large segment of its business. Whilst the business largely outperformed the market in Europe, China and Brazil, in its largest market of North America the combination of a weaker domestic automotive market, the impact of industrial action at certain customers, and reduced exports to China proved challenging, as reflected in the 2019 results. This has nonetheless provided some opportunities, with further market consolidation expected as smaller competitors exit the market.

Although sales performance was impacted by macro events, the business was largely able to protect margins through investment and efficiency programmes that are part of a wider renewed strategic plan for the business, which is being implemented after a comprehensive review of its operations and cost base. This plan has a particular focus on the underperforming Large segment of Sinter Metals and has included the closure of two plants in North America, as well as further continuous improvement initiatives to bolster Sinter Metals' market leadership in product quality and delivery. These have reduced non-conformities and unnecessary expedited freight costs. Further improvement is planned for the Large segment of Sinter Metals in 2020.

Further automation initiatives were deployed throughout the GKN Powder Metallurgy production footprint during 2019, supported by increased shop floor digitisation. The harnessing of additional activity data points has enabled more detailed and targeted mapping of future improvement initiatives in process efficiency, quality control and supply chain management, with a view to further bolstering GKN Powder Metallurgy's technological and operational leadership.

While rightly focusing on cost efficiency improvements, the business nonetheless continues to pursue expansion opportunities. After acquiring a small European sinter business in March 2019, GKN Powder Metallurgy completed its acquisition of a leading US plastic 3D polymer printing company called FORECAST 3D in January this year. This acquisition has added 25 years of polymers experience and capability to its already advanced additive manufacturing production capabilities. Once fully integrated, it will build on the success of GKN Powder Metallurgy's Metal Jet technology and further the business's geographic reach in North America as well as its market expansion and leadership ambitions in the high-growth 3D metal and plastics printing solutions market globally.

Outlook

Delivery of the operational improvement opportunities remains the key strategic focus for GKN Powder Metallurgy in 2020 as it continues to take the steps necessary to achieve its margin targets. The business is optimistic for its performance for the year, despite the challenging end-markets expected for the foreseeable period.

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 through digitisation.
- Legislative clamp-downs to reduce emissions.
- The increase of electrified vehicles and manufacturing equipment.

These trends are driving industrial transformation and digitisation in all markets in which GKN Powder Metallurgy operates. Significant growth potential is seen in the additive manufacturing market in materials, and components. The FORECAST 3D acquisition adds the more evolved polymer to the parts portfolio.

This will accelerate market penetration of 3D printing solutions with existing and new customers.

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.

Nortek Air Management

The Nortek Air Management division comprises (i) Nortek Global HVAC ("HVAC") and (ii) Air Quality and Home Solutions ("AQH").

NORTEK GLOBAL HVAC

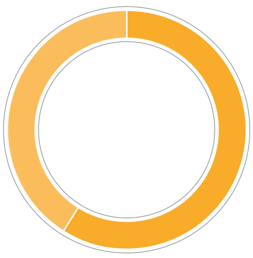
NORTEK AIR QUALITY & HOME SOLUTIONS

Key information

HVAC manufactures leading custom and commercial air solutions and StatePoint Technology® liquid cooling systems.

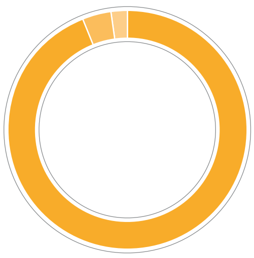
AQH is a leading manufacturer of ventilation products for the residential markets.

Revenue by business



Nortek Global HVAC	59%
Air Quality and Home Solutions	41%

Revenue by destination



The Americas	94%
Europe	4%
Asia	2%

Operational geographies

(1) Described in the glossary to the financial statements on pages 191 to 195.

nortekhvac.com
broan.com

Highlights

- Nortek Global HVAC continues to benefit from its leading edge sustainable StatePoint Technology® to reduce energy and water consumption in data centres.

£1.2bn
Statutory revenue

Proportion of Melrose

Based on adjusted[1] 2019 operating profit for all continuing trading businesses

£1.2bn
Adjusted[1] revenue

£139m
Statutory operating profit

£175m
Adjusted[1] operating profit

Nortek Global HVAC

The HVAC business includes the custom and commercial business of Nortek Air Solutions, the residential and light commercial business of HVAC and the dedicated data centre business of StatePoint liquid cooling. It employs a strategic framework of sustained growth, operational excellence, favourable cash flow conversion and a commitment to its customers.

During 2019, the HVAC business continued its focus on creating long-term value through strategies aimed at driving margin expansion and future revenue growth. The introduction of common procedures and optimisation of footprint and supply chain has simplified the business while HVAC is starting to benefit from significant investment in innovation and technology through the development of breakthrough products and new portfolios. It has sought to maximise the impact of these improvements with sales channel growth to extend market leadership in critical segments of the HVAC value chain and better cover previously under-penetrated North American regions.

Throughout the year HVAC has successfully launched new products and value propositions that address a number of key global societal challenges, including the reduction of energy usage intensity, improved water efficiency and the expansion of broader air-management standards. The regulatory changes governing refrigerants used in the HVAC sector are resulting in the largest product transition in decades, with HVAC's significant investment in innovation and technology meaning it is strategically well positioned to gain market share across its product portfolio.

This is most notably highlighted by HVAC's market leading position in the global data centre market, with very significant demand opportunities. HVAC achieved standout commercialisation of its StatePoint Technology® liquid cooling system in 2019, which included a multi-continent collaboration with a leading global technology company to provide cooling solutions. These systems deliver greatly superior performance and geographic flexibility in the design and construction of world-class hyperscale data centres across the world.

Vitally, this investment has also demonstrated HVAC's longstanding commitment to sustainability, with StatePoint Technology® cooling systems enabling surrounding communities to benefit from up to 30% energy savings and up to 90% water efficiency. These significant improvements in performance and efficiency are fundamentally important for the HVAC equipment market that is predicted to grow by over US$50 billion at a CAGR of 5% over the next five years.[(1)]

Building on its market leading position in data centres, HVAC is harnessing the advantages of its technology leadership to make developments right across its product offering, as well as into adjacent product lines such as desiccant-enhanced evaporative cooling systems. With the launch of a suite of new products and services to help end-markets react constructively to global trends, the business continued to lead the way in 2019. Nortek Air Solutions again delivered on its investments, showing further margin improvement as well as strong sales growth. The residential business faced more market challenges but was quick to react in implementing a series of efficiency initiatives, including footprint rationalisation, that mitigated some of the impact.

Outlook

Having moved into the construction phase of hyperscale data centre projects for its StatePoint Technology® cooling systems during 2019, HVAC has proven its ability to deliver on the promise of this transformational opportunity and expects to pursue similar large-scale projects in 2020. Further growth is backed by a product portfolio and technology leadership that provides a platform to remain ahead of the market. Combining this with a balanced and dynamic capital allocation strategy and experienced management team, HVAC expects further strong operational and financial performance in 2020.

Market trends
Nortek Global HVAC

Global IT spending on data centre systems reached US$205 billion in 2019, an increase of 46% from 2012[(2)]. Such hypergrowth is anticipated to magnify the demand on energy resources, especially electricity and water, and the impact of data centres on the global energy and carbon footprint. The macro-economic drivers that currently fuel the growth of this sector include the proliferation of digitisation (capturing analogue information in a digital format), the adoption of new applications and services such as cloud computing, blockchain, connected devices (from automobiles to smart cities), and nascent computing methods emanating from artificial intelligence, virtual reality and augmented reality, and cryptocurrency.

HVAC shall continue to serve its core markets through technological innovation and product leadership, to provide infrastructural solutions that seek to overcome continued environmental and regulatory pressures aimed at reducing energy and water usage intensity, reducing carbon emissions, to enable consumers and businesses to act in a more sustainable manner.

(1) Source: Technavio.
(2) Source: https://www.statista.com/statistics/314596/total-data-center-systems-worldwide-spending-forecast/

Air Quality and Home Solutions

AQH is a leading manufacturer of ventilation products for the professional building remodelling and replacement market, the residential new construction market, and the consumer 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. AQH enjoys a leading market share and installed base in US residential ventilation fans and range hoods.

Strong performances in 2019 from the business's high margin brands Zephyr and Best and above-market growth in China were enough to offset wider market headwinds, in particular weak housing starts in the US and Canada. This resulted in largely flat sales for the year, although there was some targeted growth in the appliance and wholesale channels and a breakthrough in the fresh air segment. The business was successful in negotiating pass-through arrangements to partially mitigate the negative impact of tariffs.

An installed base of 80 million units in North America following years of market leadership provides a significant opportunity for recurring replacement and remodelling revenue. Accordingly, AQH has refocused some of its new product development to address this with the aim of increasing its market share in aftermarket revenue. 2019 also saw a number of product upgrades including more powerful and efficient fresh air platforms, a new cooker hood ventilation range, and a connectable whole home air quality solution.

Operationally, AQH continued to optimise and realise production efficiencies throughout 2019 to offset margin challenges from tariffs, higher first half commodity costs and competitive pricing pressures. The business continues to manage the product transfers that are generating margin opportunities, with further supply chain and logistics improvements set to deliver additional savings in 2020.

Outlook

Some cautious recovery is expected in those North American markets that had a difficult 2019, with the business targeting sales growth for 2020 through a strong pipeline of new product development, scheduled product extensions, and the opportunities presented by the large installed base. Operationally, further supply chain, logistics and product optimisations are planned for 2020, providing confidence in the outlook of the business for the year.

Market trends
Air Quality and Home Solutions

- Outlook for the home improvement industry remains positive but not as strong as in previous years.
- Home building supply prices are expected to stabilise as no new tariffs are anticipated and commodities stabilize, and in some segments (steel) see a decline.
- Rising home prices and traditionally lower interest rates should continue to encourage homeowners to engage in ongoing maintenance and repair spending.
- China's air quality continues to improve, slowing growth of fresh air systems for consumers' purchases. Growth continues in big commercial buildings and projects.

AQH continues to refresh its product offerings across multiple categories that address market demands and competitive pressures. The ventilation category will be building on the momentum built during 2019 launches, including range hood product introductions to address competitive pressures in the chimney hood segment, and the introduction of a "connectable" whole home air quality solution. The strategy will leverage the business's market share and established product presence in the residential sector.

The digital channel and shopping market opportunity continues to grow, and the business continues to focus and invest in its digital platforms to maximise this, and to work closely with its trading partners to optimise product information and online media. This investment has been well received from all online partners and is expected to grow during 2020.

Other Industrial

The Other Industrial division[1] comprises (i) Brush, (ii) Security & Smart Technology (“Security”), and (iii) Ergotron.

£708m

Adjusted[2] revenue

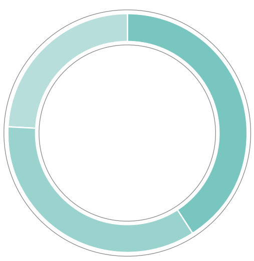
Key information

Brush is a leading independent provider of Turbo-generators, Transformers and Switchgear, and a fast-growing provider of Services across these core product segments.

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

Ergotron is a leading designer, manufacturer and distributor of ergonomic products for use in a variety of working, learning and healthcare environments.

Revenue by business



Security & Smart Technology	41%
Ergotron	35%
Brush	24%

Revenue by destination

North America	69%
Europe	20%
Rest of the world	11%

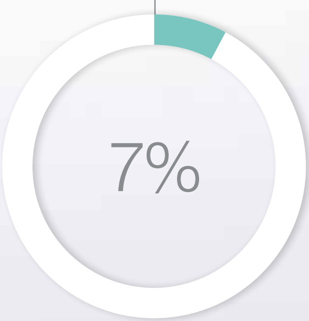
(1) The Walterscheid Powertrain Group was sold during the year and Wheels & Structures is held for sale and both are classified as discontinued operations.
(2) Described in the glossary to the financial statements on pages 191 to 195.

brush.eu
nortekcontrol.com
ergotron.com

£708m
Statutory revenue

£86m
Adjusted(2) operating profit

£170m
Statutory operating loss



Proportion of Melrose

Based on adjusted(2) 2019 operating profit for all continuing trading businesses

Brush

Brush is a profitable, cash generative business serving more diverse and growing end-markets than ever before, which benefit from supporting macro trends.

The structural realignment of Brush's manufacturing footprint is now complete and cost benefits are being realised by a strengthened and refocused management team in line with expectations. Brush is now repositioned for future growth, driven by product innovation, asset life extension, improved productivity and building on its cost reduction initiatives that continue to generate savings. Brush has continued to invest in product development across all of its businesses, including broadening its product range in Switchgear and enhancing its Turbogenerators product portfolio.

While trading conditions in the turbogenerator market remained challenging, the reshaped business matches this new reality and has mitigated the impact. For Switchgear, increased DC business from China through a number of new metro projects offset delays within the UK Distribution Network Operator sector, and the penetration of new product lines has been positive. After a slow start, activity in Transformers increased significantly during the latter half of 2019, contributing to a strong order book for deliveries scheduled well into 2020.

Services activity remained somewhat subdued across all product segments as some key customers deferred maintenance activities as a result of market conditions. However, Brush's newly strengthened commercial function for Services and increased bespoke collaboration with key industries began to yield good results in the latter half of the year.

Outlook

Brush has emerged from 2019 as a stronger and more agile business, with a significant order backlog built on a more diversified customer base and product portfolio that addresses customer needs in a broad range of traditional and emerging end-markets. After putting recent challenges behind it and now under strategic review, the business is confident of a good performance from its current base in the coming years.

Market trends
Brush

Traditional power markets have seen significant disruption in recent years, driven by the overall growth in renewables and rapidly increasing demand for more efficient sources of energy. These trends are bolstered by signs that global energy consumption is set to increase, with the main growth driven by China, India and other emerging markets.[3]

With renewable energy continuing to cause substantial structural change to electricity generation and power distribution, Brush is targeting further market opportunity in helping network operators address the challenge of supply volatility within the grid.[4]

Electrification in developing markets, greater investment in rail and tram infrastructure and regulatory strategies favouring asset upgrade as opposed to replacement, present significant growth opportunities for Brush. Brush is continuing to adapt to these new market realities, with increased focus on increased asset performance visibility, and the digitalisation of service monitoring, to reduce or avoid the prohibitive cost of failure and financial penalties associated with downtime.

(3) Source: https://www.iea.org/data-and-statistics/charts?energy=electricity&page=4
(4) Source: https://www.iea.org/data-and-statistics/charts?energy=electricity&page=5

Security & Smart Technology

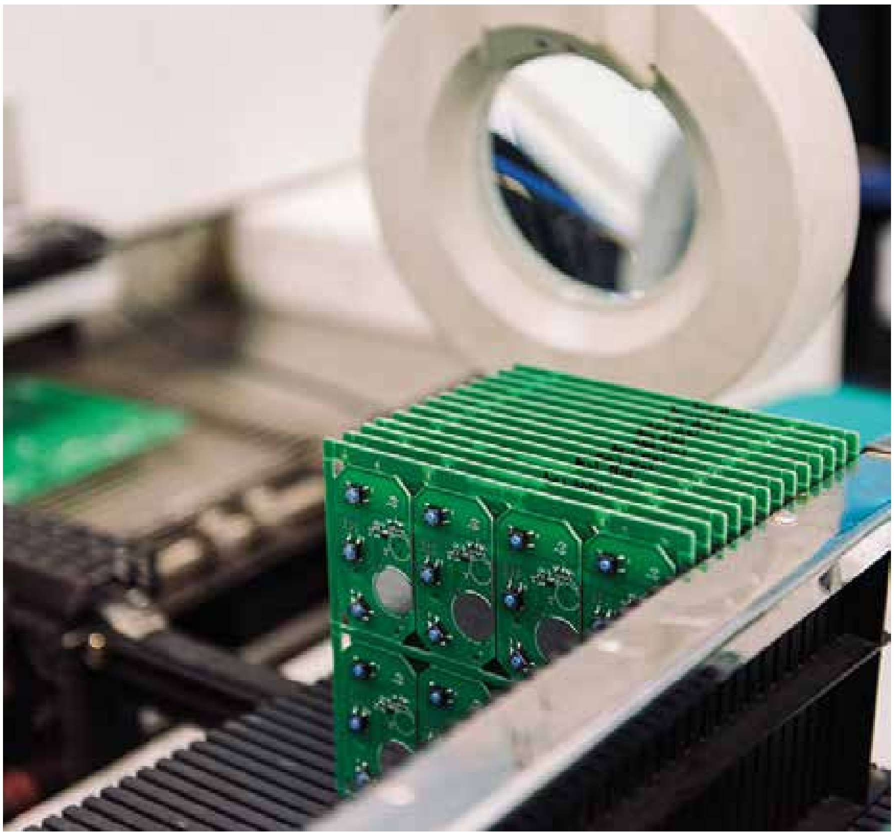
Security continues to bolster its expertise in the design and manufacture of wireless connectivity devices, to leverage its strong brand presence in professional security, integrator and custom installer channels, and to invest in its relationships with top resellers.

The business experienced another difficult year in 2019 as it faced increasing market competition and higher tariffs on many of its products, leading to the impairment announced at the half year. Throughout 2019, Security rebuilt its management team and maintained its strong focus on product development, leading to a strong pipeline of innovative products, many of which are set for release in 2020.

Security continued to optimise its operations and footprint in 2019, including the consolidation of its research and development and back-office functions into newly built headquarters in California, US, and the successful shift of production away from China in response to increasing tariffs. These efforts have resulted in reduced operating costs and an improved working capital structure, as well as providing the business with a more streamlined footprint moving forward.

Outlook

In 2020 a new management team, with a renewed discipline and focus on product development in core offerings, will be executing an updated go-to-market sales and marketing strategy. Following the successful transition of the business's production activities to a third-party manufacturer, the business is repositioned for a better performance in 2020.



Market trends
Security & Smart Technology

The Security division continues to operate in a residential security and home automation market that is:

- Increasingly competitive due to the dual forces of new market entrants and expanding offerings by existing technology companies, security providers, ISPs, and other electrical manufacturers.
- Driven by connected solutions that interact and integrate within the ever-expanding Internet of Things product space to provide enhanced functionality.
- Challenged by growing consumer concerns about the use and security of in-home devices and the personal data they generate.
- Experiencing pricing pressures due to the continued rise of DIY solutions.
- Subject to rising trade tariffs in the US.

In response to these market dynamics, the business is integrating its security and control sales groups and streamlining its marketing and brand approach to better support and educate customers across channels on its product offerings and their integrated capabilities.

The business is investing in new products with enhanced features and improved connectivity, including further integration of IntelliVision technology into a next generation security panel planned for release in 2020, that will leverage the encrypted sensor technology already developed while providing data storage and security on the edge.

Ergotron

Highlights

- Ergotron ended the year strongly with its second half profit being 26% ahead of the previous year.

Based in Minneapolis, US, Ergotron comprises four business segments: Healthcare, Office, Education and Custom.

Ergotron continues to drive a product leadership strategy, focusing on high-growth industry sectors and growing its presence in the EMEA and APAC regions. In 2019 the business was reorganised into focused end segments positioning it for growth. Tariff headwinds were mitigated through pass through arrangements and securing certain regulatory exclusions.

Significant improvements have been made in new products, rapid prototyping, test laboratories, CRM enhancement and improved channel engagement. Closure of non-core operations in Tualatin, Oregon and Phoenix, Arizona, US enabled the business to refocus its footprint to reflect its core strengths.

Outlook

Ergotron expects growth of its core businesses to accelerate in 2020, led by the healthcare segment, due to a significant number of new product launches, enhanced end-market focus, channel partner realignment and accountability. Alongside current markets, Ergotron is building its incremental growth prospects from new markets such as Office Furniture and Industrial. A new leadership team, revitalised channel engagement, new products and building on the new product momentum established in 2019, all point to a positive trajectory in 2020.

Market trends
Ergotron

- The healthcare market continues to present significant expansion opportunity for ergonomic solutions, primarily driven by continued global growth in electronic medical records, integration of mobile and tablet devices into healthcare environments, and initiatives to reduce the strain on caregivers and provide information access closer to patients.
- New growth opportunities within the corporate office market are expected to emerge from increasing user awareness about the negative effects of sedentary disease and its impact on employee health and wellbeing, increased usage of dual monitors for productivity combined with ergonomic awareness of monitor placement, and office furniture trends around collaboration and user choice.
- The evolution and adoption of active classrooms in the education market continues to grow, with increasing demand for height-adjustable student desks and device/notebook management and charging.

Ergotron continues to respond to these ongoing market trends through its broad product offering, most notably in healthcare where the business's solutions range from industry-leading mobile carts to wall mounted solutions that can be integrated with specific applications. The corporate office business vertical offers a sit-and-stand solution that retrofits to existing desks, alongside a height adjustable electric desk product line. These strong market offerings now benefit from a newly refined and repositioned brand promise, which resonates boldly with channel partners and end-users across all verticals. Finally, focus on growth in markets outside of North America and entry into new markets such as Industrial is expected to allow Ergotron to leverage existing and develop new products to satisfy market demands.

Measuring our performance

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[1] diluted earnings per share

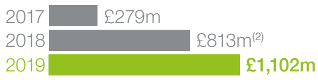
14.3 pence

Method of calculation
Group adjusted[1] profit after tax of continuing businesses, attributable to owners of the parent, during the year ended 31 December 2019, divided by the weighted average number of diluted ordinary shares in issue.

Strategic objective
To create consistent and long-term value for shareholders.

Adjusted[1] operating profit

£1,102m



Method of calculation
Adjusted[1] operating profit for the continuing businesses in existence during the year ended 31 December 2019.

Strategic objective
To improve profitability of Group operations.

Net debt to adjusted[1] EBITDA[3]

2.25x

Method of calculation
Net debt at average exchange rates divided by adjusted[1] EBITDA[3] 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.

Non-financial KPIs

Health and safety

Method of calculation
A variety of different health and safety KPIs are used by the businesses owned 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. Therefore, the larger the workforce, the more heavily such division's 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

0.13

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

0.23

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

Accident severity rate

18.23

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

The Nortek Global HVAC site in Montreal suffered a tragic fatality. Although the health and safety authorities provided their clearance, the affected business conducted an immediate and thorough internal investigation and wider audit, resulting in measures to ensure the workforce remains safe including a complete overhaul of its health and safety procedures. Within a week of the incident, the business convened a safety conference to conduct a comprehensive health and safety review, which included process safety management evaluations for all relevant operations across the business, and safety audits of powered industrial truck operations, confined space, work at elevated heights, machine guarding, control of hazardous materials and process safety management. The review resulted in the business redefining its safety policies to ensure they aligned with best practice, and the establishment of an Accident Review Board to investigate and recommend improvements.

In addition, regrettably, a separate fatality occurred at a plant in Zhoupu, China which, whilst not under GKN Automotive control, is managed locally by its joint venture partner SDS.

(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 39 and in the glossary to the financial statements on pages 191 to 195.
(2) Where appropriate comparative amounts have been restated to reflect the continuing operations only.
(3) Adjusted[1] operating profit before depreciation, and amortisation of computer software and development costs.

Adjusted[1] profit conversion to cash percentage

104%

Method of calculation

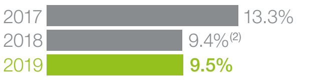
Percentage of adjusted[1] EBITDA[3] conversion to cash, as shown in the glossary to the financial statements, for continuing businesses in existence during the year ended 31 December 2019 pre-capital expenditure.

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[1] operating profit margin

9.5%



Method of calculation

Adjusted[1] operating profit as a percentage of adjusted[1] revenue, for the continuing businesses in existence during the year ended 31 December 2019.

Strategic objective

To improve profitability of Group operations.

Interest cover

10.8x

Method of calculation

Adjusted[1] EBITDA[3] of all businesses as a multiple of net 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

3.40 pence

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 pages 12 to 13.

In parallel with existing divisional initiatives, the Group's insurance brokers in the US conduct independent health and safety compliance audit reviews across the Group's US-based businesses. The audits assess for potential major and serious injuries and fatalities exposures such as machine guarding, manual material handling, forklift/powered industrial trucks, occupational health exposures including noise and chemical exposures, and confined spaces. Results vary by site and the insurers have reported that of the audits that they reviewed in 2019, the majority of material findings were addressed. 2019 represented the first full year of health and safety reporting for the GKN businesses under the Group reporting model. At the Board's request, the Group's insurance brokers are implementing a similar audit programme across the Group's non-US business activities, in close consultation with the HSE leads at GKN Aerospace, GKN Automotive and GKN Powder Metallurgy.

The Group's major accident frequency rate, accident frequency rate and accident severity rate have all decreased in 2019, representing positive improvement overall and high standards of health and safety performance across all businesses. The general trend of improvement reflects that continued investment in health and safety initiatives at the Nortek businesses has taken hold, having achieved two consecutive years of sustained improvement, and highlights a distinct culture shift during Melrose's stewardship since the Nortek businesses were acquired in 2016.

Whilst the GKN businesses demonstrated a general trajectory of improvement during the reporting period, the Board is conscious that further qualitative site health and safety reviews are required to audit the practices and culture that sits behind the statistics, much as the Board directed shortly after the acquisition of the Nortek businesses.

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_2 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 encouraging our businesses to run their operations with 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 2019 can be found within the ESG report on pages 58 to 62. The Group is required to disclose Greenhouse gas emissions data for the year ended 31 December 2019. Such data can be found within the ESG report on pages 60 to 61.

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 ESG report on pages 58 to 69.

Finance Director's review

The results for the year ended 31 December 2019 include the first full year of ownership of GKN. As a consequence, the results for the year are not directly comparable to 2018 as the prior year performance includes only eight months of GKN trading following its acquisition on 19 April 2018.

Geoffrey Martin
Group Finance Director

The comparative results in this Annual Report and financial statements have been restated to show: the results of Walterscheid Powertrain Group as discontinued following its disposal on 25 June 2019; the results of GKN Wheels & Structures as discontinued following its classification as an asset held for sale at 31 December 2019; the reclassification of the results of the Security & Smart Technology business from Nortek Air & Security to the Other Industrial division, following the Board's intention to consider strategic options for the Nortek Air Management business separate to the Nortek Security business; and to reflect the finalisation of the opening Balance Sheet review process for GKN.

Melrose Group results – continuing operations

Statutory results:

The statutory IFRS results are shown on the face of the Income Statement and show revenue of £10,967 million (2018: £8,152 million), an operating profit of £318 million (2018: loss of £387 million) and a profit before tax of £106 million (2018: loss of £542 million). The diluted earnings per share ("EPS"), calculated using the weighted average number of shares in issue during the year of 4,858 million (2018: 3,959 million), were 0.9 pence (2018: loss of 11.8 pence).

Adjusted results:

The adjusted results are also shown on the face of the Income Statement. They are adjusted to include the revenue and operating profit from equity accounted investments ("EAIs") and 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 the Group'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"). APMs used by the Group are defined in the glossary to the Annual Report and financial statements.

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 for the year ended 31 December 2019 show revenue of £11,592 million (2018: £8,645 million), an operating profit of £1,102 million (2018: £813 million) and a profit before tax of £889 million (2018: £672 million). Adjusted diluted EPS were 14.3 pence (2018: 12.7 pence).

Tables summarising the statutory results and adjusted results by reportable segment are shown later in this review.

The continuing results in 2019 included a positive impact of £81 million from utilising loss-making contract provisions as required under IAS 37: "Provisions, contingent liabilities and contingent assets", and identified during the opening Balance Sheet review process for GKN.

Reconciliation of statutory results to adjusted results

The following tables reconcile the Group statutory revenue and operating profit/(loss) to adjusted revenue and adjusted operating profit:

Continuing operations:	2019 £m	2018 £m
Statutory revenue	**10,967**	**8,152**
Adjusting item: Revenue from equity accounted investments ("EAIs")	625	493
Adjusted revenue	**11,592**	**8,645**

Adjusting revenue item:

The Group has a number of EAIs 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. During the year ended 31 December 2019, EAIs in the Group generated £625 million of revenue (2018: £493 million), 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 from these EAIs is included.

Continuing operations:	2019 £m	2018 £m
Statutory operating profit/(loss)	**318**	**(387)**
Adjusting items: Amortisation of intangible assets acquired in business combinations	534	391
Restructuring costs	238	229
Write down of asset value	179	152
Net release of fair value items	(153)	(20)
Currency movements in derivatives and movements in associated financial assets and liabilities	(55)	143
Disposal proceeds net of transaction related costs	(4)	153
Other	45	49
Reversal of uplift in value of inventory	–	103
Adjustments to statutory operating profit/(loss)	**784**	**1,200**
Adjusted operating profit	**1,102**	**813**

Adjusting items to operating profit are consistent with prior years and include:

The amortisation charge on intangible assets acquired in business combinations of £534 million (2018: £391 million), 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 excluded from adjusted results.

Restructuring and other associated costs in the year totalling £238 million (2018: £229 million), shown as adjusting items due to their size and non-trading nature and during the year ended 31 December 2019 included:

- A charge of £83 million (2018: £46 million) within the Automotive division including: costs associated with headcount reduction programmes addressing the high cost base inherited with the business and ensuring a more flexible structure; costs incurred closing two loss-making factories in the second half of the year; costs associated with further footprint consolidation opportunities; and costs incurred separating the Automotive business from other GKN businesses.
- A charge of £79 million (2018: £56 million) within the Aerospace division including: costs associated with initial headcount reductions following the commencement of a global integration process to create 'One Aerospace' and achieve a simpler, more competitive, customer-focused business; costs within the North America Aerostructures business relating to two factory closures; and costs relating to footprint rationalisation projects within the Special Technologies business.
- A charge of £19 million (2018: £11 million) within the Powder Metallurgy division including costs associated with headcount reductions and the commencement of footprint consolidation actions.
- A charge of £11 million (2018: £19 million) within Nortek Air Management primarily relating to continued factory consolidation within the HVAC business.
- A charge of £37 million (2018: £65 million) within Other Industrial businesses, predominantly relating to the closure of the Chinese manufacturing facility and switching to a third party contract manufacturing model in the Security & Smart Technology business. Restructuring charges also included the finalisation of the restructuring activities announced in Brush last year.
- A charge of £9 million (2018: £32 million) within central activities mainly relating to the separation of the GKN businesses.

An impairment charge of £179 million, booked in the first half of the year in respect of the Security & Smart Technology business, shown within the Other Industrial division, following a deterioration in performance and assumed future prospects. The impairment charge is shown as an adjusting item due to its non-trading nature and size, and has not changed in value in the second half of the year.

The net release of fair value items in the year of £153 million (2018: £20 million) where items have been resolved for more favourable amounts than first anticipated. During the year this included £122 million in respect of the release of loss-making contract provisions held within the GKN businesses, where either contractual terms have been renegotiated with the relevant customer or operational efficiencies have been identified and demonstrated for a sustained period. The net release of fair value items is shown as an adjusting item, avoiding positively distorting adjusted results.

Hedge accounting is not applied within the GKN businesses for transactional foreign exchange exposure. Consequently, for consistency and because of their volatility and size, the movements in the fair 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 in the GKN businesses, along with foreign exchange movements on the associated financial assets and liabilities are shown as an adjusting item. These movements totalled a credit of £55 million (2018: charge of £143 million) in the year.

A net acquisition and disposal related credit of £4 million (2018: charge of £153 million) including a profit on the sale of a small business and transaction costs in respect of acquisition and disposal activities. These items are excluded from adjusted results due to their non-trading nature.

Other adjusting items include the charge for the Melrose equity-settled Incentive Scheme, including its associated employer's tax charge, of £17 million (2018: £13 million) which is excluded from adjusted results due to its volatility; an adjustment of £28 million (2018: £25 million) to gross up the post-tax profits of EAIs to be consistent with the adjusted operating profits of subsidiaries within the Group; and in 2018, an £11 million past service cost in respect of gender equalisation of guaranteed minimum pensions for occupational pension schemes, which was shown as an adjusting item because of its non-trading and non-recurring nature.

In 2018, in accordance with IFRS 3, the value of finished goods and work in progress inventory acquired in the GKN business was required to be uplifted by £103 million. The impact on gross margin as the inventory was sold through in 2018 was shown as an adjusting item due to its size and non-recurring nature.

Finance Director's review

Continued

Statutory and adjusted results by reporting segment

The following table shows revenue split by reporting segment, including EAIs for adjusted revenue:

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air Mgmt. £m	Other Industrial £m	Total £m
Statutory revenue	**3,836**	**4,146**	**1,099**	**1,178**	**708**	**10,967**
Reconciling item:						
Revenue from EAIs	16	593	16	–	–	625
Adjusted revenue	**3,852**	**4,739**	**1,115**	**1,178**	**708**	**11,592**

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

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air Mgmt. £m	Other Industrial £m	Corporate £m	Total £m
Statutory operating profit/(loss)	**104**	**186**	**77**	**139**	**(170)**	**(18)**	**318**
Reconciling item:							
Adjusting items	305	181	40	36	256	(34)	784
Adjusted operating profit/(loss)	**409**	**367**	**117**	**175**	**86**	**(52)**	**1,102**

The performances of each of the reporting segments are discussed in the Chief Executive's Review. The adjusted operating costs in the corporate cost centre of £52 million (2018: £28 million) included £26 million (2018: £20 million) of Melrose corporate costs, £6 million (2018: £6 million) of the remaining GKN central costs and £20 million (2018: £2 million) of costs relating to divisional cash-based long-term incentive plans, mainly for GKN businesses in 2019.

Finance costs and income – continuing operations

Net finance costs in the year ended 31 December 2019 were £212 million (2018: £155 million), which included a credit of £1 million (2018: charge of £15 million) treated as adjusting items.

Adjusted finance costs:
The net adjusted finance costs for continuing operations in the year ended 31 December 2019 were £213 million (2018: £141 million), the year-on-year increase reflecting a full-year ownership of GKN.

Net interest on external bank loans, bonds, overdrafts and cash balances was £143 million (2018: £98 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 (2018: £11 million) amortisation charge relating to the arrangement costs of raising the Group's current bank facility; an interest charge on net pension liabilities of £31 million (2018: £21 million); a charge on lease liabilities of £21 million (2018: £nil) following the adoption of IFRS 16 on 1 January 2019, discussed later in this review; a charge for the unwind of discounting on long-term provisions of £7 million (2018: £10 million); and in the prior year £1 million relating to the interest charge in EAIs.

Adjusting items:
Adjusting items, within finance costs and income, include a credit of £1 million (2018: charge of £8 million) relating to the fair value changes on cross-currency swaps, and in the prior year included £7 million relating to the accelerated amortisation of 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.

Discontinued operations

Discontinued operations include the results of Walterscheid Powertrain Group up to the date of disposal on 25 June 2019 and the full year result of the GKN Wheels & Structures business which was classified as held for sale at 31 December 2019. For the year ended 31 December 2019 discontinued operations show revenue of £423 million (2018: £453 million), a statutory operating loss of £80 million (2018: £5 million) and a statutory loss before tax of £82 million (2018: £8 million).

Walterscheid Powertrain Group was sold to One Equity Partners, a US-based private equity firm, for cash consideration of £185 million, less costs charged in the year of £7 million. Retirement benefit obligations of £155 million were disposed with the business and the loss on disposal was £21 million after the recycling of cumulative translation differences of £13 million.

At 31 December 2019 negotiations are ongoing with potential buyers for the GKN Wheels & Structures business, which made a small adjusted operating loss in the year. It is the Board's strategic priority to dispose of this business within the next 12 months, and as such the value of the business has been remeasured on a fair value less costs to sell basis. Consequently, a charge of £64 million is included in the discontinued operations operating loss in the year.

Tax – continuing operations

The statutory results show a tax charge of £51 million (2018: credit of £75 million) which arises on a statutory profit before tax of £106 million (2018: loss of £542 million), a statutory tax rate of 48% (2018: 14%). This rate is higher 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 2019 was 21.4% (2018: 23.1%).

The Group has tax losses and other deferred tax assets with a value of £819 million (31 December 2018: £885 million). These are offset by deferred tax liabilities on intangible assets of £1,243 million (31 December 2018: £1,450 million) and £188 million (31 December 2018: £177 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 2019 was £117 million (2018: £68 million) representing 13% (2018: 10%) of adjusted profit before tax. This was lower than the effective tax rate on adjusted profit before tax because the Group benefits from certain adjusting items being tax allowable and from existing tax losses and other deferred tax assets brought forward.

IFRS 3 "Business Combinations"

In the first half of the year, the opening Balance Sheet review of GKN assets, liabilities and accounting policies was finalised and as a result the Balance Sheet at 31 December 2018 was restated, increasing goodwill by £6 million, intangible assets by £21 million, provisions and trade and other payables by £10 million and decreasing deferred tax assets by £17 million. These items remain unchanged since the half year.

Adoption of IFRS 16 "Leases"

IFRS 16 was adopted on 1 January 2019 and required operating leases to be recognised on the Balance Sheet. Previously only finance leases were recognised on the Balance Sheet and costs associated with operating leases expensed through the Income Statement as incurred.

The impact of IFRS 16, on transition, was to recognise a lease liability of £589 million with a corresponding right-of-use fixed asset in the Balance Sheet, which offset each other. The impact of IFRS 16 on the Income Statement for continuing operations in the year was to increase finance costs by £21 million, but this was broadly offset by an associated increase in operating profit. In addition, £72 million of costs have been reclassified from lease expense to depreciation in continuing operations.

Leverage calculations in the Group's banking agreements exclude lease obligations from the definition of net debt. Similarly, for bank covenant purposes only, they exclude the depreciation on right-of-use assets from the definition of EBITDA, by including a lease charge in the calculation of EBITDA.

Cash generation and management

Group net debt at 31 December 2019, translated at closing exchange rates (for 2019 being US$1.33 and €1.18), was £3,283 million (31 December 2018: £3,482 million). For bank covenant purposes the Group's net debt is calculated using average exchange rates for the previous 12 months, to better align the calculation with the currency rates used to calculate profits, and adjusted operating profit before depreciation and amortisation ("EBITDA") is adjusted for leases and EAIs. The Group net debt leverage for bank covenant purposes at 31 December 2019 was 2.25x EBITDA (31 December 2018: 2.28x).

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

Movement in Group net debt	2019 £m	2018 £m
At 1 January	**(3,482)**	**(572)**
GKN acquisition related net debt movements	–	(2,841)
Adjusted net debt brought forward	**(3,482)**	**(3,413)**
Non-trading items and discontinued operations:		
Net cash flow from disposal and acquisition related activities	103	(26)
Dividend paid to Melrose shareholders	(231)	(129)
Foreign exchange and other non-cash movements	74	(110)
Discontinued operations	(37)	29
Cash flow from non-trading items and discontinued operations	**(91)**	**(236)**
Free cash flow from continuing operations	290	167
At 31 December at closing exchange rates	**(3,283)**	**(3,482)**
At 31 December at 12-month average exchange rates	**(3,385)**	**(3,407)**

An analysis of the free cash flow is shown in the table below. The comparative period includes GKN for 8 months following the acquisition:

	2019 £m	2018 £m
Adjusted operating cash flow	**1,441**	**868**
Net capital expenditure	(495)	(345)
Net interest and net tax paid	(295)	(174)
Defined benefit pension contributions – ongoing	(72)	(43)
Dividend income from EAIs	67	66
Net other	(55)	(36)
Adjusted free cash flow	**591**	**336**
Restructuring costs	(190)	(113)
Defined benefit pension – special contributions	(111)	(56)
Free cash flow from continuing operations	290	167

The adjusted operating profit conversion to cash for the year ended 31 December 2019 was 104% (2018: 90%). Net trade working capital in the Group was reduced by £95 million, building momentum towards achieving the previously announced £400 million target for GKN.

Net capital expenditure in the year was £495 million (2018: £345 million), representing 1.2x depreciation on non-leased assets. Net interest paid in the year was £178 million (2018: £106 million) and tax paid was £117 million (2018: £68 million).

Adjusted free cash flow of £591 million (2018: £336 million), is 72% higher than the annualised adjusted free cash flow for 2018, due to improved Group cash flow processes. Adjusted free cash flow is shown before restructuring and special pension contributions, which included: £94 million (2018: £56 million), being the completion of the Melrose commitment to contribute £150 million to the GKN UK 2012 and 2016 plans within the first 12 months of GKN ownership; and before a contribution of £17 million, being 10% of the net proceeds received from the disposal of Walterscheid Powertrain Group.

Free cash flow from continuing operations in the year, after all costs, was £290 million (2018: £167 million).

Assets and liabilities

The summarised Melrose Group assets and liabilities are shown below:

	2019 £m	2018 £m
Goodwill and intangible assets acquired with business combinations	9,342	10,618
Tangible fixed assets, computer software and development costs	3,874	3,651
Equity accounted investments	436	492
Net working capital	821	976
Retirement benefit obligations	(1,121)	(1,413)
Provisions	(1,087)	(1,471)
Deferred tax and current tax	(698)	(805)
Lease obligations	(582)	(57)
Net other	(151)	(248)
Total	**10,834**	**11,743**

These assets and liabilities are funded by:

	2019 £m	2018 £m
Net debt	(3,283)	(3,482)
Equity	(7,551)	(8,261)
Total	**(10,834)**	**(11,743)**

Finance Director's review

Continued

Goodwill, intangible assets and impairment review

The total value of goodwill as at 31 December 2019 was £3,653 million (31 December 2018: £4,058 million) and intangible assets acquired with business combinations was £5,689 million (31 December 2018: £6,560 million). These items are split by reporting segment as follows:

31 December 2019	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air Mgmt. £m	Other Industrial £m	Total £m
Goodwill	941	1,027	503	592	590	3,653
Intangible assets acquired with business combinations	3,076	1,293	653	346	321	5,689
Total goodwill and intangible assets	**4,017**	**2,320**	**1,156**	**938**	**911**	**9,342**

The goodwill and intangible assets have been tested for impairment as at 31 December 2019. 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.

A full impairment review was performed on the Security & Smart Technology group of CGUs in the first half of the year, which assumed that US tariffs at the higher rate would remain in place, and resulted in an impairment charge of £179 million, shown within adjusting items. This impairment charge has not changed in the second half of the year.

The GKN businesses were acquired and recorded at fair value on 19 April 2018 and subsequently there has been a global automotive market decline, naturally reducing the headroom at this point in the cycle when testing goodwill and intangible assets in respect of the Automotive and Powder Metallurgy businesses.

The Board is comfortable that no impairment is required in respect of the goodwill and intangible assets of these businesses at 31 December 2019.

Provisions

Total provisions at 31 December 2019 were £1,087 million (31 December 2018: £1,471 million).

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

	Total £m
At 1 January 2019	**1,471**
Spend against provisions	(342)
Net charge to adjusted operating profit	92
Net charge shown as adjusting items	158
Release of loss-making contract provision to adjusting items	(122)
Utilisation of loss-making contract provision	(83)
Other (including foreign exchange)	(87)
At 31 December 2019	**1,087**

The net charge to adjusted operating profit in the year of £92 million includes £20 million in respect of certain divisional long-term incentive plans to be paid in future years, and the remainder is primarily in respect of warranty, product liability and workers' compensation charges which are matched by similar cash payments in the year.

The net charge shown as adjusting items in the Income Statement primarily includes costs associated with restructuring actions of £193 million, discussed within the adjusting items section of this review, net of a release of £35 million, mainly relating to fair value items settled for an amount favourable to first anticipated.

The utilisation of the loss-making contract provision was £83 million, of which £2 million is included in discontinued operations. Furthermore, £122 million, approximately 25%, of the remaining loss-making contract provision was released as an adjusting item in the year, either because contracts have been favourably resolved following positive negotiations with customers or because operational efficiencies have been demonstrated for a sustained period of time.

During the period £190 million of cash was spent on restructuring.

Included within other movements are foreign exchange changes, the unwind of discounting on certain provisions, the reclassification of surplus property lease provisions following the adoption of IFRS 16 and provisions either disposed or transferred to held for sale.

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".

The values of the Group plans were updated at 31 December 2019 by independent actuaries to reflect the latest key assumptions. A summary of the assumptions used are shown in note 24 of the financial statements.

At 31 December 2019 total plan assets of the Melrose Group's defined benefit pension plans were £3,412 million (31 December 2018: £3,273 million) and total plan liabilities were £4,533 million (31 December 2018: £4,686 million), a net deficit of £1,121 million (31 December 2018: £1,413 million).

The most significant pension plan in the Group at the beginning of the year was the GKN UK 2012 plan, when gross assets were £2,007 million, gross liabilities were £2,613 million and the net deficit was £606 million. On 1 July 2019 the GKN UK 2012 pension plan was separated into four pension plans, namely the GKN Group Pension Schemes (Numbers 1-4), two of which were allocated to the Aerospace division and two to the Automotive division. In total these four pension plans had aggregate gross assets of £2,243 million, gross liabilities of £2,711 million and a net deficit of £468 million at 31 December 2019. No changes to members' benefits were made on separation of the plans.

The GKN Group Pension Schemes (Numbers 1-4) are closed to new members and to the accrual of future benefits for current members.

The Group has fulfilled its commitment to contribute special one-off payments to the GKN UK plans totalling £150 million in the first 12 months of ownership of GKN, and is also making ongoing annual contributions of £60 million. In addition, the Group paid £17 million into the GKN UK plans following the disposal of Walterscheid Powertrain Group, in line with the commitment to contribute 10% of the net proceeds from disposal of GKN businesses (other than Powder Metallurgy) and 5% of the net proceeds from disposal of non-GKN businesses. The Group has committed to contribute £270 million to the GKN UK plans when Powder Metallurgy is disposed. These commitments cease when the funding target, which has been agreed with the trustees, is achieved, being gilts plus 25 basis points for the GKN UK 2016 plan and gilts plus 75 basis points for the GKN Group Pension Schemes (Numbers 1-4).

The disposal of Walterscheid Powertrain Group, the buyout of the Broan Aftermarket North America, Inc. Group Pension Plan and some members voluntarily choosing to leave certain pension plans, resulted in Group gross pension liabilities reducing by approximately £400 million in the year.

In total, ongoing contributions to the Group defined benefit pension plans and post-employment medical plans are expected to be approximately £105 million in 2020.

It is noted that a 0.1 percentage point decrease in the discount rate would increase the retirement benefit accounting liabilities of the Group, on an IAS 19 basis, by £78 million, or 2%, and a 0.1 percentage point increase to inflation would increase the liabilities by £59 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 £186 million, or 4%.

Financial risk management

The financial risks the Group faces have been considered 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 2019 was £3,283 million (31 December 2018: £3,482 million). Core funding comes from a mix of committed bank funding and capital market borrowings.

Committed bank funding consists of a multi-currency term loan denominated £100 million and US$960 million that matures in April 2021 and a multi-currency revolving credit facility, denominated £1.1 billion, US$2.0 billion and €0.5 billion that matures in January 2023.

The term loan was amended on 31 December 2019, on the same financial terms, to provide Melrose with the option at its request to extend the loan for a further three years to April 2024, if required. Loans drawn under this facility are guaranteed by Melrose Industries PLC and certain of its subsidiaries, but there is no security over any of the Melrose assets in respect of this facility. As at 31 December 2019, the term loan was fully drawn.

There remains a significant amount of headroom on the multi-currency committed revolving credit facility at 31 December 2019. Applying the exchange rates at 31 December 2019, the headroom equated to £1,136 million.

At the start of the year the Group held three capital market borrowings, inherited as part of the GKN acquisition, totalling £1.1 billion. During October 2019, one of these bonds reached maturity and the revolving credit facility was utilised to repay the notional amount of £350 million, together with the associated cross-currency swap, which was out of the money by £100 million. Capital market borrowings as at 31 December 2019 consist of:

Maturity date	Notional amount £m	Coupon % p.a.	Cross-currency swaps million	Interest rate on swaps % p.a.
September 2022	450	5.375%	US$373	5.70%
			€284	3.87%
May 2032	300	4.625%	n/a	n/a

To simplify the corporate reporting requirements of the Group, the bonds were transferred to the Professional Securities Market in March 2019 with the approval of the bondholders. The bondholders now have the same guarantees from the Melrose Group companies as those provided to the banks within the committed bank facility.

Cash, deposits and marketable securities amounted to £317 million at 31 December 2019 (31 December 2018: £415 million) and are offset to arrive at the Group net debt position of £3,283 million (31 December 2018: £3,482 million). The Board takes careful consideration of counterparty risk with banks when deciding where to place cash on deposit. The combination of this cash and the headroom on the revolving credit facility allows the Directors to consider that the Group has sufficient access to liquidity for its current needs.

The committed bank funding 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 2019 it was 2.25x (31 December 2018: 2.28x), showing sufficient headroom compared to the covenant test.

The interest cover covenant is set at 4.0x throughout the life of the facility and was 10.8x at 31 December 2019 (31 December 2018: 11.6x), affording comfortable headroom compared to the covenant test.

There are also a number of uncommitted facilities made available to the Group which include a small number of uncommitted working capital programmes, which predominately 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.

A limited number of Group trade receivables are subject to non-recourse factoring and customer supply chain finance arrangements. As at 31 December 2019, these amounted to £200 million (31 December 2018: £206 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 2019 the margin was 1.4% (31 December 2018: 1.4%) on the term loan and 1.65% (31 December 2018: 1.65%) on the revolving credit facility.

In addition to the cross-currency swaps associated with the fixed rate capital market borrowings, inherited as part of the GKN acquisition, the Group holds interest rate swap instruments to fix the cost of LIBOR on borrowings under the bank facility. The policy of the Board is to fix approximately 70% of the interest rate exposure of the Group. 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.

During the year, cross-currency swaps were also used to convert US Dollar bank debt into Euro borrowings and at 31 December 2019, US$620 million had been swapped into €559 million. These swaps are rolled on a monthly basis and help to reduce the cost of the Group's borrowings.

At 31 December 2019, the fair value liability of all cross-currency swaps held by the Group was £80 million (31 December 2018: £199 million).

The average cost of the debt for the Group is expected to be approximately 3.7% 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 Group's 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 relevant business. The Group's policy is to review transactional foreign exchange exposures, and place necessary hedging contracts, quarterly on a rolling basis. To the extent the cash flows associated with a transactional foreign exchange risk are committed, the Group will hedge 100% at the time the cash flow becomes committed. For forecast and variable cash flows, the Group 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 longer-term nature of the contracts within these divisions. Typically, in total the Group hedges around 90% of foreign exchange exposures expected over the next 12 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.

Finance Director's review
Continued

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, until foreign currency is subsequently converted to Sterling. However, the Group utilises its multi-currency revolving credit facility and cross-currency swaps, where relevant, to maintain an appropriate mix of debt in each currency. 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 Sterling dividend or Capital Return to shareholders. Protection against this risk is considered on a case by case basis and, if appropriate, hedged at the time.

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

	12-month average rate	8-month average (GKN businesses)	Closing rate
US Dollar			
2019	1.28	n/a	1.33
2018	1.33	1.31	1.27
Euro			
2019	1.14	n/a	1.18
2018	1.13	1.13	1.11

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

£m	USD	EUR	CNY	Other
Movement in adjusted operating profit	68	26	9	15
% impact on adjusted operating profit	6%	2%	1%	1%

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

A 10 percent strengthening in either the US Dollar or Euro would have the following impact on net debt as at 31 December 2019:

	USD	EUR
Increase in debt – £ million	204	75
Increase in debt	6%	2%

Contract and warranty risk management
Under Melrose management a suitable 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 cost risk management
The cumulative expenditure on commodities is important to the Group and 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 certain 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. Occasionally, businesses within the Group enter financial instruments on commodities when this is considered to be the most efficient way of protecting against price movements.

UK's relationship with the European Union
The UK left the European Union on 31 January 2020 and the transition period to agree a trade deal is due to run until 31 December 2020, meaning the shape of the future relationship beyond this date remains unclear. Due to the Group's geographically balanced manufacturing footprint, on a micro company level, any resulting tariffs and/or customs clearance would not have a material negative effect on the Group as a whole.

Sales of product between the UK and Europe are a relatively small proportion 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 7%.

On a wider macro global level, the Group's financial results may be impacted by general uncertainty and economic instability arising from the transition period, or from any wider supply-chain disruption causing scheduling issues for customers or suppliers. Depending on the outcome of the trade negotiation, 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, however transactional exposures are generally well protected in the short term due to approximately 60% to 80% of exposures being hedged over the next two years.

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

Post balance sheet event
On 2 January 2020 GKN Powder Metallurgy completed the acquisition of FORECAST 3D, a leading US specialist in plastic additive manufacturing and 3D printing services offering a full range of services from concept to series production, for a total consideration of up to £29 million, of which £20 million was paid on 2 January 2020. The acquisition furthers GKN Powder Metallurgy's ambition to achieve global market leadership in industrialising additive manufacturing. In the year ended 31 December 2019 FORECAST 3D achieved sales of approximately £17 million.

Going concern
The 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 Annual Report includes details of the 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 Group has a strong record of cash management, and, as a consequence, the Directors believe that the Group is well placed to manage its business risks successfully taking into account the various macro headwinds and the general economic environment.

After making enquiries, the Directors have a reasonable expectation that the 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
5 March 2020

Longer-term viability statement

In accordance with provision 30 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 2022.

The Directors' assessment has been made by reference to the Group's financial position as at 31 December 2019, 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)[(1)], 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 consider 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.

(1) 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 48 to 55.

Risk management

The Board recognises that operating in a dynamic and rapidly evolving commercial environment requires a pragmatic, robust 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.

Board Overall responsibility for risk management	• Agrees the Group's risk management strategy and defines its risk appetite • Reviews reports and recommendations from the Melrose senior management team and the Audit Committee on risk governance and risk processes and controls • Determines the nature and extent of the Group's principal risks and regularly discusses and assesses them throughout the year with the Melrose senior management team to determine the likelihood of those risks materialising and how they should be managed or mitigated • Maintains oversight of principal risks and mitigation plans including cyber security and fraud risk • Promotes an appropriate risk management culture and rewards system within the Group in order to maintain sound risk management and internal control systems
Audit Committee Monitors the Group's internal financial control processes	• Monitors, oversees and reviews the effectiveness of the Group's internal controls and risk management systems and processes • Supports the Board in monitoring risk exposure against risk appetite
Melrose senior management and business unit senior managers	• Set the risk management processes and controls • Agrees how the principal risks should be managed or mitigated to reduce the likelihood of their incidence or impact • Considers actual and emerging risks • Oversees and challenges risk mitigation plans and supports the legal and compliance teams within the business units
Operational managers and financial controllers	• Risk identification, assessment and monitoring at the business unit level • Implementing, reviewing and continually monitoring compliance with risk mitigation plans and controls • Embedding risk awareness and culture throughout the business

Top down
At the Group level, risk oversight and assessment

Bottom up
Risk exposure identification and assessment at the business unit level

The Board's view of the Group's principal risks and uncertainties is detailed in the table on pages 48 to 55.

Risk management strategy and framework
The objectives of the Directors and Melrose senior management include safeguarding and increasing the value of the businesses and assets of the Group for stakeholders as a whole. Achievement of these objectives requires the development of policies and appropriate internal control frameworks to ensure the Group's resources are managed properly, and for key risks to be 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 this 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" and the UK Corporate Governance Code (the "Code").

The Audit Committee monitors, oversees and reviews 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 page 86.

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 Group risk management

Risk management framework

Identification	Evaluation	Mitigation	Analysis	Review and monitoring
Financial and non-financial risks recorded in controlled risk registers	Risk exposure reviewed and risks prioritised	Risk owners identified and action plans implemented	Risks analysed for impact and probability to determine gross exposure	Robust mitigation strategy subject to regular and rigorous review

framework and internal control systems determined by the Board. The Melrose senior management team sets 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 Audit Committee on an annual basis.

During the year under review, in accordance with provisions 28 and 29 of the Code, the Board continued to monitor the effectiveness of the Group's risk management and internal control systems. The Board concluded that the Group's risk management and internal control systems and processes were operating effectively. Follow-up actions in respect of progress and improvement in relation to financial controls are further discussed in the Audit Committee report.

Following the programme of site visits and the detailed workplan employed to identify the fair value of the operational assets and liabilities of the GKN businesses during 2018, in 2019 the Melrose senior management team continued to assess the impact of the resultant findings on the Group's principal risks and internal control and risk management systems. In 2019, the Melrose senior management team enhanced the monitoring, mapping, reporting and aggregation of the Group's risk management performance by building and implementing an intelligent, interactive, data-driven Group reporting dashboard to automate the aggregation and reporting of Group risks identified from the diligence efforts and site visits undertaken to prepare the GKN opening Balance Sheet during 2018, in conjunction with ongoing divisional risk reporting and advice from external risk management consultants to provide objective independent trend analysis. This marks a significant step forward in the Group's journey towards enhancing both divisional management's risk reporting transparency, and the Board's visibility of the Group's principal risks, to enable an increasingly robust assessment of each business's risk profile and their impact on the Group risk profile as a whole. The dashboard provides the Audit Committee with objective trend analysis and data aggregation to facilitate their monitoring, oversight and review of the effectiveness of the Group's internal controls and risk management systems and processes.

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 risks, with a balanced appetite towards operational and commercial risk, and macroeconomic 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 risk and information technology cyber risk.

The results of the risk appetite review will support the Board's decision-making processes during 2020. The Board undertakes a review of its risk appetite at least annually.

Risk management actions

During 2019, the Board continued to deliver on the key management priorities identified in the 2017 review across the Group and in the 2018 review across the GKN businesses. In 2019, the Group's governance framework was refreshed and the risk management reporting platform underwent a wholesale review, in line with our ongoing continuous improvement of enterprise risk management across the Group. 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;
- continuing to enhance Melrose risk register methods and risk profile mapping application throughout the Group. 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;
- reviewing and improving the Group's processes, data extraction and consolidation, and trend analysis around the assessment of principal risks and the ongoing monitoring and reporting of the Group's risk management performance; and
- transitioning the GKN businesses out of their previous IT governance model and establishing a regular quarterly IT governance assessment for all sites across the Group to enable clarity and consistency in the assessment of IT and cyber matters that are appropriate for the stage and sophistication of the GKN businesses.

Assessment of principal risks

During the year the Board undertook a robust, in-depth and comprehensive assessment of the emerging and 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 48 to 55. Further information detailing the internal control and risk management policies and procedures operated within the Group is shown on pages 80 to 81 of the Corporate Governance report.

Risk management priorities for 2020

Continual improvements were made during 2019 in respect of the Group's risk management processes. However, the Board recognises that Melrose cannot be complacent. In 2020, management will continue to focus on refining the risk management framework and further embedding a culture of effective risk management across the Group to ensure that risks and opportunities are identified and managed, to support the delivery of long-term value creation.

Further resources will continue to be devoted to strengthening the mechanisms for providing independent assurance and objective trend analysis on the effectiveness of the Group's risk management governance, processes and controls. IT cyber risk reporting will continue to be strengthened, and external cyber security advisors will be engaged to review findings from the ongoing internal assessments, validate results, and enable an additional layer of objective review to bolster the Group's identification of emerging cyber risks, and deployment of appropriate mitigation actions.

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, 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, which is continually reviewed and adapted where necessary to reflect the risk profile of the 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 aggregated into an interactive data-driven dashboard reporting tool, to facilitate review by the Melrose senior management team, the Audit Committee and the 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.

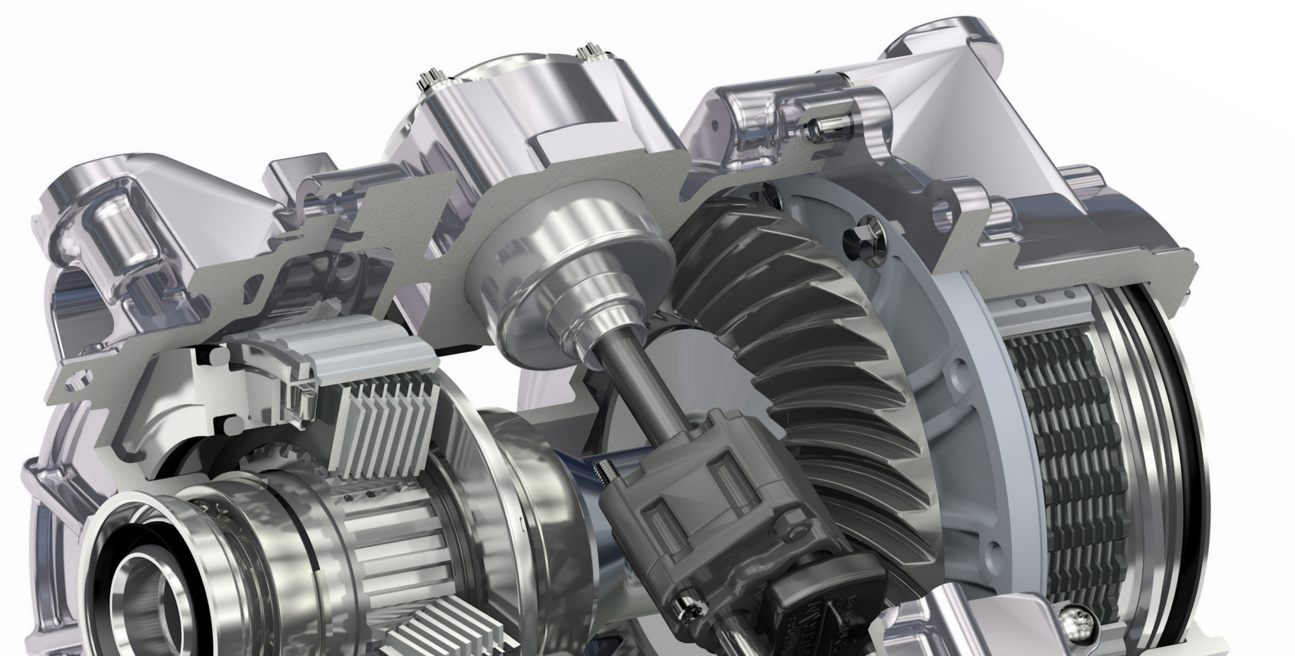
No.	Risk rating	Risk title	Risk trend since last Annual Report
1	Moderate	Acquisition of new businesses and improvement strategies	Decrease
2	Moderate	Timing of disposals	No change
3	Moderate	Economic and political	Increase
4	Moderate	Commercial	No change
5	Moderate	Loss of key management and capabilities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

Risk rating

Moderate impact

Likelihood

Unlikely -------------------> Likely



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(1)
Risk trend	↓

Trend commentary
Following the acquisition of GKN in 2018, the Group remains focused principally on improvement. Whilst no large acquisitions were made in 2019 relative to the 2018 GKN acquisition, some small bolt-on acquisitions were made by certain businesses and are expected to improve those businesses.

Strategic priorities Buy Improve

(1) Comprises executive Directors and Melrose senior management.

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 macro-economic factors. Depending on the timings of disposals and nature of the 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.

Responsibility	Executive management(1)
Risk trend	→

Trend commentary
Although global M&A markets continue to experience some uncertainty there remain opportunities for value realisation. Some non-core businesses were placed under strategic review during 2019. However, management continue to remain disciplined and there is no obligation to sell before it is appropriate to do so.

Strategic priorities Sell

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 continued headwinds in the automotive sector and a continued slowdown in US new-build residential housing markets, 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 and financial condition, and could have significant impact on the 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.

Since the period under review, the UK left the EU on 31 January 2020. There continues to be uncertainty in the UK regarding the nature of the UK's future trading relationship with the EU and other international trading partners with which the UK intends to establish new terms on which to trade, and what this will mean for business and the UK economy following expiry of the initial Brexit transition period on 31 December 2020. Whilst the long-term impact of 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.

A significant amount of the Group's revenue is generated from operations located in North America, which this year has continued to (i) experience challenging tariffs relating to the US/China trade war; and (ii) require close monitoring of the expected short to medium-term impact of potential changes to international trading relationships following Brexit. The Group's exposure to these factors as a whole has been inherently mitigated since acquiring GKN, which created a more geographically balanced manufacturing footprint, and resulted in a larger proportion of the Group's revenue being generated from the UK and European-based GKN Aerospace and GKN Automotive divisions. Further, the Group's businesses operating in North America continue to take regular specific actions to mitigate the impact of new relevant North American tariffs and changes to international trading regulations by engaging with the relevant authorities prior to and after any such changes are implemented.

Since the period under review, the potential rapid spreading of COVID-19 has become a significant emerging risk to the global economy. The Board continues to monitor the impact of the virus on the Group as more information about the epidemic emerges, with particular focus on the potential for staff shortages and production delays that could arise and potentially affect Group businesses' China-based operations and their supply chains, as well as monitoring how other operations around the world could become affected depending on the extent to which the virus spreads outside of China.

(1) Comprises executive Directors and Melrose senior management.

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 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 possible terms on which the UK fully departs from the EU.
- 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 if a 'No Deal' Brexit emerges when the initial transition period expires.
- The Group remains agile, diversified and well positioned to deal with any short-term uncertainty in the UK.

Responsibility	Executive management(1)
Risk trend	↑

Trend commentary
Geopolitical uncertainty continued during 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 Melrose senior management team continues to actively engage with the executive teams of each division to track the potential impacts of Brexit and imposition of future expected tariffs, engage actively with those who are working on the impact assessments and mitigation actions, and report the material findings to the Board. Melrose senior management team monitors key issues with the divisional management teams including the impact of geopolitical uncertainty on order books, cash generation, legal and regulatory threats and other key operational and commercial indicators, to ensure the Group and each of its businesses can respond appropriately to adverse trading conditions. Tactics for mitigating the potential impact of geopolitical uncertainty include identifying cost reduction and operational efficiency measures.

Strategic priorities Buy Improve Sell

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. The Melrose senior management team monitors the aggregated impact of such risks and provide active support and challenge to the divisional management teams in fulfilling their responsibilities.

Common commercial risk areas that potentially affect a large proportion of the Group's businesses include those related to production quality assurance, health and safety performance, customer concentration and uncertainties related to future customer demand, onerous customer and supplier contracts, 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 (the "Common Commercial Risks").

Mitigation
- The Group continued to actively invest in research and development activities in 2019 to augment its platforms for future product expansion, quality improvements, customer alignment and achieving further production efficiencies. Details about some of the Group's research and development activities are provided in the ESG report on pages 58 to 69.
- 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 in the non-financial KPIs on pages 36 and 37 and in the ESG report on page 65.
- Since acquiring GKN, the Melrose senior management team has actively engaged with and supported the GKN businesses' divisional management teams in identifying embedded contractual and business conduct risks relating to key supply chain and production programme partners. Those management teams have continued to implement and direct a series of operational change management programmes to mitigate the risks they have identified.
- The Melrose senior management team, in collaboration with Ernst & Young, enhanced the Board and Audit Committee's visibility of the Group's Common Commercial Risks during 2019 by building and implementing an intelligent, data-driven Group reporting dashboard to automate the aggregation and reporting of numerous Common Commercial Risks across each of the Group's divisions, including those identified from the diligence efforts and site visits undertaken to prepare the GKN opening Balance Sheet during 2018, and ongoing divisional risk reporting.

Responsibility Executive management[(1)]

Risk trend

Trend commentary
The Melrose senior management team actively engages 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 end-markets where customer and/or competitor concentration is high and heavier reliance is placed on supply chain efficiency and programme partner management. The divisional CEOs report material updates directly to members of the Melrose senior management team which maintains a number of contact points throughout the Group to increase awareness. The Group continued to actively invest in research and development initiatives during 2019 to augment its platforms for future expansion, to benefit product quality improvements and increased customer alignment, and to achieve further production efficiencies.

Strategic priorities Improve

(1) Comprises executive Directors and Melrose senior management.

Risks and Uncertainties

Continued

Operational risks continued

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 Group 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 via the Melrose senior management team.
- 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(1)
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, will remain an area of particular management focus in 2020.

Strategic priorities Buy Improve Sell

(1) Comprises executive Directors and Melrose senior management.

Compliance and ethical risks

Risk 6

Legal, regulatory and environmental

Description and impact

Considering the breadth, scale and complexity of the Group, there is a risk that the Group may not always be in complete compliance with laws, regulations or permits. The Group could be held responsible for liabilities and consequences arising from (i) past or future environmental damage, including potentially significant remedial costs; (ii) employee matters including liability for employee accidents in the workplace or consequences of environmental liabilities, which may be susceptible to class action law suits, particularly but not exclusively with respect to Group businesses operating in North America; (iii) restrictions arising from economic sanctions, export controls and customs, which can result in fines, criminal penalties, adverse publicity, payment of back duties and suspension or revocation of the Melrose Group's import or export privileges; and (iv) product liability claims, which can result in significant total liability or remedial costs, particularly for products supplied to large volume global production programmes spanning multiple years, for example in the aerospace and automotive industries, or to consumer end-markets for example in the air management industry. 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 may impact our business strategy.

Mitigation

- Regular monitoring of legal and regulatory matters at both a Group and business unit level. Consultation with external advisors where necessary.
- Group-wide standard and enhanced application to trade authorisation procedures are in place and regularly reviewed against the ever-changing global trade compliance landscape, supported by access to external trade compliance legal and regulatory specialists and electronic counterparty screening systems.
- Our businesses are validated and certified in respect of quality management, environmental management and health and safety with the appropriate bodies including ISO and BS OHSAS, where relevant to their operations. The Group's businesses are either already compliant with or working towards timely compliance with new and upcoming standards. This includes Group businesses that are currently certified to BS OHSAS 18001 and are actively driving towards full transition to ISO 45001:2018.

- 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 and the Group's insurers are instructed to carry out external audits of specified areas of legal and compliance risk including health and safety.

Responsibility	Executive management(1)
Risk trend	

Trend commentary
Each business has a fully developed legal function, headed by their respective General Counsel reporting to their executive management team, and are properly staffed and supported by external advisors where necessary or helpful to ensure ongoing compliance in the jurisdictions in which they operate across the globe. This is augmented by central oversight from the Melrose legal team and robust annual reviews to ensure it has a strong legal and compliance framework and considers the risk to be consistent with prior years.

Strategic priorities Improve

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 remains high due to the scale, complexity and public-facing nature of the Melrose Group. 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 defense 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 mitigation measures are in place for the Group.
- In 2019, Melrose completed the deployment of its information security strategy and risk-based governance framework to all businesses within the Group. The framework follows the UK Government's recommended steps on cyber security. This strategy has enabled risk profiling and mitigation plans to be developed for each business to mitigate and reduce their exposure to cyber risk.
- As part of Melrose's overall information security strategy, IT Security awareness training was deployed to all Melrose businesses.
- The progress of each business is measured against the information security strategy and is monitored on a quarterly basis.

Responsibility	Executive management(1)
Risk trend	

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 companies to monitor, improve and refine its Group-wide strategy to aid the prevention, identification and mitigation of any threats.

Strategic priorities Improve

(1) Comprises executive Directors and Melrose senior management.

Risks and Uncertainties

Continued

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 the 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.

Responsibility	Executive management(1)
Risk trend	→

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 38 to 44.

Strategic priorities Buy Improve Sell

(1) Comprises executive Directors and Melrose senior management.

Risk 9
Pensions

Description and impact

Any shortfall in the Group's defined benefit pension schemes may require additional funding. As at 31 December 2019, the Group's pension schemes had an aggregate deficit, on an accounting basis, of £1,121 million (2018: £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 UK defined benefit pension 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.
- On 1 July 2019 the large UK GKN defined benefit pension scheme was split into four new schemes, two of which have been allocated to GKN Aerospace and two to GKN Automotive, in order to more appropriately balance liabilities across supporting businesses.

Responsibility	Executive management(1)
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 remains significant. During the period, gross liabilities were reduced as a result of people leaving group schemes on the sale of their employer company, voluntarily or through an insurance buy-out, which together with contributions of £185 million (including the balance of the initial £150 million funding commitment to the GKN schemes) and the better hedging of interest and inflation risks decreased both the overall liability and volatility risk to the Group.

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 38 to 44, the Group has term loans of US$960 million and £100 million and revolving credit facilities comprising US$2.0 billion, €0.5 billion and £1.1 billion.

In addition, the GKN net debt at acquisition included capital market borrowings across three unsecured bonds that totalled £1.1 billion. Two of these bonds – totalling £750 million – remain outstanding as at 31 December 2019 and further detail is provided in the Finance Director's review on pages 38 to 44.

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 gained agreement from its lenders to a three-year extension, at the Group's option to be built into its multi-currency term loan denominated £100 million and US$960 million, exercisable at any time prior to 1 April 2021 that would extend the maturity date of the loan to April 2024.
- 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(1)

Risk trend

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

Strategic priorities Buy Improve

(1) Comprises executive Directors and Melrose senior management.

Section 172 statement

This is an overview of how the Directors performed their duty to promote the success of the Company under section 172 of the Companies Act 2006.

Purpose, strategy and values

Melrose was founded in 2003 to empower businesses to unlock their full potential for the benefit of all stakeholders, whilst providing shareholders with a superior return on their investment. This has been delivered through our "Buy, Improve, Sell" strategy, whereby we acquire high quality but underperforming manufacturing businesses and invest in them heavily to improve performance and productivity, so that they become stronger, better businesses under our responsible stewardship. At the appropriate time, we find them a new home for the next stage of their development and return the proceeds to shareholders.

The Company's purpose and strategy is underpinned by the principles and values on which it was founded in 2003. We act with integrity, honesty, transparency and decisiveness, and believe in a lean operating model and high productivity. We invest in the companies we own as if we are going to own them forever. We do not shy away from difficult decisions. We provide the space and resources to empower people to perform and reward them well when they do. These are the principles that lie at the heart of the success of Melrose and are the basis on which we strive for more success in the future.

Duty to promote the success of the Company

In executing our strategy, Directors must act in accordance with a set of general duties detailed in section 172 of the Companies Act 2006. These general duties include a duty to promote the success of the Company, and specifically to act in a way that the Director considers, in good faith, would be most likely to promote the success of the Company for the benefit of its shareholders as a whole and, in doing so, having regard (amongst other matters) to the:

- likely consequences of any decisions in the long-term;
- interests of the Company's employees;
- need to foster the Company's business relationships with suppliers, customers and others;
- impact of the Company's operations on the community and environment;
- desirability of the Company maintaining a reputation for high standards of business conduct; and
- need to act fairly as between shareholders of the Company.

This statement has been prepared in accordance with the requirements of The Companies (Miscellaneous Reporting) Regulations 2018, which require the Company to describe how the Directors have had regard to the matters set out in section 172 of the Companies Act 2006 during the financial year under review. It is noted that the Directors have always acted in accordance with such duties in their decision making and they will continue to do so. In light of the additional disclosure requirements, we have set out below further detail on how the Directors have fulfilled their duties during the course of 2019.

The Group operates on a decentralised basis, with the Board having established an organisational structure with clear reporting procedures, lines of responsibility and delegated authority, as depicted in the diagram on page 46 and in line with the Group's governance framework, which the Board reviews regularly. The Board is ultimately accountable to the Company's shareholders for setting the Group's strategy and for overseeing the Group's financial and operational performance in line with Melrose's strategic objectives, with implementation of the Group's strategic objectives, as determined and overseen by the Board, delegated to the Melrose senior management team, and with day-to-day operational management delegated to the business unit executive teams.

The Board cultivates strong relationships with key stakeholders so that it is well placed and sufficiently informed to take their considerations into account when making decisions where appropriate in order to discharge their legal obligations and to pursue the Company's strategic objectives. Our purpose is to create long-term value for stakeholders and in order to do this, we need to understand our stakeholders and what matters to them.

Having regard to the likely consequences of any decisions in the long-term

In line with our strategy, Melrose's core purpose is to acquire good engineering businesses with strong market positions that are underperforming their potential, with a view to investing in those businesses and empowering their management teams to unlock operational improvements and to drive value and performance for the benefit of all stakeholders. Although our strategy necessarily means that new homes are eventually found for all our businesses at the appropriate time, during our ownership we invest in them as if we were going to own them forever. This has been proven time and again, with long-term significant investments being made that are set to generate returns far beyond our ownership period, such as StatePoint Technology® for HVAC and the Global Technology Centre for GKN Aerospace. We build better, stronger businesses.

Financial robustness is also an important part of this value creation process, and we aim to provide our shareholders with sustained returns through a combination of dividend income and special distributions following sales of businesses. We operate both (i) a progressive dividend policy whenever the financial position of the Company, in the opinion of the Board, justifies the payment (as discussed in the financial key performance indicators on pages 36 to 37 and in the Directors' report, both of which are incorporated into this Section 172 statement by reference); and (ii) a prudent approach to capital allocation that considers working capital requirements, investment, capital expenditure, research and development and capital distribution (as further discussed in the financial statements). For each of (i) and (ii), relevant events and circumstances that have arisen during the relevant period are considered, alongside the interests of the Company's shareholders as a whole, and the long-term viability of the Company (for 2019, as further discussed in the Longer-term viability statement on page 45), capital investment requirements, and research and development. The building of stronger businesses is not limited purely to financial returns, but also encompasses a wide range of non-financial improvement areas including risk management and compliance, and environmental, social and governance matters, all of which we seek to improve for the long-term, not just during our period of ownership.

With this in mind, we apply the same high standards of responsible stewardship to our businesses as if we were to own them forever, and it is this approach to decision making that requires the Directors to have regard to the likely consequences of decisions for the long-term.

The Board is ultimately responsible for determining and reviewing Melrose's strategy, which during 2019 was very much focused on the "Improve" aspect of "Buy, Improve, Sell". In considering requests for major capital expenditure throughout the year, the Chief Executive, supported by the Directors, considered and approved a number of operational improvement initiatives to help improve the functioning of the Group's businesses. These initiatives included investments in research and development, organisational design improvements, and social investments through the Melrose Skills Fund. Further detail on our approach to stewardship and risk management can be found in the ESG report on pages 58 to 69.

Having regard to the interests of the Company's employees

In 2019, the Board established a workforce advisory panel ("WAP") in order to promote effective engagement with, and encourage participation from, the Group's workforce. The structure of the WAP deliberately reflects the decentralised nature of the Melrose model and ensures that the voice of the respective workforce is heard where it is most effective in the business unit executive decision-making process. Clarity and oversight of all actions across the Group are heard at Board level, as well as providing an opportunity for each business to gain insight into best practice from their peers. Further details about the WAP can be found in the ESG report on pages 58 to 69.

The Board continued to monitor the nature of issues reported through the whistleblowing hotlines operated by the Group. An annual report is prepared for the Board which highlights whistleblowing activity across the business units, together with a summary of the approach taken by each business unit in their whistleblowing process. The Board reviews this report and instructs the Melrose senior management team to work with the business unit executives to identify and rectify any adverse trends relating to material matters raised through the whistleblowing platform. The integrity of this process is an important part of the Company's governance arrangements and the Board will review this once again in 2020 to ensure it remains effective.

Further to the commitments given on the acquisition of GKN, constructive engagement with the GKN pension scheme trustees and members continued in 2019. The Company increased the prudence of funding targets during 2019, while cash contributions have helped to halve the amount required to take the GKN pension schemes to being well funded.

Having regard to the need to foster the Company's business relationships with suppliers, customers and others

Fostering positive business relationships with key stakeholders, such as customers and suppliers, is also important to the success of the Group's businesses. As a result of Melrose's decentralised model, engagement with customers and suppliers is a matter that is largely delegated to the management teams of each business, who know their businesses best. The Board has been, and continues to be, available to support the businesses in this area as and when required. Our businesses have heavily invested in their relationships with suppliers and customers throughout 2019, and details of this are set out on page 63 of the ESG report.

The Group has multiple interactions with government bodies in a number of jurisdictions across the world, many of which are of strategic importance to the Company's long-term success. In the UK, the Company specifically has regular dialogue with the Department for Business, Energy and Industrial Strategy (BEIS), the Ministry of Defence and the UK Panel on Takeovers and Mergers regarding ongoing compliance with the undertakings and other continuing obligations given to the UK Government and other regulatory bodies in connection with the acquisition of GKN.

The Company also speaks regularly to various governance bodies regarding the key aspects of our governance framework that the Board considers to be of long-term strategic importance, including gender diversity and executive remuneration. These governance bodies represent a large part of our shareholder community and it is important to us that we have their support in relation to areas of corporate governance.

Having regard to the impact of the Company's operations on the community and environment

In their decision making, the Directors need to have regard to the impact of the Company's operations on the community and environment. The Board plays a constructive role in tackling issues through engagement and investment.

It is important for the long-term future of our businesses that we protect and enhance the environment. Climate change will affect how much non-renewable energy is available, and stakeholders are rightly concerned about the resilience of supplies and are looking to companies to adapt and take the necessary steps to reduce their climate change risk. We encourage our businesses to innovate and invest in new technologies to solve environmental challenges for future generations. We are also committed to reducing our carbon footprint and contribution to climate change where economically viable.

Throughout 2019, the Board continued to review a range of ESG matters affecting the Group and relating to the community and environment. In recognition of the rising emphasis on reporting on these matters, the Board decided that the 2019 Annual Report and financial statements would include a dedicated ESG report to provide external stakeholders with a consolidated view of the Group's achievements in this area, including in relation to the businesses' environmental impacts and delivering improvements to each business on key matters having a positive environmental, social or governance-related impact. The ESG report can be found on pages 58 to 69 of this Annual Report.

Having regard to the desirability of the Company maintaining a reputation for high standards of business conduct

The Board recognises that culture, values and standards are key contributors to how a company creates and sustains value over the longer term, and to enable it to maintain a reputation for high standards of business conduct. High standards of business conduct guide and assist in the Board's decision making, and in doing so, help promote the Company's success, recognising, amongst other things, the likely consequences of any decision in the long-term and wider stakeholder considerations. The standards set by the Board mandate certain requirements and behaviours with regards to the activities of the Directors, the Group's employees and others associated with the Group.

Reflecting the decentralised nature of the Group, responsibility for the adoption of policies, practices and initiatives sits at a divisional level, including the Melrose Code of Ethics and Group compliance policies. Further detail on the Group's policies and compliance framework are set out on pages 68 to 69.

The Group engages external audit firms to monitor and verify performance at a business unit level, which is conducted in respect of both financial and non-financial performance.

Having regard to the need to act fairly as between shareholders of the Company

The Company has one class of ordinary shares, which have the same rights as regards voting, distributions and on a liquidation. Management are also significant shareholders in the Company, holding approximately 1.5% of the register, together putting them in the top 10 shareholders of the Company. On this basis the Board feels that the executive Directors are fully aligned with shareholders.

Shareholder support is integral to the successful execution of our "Buy, Improve, Sell" strategy. Melrose has attracted long-term support from its key shareholders since its establishment in 2003 and has generated consistent returns throughout that time. Melrose has always prided itself on the timeliness and transparency of the information we provide to our shareholders. We rely on the depth of the understanding amongst our investors as we often need to move quickly to secure the opportunities that have been critical to Melrose's success. See pages 63 to 64 for further details on the Board's programme of shareholder engagement in 2019.

The views of key analysts and shareholders are also 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. The Chairman and Non-executive Directors are also available to meet institutional shareholders should there be unresolved matters that shareholders wish to bring to their attention.

On the basis of the above, the members of the Board consider, both individually and together, that they have acted in the way they consider, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole (having regard to the stakeholders and matters set out in s172(1)(a-f) of the Companies Act 2006) in the decisions taken during the year ended 31 December 2019.

Investing in our businesses to drive ESG excellence

Our ESG purpose and values: Melrose empowers its businesses to unlock their full potential for the collective benefit of stakeholders, whilst providing shareholders with a superior return on their investment. This is delivered through our "Buy, Improve, Sell" strategy, through which we acquire good quality manufacturing businesses that are underperforming their potential, and invest heavily to improve performance and productivity as they become stronger, better businesses under our responsible stewardship.

Consistent with our "Buy, Improve, Sell" strategy, some of the businesses we acquire may be underdeveloped in one or more areas of ESG focus. As a key part of the "Improve" limb, whilst under our ownership, we look to empower and resource our businesses to improve their environmental, social and governance performance, to enable them to make better contributions to industry, society and the environment for the long-term.

The successful execution of our strategy is underpinned by our focus on conducting business with the highest standards of integrity, honesty, and transparency.

We welcome the evolving focus and clarity on ESG matters as another opportunity to demonstrate how we build better, stronger businesses for the collective benefit of stakeholders, whilst producing excellent returns for shareholders.

The Melrose opportunity: We set the example for our manufacturing businesses and empower them to follow. We provide the investment, support and encouragement to improve management practices that seek to promote long-term growth and prosperity, whilst addressing ESG underperformance.

Our approach to driving positive ESG contributions: We implement our strategy on an accelerated timetable during our ownership period. We operate a decentralised management structure, so that responsibility for implementing the right measures to improve ESG performance sits with those who are best placed to be most effective in achieving our businesses' ESG goals and aligned with what is most relevant to their specific markets and operating environments. We support the executive management teams of our businesses by providing better-targeted investment with a long-term view. We streamline group structures to ensure responsive, lean management and proactive leadership, and enhance research and development to better serve customers in achieving their commercial and environmental objectives. We encourage our businesses to work with suppliers to strengthen supply chain resilience, and implement stronger governance standards to respect their employees and meet environmental standards, whilst ingraining strict financial prudence across our businesses to enable them to build and sustain the resources required to deliver stronger financial, operational and ESG performance over the long-term.

The Melrose ESG improvement model is founded upon the following key objectives and principles:

Our ESG objectives	Our ESG improvement principles
Respect and protect the environment 1	• Invest in research and development to support and harness product innovation and quality for our businesses, to help their customers deliver on their commercial and environmental goals and to help find effective solutions to assist them in combatting climate change. • Drive divisional management teams to improve their operational, resource and energy efficiency to minimise the impact of their businesses' operations on the environment, including Greenhouse gas emissions and water usage. Improve Sell
Purposefully engage with key stakeholders to better understand and deliver on their expectations 2	• Engage where appropriate in regular, constructive dialogue with a variety of key stakeholders at each stage of our "Buy, Improve, Sell" cycle, and encourage and empower our businesses to do the same. • Maintain an informed focus on delivering improved returns for shareholders whilst also meeting best practice for ESG performance, that is attuned to the expectations and concerns of our businesses' employees, customers, regulators, governments, suppliers and investors. Buy Improve Sell
Prioritise and nurture the wellbeing and skills development of employees and the communities that they are part of 3	• Ensure the pension schemes that we inherit are managed prudently and effectively for both employees and retirees, and where relevant seek to create better-funded schemes with more prudent targets under our stewardship. • Implement effective policies and procedures, supported by local management accountability and a culture of strong awareness, training and investment in employees, to drive health and safety best practice. • Promote fair employment and skills development. • Drive our businesses to ensure the highest standards of health and safety for their people, as well as the protection of human rights, and encourage positive contributions to the communities in which they operate. • Promote inclusion and diversity at all levels. • Ensure that our people have a voice and can inform executive decisions. Buy Improve Sell
Exercise robust governance, risk management, and compliance 4	• Direct, oversee and challenge divisional management teams in implementing and enforcing effective compliance policies and business practices. • Ensure each division conducts business with integrity and in a responsible, ethical and sustainable manner. • Invest in research and development to ensure the highest standards of product safety, and encourage our businesses to protect the ultimate wellbeing of their end-users by adhering to market standards and best practice. Respect labour and human rights and support our businesses' suppliers to ensure the environment throughout their supply chains. • Protect information security and data privacy. • Carry out prudent and responsible financial and tax planning and management and pay tax responsibly when due. • Maintain sensible and sustainable leverage to support investment. Improve Sell

Executing strategic ESG leadership

Melrose strives to have a good ESG track record. As an experienced owner of businesses, we set out to accelerate the pace of improvement at our businesses during our ownership period. The Board, with direct support from the Melrose senior management team, operates a decentralised stewardship model that equips the Group's businesses with the management expertise, operational investment, and robust governance practices to implement ESG improvements, as enshrined in the Melrose Code of Ethics, compliance policies and procedures. By empowering divisional management teams to run their businesses in an appropriately self-sufficient manner, we position them to sustain their improvements over the long-term, and after they invariably exit the Group. The Melrose senior management team applies close oversight and challenge to encourage the adoption of better practices and behaviours within each business whilst owned by Melrose, and keep the Board well-informed to exercise their role of oversight, review and challenge.

In particular, the Board:

- proactively reviews, challenges and approves the Group's risk management strategy, which includes financial and non-financial risks;
- scrutinises quarterly management reports including material aspects of the Group's ESG performance;
- has regular access to divisional management teams and conducts regular face-to-face business and budget reviews during the year, covering operational, commercial, finance and ESG matters; and
- reviews, challenges and approves key policies and compliance statements that require a coordinated approach across the Group, including the Modern Slavery and Human Trafficking Policy and annual statement, tax strategy, and the Group's annual health and safety, diversity, equal pay, stakeholder engagement and Greenhouse gas ("GHG") performance disclosures.

1

Respect and protect the environment

Improve | Sell

Melrose's position on climate change

We recognise that climate change may have significant implications on the long-term successes of our businesses. We seek to set a positive example for our businesses to follow and we invest in and encourage them to improve their operations and market offerings in a direction that minimises their impact on climate change, and makes them less vulnerable to climate-related risks.

We are true believers in industry, and in the potential of industry, to help solve society's most pressing needs. We buy high-quality but underperforming industrial businesses, with established positions in their markets. By investing heavily in research and development, we enable our businesses to develop and provide the innovative and cost-effective solutions that their customers need to help tackle underlying causes of climate change. Examples of such solutions can be found on page 62 of this ESG report.

Efficiency in this area is a material concern for nearly all manufacturing industries, and our businesses are no exception. We therefore support and invest in them to accelerate their efforts to reduce their carbon footprint by, where economically appropriate, taking measures to improve their energy, water and material efficiency by seeking viable, lower-impact, and increasingly lower-cost, renewable energy sources. Energy consumption (including GHG consumption) across the Group as well as examples of our businesses' improvement efforts can be found on page 61 of this ESG report. These actions not only make good long-term business sense, but also respond directly to the expectations set by governments, and the emerging realities of the markets in which our businesses operate.

We are already taking active steps to anticipate how climate change will affect our businesses, and to encourage firm progress from our businesses in respect of positive climate action. We will continue to strengthen our understanding of the specific climate-related risks our businesses face as we work to mitigate these risks.

(1) Source: https://carbonneutral.com/the-carbonneutral-protocol
(2) See Table 2 on page 60.
(3) See Table 1 on page 60.

CERTIFIED CARBON NEUTRAL® company
CarbonNeutral.com

Melrose sets a positive example, and enables and empowers its businesses to follow. Whilst the central Melrose carbon footprint is relatively limited, we nevertheless offset the emissions that we do generate. The Melrose corporate offices have attained the CarbonNeutral® company certification for 2019 and 2020 through a combination of internal energy efficiency initiatives and financing high-quality, high-impact emission reduction projects in accordance with The CarbonNeutral Protocol[1]. The Melrose corporate office in the US has also achieved the HinesGo (Green Office) designation in recognition of its sustainability practices and energy efficiency performance, among other environmental and wellbeing criteria.

We believe that improving operational efficiency is one of two key factors that shape the long-term profitability and sustainability of our businesses, and enables their compliance with increasing environmental standards and regulation. The other key factor is cultivating the technical and innovation capabilities and foresight to provide effective solutions to the emerging ESG challenges that their customers face, including combatting climate change.

Highlights from 2019 include:

30% reduction

in combustion of fuel & operation of facilities (scope 1)[2] across GKN compared to 2017, on a like-for-like basis

23% reduction

in emissions reported above normalised to tonnes per £1,000 turnover[3] across the non-GKN divisions compared to 2018, on a like-for-like basis

25% reduction

in total purchased electricity (scope 2)[3] across the non-GKN divisions compared to 2018, on a like-for-like basis

Reducing the operational environmental impacts of our businesses

Our businesses are charged with identifying, monitoring and managing the environmental risks that affect their operating and market environments. With Melrose support, each Group business invests in and implements appropriate systems and processes to manage their impact on the environment, and continually reviews these in line with evolving expected practices. For example, at the end of 2019, over three quarters of the manufacturing facilities across our businesses had chosen to be certified or compliant with the ISO 14001:2015 Environment Management Standard.

Business units also monitor their environmental progress and plan for continuous improvements in ways that are suitably tailored to their activities, in areas such as energy consumption, GHG emissions, water consumption, water disposal quality, waste generation, recycling and disposal, and volatile organic compound emissions.

In 2019, our businesses continued to invest in operational improvements with direct environmental benefits such as improved energy and/or water efficiency, reduced waste or pollution prevention.

Energy and GHG emissions

The Group recognises the serious threat posed by climate change and the urgent need for meaningful action. As part of their improvement plans, our businesses seek to reduce their GHG emissions over time through more efficient use of electricity, fuel and heat, and by increasing the proportion of renewable energy where commercially viable.

This section of the report has been prepared for the reporting period of 1 January 2019 to 31 December 2019, and in accordance with the principles and requirements of the Greenhouse Gas Protocol, Revised Edition, ISO 14064 Part 1 and the Environmental Reporting Guidelines: including Streamlined Energy and Carbon Reporting guidance dated March 2019.

We have reported on all of the emission sources required under the Companies Act 2006 (Strategic Report and Directors' Reports) Regulations 2013. We have also reported this year, complying early, the information required by the Streamlined Energy and Carbon Reporting requirements (the "SECR"), which apply to accounting periods beginning on or after 1 April 2019. All material emissions from within the organisational and operational scope and boundaries of the Group are reported.

These sources fall within our consolidated financial statement. We do not have responsibility for any emission sources that are not included in our consolidated statement. We have used the GHG Protocol Corporate Accounting and Reporting Standard (revised edition), data gathered in accordance with our GHG reporting procedure. The emission factors from the UK Government GHG Conversion Factors for Company Reporting 2019 have been used to calculate the GHG emission figures, together with International Energy Agency country-specific factors for the associated overseas electricity usage.

Table 1: Total Melrose Group GHG emissions (excluding the GKN businesses)

Global GHG Emissions data for period 1 January 2019 – 31 December 2019 excluding GKN businesses (tonnes of CO_2e[1] unless stated)

Emissions sources	2018	2019
Combustion of fuel & operation of facilities (scope 1)[2]	23,261	19,638
UK Electricity	1,718	1,088
Overseas Electricity	29,592	22,460
Total purchased electricity (scope 2)[3]	31,310	23,548
Other purchased energy (scope 2)[3]	1,801	1,595
Company's chosen intensity measurement: Emissions reported above normalised to tonnes per £1,000 turnover[4]	0.030	0.023

(1) CO_2e – carbon dioxide equivalent, this figure includes GHGs in addition to carbon dioxide.
(2) 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.
(3) Our scope 2 estimates include emissions from electricity and heat purchased by the Group's businesses (excluding the GKN businesses). Scope 2 emissions, and total GHG emissions, are calculated using the location-based method.
(4) The turnover figure used to calculate the intensity ratio does not include any share of revenues from entities in which the Group holds an interest of 50% or less.

Table 2: Total GKN Group GHG emissions

Global GHG Emissions data for period 1 January 2019 – 31 December 2019 (tonnes CO_2e[1] unless stated)

Emissions sources	2017	2019[2]
Combustion of fuel & operation of facilities (scope 1)[3]	290,541	204,209
Electricity (scope 2)[4]	1,003,000	779,499

(1) CO_2e – carbon dioxide equivalent, this figure includes GHGs in addition to carbon dioxide.
(2) The 2019 emissions data does not include the Walterscheid Powertrain Group as it was sold part way through that year.
(3) As per page 50 of the GKN 2017 Annual Report, the scope 1 estimates include emissions from fuel used on premises, transport emissions from owned or controlled vehicles, losses of refrigerant, and process and fugitive emissions.
(4) The scope 2 estimates include emissions from electricity and heat purchased by the Group's businesses. Scope 2 emissions, and total GHG emissions, are calculated using the location-based method.

Table 3: Total Melrose Group GHG emissions (including the GKN businesses)

Global GHG Emissions data for period 1 January 2019 – 31 December 2019 (tonnes of CO_2e[1] unless stated)

Emissions sources	2018[2]	2019[3]
Combustion of fuel & operation of facilities (scope 1)[4]	23,261	223,847
UK Electricity	1,718	26,909
Overseas Electricity	29,592	774,569
Total purchased electricity (scope 2)[5]	31,310	801,478
Other purchased energy (scope 2)[5]	1,801	3,165
Company's chosen intensity measurement: Emissions reported above normalised to tonnes per £1,000 turnover[6]	0.030	0.092

(1) CO_2e – carbon dioxide equivalent, this figure includes GHGs in addition to carbon dioxide.
(2) The 2018 emissions data does not include the GKN business units as they were acquired part way through that year.
(3) The 2019 emissions data does not include the Walterscheid Powertrain Group as it was sold part way through that year.
(4) 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.
(5) Our scope 2 estimates include emissions from electricity and heat purchased by the Group's businesses. Scope 2 emissions, and total GHG emissions, are calculated using the location-based method.
(6) The turnover figure used does not include any share of revenues from entities in which the Group holds an interest of 50% or less.

Table 4: Melrose Group Energy Consumption by Type

Energy type	UK consumption MWh	Overseas consumption MWh	Total consumption MWh
Natural Gas	121,350	962,039	1,083,389
LPG	320	50,221	50,541
Heating Fuel	0	30,071	30,071
Transport Fuels	943	14,201	15,144
Electricity	108,459	2,055,094	2,163,553
Steam	0	19,383	19,383
Wood Pellets	0	30,253	30,253
Renewables	274	6,021	6,295
Total Energy	231,346	3,167,283	3,398,629
Company's chosen intensity measurement: MWh per £1,000 turnover[1]	0.021	0.283	0.304

(1) The turnover figure used does not include any share of revenues from entities in which the Group holds an interest of 50% or less.

The GHG emissions reported on page 60 cover all entities over which the Group had financial control for a period of at least one year as of 31 December 2019. Emissions from entities acquired or disposed of during the reporting period (i.e. disposed of before 31 December 2019 or acquired after 1 January 2019) are not accounted for in this report.

For all of the emissions data contained in this report, 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 performance of the Group's businesses in the relevant area.

The emissions associated with the GKN businesses, which were acquired part way through 2018, are included for the first time in this report as per our GHG accounting procedure, and as predicted in our 2018 Annual Report, have contributed to a significant increase in the overall Melrose Group emissions. In particular, the increase in the intensity ratio is reflective of the fact that whilst relatively low level, the GKN businesses are more energy-intense operations than the Group's other business units, which is to be expected given the nature of their on-site activities. Table 3 shows the total 2019 GHG emissions data including the GKN business units.

In addition, as can be seen from Table 2, comparing the 2019 emissions figures for the GKN businesses to the last figures reported for the GKN Group in its 2017 Annual Report (being the last financial year in which this data was reported) shows a 30% reduction in scope 1 emissions and a 23% reduction in scope 2 emissions.

Table 4 shows the energy consumption by type for the Group's business units, broken down by UK and overseas consumption, in accordance with the requirements of the SECR. This is the first time that this information has been collated and therefore no year-on-year comparison is available. However, this will be provided in future years. The Company's chosen intensity ratio in this regard is megawatts usage (MWh) per £1,000 of turnover.

In addition, in 2019 the Group complied with its obligations under Article 8 of the EU Energy Efficiency Directive (known as ESOS in the UK) in each of the relevant EU member states. As part of this process, the Group was required to monitor and calculate the total energy consumption associated with its businesses across their European sites, in order to identify commercially viable opportunities to save energy.

Energy efficiency initiatives in production and manufacturing

Each business is driven to take an appropriately tailored approach to energy efficiency that suits their business requirements, and operational and market environments, reflecting their maturity in this area at the time of becoming part of the Group.

During 2019, the business units within the Group implemented a range of energy efficiency initiatives with expected notable energy and carbon emission savings, with significant progress being achieved by our two largest divisions:

- Along with a number of energy efficiency projects, including the certification of a further five sites to ISO 50001 Energy Management Standard, GKN Aerospace signed an agreement to generate hydroelectric power from the Göta Älv River near to its site in Trollhättan, Sweden that is expected to generate material emissions savings over the long-term.
- GKN Automotive's European sites continue to drive efficiency and cost savings. Notable examples include the installation of a new chiller system in the Eskisehir, Turkey plant, which has resulted in monthly electricity savings of 46,000 kWh, with a new ground water cooling system at the Bruneck, Italy plant anticipated to generate savings of 1,000,000 kWh per year. The application of a new eco-mode for engines and pumps has also generated further energy savings of about 38,052 kWh, and the procurement of green energy for their Bruneck and Firenze, Italy plants has resulted in the equivalent annual reduction of nearly 11,000 tonnes of CO_2 compared to 2018.

The GKN Aerospace, GKN Automotive and GKN Powder Metallurgy sites globally are in the process of attaining their certification to the ISO 50001 Energy Management Standard, in recognition of their strong focus on ensuring an efficient and sustainable use and management of energy.

Water and waste

Water consumption and waste generation improvements are actively encouraged by Melrose. We have set out below the 2019 water consumption and waste generation for our largest business units: GKN Aerospace, GKN Automotive and GKN Power Metallurgy. This is the first time that this information has been collated, and therefore no year-on-year comparison is available for 2019. We will seek to expand the disclosure in future years to include other businesses in the Group.

Water and waste prevention initiatives

In 2019 our largest divisions made encouraging steps towards reducing their environmental impacts:

- GKN Aerospace's site in Bristol, UK worked with supply chain partners to identify opportunities to successfully eliminate excessive packaging, saving 4km of excess bubble wrap and strap per annum with one supplier alone.
- GKN Automotive at its Newton, US site's zero landfill programme has achieved an annual reduction of 660 tonnes of waste sent to landfill and the ePowertrain division has successfully reduced waste to landfill by 90% in 2019 (vs 2018).
- GKN Powder Metallurgy's site in Germantown, US replaced piping and valves to reduce the need for system improvements and the plant's reliance on municipal water supply. In addition, the sinter metals and forge operation at Bad Brückenau, Germany made improvements to its wastewater treatment system so that it will clean and recirculate up to 2m³ of service water per day, expected to eliminate the need for withdrawal of more than 500m³ of municipal water annually.
- The Nortek Global HVAC site in Tualatin, US received the Washington County Recycling award in recognition of its efforts to increase recycling rates and reducing the amount of waste sent to landfill.

Water and waste consumption data for period 1 January 2019 – 31 December 2019

Area	GKN Aerospace	GKN Automotive	GKN Powder Metallurgy
Volume of water consumption in operations (m³)	1,605,861	1,264,142	1,032,233
Weight of total generated waste (tonnes)(1)	20,189	105,590	42,023
Recycled (tonnes)	12,301	102,297	39,387
Landfill (tonnes)	4,084	1,455	2,474
Hazardous waste disposed through legally approved routes (tonnes)(2)	4,751	3,908	4,278

(1) This figure reflects the waste sent to incineration, which is neither recycled nor landfilled.
(2) This figure was calculated on the basis of the guidance published by the EU (see source: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02000D0532-20150601), which includes waste from physical and chemical processing of metals that are hazardous to humans and wildlife, oil spills and waste materials containing oil, wastes containing mercury and heavy metals, waste paint, varnish and coatings containing organic solvents and other hazardous substances.

ESG report
Continued

Helping our customers deliver on their environmental goals

We recognise the opportunities that the transition to a net-zero emissions economy present, and our businesses are well positioned to help their customers tackle pressing environmental challenges such as climate change, and to meet emerging regulatory requirements and wider environmental expectations. Our businesses work closely with their customers and world-class research institutions to develop market-leading, cost-effective innovations, that deliver the solutions their markets need. In 2019, our businesses actively invested in developing products that help their customers improve energy efficiency and reduce GHG emissions, water consumption and waste generation, in their operations or during the use of their products, for example:

GKN Aerospace

- Invested in products that are lighter and more fuel efficient, to enable Customers to improve fuel efficiency and reduce their carbon emissions. Through its Global Technology Centre in Bristol, UK it manufactured the first composite components for the Airbus *Wing of Tomorrow* research programme, representing a step change in the aerospace industry. The new Fixed Trailing Edge for the Airbus A350 XWB, is lighter and stronger than its metallic equivalent and can achieve up to 20% fuel efficiency per passenger kilometre.
- Developed relationships with companies focused on the electrification of aircrafts, including close engagement with Eviation to support in the lightweight airframe design of the 'ALICE' aircraft. Specifically, GKN Aerospace has agreed to design and deliver the prototype flying wing to enable the aircraft's first flight in 2020, with potential future design and production partnership opportunities. This aircraft is an exciting proposition in the quest for sustainable aviation, integrating existing and maturing technologies into a commercially feasible sustainable aircraft. Key technologies include electric motors, batteries, lightweight structures and aerodynamic enhancements. More broadly, with Melrose support GKN Aerospace will commence a cutting-edge propulsion project in 2020, which aims to accelerate the adoption of hydrogen electric propulsion within the aerospace industry, starting with demonstrating significant improvements in power density and range capability in the sub-regional, and later, regional aircraft markets. This project offers a route to absolute zero emissions flight for ranges up to 2000km.
- Produced electro-thermal heater mats in Luton, UK for the Boeing 787 aircraft, to prevent ice from building up on the leading edge of the wing. This technology replaces traditional de-icing systems that rely on engine bleed and can achieve fuel savings of about 3%.
- Strengthened collaborations with existing key customers to make progressive improvements to existing technologies, for example the development of a fan case mount ring using additive manufacturing technology (laser metal deposition with wire) for engines customer Pratt & Whitney was a revolutionary technological development, which enables an annual reduction in CO_2 from the manufacturing process alone of over 1500 tonnes per year.
- Was the inaugural sponsor and partner in the Boeing-ATI Accelerator programme, which supports start-ups creating Industry 4.0 and sustainability-enabling technologies with the potential to bolster the growth and competitiveness of the UK aerospace industry. GKN Aerospace has worked with and offered mentoring support to dozens of start-ups, leading to the final selection of ten companies who were each offered £100,000 equity investment from Boeing HorizonX Ventures, and are now actively engaged in the programme. A second cohort of start-ups will join the programme in 2020.

GKN Automotive

- Continued to actively contribute towards low-carbon green transportation solutions. Its P4 e-Drive systems can lead to 100% CO_2 reduction for battery electric vehicles, and up to 50% reduction for hybrid vehicles (tank-to-wheel consideration based on WLTP(1)). In addition, the division's proprietary Active Connect Technology can generate CO_2 savings of more than 5% compared to traditional all-wheel-drivetrain technologies.
- Recently initiated a strategic collaboration with Delta Electronics Inc., representing a significant milestone in the expansion of the business's portfolio of scalable, integrated 3-in-1 eDrive solutions and the business's capabilities in rapidly bringing new cost competitive technologies to market.

GKN Powder Metallurgy

- Continued to deliver customised, scalable and fast metal shape solutions to help customers solve the world's biggest challenges.
- Developed new 100%-recyclable e-pumps to substitute engine-driven pumps on vehicle transmissions. These innovative e-pumps can generate greater fuel efficiency (of up 30%), compared to an engine driven pump, by working only on demand.
- Is a leading producer of variable oil pumps. This solution can increase the overall engine efficiency of the vehicle and lessen CO_2 emissions by up to 20% by modulating the injected oil volume according to the engine's actual RPM (compared to the fixed displacement system of conventional lubrication oil pumps).
- Developed a unique high-performance, cost-effective process to produce the core components of the variable (cylinder) valve timing system used by a vehicle's engine. The system is crucial for the optimal performance of the engine and can achieve up to 25% reduction in CO_2 emissions.

Nortek Global HVAC

- Its StatePoint Technology® reduces the carbon and water footprint associated with cooling and maintenance of data centres, which are power and water intensive processes. This is saving clients, including a global technology company, up to 20% in energy consumption and up to 90% in water usage.
- Developed technology directly benefitting communities around the world to ensure continuity of critical services during extreme weather, for example the business supplies best-in-class earthquake resistant climate control technology to hospitals on the US West Coast.

Brush

- Its Power Management Systems are dedicated microsystems providing intelligent automation for industrial power grids to proactively prevent blackouts and enable uninterrupted performance of critical processes and operations. Synchronous Condensers are also helping customers address this challenge by absorbing or supplying reactive power, offering a cost-effective alternative to supplying bulk variable power compared to static variable compensators.

(1) Worldwide harmonized light vehicles test procedure is a global, harmonized standard for determining the levels of pollutants, CO_2 emissions and fuel consumption of traditional and hybrid cars, as well as the range of fully electric vehicles.

2

Purposefully engage with key stakeholders to better understand and deliver on their expectations

Buy Improve Sell

At each stage of our "Buy, Improve, Sell" strategy we seek to engage in constructive dialogue with stakeholders as appropriate to gather a holistic understanding of their key expectations and concerns. Our key stakeholder groups include shareholders, governments and regulators, employees, customers, suppliers, corporate governance agencies, and the communities in which we operate. Our open and transparent approach is crucial in supporting our acquisition strategy, directing our improvement plans, and supporting our businesses' implementation of those plans, to deliver better collective outcomes for stakeholders.

Some examples of how Melrose purposefully engages with key stakeholder groups are set out below, with further detail provided in the Section 172 statement on pages 56 and 57 with respect to engagement specifically relating to 2019.

Employees and their representative bodies

For our businesses to outperform their potential they require a strong and capable workforce. Employees within the Group are therefore key strategic stakeholders and the Board firmly believes that their wellbeing is central to the long-term sustainability and prosperity of our businesses. The Board seeks to ensure that it is informed of employee interests when making strategic decisions, whilst recognising that each business pursues bespoke talent management and development objectives that are appropriate to their respective workforce dynamics.

We invest in and support our businesses to implement accessible platforms and forums that foster an inclusive culture, which encourages employees to propose ideas and raise concerns. In 2019 the Group established a workforce advisory panel ('WAP') comprising the Chief Human Resources Officer (or equivalent) from each business unit, and a member of the Melrose senior management team. Each member of the WAP is responsible for promoting workforce engagement, disseminating information, collating the voice of the workforce and demonstrating how that voice is fed into executive management decisions.

Recognising the importance of a strong and skilled workforce, Melrose requires all Group businesses to safeguard the contractual and statutory employment rights of their employees. Each business is also encouraged to maintain constructive relationships with employee representative bodies, including unions and works councils.

With every acquisition, Melrose seeks to strengthen pension scheme arrangements for the benefit of employees and retirees. The UK pension schemes of each material business sold by Melrose since its inception have been transferred to their new owners in a significantly stronger financial position than at the time of our acquisition. For further information about Melrose's engagement with pension scheme trustees and our investment in transforming the UK defined benefit pension schemes of our businesses, please refer to pages 64 and 65.

Customers and suppliers

Melrose encourages and supports its businesses to engage with customers and suppliers on an ongoing basis, with a view to:

- realise technological breakthroughs and innovative collaborations to enhance market and product leadership, and safety excellence;
- enable our businesses to deliver products in line with customer expectations and help customers achieve their environmental and safety objectives; and
- ensure efficient sourcing of key goods and services to safeguard stability for the collective benefit of stakeholders within our businesses' value chains.

Further details of our landmark collaborations with customers and suppliers to benefit key global environmental aims can be found in this report on page 62.

Shareholders, analysts, and corporate governance agencies

The success of our "Buy, Improve, Sell" strategy relies on maintaining strong investor support, which Melrose achieves by providing a consistent and transparent flow of useful information and management insight to shareholders and the wider investment community. Melrose takes an honest, transparent and open approach to investor relations and communications. We recognise that analysts require robust information in order to best inform investors, investors themselves benefit from disclosure in line with regulatory requirements, as well as enhanced disclosure on material topics to the Company (including ESG and key acquisition matters) to inform their independent investment decisions, and corporate governance agencies require transparency and active engagement in order to accurately review and assess our performance in line with expected practices.

In addition to our annual programme of key information publications and engagement initiatives including the annual general meeting, extraordinary general meetings on specific material items, publication of full and half year results, and this Annual Report, the Board and the Melrose senior management team meet and communicate with shareholders on a frequent and proactive basis throughout the year.

These efforts include face-to-face investor roadshows in the UK and the US at least once a year, trading updates, capital markets presentation days as appropriate to provide key shareholders, analysts and their representatives with direct access to the Directors and the opportunity to engage directly with the executive management teams of our largest businesses during key points in their improvement cycle, and, where requested, open agenda meetings for key shareholders attended by the Chairman.

In 2019 the Board hosted a capital markets day for institutional investors and financial analysts in London. The event included presentations from the CEOs of the Group's two largest divisions, GKN Aerospace and GKN Automotive, containing updates on key financial information. This also allowed shareholders to hear directly from the businesses on their progress with the Company's investment strategy.

The Melrose investor relations function schedules further bespoke interactions between investors, analysts and members of management on a regular basis. Similarly, throughout the year the Group company secretariat engages with the responsible stewardship and sustainability representatives of key investors and corporate governance agencies, including direct discussions with members of the Board. During 2019 these wider interactive engagement processes were undertaken in relation to items of a particularly material or otherwise multi-faceted or sensitive nature, including:

- Chairman's tenure – following the 2019 AGM, the Senior Independent Director and Chairman of the Nomination Committee commenced an engagement process with shareholders with respect to the tenure of the Chairman of the Board, who will have served as a director for nine years in September 2020. The Board's eventual decision to extend the Chairman's tenure was made only once the Board understood that the Company's key shareholders supported this proposal.
- Renewal of the Directors' remuneration policy and LTIP – building on the remuneration-focused engagement with shareholders in 2018, a further extensive and dedicated engagement process has been conducted by the Chairman of the Remuneration Committee with key shareholders and corporate governance agencies with respect to the renewal of the Directors' remuneration policy and long-term incentive plan at the 2020 AGM. This process has been informative and successful so far, with a significant proportion of shareholders constructively engaging during meetings, calls and email exchanges, and almost all of those that have spoken with the Company expressing strong support for the proposals.

In both instances, investors were contacted by letter, which was followed up with further communications and, where requested, in-person meetings.

ESG report
Continued

Up to
£1bn to the pension funds

£150 million initially contributed by Melrose to fund the two inherited underfunded GKN pension schemes within the first year of ownership

£60m

continuous annual funding commitment after year one, doubling existing annual contributions

5% to 10% and £270m

Melrose promised to pay between 5% and 10% of net proceeds of any Melrose divestment, and £270 million on the sale of GKN Powder Metallurgy, for so long as the schemes remain in deficit

More secure funding targets

enhancing the long-term viability of the GKN pension schemes meeting their obligations, by setting funding targets of Gilts + 75bps for the 2012 scheme and Gilts +25bps for the 2016 scheme

Independent stewardship

appointment of the schemes' first independent Chairman, to ensure robust oversight and accountability

In focus: Engaging with key stakeholders and building their trust and support for the GKN acquisition

The public and unsolicited nature of the GKN acquisition required Melrose to engage closely with a wide range of stakeholders, in order to successfully acquire GKN and begin the process of improving the businesses.

Pension scheme beneficiaries
Proactive engagement with the GKN pension trustees led to the approval of Melrose's detailed commitment to improve GKN's significantly underfunded pension schemes for the protection of all GKN scheme beneficiaries, to reassure them of Melrose's intentions that the GKN pension schemes would emerge from our ownership better funded.

Melrose aims to ensure that all UK defined benefit schemes end up stronger under Melrose ownership than when they joined the Group.

Governments and regulators
We actively engaged with the UK and US Governments, the UK Panel on Takeovers and Mergers, and other regulatory bodies to reassure stakeholders that Melrose was conducting the acquisition process in accordance with the highest standards of legal and regulatory scrutiny.

After carefully listening to the issues raised by a number of stakeholders including local elected representatives, UK parliamentarians and union representatives about securing the future of the GKN businesses, providing comfort to government end-users to protect national security interests, and to support national aims to increase the productivity of the UK's industrial sector and invest heavily in research and development, Melrose responded by making appropriate commitments in respect of certain key ESG issues. These commitments were in relation to long-term research and development investment, directors' domiciliation, the establishment of a skills fund, support for the GKN name, and safeguards to protect national security interests. Melrose has and continues to fully respect and comply with those commitments and promises.

Shareholders
Melrose has attracted long-term support from its key shareholders since its establishment in 2003 and this support is vital in securing our material acquisitions. Throughout the GKN acquisition, openness and transparency about Melrose's intentions for the GKN businesses was paramount in securing shareholder approval for the acquisition. The unsolicited nature of the acquisition required Melrose to demonstrate to its own shareholders and the GKN plc shareholders that the long-term prosperity of the GKN businesses would benefit from Melrose's stewardship. This required Melrose to provide timely information in a wholly transparent manner throughout the accelerated timetable of a rigorously regulated takeover process, to enable shareholders on all sides to make their investment decisions on an informed basis. Conclusively, Melrose shareholders approved the deal, and GKN shareholders accepted Melrose's offer.

3

Prioritise and nurture the wellbeing and skills development of employees and the communities that they are part of

Buy Improve Sell

Melrose is responsible for ensuring that its workers are safe, and prioritises the safeguarding of their health and wellbeing. The Group employs more than 55,000 people who are largely based in manufacturing facilities across the globe, which requires each business to create and maintain safe and healthy workplaces and operational practices, and a robust culture of health and safety awareness, training and performance.

In its first year
the Melrose Skills Fund

provided financial support to initiatives driven by Melrose, GKN Aerospace, GKN Automotive and Brush

£593m
contributed

to our businesses' pension schemes since 2003

Over
£1m

in cash donations and raised funds for charitable causes across the Group

30% and 33%

of the Board and Melrose Executive Committee respectively are women

200+

apprenticeships provided across our GKN Aerospace, GKN Automotive and GKN Powder Metallurgy divisions in 2019

The Melrose approach to employee wellbeing does not stop at the workplace. We also support Group businesses and their employees in contributing to charities and projects that benefit the communities they operate and live in if they wish to.

Importantly, our support does not end when employees retire. Assisting with the future of employees and retirees through responsible stewardship of their pensions is of importance to the Board.

Pensions

Since its establishment in 2003, Melrose has contributed £593 million to the pension schemes of its businesses. We also take pride in having substantially improved all the UK pension schemes under our ownership, with many of them becoming fully funded on departure from the Group, as set out on page 7. Our model for ensuring the long-term prosperity of our businesses' pensions schemes is founded on the following principles:

- Improve funding targets to ensure improved financial health for the long-term sustainability of our businesses' pension schemes.
- Increase funding levels to begin an enhanced level of immediate support during our period of stewardship.
- Provide better structural and financial security to our businesses' pension schemes during our ownership.
- Insist on independent chairs to govern our businesses' pension schemes in accordance with governance best practice.

For further details, please see the "In focus: stakeholder engagement during the GKN acquisition" case study on page 64 of this report, and the Shareholder value creation section on pages 6 and 7 for further details on pension schemes deficit funding.

Health, safety and wellbeing

Health and safety is a priority for the Board and the management teams of all Group divisions. The Board sets high standards of health and safety management, compliance and awareness throughout the Group, by way of robust policies and reporting requirements. This is first informed by reviewing and challenging the health and safety performance of each Group business every quarter, supplemented by further reporting from business unit executive teams in respect of particular or serious health and safety incidents or issues. This enables the Board to fulfil its responsibility for driving implementation of strong investigative, preventative and corrective actions by the divisional management teams.

Whilst the Board takes a zero-tolerance approach to avoidable health and safety risks, during 2019 the Nortek Global HVAC site in Montreal, Canada tragically suffered a fatality. The Board and Melrose senior management team immediately supported the business executive team in investigating the incident without delay, overhauling relevant health and safety procedures and employee training and awareness to ensure implementation of the improvements, and ensuring that the affected family was duly compensated. Further details about the improvement measures that were implemented are set out in the key performance indicators section on pages 36 and 37.

At a business level, the executive teams are best placed to understand the requirements of their employees' specific working environments, and are therefore empowered to implement best practice and ensure that (i) their businesses have robust measures in place to identify, monitor and manage health and safety risk; and (ii) their employees are aware of those practices and trained to implement them correctly. This is supported by internal health and safety effectiveness audits, external Group insurance reviews, external certifications such as ISO standards, and regular challenge and continual oversight from the Melrose senior management team.

Each division is responsible for implementing local legislation and standards appropriate to the specific nature of activities undertaken at each of their facilities. Two-thirds of the Group's manufacturing facilities are OHSAS 18001 (Occupational Health and Safety Assessment Series) certified. In addition, all GKN and Brush sites have begun the process of attaining the certification of the upgraded ISO 45001:2018 standard for management systems of occupational health and safety – developed based on the latest best practices and approaches to prevent work-related injury and ill-health and to provide safe and healthy workplaces.

The Group also encourages and supports divisions to embed a proactive, safety-aware culture. Behaviour-based programmes and continuous training and awareness campaigns remain central to the approach of all divisions, aided by strengthened emphasis on leading indicators such as near-misses and hazard identification and awareness. Our aim is to drive our businesses to step up from solely overcoming shortfalls in their performance, to achieving longer term improvement. We encourage our businesses to focus on improving their leading indicators of attaining a sustainably positive health and safety regime by preventing incidents and near misses, to enable enhanced focus on identifying hazards to change the culture and performance of their health and safety functions over the longer term.

By way of example, GKN Aerospace, one of the Group's largest divisions, has made positive strides towards achieving this, by having:

- reduced serious incidents by approximately 90% over the last five years, with over 80% of that improvement occurring since 2018;
- reduced near misses by approximately 83% since 2017; and
- demonstrated a greater focus on hazard identification as an early warning sign to then mitigate risk of injury, with such identification increasing by approximately 60% since 2018.

Employee wellbeing and contributing to the communities around us

The Group recognises the increasing importance of taking a holistic approach to employee wellness, to protect their physical health and social wellbeing, and to foster a positive workplace culture that attracts and retains a highly skilled workforce. During 2019 numerous wellbeing initiatives were implemented across our businesses, from the provision of occupational health advisors to the holding of global wellness events.

Our businesses also promote the social wellbeing of employees by encouraging them to actively contribute to a range of charitable and community projects. In total, our businesses made cash donations and raised funds for charitable causes in 2019 of over £1 million:

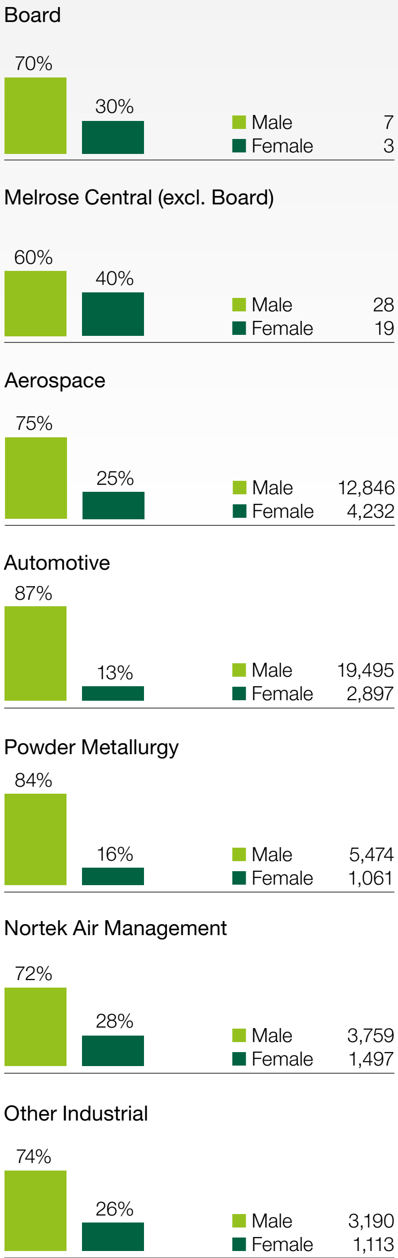
- GKN Aerospace continued to support the Aerospace Bristol museum and learning centre with an annual donation of £100,000. The charity seeks to inspire current and future generations through stories and achievements of the local aerospace industry and to advance learning, skills and training, particularly in science, technology, engineering and design.
- GKN Automotive continued to support a village school in India that is home to underprivileged children, and this year constructed new bathrooms for the children.
- GKN Powder Metallurgy contributed over £321,000 to charitable causes. In the US, employees are actively involved in the Hearts of Gold community programme, volunteering their time and expertise, participating in sponsored runs and relays and raising funds for much needed causes.

ESG report
Continued

Promoting diversity at all levels

Melrose recognises the importance of diversity in delivering better business performance and building a high-calibre workforce, as well as good labour relations, employee engagement and people development. Melrose champions diversity in the broadest sense, be that along geographical, cultural, personal or market lines, encompassing gender, race, sexual orientation and disability. Whilst remaining a meritocracy, Melrose is actively engaged in finding ways to increase the diversity across the Group, and the sectors in which it operates.

Gender diversity within the Group as at 31 December 2019



Melrose leads its businesses by example, starting at Board level. Since 2018, all Board appointments have been female and two of the most important roles on the Board, being the Senior Independent Director and the Chairman of the Audit Committee, are held by a woman. With the retirement of Mr David Roper in May 2020, Melrose will have achieved ahead of schedule the 2020 target set out in the Hampton-Alexander Review of having 33% female representation on its Board. It has also achieved ahead of schedule the 2021 target set out in the Parker Review of having one director of colour on its Board.

The Board has implemented the same high standards and values among Melrose senior management, where 33% of the Executive Committee are female, and those standards and values are driven through our businesses.

At a business unit level, GKN Aerospace has launched the inaugural 'Inspired Women's Leadership Development Programme' with the professional training and coaching company Forward Ladies, designed to help women in the organisation succeed and to encourage women to mentor other female colleagues in the business. The programme saw 35 female leaders globally from across the division come together to hear industry-leading speakers and to share their own learning, resources and insights relevant to their roles and careers. GKN Aerospace was also pleased to strengthen its executive committee with two new female appointments in 2019.

Through the Melrose Skills Fund, Melrose is working on a diversity project to help improve diversity within the engineering sector as a whole. This project is being led by Enginuity (formerly known as Semta), a not-for-profit organisation that leads on several initiatives to support the engineering and manufacturing sectors, and also involves Unite. The aim of this project is to conduct research into identifying barriers that are hindering socio-economic and ethnic diversity within the engineering sector, with a view to provide support to projects and potentially provide bursaries to help increase diversity based on these findings. A meeting of the project steering committee, which consists of Melrose, Enginuity and Unite, was held in January 2020 to discuss the findings of the initial report, which will inform the development of short, medium and long-term actions that can be undertaken to increase diversity in the sector.

Further details on diversity can be found in the Nomination Committee report on pages 88 to 89, and a copy of our diversity policy can be found on our website at https://www.melroseplc.net/about-us/governance/code-of-ethics/corporate-responsibility/.

Senior managers

In accordance with section 414C of the Companies Act 2006, the definition of senior managers is required to include Group employees who are directors of Group undertakings, but excludes the Board of Melrose Industries PLC. Melrose does not consider that including the employee directors of its undertakings provides an accurate reflection of the senior management at Melrose, nor its executive pipeline. As reflected in note 3 to the financial statements, Melrose has many undertakings, including dormant, non-trading and immaterial subsidiaries. We have 33% female representation on our Executive Committee which represents a more accurate reflection of the senior management team and executive pipeline at Melrose.

Total Group gender diversity	Total	Male	Female
Total Group	55,621	44,799 (81%)	10,822 (19%)

Senior Managers (section 414C of the Companies Act 2006)	Male	Female
Employees in senior management positions	20 (71%)	8 (29%)
Directors of group undertakings, excluding the above	183 (92%)	15 (8%)
Total Senior Managers	203 (90%)	23 (10%)

Promoting fair employment and skills development

Melrose drives its businesses to create inclusive and rewarding workplaces and is committed to providing equal opportunities for all employees within the Group. In line with our decentralised model, the executive management team of each business is empowered to handle employee matters, to ensure the approach taken is attuned to the specific needs of the business as well as of their employees. This enables the divisional management teams to cultivate their own authentic employer brand, in a manner that is sensitive to their respective commercial, operational, market and geographical context.

Inclusive and fair employment

A culture of clear communication and employee consultation and engagement is inherent across the Group. The majority of business units, for example, operate "town hall" meetings to communicate strategy, key changes, financial results, achievements and other important issues to employees, and to listen to their feedback. Employee surveys, notice boards, team meetings, suggestion boxes and newsletters are also used to communicate and engage with employees, and to seek their feedback on issues of concern to them. GKN Powder Metallurgy has developed a 'PM Connect' app which is free for employees to download, has a translation function, and informs employees of internal announcements and communications.

The WAP is a key Group forum to promote effective engagement with, and encourage participation from, all people working within the Group. The Board places strategic importance on the WAP to report and elevate all material feedback from the workforce, whether positive or negative, and how it has been incorporated into decision making at a business unit executive level – where it is most impactful and effective. This feedback is discussed at Board meetings along with the whistleblowing report which highlights whistleblowing activity across the business units and a summary of the approach taken.

Applications for employment by disabled persons are fully and fairly considered by the Group on the basis of merit, with regard only to the job-specific requirements and the relevant applicant's aptitude and ability to carry out the role. 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 for disabled persons to be treated fairly, so that they can contribute on an equal-opportunity basis to business success, to society and to economic growth.

Skills development

The Group champions talent development and recognises the importance of investing in human capital and skills for the long-term success of each business. This is central to Melrose's strategy to boost productivity and improve business performance, and the Melrose senior management team, at the direction of the Board, work closely with all divisions to achieve this.

The GKN Aerospace division committed to invest over £30 million in its Portsmouth, Luton and Bristol sites in the UK to boost their capabilities and transform them into global centres of excellence. Through these substantial investments the three manufacturing sites will further support job creation and engineering skills development, and reinforce the important role they play in the communities around them.

Extensive training opportunities are available and promoted to all workers to ensure that high skills levels are cultivated and maintained across the Group. In particular, GKN Aerospace has launched a new learning management system for a wide range of learning activities from e-learnings to instructor-led courses. Since its launch in June 2019, 12,500 courses have been enlisted in and the curriculum has doubled from 50 to 100 learning and development opportunities.

Training programmes across the business units focus on leadership, interpersonal and functional skills development for managers, supervisors and shop-floor employees.

Employees across the Group are encouraged to think innovatively and to have regard for the financial sustainability of the Group, as well as their business's impact on internal and external stakeholders. The importance of training extends beyond on-the-job training and focuses on enhancing personal development. As a sign of its commitment to fostering and developing talent, in 2019 GKN Automotive won the 'Ovation Award' from Capital Associated Industries for the second time in respect of its career mapping process.

In addition, apprenticeship programmes assist with training a new generation of employees and ensure knowledge is retained within the businesses. More than 200 apprenticeships were provided across our GKN Aerospace, GKN Automotive and GKN Powder Metallurgy divisions in 2019. In recognition of their strong commitment and continuous improvement of their apprenticeship programmes, the GKN Aerospace's Filton and Western Approach, UK sites were named 'Large Employer of the Year' for the sixth consecutive year in the Bristol & Bath Apprenticeship Awards.

Similar focus is placed on training and developing graduates. In 2019 GKN Aerospace held a two-week global graduate on-boarding event in Sweden, where graduates were provided with an insight into the engines business and space industry, and were also given tours of the site and facilities.

In focus: The Melrose Skills, Innovation and Productivity Fund

The GKN acquisition demonstrated Melrose's long-standing belief in building industrial excellence, and investing in underperforming businesses to unlock and promote their long-term prosperity for the collective benefit of stakeholders, including the next generation of engineers. We identified a strong need to develop the human capital required to transform GKN into a stronger engineering and manufacturing powerhouse and responded with a pledge to invest £10 million over five years to further this cause. 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 it needs.

The GKN Aerospace, GKN Automotive and Brush businesses have implemented initiatives with the financial support of the Melrose Skills Fund. In 2019, GKN Aerospace deployed funding to develop a comprehensive programme of training materials and digital learning modules to upskill its teams. So far workers across different disciplines have benefited from training relating to all manner of topics, from root cause corrective actions, through geometric design to robotic language programming. GKN Automotive has capitalised on funding to further the aims of its Innovation Centre's Engineering Skills Development Programme which seeks to develop high-calibre engineering talent and engage and develop existing staff in the UK. In 2019, 442 people took part in GKN Automotive-led STEM activities and the business recruited apprentices and sponsored a PhD position.

Melrose is also working on a diversity project which is supported by the Melrose Skills Fund with the aim of increasing socio-economic and ethnic diversity within the engineering sector. This project is being led by Enginuity and also involves Unite. Further details can be found on page 66.

4

Exercise robust governance, risk management, and compliance

Improve Sell

Sound business ethics and integrity are core to the Group's values and are fundamental for the success of our strategy. Melrose is a UK premium listed company with strong, established financial controls that are continually assessed, tested and reviewed. This robust framework is supported by an independent internal audit function, regular public disclosure and financial reporting, external audits, and public accountability and conformance with leading benchmarks set by the UK Corporate Governance Code, investor requests, corporate governance advisors' recommendations, and extensive engagement with the Group's wider stakeholder base to ensure best market practice.

These high standards of robust financial controls, and strong governance backed by internal and external auditing of financial and non-financial compliance, are enforced throughout the Group. All businesses are required to comply with Melrose's Code of Ethics. These include policies covering best practice with respect to anti-bribery and anti-corruption, anti-money laundering, anti-tax evasion, competition, trade compliance, data privacy, whistleblowing, treasury and financial controls, anti-slavery and human trafficking, document retention and joint ventures.

22,000 employees

completed IT and cyber security training during 2019

Strict procedures

in place to ensure Tungsten, Tantalum, Tin, and Gold are sourced responsibly and from conflict-free regions of the world

Their implementation is then supported by risk assessments, audits and reviews, annual compliance certifications, and a Group-wide whistleblowing platform monitored by the businesses' legal and compliance functions and supported by the Melrose senior management team, to empower employees to raise concerns, in confidence, about possible wrongdoing in any aspect of their business, including financial and non-financial matters. Melrose strongly believes that policies and procedures are only as effective as the people who implement them. To that end, all of the above measures are backed by investment, resources and training.

The Company takes a zero-tolerance approach to bribery, corruption and other unethical or illegal practices and is committed to acting professionally, fairly and with integrity in all business dealings and relationships, within all jurisdictions in which we operate. Melrose also requires its businesses to adopt high governance standards, to ensure that the Group conducts business responsibly, sustainably, and in the pursuit of long-term success for collective benefit of stakeholders.

Please refer to pages 46 to 47 for full details on the Group's approach to Risk management.

Ensuring the highest standards of product quality and safety

Melrose is committed to ensuring that our businesses achieve the highest standards of product quality, reliability and safety, in recognition of their importance in protecting the wellbeing of ultimate end-users, and futureproofing each business and its ability to deliver profitable long-term performance. Each division follows strict product design and development procedures to ensure precise delivery to customer specification, and to seek opportunities to enhance quality and safety performance. This is especially critical in the highly regulated aerospace and automotive sectors, demonstrating the high standards that the Group is held to:

- GKN Aerospace's Zero Defects programme is aligned to the emerging aerospace industry Advanced Quality Product Planning and Production Part Approval Process and draws on best practice from across the industry and GKN Aerospace. To date, leaders throughout the business and over 25% of the manufacturing engineers have completed rigorous, industry-leading training to uphold production excellence.
- GKN Automotive's customers continue to recognise its dedication to quality and safety excellence and in 2019 its sites received the Toyota Quality Excellence Award, Mitsubishi Quality Awards and Nissan's Safety Excellence Award.

In 2019, our businesses continued to invest in developing products that help customers achieve better quality, reliability and safety outcomes, either in their operations, or in the use of their products. Examples of such solutions include:

- GKN Automotive's torque vectoring technology for all-wheel-drivetrain ('AWD') products stabilises conventional and electrified cars during cornering and accelerating and improves the safety of the vehicle in all conditions, especially on corners or on wet, dirty, and icy roads.
- As part of its 'Design for PM' experience, GKN Powder Metallurgy offers customers a product development cooperation service which often leads to the redesign of products and sub-assemblies. The business has invested approximately 71% of its total research and development expenditure in helping customers achieve better quality outcomes through advanced simulation and lab support, material optimisation and systematic testing methods and in 2019 received nine product quality awards.
- All HVAC products are designed, tested and rated on safety performance to exceed industry standards, such as those set by the California's Office of Statewide Health Planning and Development and the American National Standards Institute, and are designed with the safety of the end-user and the maintenance technician in mind. The business has recently launched a new platform of entry-level spilt systems which have eliminated rattling, removed hard to handle single piece metal jackets with panelised wire guards in order to minimize sharp edges and laceration risks.
- All AQH products are focused on improving the air quality inside the home by safely eliminating pollutants that can adversely impact human health. In 2019 the business invested in innovations to improve air quality across the whole house. One such example includes a new set of air quality sensors linked with a proprietary algorithm that operates a cooker range hood autonomously to maintain the air quality of the kitchen.

- As a leading manufacturer of medium and high voltage technology, safety considerations are critical to Brush. In 2019, 10% of its research and development spend was dedicated to this area. In one such example, the Safer Isolation SafeBond project enables customers to reduce the downtime of their network during maintenance and achieve a safer bounding of the live rail with minimum human interaction.
- All products that Ergotron develops, from monitor arms to sit-stand desks, electric desks, and heath care carts, are designed to improve how people work, learn, play and care for others and help customers achieve better health and safety outcomes.

Working with our suppliers to ensure respect for labour and human rights and the environment

Melrose recognises the potential risks of human rights abuses and modern slavery, as well as the environmental impacts inherent to global, complex, multi-tier supply chains. We are committed to acting in an ethical manner with integrity and transparency in all business dealings, and to creating effective systems and controls across the Group to safeguard against adverse human rights and environmental impacts. The Group has also taken steps to encourage business divisions to implement effective and proportionate measures to ensure that there are no forms of modern slavery in their operations or supply chain.

Modern slavery and human trafficking
As set out in the Melrose Anti-slavery and Human Trafficking Policy, the Group has a zero-tolerance approach to any form of modern slavery. In accordance with the Modern Slavery Act 2015, Melrose publishes its own Modern Slavery Statement which is approved by the Board annually and can be found on our website at https://www.melroseplc.net/media/2487/modern-slavery-statement-june2019.pdf. Under Melrose's decentralised group structure, each division is responsible (where applicable) for publishing their own Modern Slavery Statements in accordance with the requirements under the Modern Slavery Act 2015, with support provided by Melrose where needed. This approach ensures that those senior managers closest to the business operations devise appropriate measures to eradicate slavery from their supply chains.

Each division is in the process of rolling out training to employees on the implementation of Melrose's anti-slavery and human trafficking policy so that employees understand the risks and what actions should be taken if they suspect that modern slavery is happening internally or within the supply chain.

Supplier qualification and compliance
The security, assurance and ethical compliance of suppliers is very important to Melrose in building the resilience of its businesses to supply chain shocks and reputational risks. Responsibility for the implementation and management of all supplier-related policies rests with local management. The Group supports its businesses in implementing and managing such policies across their respective supply chains, in line with the nature and geographical representation of their supplier base. In addition to providing the highest quality products or services, suppliers are expected to operate their businesses in a way that supports the Group's commitment to acting ethically and responsibly. All business divisions have a supplier qualification process which as a minimum, requires suppliers to sign the respective division's Supplier Code of Conduct or equivalent policy and depending on the determined level of risk may also result in an audit or further reviews.

All businesses that source products or raw materials containing Tungsten, Tantalum, Tin, and Gold ('3TG') have strict procedures in place to ensure that 3TG minerals are sourced responsibly and from conflict-free regions of the world. Relevant suppliers are required to perform due diligence to ascertain the point of origin of 3TG minerals in products and to complete the Responsible Minerals Initiative reporting template or equivalent.

Protecting information security and data privacy
Melrose strongly respects privacy and seeks to minimise the amount of personal data that it collects, as well as ensuring the robust and sufficiently segregated storage of any data that is held. Information security and cyber threats are an increasing priority across all industries globally, and like many businesses, Melrose recognises that the Group must be protected from potential exposures in this area particularly in light of its scale, reach, complexity and public-facing nature, as well as the potential sensitivity of data held in relation to civil aerospace technology and controlled defense contracts.

The Melrose senior management team continues to work with the divisional executive teams and external security consultants to track the Group's exposure to cyber security risk and, to ensure appropriate compliance with the GDPR, mitigation measures are in place for the Group. In 2019, Melrose completed the deployment of its information security strategy and risk-based governance framework to all businesses within the Group, which follows the UK Government's recommendations on cyber security. This strategy has enabled risk profiling and mitigation plans to be developed for each business to mitigate and reduce their exposure to cyber risk in a manner that is adequate for their level of sophistication. This ensures clarity and consistency in the assessment of IT and cybersecurity matters across our diverse and decentralised Group. The progress of each business is measured against the information security strategy and is monitored on a quarterly basis.

As part of Melrose's overall information security strategy, IT Security awareness training was deployed by all businesses, with more than 22,000 employees in attendance over the course of 2019.

Paying tax responsibly
Melrose is committed to paying taxes that are due, complying with all applicable laws, and engaging with all applicable tax authorities in an open and cooperative manner. The Group's tax strategy is reviewed, discussed and approved by the Board annually with continuous commitment not to engage in aggressive tax planning.

The Group has adopted a policy in respect of the prevention of the facilitation of tax evasion which has been implemented by the businesses, with guidance on undertaking risk assessments and training to employees in relevant roles.

We hope that our inaugural ESG report has provided clarity and comfort for stakeholders in respect of all the actions and ambitions of Melrose and the businesses we own. We continually strive for improvement and look forward to providing further updates on progress in due course.

The Strategic Report, as set out on pages 4 to 69, has been approved by the Board.

On behalf of the Board

Simon Peckham
Chief Executive
5 March 2020

Governance overview

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.

Justin Dowley
Non-executive Chairman

As part of this approach, the Board has applied the principles and complied with the provisions of corporate governance contained in the UK Corporate Governance Code 2018 (the "Code") issued by the Financial Reporting Council (the "FRC") and available to view on the FRC's website at: www.frc.org.uk.

In support of this commitment, the Board carried out a number of key governance activities during 2019 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.

Succession planning

Succession planning was an area of focus for Melrose in 2019. The Nomination Committee and the Board considered the leadership needs of the Group, present and future, together with the skills, experience 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.

In order to facilitate effective succession planning and the development of a diverse Board, following discussion and engagement with key shareholders, the Nomination Committee and the Board approved extending my tenure as Non-executive Chairman for up to a further three years beyond 2020, subject to my annual re-election at the Company's AGM. This is outlined in further detail in the Nomination Committee report on pages 88 to 89, together with further details on how succession planning arrangements for the Board and Melrose senior management team were reviewed and considered.

Following a review by the Nomination Committee of the composition of the Board and subsequent recommendation by the Nomination Committee that the number of independent Directors be increased, Ms Funmi Adegoke was appointed to the Board with effect from 1 October 2019. Further details of Ms Adegoke's appointment is outlined in the Nomination Committee report on pages 88 to 89.

Melrose Executive Committee

The Melrose Executive Committee operates under the direction of the Chief Executive. It is chaired by a member of the Melrose senior management team on a rotating basis to encourage diversity, and comprises members of the Melrose head office team from London, Birmingham and Atlanta. The Melrose Executive Committee meets on a weekly basis and executive and Non-executive Directors attend by invitation. Its key roles are to ensure that there is a full knowledge of, and coordination between, the central team on all important issues; to consider what, if any, actions are required that week in respect of acquisitions, disposals and day-to-day management; to ensure that the appropriate resource is being devoted to resolve any such issues; and to ensure that actions being taken are supportive of the Group's aims, objectives and culture.

Remuneration

The Directors' Remuneration report, comprising the annual statement from the Chairman of the Remuneration Committee, the Annual Report on Remuneration and the proposed new Directors' remuneration policy, are available on pages 90 to 111.

As further detailed in the Directors' Remuneration report, the current Directors' remuneration policy and long-term incentive plan are due for renewal by shareholders this year. The current Directors' remuneration policy and long-term incentive plan have had significant continuity from Melrose's establishment in 2003 and have been at the heart of Melrose's long-term success since, as evidenced by it being the second highest performer in the FTSE 350 over the past decade. Recognising the importance of the renewal, we undertook a detailed planning process, including engagement with key shareholders and governance bodies. Having completed this process, subject to approval at the 2020 AGM, the Remuneration Committee is proposing to adopt a new Directors' remuneration policy (the "2020 Policy") and long-term incentive plan on broadly consistent terms as those previously approved, save for two key changes to the long-term incentive plan, which seek to further enhance protection for shareholders (see pages 103 to 111 for the 2020 Policy).

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 pay only for performance.

Risk management and compliance

Melrose has implemented a uniform Enterprise Risk Management programme across all its business units. Our processes and procedures are now fully embedded in the GKN businesses, alongside Brush and the Nortek businesses.

The Group's compliance policies have been fully implemented across all 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 46 to 47 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. Further details of the Group's stance and focus on ensuring effective stewardship in respect of key environmental, social and governance matters are set out in the ESG report on pages 58 to 69. Supporting our updated compliance policies are a comprehensive online training platform, an industry-leading whistleblowing reporting facility and a new data-driven risk reporting dashboard providing increased risk management visibility and trend analysis to senior management and the Audit Committee. The integrity of the compliance framework is further reinforced by the use of independent assurance and compliance audits.

Engagement with stakeholders

Engagement with key shareholders and governance bodies has continued throughout 2019. In advance of the upcoming renewal of our Directors' remuneration policy and incentive arrangements, in addition to the decision to extend my tenure as Non-executive Chairman for up to a further three years beyond 2020, we have engaged constructively with major investors and governance bodies as applicable in order to understand their views on the proposals. The Board is pleased with the support and feedback received throughout these discussions. Otherwise, we have continued to engage with shareholders on a number of important topics, such as diversity and modern slavery, and it is our intention to continue with this programme of engagement in 2020. Further detail on how the Board considers stakeholders in its decision-making is set out in our Section 172 statement on pages 56 to 57 and in the ESG report on pages 58 to 69.

J Dowley

Justin Dowley
Non-executive Chairman
5 March 2020

Main responsibilities of the Board

- Effectively manage and control the Company via a formal schedule of matters reserved for its decision
- Define the Group's purpose, determine and review Group strategy and policy to deliver that purpose, and provide strategic leadership to the Group
- Set the Group's values and behaviours that shape its culture and the way it conducts business
- 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
- Engage with stakeholders and key shareholders on issues that are most important to the long-term success of the Company
- Consider the views of the Group's workforce as provided in the feedback from the Workforce Advisory Panel, in its discussions and decision making
- 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
- Oversee 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
- Promote the success of the Company over the long-term for the benefit of shareholders as a whole, having regard to a range of other key stakeholders and interests, including environmental, social and governance matters

Board of Directors

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[1]	4
Business reviews attended	3

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

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[1]	4
Business reviews attended	2

Other significant appointments
- Trustee of the Prostate Cancer Research Centre

Independent	Not applicable

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[1]	4
Business reviews attended	3
Independent	Not applicable

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[1]	4
Business reviews attended	3

Other significant appointments
- Non-executive Director of Novo Nordisk A/S, National Grid PLC (with effect from 1 January 2020), 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

Independent	Yes

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[1]	4
Business reviews attended	3

Other significant appointments
- Non-executive Director of Electra Private Equity PLC

Committee membership
- Audit
- Nomination
- Remuneration (Chairman)

Independent	Yes

Archie G. Kane
Independent Non-executive Director

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

Skills and experience
Archie has held several senior roles in the financial services sector and brings extensive financial experience to the Board. Archie qualified as a chartered accountant with Mann Judd Gordon & 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 appointed as 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. He was also Non-Executive Governor of the Board of the Bank of Ireland until July 2018.

Board meetings attended[1]	4
Business reviews attended	3

Other significant appointments
- Non-executive Chairman of ReAssure Group Limited

Committee membership
- Audit
- Nomination (Chairman)
- Remuneration

Independent	Yes

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 (1)	4
Business reviews attended	3
Independent	Not applicable

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. During this time, Geoffrey was involved in a number of projects, including raising public equity, debt refinancing and the restructuring and outsourcing of the manufacturing and supply chain.

Board meetings attended (1)	4
Business reviews attended	3
Independent	Not applicable

Charlotte Twyning
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 Executive Director Policy, Communications and Strategy. Charlotte is currently Consents Director on the Heathrow Expansion Programme Committee responsible for securing the approvals for its expansion.

Board meetings attended (1)	4
Business reviews attended	3
Committee membership • Audit • Nomination • Remuneration	
Independent	Yes

Funmi Adegoke
Independent Non-executive Director

Year appointed
Appointed as a Non-executive Director on 1 October 2019.

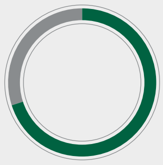
Skills and experience
Originally qualifying as a barrister, Funmi has well over a decade of working in and leading legal teams across the globe at the large multi-nationals Bombardier and BP. During this time she gained extensive experience within the aerospace, engineering, manufacturing and energy sectors. Funmi brings diverse industrial knowledge as well as significant transactional and commercial management expertise to the Board.

Board meetings attended (1)	1 (2)
Business reviews attended	1 (2)
Committee membership • Nomination • Remuneration	
Independent	Yes

(1) Meetings attended refers to scheduled meetings.
(2) Appointed to the Board with effect from 1 October 2019 and attended all Board meetings and business reviews held during the period 1 October 2019 to 31 December 2019.

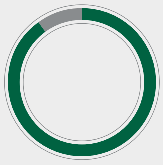
Diversity and skills overview

Board gender diversity



Male	70%
Female	30%

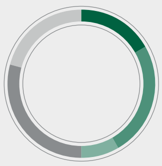
Board ethnic diversity(1)



Non BAME	90%
BAME	10%

(1) In accordance with the Parker Review, BAME individuals are those who identify as or have evident heritage from African, Asian, Middle Eastern, Central and South American regions.

Board skills

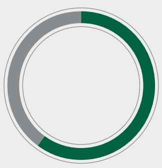


Industrial	4
Accounting and Finance	6
Legal	2
Investment	7
Corporate Governance	5

Melrose Executive Committee

Male	67%
Female	33%

Melrose Central employees (excl. Board)



Male	60%
Female	40%

The Directors of Melrose Industries PLC present the Annual Report and financial statements of the Group for the year ended 31 December 2019.

Incorporated information

The Corporate Governance report set out on pages 77 to 81, the Finance Director's review on pages 38 to 44 and the ESG report section of the Strategic Report on pages 58 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 Leconfield House, Curzon Street, London W1J 5JA at 11am on 7 May 2020. A detailed explanation of each item of business to be considered at the AGM is included with the Notice of Meeting (the "AGM Notice"), which is provided to shareholders with this Annual Report.

Directors

The Directors of the Company as at the date of this Annual Report, together with their biographies, 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 77 to 81. Details of Directors' service contracts are set out in the Directors' Remuneration report on page 101.

The Statement of Directors' responsibilities in relation to the consolidated financial statements is set out on page 112, 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 Funmi Adegoke who will be standing for election for the first time following her appointment on 1 October 2019, all current Directors of the Company will be standing for re-election by 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 2 January 2020 GKN Powder Metallurgy completed the acquisition of Forecast 3D, a leading US specialist in plastic additive manufacturing and 3D printing services offering a full range of services from concept to series production, for a total consideration of up to £29 million, of which £20 million was paid on 2 January 2020. The acquisition furthers GKN Powder Metallurgy's ambition to achieve global market leadership in industrialising additive manufacturing. In the year ended 31 December 2019 FORECAST 3D achieved sales of approximately £17 million.

Capital structure

The table below shows details of the Company's issued share capital as at 31 December 2018 and as at 31 December 2019.

Share class	31 December 2018	31 December 2019
Ordinary shares of 48/7 pence each	4,858,254,963	4,858,254,963
Incentive Shares (2017)	12,831(1)	12,831

(1) 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.

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

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 5 March 2020, 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 2020 AGM are set out in the AGM Notice, which is provided to shareholders with this Annual Report.

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 Financial Conduct 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 2019, 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 2019
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 2020 and 5 March 2020 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 3.4 pence per share (2018: 3.05 pence) to be paid on 20 May 2020 to ordinary shareholders on the register of members of the Company at the close of trading on 3 April 2020. This dividend recommendation will be put to shareholders at the forthcoming AGM of the Company, to be held on 7 May 2020. Subject to shareholder approval being obtained at the AGM for the final dividend, this will mean a full year 2019 dividend of 5.1 pence per share (2018: 4.6 pence).

For discussions on the Board's intentions with regard to the dividend policy, please see the Chairman's statement on pages 12 to 13, 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.

Historic dividends

The Company administers the unclaimed dividends of the former FKI plc (now "Brush Holdings Limited") and the former GKN plc (now "GKN Limited"). Pursuant to law and the articles of association of the respective companies, the Company is obliged to pay such unclaimed dividends for a period of 12 years from the date on which they were declared or became due for payment ("Unclaimed Dividends"). Six months after this time period has expired, the Company's policy is to donate the amount of the Unclaimed Dividends to a charity of the Company's choice. As at 31 December 2019, the total amount of such Unclaimed Dividends was £224,837.06. If the Unclaimed Dividends are not claimed by 30 June 2020, the Company will donate the funds to charity.

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 9 May 2019, the Company is authorised to make market purchases of up to 485,825,496 of its ordinary shares, representing approximately 10% of the current issued ordinary share capital of the Company. 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, which is provided to shareholders with this Annual Report.

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 Director's review on pages 38 to 44, the Risks and Uncertainties section of the Strategic Report on pages 48 to 55 and in note 25 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 16 to 35, which are incorporated by reference into this Directors' report, investment into research and development activities continued throughout 2019. In GKN Aerospace, over £50 million was committed to new investment productivity across key European and US facilities with Melrose support. Investment in technology also saw GKN Aerospace manufacture and deliver the first components for Airbus' *Wing of Tomorrow* programme. GKN Automotive recently announced a strategic collaboration with Delta Electronics Inc., a global power electronics specialist, for the joint development of advanced eDrive technology, with Delta inverters integrated with GKN Automotive's eMotor and gearbox systems. This important development milestone has been matched by the delivery of GKN Automotive's one millionth eDrive system.

The significant investment in innovation and technology at HVAC has culminated in the successful commercialisation of its StatePoint Technology® cooling system, including a multi-continent collaboration with a leading global social media conglomerate to provide cooling systems to data centres across the world. Investment in this area is expected to continue in order to maximise the full potential of these technological developments.

Brush has also continued to invest in product development across all of its businesses, including broadening its product range in switchgear and enhancing its turbogenerators product portfolio.

The Melrose Skills Fund has also funded initiatives in the GKN Aerospace, GKN Automotive and Brush businesses. Further details on the initiatives being implemented are set out in the ESG report section of the Strategic Report on pages 58 to 69.

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 12 to 13 and the Strategic Report on pages 4 to 69 of this Annual Report (including the Longer-term viability statement on page 45 and the Risks and Uncertainties section on pages 48 to 55), which are incorporated into this Directors' report by reference.

Employee engagement

Details in relation to the Workforce Advisory Panel, employment policies, employee involvement, consultation and development, together with details of some of the human resource improvement initiatives implemented during 2019 are shown in the ESG report section of the Strategic Report, and in the Section 172 statement set out in the Strategic Report, both of which are incorporated by reference into this Directors' report.

Business relationships

Details of our businesses' clients and suppliers and how they work and engage with them are described in the ESG report section of the Strategic Report, and in the Section 172 statement set out in the Strategic Report, both of which are 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 60 to 61 of the ESG report section of the Strategic Report, which is incorporated by reference into this Directors' report.

Directors' report

Continued

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 2019 (2018: nil).

Branches

The Melrose Group and its businesses operate across various jurisdictions. The 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 95 of the Directors' Remuneration report and note 23 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 2017 Incentive Plan (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 5 March 2020.

The Group has a committed bank facility, comprising a multi-currency term loan denominated £100 million and US$960 million 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 page 43 and note 25 to the financial statements.

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 outstanding £450 million fixed rate notes paying 5.375% p.a. interest and maturing on 19 September 2022 and £300 million fixed rate notes paying 4.625% p.a. interest and maturing on 12 May 2032, in each case issued under Euro medium-term note programmes (together, the "Notes"). Pursuant to the terms and conditions of each of 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 together with accrued interest, 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 2017 Incentive Plan 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. Some of these are summarised below.

In April 2018, the Company agreed to certain (i) undertakings and consent requirements with the UK Secretary of State (SoS) for Business, Energy and Industrial Strategy (BEIS) in relation to maintaining ownership of the core GKN Aerospace business until April 2023; and (ii) restrictions and consent requirements with the UK SoS for Defence related to production of controlled items by the GKN Aerospace business.

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 rights of the GKN Aerospace and GKN Automotive businesses to use the GKN trademarks, and maintaining an agreed level of R&D spend for the GKN businesses.

Auditor

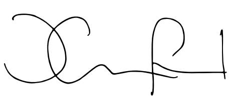
So far as each Director is aware, there is no relevant audit information (being information that is needed by the Company's auditor to prepare its report) of which the Company's auditor is unaware. Each Director has taken all the steps that he or she ought to have taken as a Director to make him or herself 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 2019 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
5 March 2020

Corporate Governance report

In line with the UK Corporate Governance Code 2018 (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 the principles and complied with the provisions of the Code applicable during the year ended 31 December 2019.

The Audit Committee report, Nomination Committee report, Directors' Remuneration report, Statement of Directors' Responsibilities, the Risk Management and Risks and Uncertainties sections of the Strategic Report, together with the ESG report and the Section 172 statement also form part of this Corporate Governance report.

Statement of compliance

Throughout the year ended 31 December 2019, the Company has applied the principles and complied with the provisions of the Code.

1. Principles A-E: Board Leadership and Company Purpose

Sustainability of success

The Board is constituted of individuals from a diverse range of backgrounds and with a wealth of knowledge, understanding and experience. The Chairman, with the assistance of the Vice-Chairmen, is responsible for leadership of the Board. The division of responsibilities is described further in section 2 below.

The Board's overarching objective is to generate value for the Company's shareholders in a way that is sustainable in the long-term and contributes to wider society. The Section 172 statement on pages 56 to 57 sets out the ways in which the Board took these considerations into account in its decision-making in 2019.

Purpose, strategy and values

Melrose was founded in 2003 to empower businesses to unlock their full potential for the benefit of all stakeholders, whilst providing shareholders with an above average return on their investment. This has been delivered through Melrose's "Buy, Improve, Sell" strategy, which means we buy good quality but underperforming manufacturing businesses and then invest heavily to improve performance and productivity as they become stronger, better businesses under our responsible stewardship. At the appropriate time, we find them a new home for the next stage of their development and return the proceeds to shareholders. This current set of results is a strong demonstration of this strategy in action, with improvements across the board in a number of businesses and areas.

The Company's purpose and strategy is underpinned by the principles and values on which it was founded. We act with integrity, honesty and decisiveness and believe in a lean operating model and high productivity. We do not shy away from difficult decisions based on sound financial information, holding people accountable but always treating them fairly. We provide the space and resources to empower people to perform and reward them well when they do. These are the principles that lie at the heart of the success of Melrose and are the basis on which we strive for more success in the future.

Resources and controls

As described in more detail in the Risk Management section of the Strategic Report, the Board has established a framework of reporting procedures, lines of responsibility and delegated authority, which is updated regularly and understood by all Board members and the Melrose senior management team. These reporting processes allow the Board and Melrose senior management team to allocate resources appropriately, enabling the Group to meet its objectives and measure performance effectively. The Board and the Audit Committee have access to the Melrose senior management team and to external assistance in order to satisfy themselves that appropriate and effective controls are in place.

Stakeholder engagement

Through presentations and regular meetings 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 2019, in addition to the usual disclosure rounds following the release of annual and interim results, the Company continued its programme of engagement with major investors and the corporate governance bodies in respect of specific material topics including the renewal of the Directors' remuneration policy and incentive arrangements, and the Chairman's tenure, as well as open-agenda discussions between key shareholders and members of the Board. Engagement with key shareholders, proxy advisors and other governance bodies remains a central part of the Company's approach to stakeholder engagement and governance and shall continue in the lead up to the 2020 AGM. Further details on the Company's engagement with stakeholders is contained in the Section 172 statement on pages 56 to 57 and in the ESG report on pages 58 to 69.

In 2019, the Board established a workforce advisory panel ("WAP") in order to 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 the Chief Human Resources Officer (or equivalent) from each business unit and a Melrose Group representative. Each member of the WAP is responsible for determining how the workforce should be defined for their respective business unit, promoting workforce engagement, collating the voice of the workforce and demonstrating how that voice is fed into executive decisions. During the year, the WAP met twice. Further details on the WAP are contained in the Company's Section 172 statement on pages 56 to 57.

Workforce policies and practices

Melrose's reputation for acting responsibly plays a critical role in its success as a business and its ability to generate shareholder value. It maintains high standards of ethical conduct which are reflected in certain policies that are rolled out to the business units, including the anti-bribery and corruption policy and the anti-slavery and human trafficking policy.

The Company also operates externally hosted whistleblowing portals which are readily available to all Group employees and supported by regularly updated policies, procedures and awareness campaigns to create an environment in which the workforce feels it is safe to raise concerns, and to foster an ethical and supportive culture within each of the Group's business units. The Board is provided with updates on material whistleblowing events as they are reported from time to time to the Melrose senior management team, and they are provided with an overview of whistleblowing activity on a quarterly basis. An annual report is prepared for the Board which highlights whistleblowing activity in further detail across the business units, together with a summary of the approach taken by each business unit in their whistleblowing process.

2. Principles F-I: Division of Responsibilities

The Board

Details of the structure of the Board and its key responsibilities are shown on pages 72 to 73, and 78 to 79.

There were four formally scheduled Board meetings held during the year and the attendance of each Director at these meetings is shown on page 79.

Business review meetings are held between scheduled Board meetings. There were three business review meetings held during the year, and the attendance of Directors at these review meetings is set out on page 79. These meetings provide 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 businesses are periodically invited to attend

Corporate Governance report

Continued

and present to these meetings, providing the Directors with an opportunity to discuss each business directly and to develop relationships with their leadership teams. The executive Directors also visit the sites of the business units on an ad hoc basis and sessions are held between the executive Directors and the business unit executive teams at such site visits.

Detailed briefing papers containing financial and operational business summaries and an agenda are provided to the Directors in advance of each Board, Committee (where relevant) 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, advisors and Melrose senior management.

The Board has a fully encrypted electronic portal, enabling Board, Committee and business 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 assisting the Chairman in 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, supported by the Group company secretariat, 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 the Code 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 in order to facilitate constructive discussions with effective contributions from the Non-executive Directors, particularly on those issues of a strategic nature. The Chairman with the support of the Company Secretary also facilitates constructive board relations by providing accurate and clear information in a timely manner. Responsibility for ensuring effective communications are made to shareholders rests with the Chairman, Vice-Chairmen and the two other executive Directors.

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 business review sessions and on an ad hoc basis. The Non-executive Directors come from a diverse range of backgrounds and as such are able to draw on their own specialist knowledge to give necessary guidance and advice, and hold management to account.

The Board consists of four executive Directors, five Non-executive Directors (inclusive of the Senior Independent Director) and the Non-Executive Chairman. As such, the Board is satisfied that there is 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.

Together with the Chairman, each of the Non-executive Directors are members of the Nomination Committee and as such, they play a key role in appointing and removing executive Directors. As considered in section 3, the Non-executive Directors are also key in evaluating the performance of the Directors.

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.

Upon Mr Justin 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, and acts as an intermediary for the other Directors and shareholders. These changes took effect from 1 January 2019. In accordance with the Code requirements, at least half of the Board, excluding the Chairman of the Board, comprises Non-executive Directors determined by the Board to be independent.

Although Mr Dowley has only served as independent Non-executive Chairman for a short period, the Board recognises that he will have served as a Non-executive Director for nine years in September 2020 and the Code provides that service on the Board for more than nine years from the date of first appointment is a circumstance which may impair independence. The Company therefore conducted an engagement exercise with its key shareholders regarding the possible extension of his tenure past the nine-year period. The feedback was unanimously supportive and accordingly, the Board has proposed that Mr Dowley's appointment as Chairman continue for up to a further three years, subject to annual re-election, to provide stability and certainty following the acquisition of GKN and elevation of the Company to the FTSE 100, as well as to oversee smooth succession and increasing diversity for the Board.

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

Corporate governance framework and terms of reference

The Board has an 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 units' bottom-up risk management responsibilities. Each member of the Board is provided with a copy of the Company's corporate governance framework, which they review, discuss and update regularly.

Each of the Committees have their own written terms of reference. The Company Secretary supports the Committees in updating these terms of reference in order to comply with the Code and other good corporate practice. The terms of reference are continuously reviewed, although they are more formally reviewed on an annual basis in the Committee meetings. The terms of reference are available via the Melrose website at www.melroseplc.net.

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.

Time commitments and attendance of Directors at meetings

When considering appointments to the Board, the Board in conjunction with the Nomination Committee review any other demands on a candidate's time, and new Directors are required to disclose any directorships held and other business interests. The ability of Directors to have sufficient time to meet their board responsibilities is considered on an annual basis as part of the performance evaluation process. None of the executive Directors have any non-executive directorships in any FTSE 100 company and do not hold any other significant appointments.

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. The table also shows attendance at business review meetings held between scheduled Board meetings. Non-executive Directors are invited to, but are not required to attend, such meetings.

Attendance of Directors

	Board	Audit	Nomination	Remuneration	Business review
Number of meetings(1)	4	4	2	2	3
Justin Dowley	4	4	2	2	3
Christopher Miller	4	–	1(2)	–	2
David Roper	4	–	–	–	3
Simon Peckham	4	–	–	–	3
Geoffrey Martin	4	4(3)	–	–	3
Liz Hewitt	4	4	2	1(4)	3
David Lis	4	4	2	2	3
Archie G. Kane	4	4	2	2	3
Charlotte Twyning	4	4	2	2	3
Funmi Adegoke(5)	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) Christopher Miller stepped down from his membership on the Nomination Committee prior to any Committee meetings taking place in 2019 and attended a meeting by invitation.
(3) Geoffrey Martin attends by invitation.
(4) Liz Hewitt stepped down from her membership on the Remuneration Committee prior to the second scheduled meeting taking place.
(5) Funmi Adegoke was appointed as a Non-executive Director with effect from 1 October 2019 and was also appointed to the Nomination Committee and Remuneration Committee. She has attended all meetings and business reviews since that date.

3. Principles J-I: Composition, Succession and Evaluation

Board composition

The Board believes that the Directors bring a combination of skills, experience and knowledge to the Board that is complementary to the activities of the Company. Biographies of the Directors are shown on pages 72 and 73, and on the Company's website at www.melroseplc.net. These biographies identify any other significant appointments held by the Directors.

Mr Dowley, the Company's inaugural Non-executive Chairman, will have been on the Board for nine years in September 2020, having been a Non-executive Director and Senior Independent Director prior to his appointment to this role. Given the recent acquisition of GKN and the intended retirement in May 2020 of Mr David Roper, executive Vice Chairman and co-founder of Melrose, the Nomination Committee and Board consider that there is a need for continuity and stability at Board level to facilitate succession planning arrangements. As such, upon recommendation from the Nomination Committee and support of shareholders following an engagement exercise, the Board has approved extending Mr Dowley's Chairmanship tenure for up to a further three years beyond September 2020, subject to annual re-election at the Company's AGM.

On the recommendation of the Nomination Committee, the Board decided to increase the number of independent Non-executive Directors in 2019. 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 Funmi Adegoke was identified as the Board's preferred candidate and accepted the offer of appointment with effect from 1 October 2019.

The Board is satisfied that the appointment of Ms Adegoke has also further strengthened the diversity of the Board. There is currently 30% female representation on the Board and upon the retirement of Mr Roper, the Company will have achieved ahead of schedule the 2020 target set out in the Hampton-Alexander Review of having 33% female representation on the Board. It has also achieved ahead of schedule the 2021 target set out in the Parker Review of having one director of colour on the Board.

Succession planning

Succession planning is coordinated via the Nomination Committee in conjunction with the Board and includes all Directors and senior management. It was a core focus in 2019 and as explained above, the Board approved the extension of Mr Dowley's Chairmanship tenure in order to aid effective succession planning.

Whilst succession planning arrangements for the Board as a whole were reviewed, the Nomination Committee and the Board gave particular focus to reviewing and developing the succession planning arrangements in place for the roles of Chief Executive and Group Finance Director. This included reviewing the tenure of those already on the Board, and reviewing the senior management team including the career planning and talent management programmes in operation for them, to ensure that the right balance of skills, experience and diversity were reflected and being developed.

Given the strength of Melrose's decentralised operating structure in achieving the Group's strategic objectives, the Nomination Committee does not have direct involvement in the succession planning arrangements of the divisions. However, the Nomination Committee has access to the divisional executive teams through the business review cycle and going forward, the Nomination Committee will have greater awareness of the high level succession planning arrangements of each business unit.

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. The Company will again be conducting an external evaluation in 2020.

Whilst the Company is not required to undertake another externally facilitated Board and Committee evaluation until 2020, during 2019 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 Chairman of each Committee respectively. These evaluations were conducted and facilitated by the completion of questionnaires, and discussions at the applicable Board and Committee meetings, with follow-up actions taking place as relevant. Members were also given the option for meetings to be scheduled with the Chairman or the Chairman of the relevant Committee about any relevant matters that they wished 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 independent Non-executive Director would further bolster its effectiveness by allowing sufficient challenge by Non-executive Directors of executive management in meetings of the Board, whilst the retention of the current 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 2020:

- continue to monitor senior management succession;
- having further developed the Board's visibility over the impact of principal risks on the business divisions, continue to monitor and enhance the Group's management of risk;
- although considerable steps were taken to improve cyber security across all business units in 2019, it was recognised that cyber security is an ongoing risk and will, therefore, be focused on again in 2020;
- continue to improve and monitor the cash management culture within the businesses (particularly within the GKN businesses) and to improve cash performance;
- continue to proactively address loss-making 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' executive 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
- continue to update and implement the Board's overarching corporate governance framework to ensure the continued alignment of the Board and Committee members' roles and division of responsibilities with the recent changes to the Code, and to ensure that the Group's culture aligns with its purpose, values and strategy, through Melrose's top-down Board and senior management risk oversight, and the business divisions' bottom-up risk management responsibilities.

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 Adegoke who was appointed with effect from 1 October 2019), stood for election or re-election at the 2019 AGM. With the exception of Ms Adegoke 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.

In considering whether each Director should stand for re-election, the Nomination Committee in consultation with the Board considers whether the Board has the appropriate balance of skills, experience, independence and diversity to enable the Board to carry out its duties and responsibilities effectively. The time commitments of each Director are also reviewed as part of this assessment, and Directors are required to disclose any directorships held and other business interests. The annual performance evaluation referred to on page 79 assists with determining whether each Director should stand for re-election.

Following performance evaluations of each of the Directors, and having considered in turn the individual skills, relevant experience, contributions and time commitment of the Directors to the long-term sustainable success of the Company, 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.

The justification for Mr Dowley's re-election as Chairman is considered in section 2 above.

Mr Simon Peckham, Chief Executive, is standing for re-election as Director due to his deep understanding of the Melrose business model, having joined the Company initially in 2003 as Chief Operating Officer. He has widespread expertise in corporate finance, mergers and acquisitions, strategy and operations.

Mr Christopher Miller and Mr Roper (Vice-Chairmen) are also standing for re-election on the basis of their deep understanding of the Melrose business model, having co-founded Melrose. Mr Miller has long-standing involvement in manufacturing industries and private investment, and Mr Roper (who will retire from the Board in May 2020) has significant financial and operational expertise.

Mr Geoffrey Martin, Group Finance Director, is standing for re-election due to his deep understanding of the Melrose business model, having been appointed as Group Finance Director in 2005. He also brings to the Board considerable public company experience and expertise in corporate finance, equity finance raising and financial strategy.

Ms Hewitt, Senior Independent Director, is standing for re-election as Director due to her extensive business, financial and investment experience gained from a number of senior roles in international companies. In particular, Ms Hewitt is the longest serving Non-executive Director after the Chairman, having served on the Board since 2013, and fulfils the pre-requisite of being independent.

The remaining Non-executive Directors are standing for re-election (and in the case of Ms Adegoke, election for the first time) due to their independence, diversity, skills and experience. In particular, Mr David Lis brings to the Board extensive financial experience and deep insight into the expectations of Melrose's institutional investor base, having held several roles in investment management. Mr Archie G. Kane has extensive financial and general management expertise, having held several roles in the financial services sector and public company boards. Ms Charlotte Twyning brings a broad frame of reference and acute commercial judgement based on her excellent experience of working at the highest levels with the UK Government and regulators. Finally, the Company's newest appointment to the Board, Ms Adegoke, brings diverse industrial knowledge as well as significant transactional and commercial management expertise due to her extensive experience working in and leading legal teams across the globe at multi-national organisations.

Biographies of the Directors are shown on pages 72 to 73, and on the Company's corporate website at www.melroseplc.net. Detailed justifications for each Director's re-election (and election) are set out in the AGM Notice, which is provided to shareholders with this Annual Report.

4. Provisions M-O: Audit, Risk and Internal Control

Objectives and policy

The objectives of the Directors and Melrose senior management are to safeguard and increase the value of the businesses 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 Melrose 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 87 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 46 to 47.

Further information regarding the Group's financial risk objectives and policies can be found in the Finance Director's review on pages 38 to 44. A summary of the principal risks and uncertainties that could impact upon the Group's performance is set out on pages 48 to 55.

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 87, the Group engages BM Howarth as internal auditor. A total of 44 internal audit visits were completed by BM Howarth and EY during 2019 in respect of each of the GKN, Nortek and Brush businesses.

The Directors are pleased to report that there has been progress across the Group following the 2019 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.

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, anti-tax evasion, 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 advisors, 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.

During 2019, the Company completed its roll-out of an online compliance training platform to all businesses, covering topics such as antitrust, trade compliance and export controls, data privacy, anti-bribery and anti-corruption and anti-money laundering, to enhance and supplement the existing compliance regime.

The Company's Modern Slavery Statement is approved by the Board annually and is available on the Company's website at https://www.melroseplc.net/media/2487/modern-slavery-statement-june2019.pdf. Under Melrose's decentralised group structure, each division is responsible (where applicable) for publishing their own Modern Slavery Statements in accordance with the requirements under the Modern Slavery Act 2015 and are supported by Melrose where needed. To support the Company's belief in the importance of this matter, it has a Group-wide policy on the prevention of modern slavery and human trafficking, which the businesses have rolled out to employees, along with an online compliance training module. Please also refer to section 1 above for details of the Company's whistleblowing policies and procedures.

5. Provisions P-R: Remuneration

Policies and practices

Melrose's remuneration philosophy has been the same since being founded in 2003 and requires that executive remuneration be simple and transparent, support the delivery of the value creation strategy and pay only for performance. The Company's policy of restricting opportunity in annual salary, bonus and benefits, while heavily weighting potential reward to the variable long-term incentive plan, reflects those principles and is intended to align management's incentive arrangements directly with the interests of shareholders. In compliance with the Code, the 2017 Incentive Plan has a five-year total vesting and holding period, which promotes long-term sustainable success for shareholders. Similarly, the 2020 Incentive Plan, which is subject to shareholder approval at the 2020 AGM, will have a five-year total vesting and holding period.

Development of policies

The Remuneration Committee has a formal and transparent procedure for developing the policy on executive remuneration. It regularly engages with shareholders to seek their views, obtains advice from external remuneration advisors, and undertakes benchmarking exercises with respect to executive pay. As described further in the Directors' Remuneration report, the Chief Executive retains responsibility for setting and managing the remuneration of Melrose senior management and divisional CEOs, of which the Remuneration Committee has full disclosure. No Director is involved in deciding their own remuneration outcome.

Independent judgement and discretion

The Directors exercise independent judgement and discretion when authorising remuneration outcomes, taking account of both Company and individual performance, and wider circumstances. As mentioned above, the Remuneration Committee obtains regular advice from external remuneration advisors in order to ensure that proposals are in line with the Code, and benchmarked against the FTSE 100. The current Directors' remuneration policy provides the Remuneration Committee with the ability to exercise discretion to override formulaic outcomes and, if approved, the new Directors' remuneration policy will provide the same ability for the Remuneration Committee to exercise discretion.

Details regarding Directors' remuneration, both generally and in relation to the requirements of the Code, are set out in the Directors' Remuneration report on pages 90 to 111, which is presented in the following three sections:

- the annual statement from the Chairman of the Remuneration Committee, which can be found on pages 90 to 91;
- the Annual Report on Remuneration, which can be found on pages 92 to 102; and
- the proposed new Directors' remuneration policy, which can be found on pages 103 to 111.

The current Directors' remuneration policy can be found in the circular dated 7 April 2017 available at www.melroseplc.net/media/1728/21347274-_-1-_circular.pdf, as clarified (see pages 104 to 107 of the 2018 Annual Report). As mentioned in the Directors' Remuneration report, the current Directors' remuneration policy is due for renewal by shareholders at the 2020 AGM and the Group is seeking shareholder approval of the new Directors' remuneration policy, which, if approved, will apply to payments made from that date.

Audit Committee report

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.

Liz Hewitt
Audit Committee Chairman

Member	No. of meetings(1)
Liz Hewitt (Chairman)	4/4
David Lis	4/4
Archie G. Kane	4/4
Charlotte Twyning	4/4

(1) In addition to the usual scheduled three meetings per year, an exceptional meeting was held and attended by representatives of the Financial Reporting Council, who presented to the Audit Committee their Report on the Deloitte audit of GKN's 2017 Financial Statements.

Role and responsibilities

The Committee's role and responsibilities are set out in its terms of reference. These were updated in November 2019 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;
- overseeing the adequacy and security of the Company's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters;
- 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, and its systems and controls for the prevention of bribery;
- developing, implementing and monitoring the Group's policy on external audit and for overseeing the objectivity and effectiveness of the external auditor;
- 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;
- 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 significant and relevant financial experience to that role, as described in her biography on page 72.

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 the external and internal auditors without management present, and the Chairman of the Committee speaks with 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 2019, the Committee met in March, 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, in June 2019 the Committee met with representatives from the Financial Reporting Council ("FRC") to discuss their Report on Deloitte's Audit of GKN's 2017 Financial Statements. At this meeting, the Audit Committee also presented a summary of the key actions completed by the Company since acquiring GKN in 2018, in order to strengthen financial controls at the GKN businesses since acquiring them, most notably in respect of the North American GKN Aerospace business.

Significant activities related to the 2019 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 the interim financial statements, including the going concern of the Group 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 statements, as well as a paper prepared by management in respect of the long-term viability and a presentation from management;
- 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 2019 Annual Report and financial statements. The Committee advised the Board that, in its view, the 2019 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 2019 annual accounts by the external auditor and the scope of work to be undertaken in 2020 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 2019

Significant issue considered by the Audit Committee	How the issue was addressed by the Audit Committee
Finalisation of the GKN acquisition accounting The Group acquired GKN on 19 April 2018 and the consolidated financial statements at 31 December 2018 included a provisional assessment of the fair values of acquired assets and liabilities. It was disclosed that the fair values remained provisional at 31 December 2018 as there could be further adjustments recognised if additional information came to light. During the remaining acquisition accounting measurement period to 19 April 2019, the Group completed its review of the assets and liabilities acquired. As a result, during the first half of the year, the Group recorded its final adjustments. In accordance with IFRS 3: "Business Combinations" the acquisition balance sheet has been updated and the balance sheet at 31 December 2018 restated accordingly. *(Refer to note 1 of the financial statements)*	Management noted in their report to the Committee that there were very few changes to the GKN opening Balance Sheet provisionally reported at the 2018 year-end, with goodwill of £2.5 billion only increasing by £6 million (less than 1%). The changes resulted from businesses correcting a small number of items and the Group addressing matters identified too late in the 2018 year-end process to be fully reflected. Having reviewed management's paper, the Committee challenged certain assumptions and enquired of Deloitte's views. The Committee was satisfied that the assumptions used were reasonable and that the updated fair value of assets and liabilities had been established appropriately.
Accounting for revenue under IFRS 15 Following the Group's adoption of IFRS 15 "Revenue from Contracts with Customers" in 2018, management undertook a review of the key assumptions that had a significant impact within the GKN Aerospace business, specifically regarding recognition of variable consideration within risk and revenue sharing partnerships (RRSPs). The review led to updates to assumptions and additional controls which were introduced by management in light of the complex commercial arrangements, evolving programme matters and dynamic market conditions. Additionally, the Group was selected by the Financial Reporting Council ('FRC') for inclusion in its thematic review of a sample of company annual reports and accounts where IFRS 15 was being applied for the first time in 2018. The FRC's review was based on the Company's 2018 Annual Report and financial statements rather than a detailed knowledge of the Company's business or an understanding of the underlying transactions entered into. *(Refer to notes 3, 4 and 17 of the financial statements)*	The Committee discussed with management the implications of IFRS 15, which included an assessment of estimates used in calculating variable consideration within RRSPs. In addition, the Committee reviewed correspondence with the FRC which primarily focused on the disclosures to be included in the 2019 Annual Report and financial statements. The changes in estimates, relating to both the amount and timing of revenue recognition, were primarily based on commercial progress of specific programmes. Whilst the impact of changes was immaterial for 2019, there could be a more significant impact in the future. The Committee discussed the audit work performed by Deloitte, to assess whether the proposed revenue to be recognised, together with incremental disclosures, were appropriate. The Committee was satisfied that the approach and assumptions used remained both reasonable and appropriate. However, it is understood that there are reasonably possible changes in assumptions, that could lead to the recognition of further variable consideration in the next year in respect of previous performance obligations. The correspondence with the FRC was reviewed and the Committee was pleased with the transparent additional disclosures proposed, and the approach and judgements taken.

Audit Committee report

Continued

The Audit Committee's activities during 2019

Significant issue considered by the Audit Committee	How the issue was addressed by the Audit Committee
Provisions for loss-making contracts The level of provisioning for loss-making contracts requires estimation and assumptions for long-term programmes. Although provisions are reviewed on a regular basis and adjusted for management's best views, their inherently subjective nature means that future amounts settled may be different from those provided. During the year, as a result of a focus on improving profitability primarily through operational actions or enhancing commercial terms with customers, a number of contracts have successfully become break-even or better. There has been a consequential release of provisions of £122 million, recorded as an adjusting item to avoid positively distorting adjusted operating profit. *(Refer to notes 3 and 21 of the financial statements)*	At 31 December 2019, the carrying value of loss-making contract provisions in the Group was £384 million (2018: £616 million). The Committee considered management's position and challenged the proposed changes during the year as well as the closing provisions. The key assumptions and estimates include volumes, price and costs to be incurred over the life of the contract and where changes have occurred in commercial terms, relevant legal advice. Deloitte also reported on loss-making contract provisions to the Committee. Having considered the matters presented and responses to challenge, the Committee concluded that management's proposed provisioning, released amounts and the associated disclosures in the financial statements were appropriate and the approach taken was consistent with previous years.
Discontinued operations and assets held for sale During the year the Group sold the Walterscheid Powertrain Group and reclassified its Wheels & Structures business to an asset held for sale due to formally commencing a disposal process with a high expectation this will conclude within one year. Both of these businesses have been deemed a major separate line of business due to distinct management teams, treatment as a stand-alone cash generating unit and independent operations. Accordingly, their results in the period have been presented as discontinued operations in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", and comparative amounts have been restated accordingly. *(Refer to note 13 of the financial statements)*	The Committee considered management's paper and the additional disclosures included in the financial statements as well as the completeness of reporting in respect of the Group's other businesses. Having taken into account the matters presented and responses to challenge, in particular relating to the remeasurement charge for the Wheels & Structures business of £64 million, along with Deloitte's reporting, the Committee concluded that management's proposed accounting, presentation and associated disclosures in the financial statement were appropriate.
Change in operating segments Following a review of strategic options during the second half of the year, the Board (deemed to be the Group's Chief Operating Decision Maker) decided to change its internal reporting. The decision was taken to ensure that the allocation of resources to the segments and assessment of performance reflected the strategy of the Group. As a consequence, the Nortek Air & Security operating segment was revised with the Security & Smart Technology business now included in Other Industrial. Other Industrial has also been impacted by the Walterscheid Powertrain Group and Wheels & Structures businesses which have been included in discontinued operations. Comparative amounts have been restated accordingly. *(Refer to note 5 of the financial statements)*	As reported elsewhere in the Annual Report and financial statements, Nortek Air Management is under strategic review as a stand-alone business. The Committee reviewed and challenged the rationale presented by management and challenged the revised segments proposed. In addition, the work performed by Deloitte was assessed. The Committee was satisfied that the approach and rationale were consistent with the accounting requirements.
Adoption of IFRS 16 The Group adopted IFRS 16 "Leases" on 1 January 2019 using the modified retrospective approach, resulting in no adjustments to the prior year comparatives. IFRS 16 superseded the previous lease guidance, including IAS 17: "Leases" and related interpretations. IFRS 16 requires all leases, except where exemptions are applied, to be recognised on the balance sheet as a lease liability with a corresponding right-of-use asset presented within property, plant and equipment. As a result of the transition to IFRS 16, the Group recognised right-of-use assets and lease liabilities of £589 million. *(Refer to notes 1, 14 and 28 of the financial statements)*	The Committee discussed management's report on the adoption of IFRS 16 and sought a view from Deloitte following their audit work, to assess whether the balances included in the Group consolidated financial statements were appropriate. The Committee challenged the impact of IFRS 16, on transition, and the impact on the income statement in the year. It was noted that the increase in finance costs of £21 million was broadly offset by an associated increase in operating profit. Having considered the matters presented and evidence provided, the Committee concluded that management's response to issues was appropriate and balances were reasonably stated.

The Audit Committee's activities during 2019

Significant issue considered by the Audit Committee	How the issue was addressed by the Audit Committee
Impairment testing of goodwill 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. During 2018, the Group disclosed additional sensitivities for the Security & Smart Technology and Ergotron groups of CGUs due to highly uncertain matters at that time, particularly with respect to the possible increase in tariffs in the US for goods being imported from China; and the level of competition and technological change in the market. Due to favourable events in the year, there has not been a need to impair the Ergotron group of CGUs. However, there has been further deterioration in both the performance in the year and forecast future prospects, particularly following increases in US tariffs for goods being imported from China. This along with the increased level of competition and technological change in the market has resulted in the necessity to impair goodwill allocated to the Security & Smart Technology group of CGUs by £179 million. Whilst there has not been any change to the groups of CGUs in the year, following the announcement of a new operating model in the GKN Aerospace business, a new CGU structure will be effective from 1 January 2020. Rather than three groups of CGUs in GKN Aerospace; Engine Systems, Aerostructures and Special Technologies, there will be two: Engine Systems and Aerostructures. *(Refer to notes 3 and 11 of the financial statements)*	The Committee challenged the outcome of the impairment review in respect of the Security & Smart Technology group of CGUs and also considered the proposed disclosures in respect of the Automotive, Driveline and Powder Metallurgy groups of CGUs, given their sensitivity to reasonably possible changes in assumptions. In doing so the Committee considered the following: • a paper prepared by management, which included the key outputs from the impairment models; • the trading assumptions, including macro-economic factors, applied in the models and in particular those that were key, being revenue growth and operating margin; • the market-based assumptions for the long-term growth rates and the discount rate; • 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 • 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. The Committee discussed with Deloitte the audit work performed by them and their conclusion regarding the impairment charge recorded. 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.
GKN Aerospace North America financial information in relation to inventory balances The Group has again reviewed the inventory balances in GKN Aerospace North America following historical concerns, to ensure that balances were appropriately stated. The current year review has been less intrusive into the business than the prior year, with assurance taken from necessarily higher-level procedures. The review focused on inventory provisioning, as these calculations often require judgement by management of the expected value of future sales. *(Refer to notes 3 and 16 of the financial statements)*	During the year, the Committee reviewed a report updating on the previously disclosed concerns relating to GKN Aerospace's North American business. The assessment considered trends in inventory carrying amounts as well as the overall control environment and progress since the prior year. The Committee discussed the results from year-end testing with management as well as the findings from Internal Audit. Additionally, the Committee sought a view from Deloitte following their audit work, to assess whether the balances included in the Group consolidated financial statements were 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.
Going concern and viability The Committee is required to make an assessment of the going concern assumptions for the Group and the basis of the viability statement before making a recommendation to the Board.	The Committee reviewed and approved management's recommendation to prepare the financial statements on a going concern basis. The Committee also considered a paper and financial model prepared by management in respect of the longer-term viability statement to be included in this Annual Report and financial statements as well as analysis conducted by the external auditor. The Committee challenged the assumptions and judgements made by management before concluding that the longer-term viability statement was appropriate.
Classification of adjusting items and use of Alternative Performance Measures ("APMs") 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"). The Committee considers this a key consideration when reviewing if the financial statements are fair, balanced and understandable. *(Refer to notes 3 and 6 of the financial statements)*	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 the financial statements. The Committee reconsidered the Company's accounting policy in respect of restructuring and approved updated internal guidance. Following review of management's paper and challenge, the Committee is satisfied that there has not been any significant change in substance to the policy. The Committee also determined that disclosures are clear and transparent, assisting shareholders in measuring the operating performance of the Group. The Committee therefore concluded that adjusting items were appropriately captured and disclosed. 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 the 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.

Audit Committee report

Continued

The Audit Committee's activities during 2019	
Significant issue considered by the Audit Committee	**How the issue was addressed by the Audit Committee**
Committee evaluation Monitoring and evaluating the effectiveness of the Committee.	In 2017, an externally facilitated review of the Committee was undertaken by Lintstock Ltd. Whilst under the UK Corporate Governance Code (the "Code"), the Company is not required to undertake another externally facilitated Committee evaluation until 2020, in 2019 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 the 2017 external review and the 2018 internal review. Alongside such formal feedback, the Committee continued to facilitate direct ongoing contact between its members and the Chairman of the Committee 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.

Risk management and internal control

During 2019, the Committee continued to monitor and review the internal financial control systems and effectiveness of the Group's risk management through regular updates from management. This included review of the key findings presented by the external and internal auditors having agreed the scope, mandate and review schedule in advance.

During 2019, management with support from Ernst & Young consolidated the Group businesses' risk reporting to the Company into an online interactive dashboard, which built on the existing Group risk management processes, to enhance the Committee's oversight of risk areas and trends, as well as to provide a more detailed consolidated view of Group risk. The dashboard includes data from the risk registers prepared by the risk and legal leads from each business, as well as objective trend analysis based on that data and independent insight from Ernst & Young. The Committee reviewed and challenged the process of compiling the dashboard, as well as a summary report of the Group enterprise risk management profile which guided the Committee on relevant updates to the Group risks as reported in the Risks and Uncertainties section on pages 48 to 55, and set out a consolidated risk profile report for each business within the Group.

Management also 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 the Risk Management dashboard across all Group business units. No significant weaknesses were identified. The Committee reported its conclusions to the Board at the next scheduled Board meeting.

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 2019, a series of questions covering key areas of the audit process, that the Committee is expected to have an opinion over, was 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.

Committee members, together with the Group Finance Director and the divisional finance directors, were requested to provide detailed feedback on the effectiveness of the external auditor. The Chairman also sought feedback from the Chief Executive and the internal auditor. The Company Secretary subsequently produced a report summarising the responses, which was considered by the Committee at length. The Committee subsequently 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.

Audit tendering

The Committee has considered 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"). The Committee understands that, under CMA and EU rules, rotation of the external audit firm is required by 2024. The Committee's intention is 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 2019. The Company's audit firm is required to be rotated by 2024. Therefore, the new audit engagement partner will serve a full five-year term for the Group 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 provided by Deloitte 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 2017, 2018 and 2019 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. 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. 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).

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 reward, tax, accounting, consulting advice and advice on the remuneration reporting regulations and preparation of the Directors' Remuneration report from PwC LLP.

During 2019, the main non-audit services provided by Deloitte LLP were in relation to non-statutory audits of carve-out financial statements, assurance reports for government grants or subsidies and tax compliance in non-EU subsidiaries. The Company did not use Deloitte LLP for any significant taxation services and does not intend to during 2020. The Company's non-audit fee paid to the external auditor of £1.0 million represents 12% of the audit fees for 2019.

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 the auditor for non-audit work, for example on certain compliance projects.

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.

Auditor objectivity and independence

The Committee carries out regular reviews to ensure that auditor objectivity and independence are maintained at all times. As in previous years, the Committee specifically considered the potential threats that each limited non-audit engagement 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. No fees were paid to Deloitte LLP on a contingent basis.

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.

Based on these strict procedures, the Committee remains confident that auditor objectivity and independence have been maintained.

Internal audit

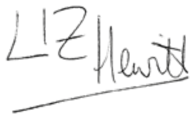
Due to the size and complexity of the Group, it is appropriate for an internal audit programme to be used within the business. BM Howarth Ltd, an external firm, provides internal audit services to the Group in accordance with an annually agreed Internal Audit Charter and internal audit plan. Where additional or specific resource is required, additional support is provided by Ernst & 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. 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 Ltd and Ernst & Young across a total of 44 sites in 2019. A report of significant findings is presented by the internal auditor to the Committee at each meeting and implementation of recommendations is followed up at the subsequent Committee meeting.

During the previous year there were no significant deficiencies found in internal financial controls that needed action by the Group Finance Director and the Melrose accounting function. Any control findings are followed up by the businesses to ensure a strengthening of the local accounting functions, including specific action plans to address the shortcomings identified. Follow-up visits were performed during 2019 which identified significant progress in the improvement of financial controls at sites.

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. This also considers the insights provided, improvements achieved and feedback from a number of sources including key representatives of the Company.

The Committee reviewed the reappointment of BM Howarth Ltd as internal auditor, following an assessment of the services delivered and approved their reappointment.



Liz Hewitt
Chairman, Audit Committee
5 March 2020

Nomination Committee report

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 to enable them to discharge their respective duties and responsibilities effectively.

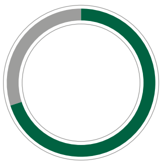
Archie G. Kane
Nomination Committee Chairman

Member	No. of meetings
Archie G. Kane (Chairman)	2/2
David Lis	2/2
Justin Dowley	2/2
Liz Hewitt	2/2
Charlotte Twyning	2/2
Funmi Adegoke[(1)]	1/1
Christopher Miller[(2)]	0/0

(1) Ms Funmi Adegoke was appointed as a Non-executive Director with effect from 1 October 2019. Ms Adegoke attended all Committee meetings held during the period from 1 October 2019 to 31 December 2019.
(2) Mr Christopher Miller stepped down from the Committee in May 2019 prior to any meetings taking place.

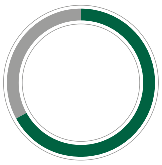
Diversity overview

Board gender diversity



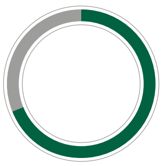
Male	70%
Female	30%

Melrose Executive Committee



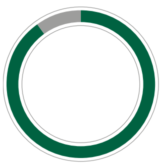
Male	67%
Female	33%

Senior management and direct reports[(1)]



Male	69%
Female	31%

Board ethnic diversity[(2)]



Non BAME	90%
BAME	10%

(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.
(2) In accordance with the Parker Review, BAME individuals are those who identify as or have evident heritage from African, Asian, Middle Eastern, Central and South American regions.

Discharge of responsibilities

The Committee discharges its responsibilities through:

- regularly reviewing the size, structure and composition of the Board including by means of overseeing the annual evaluation processes of the Board and its committees, 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 to ensure that it meets the needs of the business;
- managing the Board recruitment process and evaluating the skills, knowledge, diversity and experience of potential Board candidates in order to make appropriate nominations to the Board;
- reviewing and 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's terms of reference, which were last revised in November 2019, are available to view on the Company's website at: https://www.melroseplc.net/about-us/governance/nomination-committee/.

Committee membership and attendance

The Committee consists of independent Non-executive Directors and all of the current Non-executive Directors are members of the Committee. Mr Christopher Miller, executive Vice Chairman, stepped down from the Committee in May 2019 to ensure the full independence of the Committee, and Ms Funmi Adegoke was appointed as a member of the Committee following her appointment to the Board on 1 October 2019.

The Committee is expected to meet not less than twice a year and during 2019, the Committee met twice. The attendance of its members at these Committee meetings is shown in the table opposite.

The Company Secretary acts as secretary to the Nomination Committee. On occasion, the Nomination Committee invites the Chief Executive, the executive Vice-Chairmen and the Group Finance Director to attend discussions where their input is required.

Board composition and succession planning

The Committee keeps under review the membership of the Board, including its size and composition, and makes recommendations to the Board on any adjustments it thinks necessary. The Committee recognises the value in attracting Board members from a diverse range of backgrounds who can contribute a wealth of knowledge, understanding and experience. The Committee works with the Board in order to ensure both of these matters are taken into account to ensure effective succession planning.

During the year, the Committee had recommended that the number of independent Non-executive Directors be increased. Stonehaven International, an external recruitment consultancy firm unconnected with the Company and its Directors, 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 Committee. Ms Adegoke was identified as the Board's preferred candidate and was appointed to the Board with effect from 1 October 2019.

Ms Adegoke brings diverse industrial knowledge as well as significant transactional and commercial management expertise to the Board. She has spent well over a decade working in and leading legal teams across the globe at the large multi-nationals Bombardier and BP. During this time, she gained extensive experience within the aerospace, engineering, manufacturing and energy sectors. In accordance with the Articles, Ms Adegoke will stand for election at the 2020 AGM.

In light of Ms Adegoke's appointment to the Board and her appointment to the Nomination Committee and the Remuneration Committee, Ms Liz Hewitt stepped down from her membership of the Remuneration Committee, whilst continuing her chairmanship of the Audit Committee and membership of the Nomination Committee.

Whilst succession planning arrangements for the Board as a whole were reviewed by the Committee, the Committee and the Board gave particular focus in 2019 to reviewing and developing the succession planning arrangements in place for the roles of Chief Executive and Group Finance Director. This included reviewing the tenure of those already on the Board, and reviewing the Melrose senior management team including the career planning and talent management programmes in operation for them, to ensure that the right balance of skills, experience and diversity were reflected and being developed.

Given the strength of Melrose's decentralised operating structure in achieving the Group's strategic objectives, the Committee does not have direct involvement in the succession planning arrangements of the divisions. However, the Committee has access to the divisional executive teams through the business review cycle and going forward, the Committee will be provided with greater awareness of the succession planning arrangements of each business division.

Chairman's Tenure

The Committee has also reviewed the role of Mr Justin Dowley as Melrose's inaugural Non-executive Chairman. Although only recently taking up the role of Chairman, Mr Dowley first joined the Board as a Non-executive Director in September 2011, meaning he will have served for nine years in September 2020. Under the new UK Corporate Governance Code (the "Code"), which was brought into force after the announcement of Mr Dowley's appointment, this is a key date in the consideration of the independence of the Chairman.

Given the recent acquisition of GKN, the elevation of the Company to the FTSE 100, and the intended retirement in May 2020 of Mr David Roper, executive Vice Chairman and co-founder of Melrose, the Committee considered that there was a need for continuity and stability at Board level to facilitate succession planning arrangements and the development of a diverse Board. The Committee therefore considered it vital that any Chairman must have an in-depth understanding of the unique and particular drivers behind Melrose's business model so as to be able to provide the necessary leadership in such a period of change. Mr Dowley has served in leadership roles on a number of boards, including as Melrose senior independent director for the two years prior to his appointment as Chairman, and is able to utilise the extensive experience gained during his 35-year career in the banking, investment and asset management sector. These were key factors in his appointment, which were well supported by shareholders at last year's AGM, and remain critical to the ongoing success of Melrose now.

The Committee undertook an engagement process with key institutional shareholders as part of its review of Mr Dowley's tenure. This process involved engaging directly with shareholders to explain the proposed extension of Mr Dowley's tenure. All feedback received was instrumental in support of extending Mr Dowley's tenure. As a result, the Committee considers Mr Dowley the most appropriate candidate for the role of Non-executive Chairman and is therefore recommending to the Board that Mr Dowley stay in this position for up to a further three years beyond 2020, subject to annual re-election at the Company's AGM.

Re-election of Directors

The effectiveness and commitment of each of the Directors is reviewed annually as part of the Board evaluation upon recommendations from the Committee. The Committee reviewed each Director in turn to satisfy itself as to the individual skills, relevant experience, contributions and time commitment of the Directors to the long-term sustainable success of the Company. The Committee and Board have satisfied themselves that each of the Directors should stand for re-election (and Ms Adegoke should stand for election for the first time), and the justifications for such re-elections (and election) are set out on page 80 of this Annual Report.

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 Committee 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 needed to ensure a rounded Board, and the diversity benefits each candidate can bring to the overall Board composition.

Since 2018, all Board appointments have been female, and the recruitment process for these appointments has involved all-female candidate lists being reviewed. Melrose's efforts in pursuing gender diversity at a Board level are reflected in the fact that, with the retirement of Mr Roper in May 2020, it will have achieved ahead of schedule the 2020 target set out in the Hampton-Alexander Review of having 33% female representation on its Board. Further, Melrose's efforts in pursuing ethnic diversity at a Board level are reflected in the fact that Melrose has achieved ahead of schedule the 2021 target set out in the Parker Review of having one director of colour on its Board. 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.

Below Board level, Melrose has established an Executive Committee and focus has been placed on pursuing diversity at this level in order to pave the way for a diverse pipeline for succession planning purposes. This focus is represented through the fact that the Executive Committee consists of 33% female representation, and the Executive Committee together with its direct reports consists of 31% female representation.

While recognising that the Melrose "Buy, Improve, Sell" model means the Company inherits the shape of the workforces of the businesses it acquires, the Board nonetheless understands the importance of diversity throughout the Group both in terms of reflecting the values of stakeholders, and also projecting those values externally. Melrose is actively engaged in supporting initiatives to increase the Group's diversity, as well as supporting diversity initiatives in the industries in which its businesses operate, and seeks further opportunities to do so. In particular, Melrose is working with Enginuity (formerly known as Semta) to identify barriers that are hindering socio-economic and ethnic diversity within the engineering sector, with a view to supporting projects and potentially providing bursaries to help increase diversity based on these findings.

Further details of Melrose's commitment to diversity and the various diversity initiatives undertaken within the Group can be found on page 66 of this Annual Report, and Melrose's diversity policy can be viewed on the Company's website at https://www.melroseplc.net/about-us/governance/code-of-ethics/corporate-responsibility/. Additionally further details on diversity and Board skills can be found on page 73 of this Annual Report.

Evaluations

During 2019 an evaluation of the Chairman, the Board and its committees was undertaken in line with their respective terms of reference. These evaluations were conducted internally and were facilitated by the completion of questionnaires, discussions at the applicable Board and committee meetings, with follow-up taking place as relevant. This evaluation process demonstrated that the Board and its committees were operating effectively and the composition of such Boards and committees promoted the long-term sustainable success of the Company. In line with Code guidance, an external evaluation process will take place in 2020.

A. G. Kane

Archie G. Kane
Chairman, Nomination Committee
5 March 2020

Directors' Remuneration report
Chairman's Annual Statement

David Lis
Chairman, Remuneration Committee

Dear Shareholders,

The past few years, including the acquisition of GKN, have been some of the most exciting since Melrose was founded in 2003, and a testament to the support of our shareholders and the strength of the Melrose "Buy, Improve, Sell" model. It is a model that has a proven track record, and 2019 has been another successful year as this Annual Report and financial statements describes.

Long-term performance

Our highly successful management team has made the necessary operational improvements on past acquisitions that have increased margins by between 30%-70%, building stronger, better businesses. This has led to the creation of £6.3 billion in shareholder value, of which £4.7 billion has already been returned to shareholders in cash, and an average return of 2.6x shareholders' equity for businesses already sold. Your Board remains convinced that we will achieve the targeted performance from GKN and Nortek and continue to deliver the high level of returns that shareholders have enjoyed for many years.

This level of performance compares very favourably against our peers, with a TSR of 2,579% since our first acquisition in 2005, being the second highest performance in the FTSE 350 over the past decade. Our remuneration structure is at the heart of this long-term performance. Therefore, as we consider the renewal of the Directors' remuneration policy at the 2020 AGM, including the Company's long-term incentive plan (the "LTIP"), we continue to believe that maintaining the current core principles of simplicity, transparency, driving the value creation strategy and paying only for performance is central to Melrose's ongoing success. The Committee strongly believes that the current and previous LTIPs have been very effective in incentivising management to deliver real value to shareholders over the applicable performance periods.(1)

Current remuneration structure

Executive Directors' salaries have always been set well below the lower quartile of our FTSE 100 peers and annual bonuses are similarly capped well below our peers at 100% of salary. The only significant benefits executive Directors receive are medical cover and a pension contribution capped at 15% of salary, which is the same percentage of salary as all other Melrose employees receive, but far less than directors at FTSE 100 peers. The table on page 93 sets out the most recently available CEO annual remuneration (excluding the LTIP element for comparison) and puts this deliberate strategy in context, highlighting a difference of over £1.7 million per year from the average FTSE 100 CEO annual remuneration.

The current year has clearly demonstrated the application of our remuneration strategy, with executive Directors receiving an inflationary increase to base salary of 3%, but total remuneration decreasing by approximately 3%, with no awards crystallising under the LTIP. Full details are set out in the Annual Report on Remuneration on pages 92 to 102 that will be put to an advisory vote at the 2020 AGM.

As this and the table on page 93 clearly indicate, the opportunity for significant reward has always been heavily weighted to the LTIP, which is long-term in nature and entirely based on performance. Executive Directors have the opportunity to share in the value they create for shareholders above a threshold return over a three-year performance period. However, if executive Directors do not deliver the required level of performance to achieve the threshold return, they receive no payout. It is worth noting that at a 31 December 2019 share price, the current LTIP would have paid nothing to the executive Directors as the value accretion had been taken up by the charge rate (see page 95). We strongly believe that this continues to be the right approach. Furthermore, all LTIP awards are made in shares and are subject to a further two-year holding period, so that executive Directors remain aligned with shareholders.

Renewal on consistent terms

These are fundamental elements of our remuneration structure and lie at the heart of the success enjoyed by Melrose and its shareholders. These elements, which have always been very strongly supported by our shareholders, will not change and will be the basis on which the renewal of the Directors' renumeration policy is proposed. The full detail of this proposal is set out in the 2020 Directors' Remuneration Policy on pages 103 to 111, which benchmarks very well against governance standards and will be put to a binding vote at the 2020 AGM.

Notwithstanding the strong support for our current Directors' remuneration policy, we have also listened to feedback during our engagement process from certain key shareholders and views expressed by some in the wider stakeholder community. As a result, the Remuneration Committee will be proposing two key changes to the LTIP at renewal, which will bring us in line with best market practice on governance: an increase in the annual charge rate to 6% and the introduction of a rolling annual cap for each executive Director on the vesting of awards.

Increasing the charge rate increases both the challenge for the management team as well as the amount of returns enjoyed by shareholders before management are entitled to any award. Set at 6% per annum, it simplifies the scheme (and makes it more predictable) by having a known rate from the outset. This annual charge rate is applied to invested capital, which is initially the market capitalisation of the Company at the LTIP renewal date on 31 May 2020 (subject to the floor as set out on page 95). Increasing the charge rate to 6% means that management will not be eligible for any reward under the renewed LTIP unless and until they have created at least a further £2.2 billion in shareholder value over the three-year performance period.(2)

In introducing a rolling annual cap, we considered it vital to strike a balance between the core rationale of incentivising management to maximise the returns for shareholders, whilst ensuring shareholders have the benefit of adequate protections. With the Melrose management team's track record of outperformance, while deliberately restricting annual salaries, bonuses and benefits, your Remuneration Committee considers it appropriate to set the cap within the upper decile range of executive remuneration for the FTSE 100 and thus apply a rolling annual cap of £10 million, expressed in shares. In order to be eligible to achieve this maximum, management will need to create at least £5.5 billion of shareholder value in the next LTIP period and, as stated above, over £2.2 billion before getting any payment at all.(2) Although the potential to earn up to the rolling annual cap is rightly significant in order to properly incentivise executive Directors to maximise shareholder returns, it is appropriate when put in the context of that level of performance and the deliberate strategy on fixed remuneration.

The new Directors' remuneration policy proposes that, for this next three-year performance period from 2020 to 2023, there will be a maximum of up to three annual rolling capped awards in 2023, 2024 and 2025, subject to income tax and made in shares. In each year, the cap will be the number of shares equivalent to £10 million divided by the share price on the commencement date in May of this year. Thus, the executive Directors have a continuing exposure to the share price (positively and negatively) under the terms of the scheme after crystallisation in 2023. Depending on the share price at the later dates of vesting, the value vested may be greater or less than £10 million and provides continuing incentive to deliver strong performance.

The Remuneration Committee was rightly mindful of how best to introduce a cap on a successful incentive scheme for the protection of shareholders, whilst not reducing the incentivisation for the executive Directors to continue to outperform that the scheme delivers. Setting the rolling annual cap as a number of shares at the commencement date best strikes this balance, ensuring that executive Directors are not unfairly penalised for good performance and are further aligned with shareholders, while shareholders are not unduly diluted.

Further to feedback received as part of the recent stakeholder engagement process, we are also proposing to increase both the minimum shareholding requirements for executive Directors to 300% of salary, and the post-cessation minimum shareholding requirements to 300% of salary for two years post-cessation, for the new Directors' remuneration policy.

Benchmarking

The Remuneration Committee has also always been clear that the LTIP focus on the creation of shareholder value is not at the expense of other stakeholders. Pension schemes under Melrose's responsible stewardship benefit from more prudent funding targets, improved funding and increased security for members. Gender and ethnic diversity are active pursuits, with targets set and hit ahead of time. Our global workforce is engaged in executive decision making, there is an awareness of our community responsibilities and the next generation supported in their development. These factors are taken into consideration on the strategic element of the annual bonus, and full disclosure of our actions in these areas is provided in our ESG report on pages 58 to 69.

The Committee firmly believes that the renewal of the LTIP and Directors' remuneration policy on consistent terms whilst incorporating the added protections of a cap and increased charge rate is vital for the continuation of the success enjoyed by Melrose stakeholders to date. As encouraged by the UK Stewardship Code, the Melrose remuneration structure is deliberately not the same as the average FTSE company. However, it is appropriate for the Melrose model, properly incentivises management and drives the value creation strategy. Furthermore, when benchmarked against the UK Corporate Governance Code (the "Code") and the guidelines of other stakeholders who have published their views on remuneration, it is also clear that it reflects best market practice from a governance perspective.

Stakeholder engagement

Melrose always strives for the full support of all our shareholders in all that we do. They are critical to our success and their support is never taken for granted. Following on from similar exercises last year, we have conducted an extensive and dedicated engagement process on the proposed renewal of the Directors' remuneration policy with a wide variety of stakeholders, including proxy advisors and key shareholders who together represent over 65% of our register. It was important to us that we conducted this thorough, comprehensive and open-minded engagement, understanding the focus on executive remuneration in the wider governance community. The engagement process was both informative and successful, and we thank the participants for their time. We have enjoyed a significant level of constructive engagement that has helped shape and refine the proposals.

Your Board considers that the Melrose remuneration structure is highly successful, appropriate for the value creation strategy and is critical to the ongoing long-term performance of the Company. We encourage you to provide your support for both the Annual Report on Remuneration and the new 2020 Directors' Remuneration Policy.

Yours sincerely

David Lis
Chairman, Remuneration Committee
5 March 2020

(1) All calculations in this section are based on the closing middle market quotation of an Ordinary Share as derived from the Daily Official List on 31 December 2019 and assume a continuous shareholding and participation in every fundraising, capital return and dividend receipt pro rata to ownership.
(2) Based on a 31 December 2019 share price of 240.1 pence, being the closing middle market quotation of an Ordinary Share as derived from the Daily Official List on 31 December 2019.

Directors' Remuneration report

Continued

Annual Report on Remuneration

On behalf of the Board, I am pleased to present our annual report on Director remuneration (the "Annual Report on Remuneration") at the end of another very successful year for Melrose.

In this section of the Directors' Remuneration report, we set out:

- the actual performance and executive remuneration outcomes for the 2019 financial year; and
- the application of the current Directors' remuneration policy (the "Directors Remuneration Policy") to the 2019 financial year and how the Directors' Remuneration Policy was operated in 2019.

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.

Key elements of the Annual Report on Remuneration and where to find them

Element	Page
Single figure of remuneration	93
Share interests awarded in the Financial Year	97 and 101
Statement of Director shareholdings and interests	97 and 101
Performance graph and table	99
CEO pay ratio	98
Percentage change in remuneration of the CEO	99
Relative importance of spend on pay	100
Consideration of matters relating to Directors' remuneration	92 to 93
Statement of voting	102
2020 Directors' Remuneration Policy	103 to 111
Payments to Past Directors / For Loss of Office	None

Melrose's Remuneration Strategy

Since the Company was first established, the Remuneration Committee (the "Committee") has pursued a consistent remuneration strategy that closely aligns the executive Directors with the Company's shareholders, drives the Company's "Buy, Improve, Sell" model and has been central to its success. This strategy is based around four key principles – namely, that executive remuneration is:

(1) **Simple** – since Melrose was first established, executive Directors have received the same four simple elements as the rest of the Melrose employees – base salary, annual bonus, pension contribution (15% of salary, being the same percentage as the rest of the Melrose employees) and medical benefits – as well as being eligible under a single and consistent long-term incentive plan based on a single value creation metric.

(2) **Transparent** – each year, there is full and detailed disclosure in the Directors Remuneration report of each component of remuneration, including an explanation of the calculation of any variable element and the current value of any unvested award pursuant to the long-term incentive scheme.

(3) **Supports the delivery of the value creation strategy** – with the fixed elements and the annual bonus cap being deliberately pegged well below the lower quartile of FTSE 100 peers, the opportunity for any significant reward is heavily weighted to the long-term incentive plan, that is entirely based on the creation of shareholder value.

(4) **Pays only for performance** – executive remuneration is heavily weighted to the long-term incentive plan, which pays nothing to participants unless the executive Directors deliver a threshold return to shareholders over a three-year period, and only pays a significant award if they materially outperform in the creation of shareholder value.

These four key principles are wholly aligned with the UK Corporate Governance Code (the "Code") factors of clarity, simplicity, risk, predictability, proportionality and alignment to culture, as set out on pages 110 to 111. The Committee ensures it takes all these elements into account when establishing the Directors' Remuneration Policy, as well as its application to executive Directors.

Operation of the Directors' Remuneration Policy in 2019

2019 was another successful year for Melrose as highlighted by this Annual Report and financial statements 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 2019 and 2020.

2019 key decisions

The Committee remains committed to a responsible approach to executive pay in accordance with the current Directors' Remuneration Policy and its four key remuneration principles.

In line with increases in previous years, an inflationary increase of 3% was made to the executive Directors' base salaries with effect from 1 January 2019, consistent with the salary rises awarded to the wider Melrose head office population. There were changes made to non-executive fees as set out on page 101, based on a benchmarking exercise undertaken in 2018 taking into account the increase in the size and scope of the Non-executive Directors' roles following the acquisition of GKN.

The Committee has reviewed the remuneration outcomes for the year and confirm that the Directors' Remuneration Policy has operated as intended. The 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.

Stakeholder engagement

After conducting an extensive and focused stakeholder engagement exercise at the time, the Committee was pleased that the most recent Directors' Remuneration Report and the Directors' Remuneration Policy were approved by shareholders at the AGM in 2019 and general meeting in 2017 respectively (with 87.83% and 82.04% voting in favour, respectively).

The Committee has taken the same approach ahead of the renewal of the Directors' Remuneration Policy this year. As set out in my Annual Statement on page 91, the multi-round engagement included key shareholders holding approximately 65% of the Company's ordinary shares in issue and other stakeholders, commencing shortly after the 2019 AGM and continuing until the renewal proposal was finalised this year. Both the Directors' Remuneration report and the 2020 Directors' Remuneration Policy will be put before shareholders at the 2020 AGM, and we look forward to your ongoing support.

Business Performance

As set out in my Annual Statement on page 90, the Melrose "Buy, Improve, Sell" model has been highly successful in delivering long-term performance, with its remuneration structure at its heart. 2019 has seen a continuation of this success, despite some macro challenges, as the Company continues to unlock the full potential of the businesses it owns. This Annual Report and financial statements and specifically the Group's strategic KPIs on pages 36 to 37 demonstrate the strong progress that has been made in 2019 towards the achievement of our objective of building better, stronger businesses under our ownership.

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, and the 2020 Incentive Plan will be no different.

Single total figure of remuneration for the executive Directors for the 2019 financial year (audited)

The following chart summarises the single figure of remuneration for 2019 in comparison with 2018:

Executive Director	Period	Total salary and fees £000	Taxable benefits £000	Bonus £000	LTIP(1) £000	Amount of LTIP award attributable to share price appreciation(1) £000	Pension(2) £000	Total Fixed £000	Total Variable £000	Total £000
Christopher Miller	2019	520	3	n/a	–	n/a	78	**601**	**0**	**601**
	2018	490	11	n/a	–	n/a	74	**575**	**0**	**575**
David Roper	2019	520	4	n/a	–	n/a	78	**602**	**0**	**602**
	2018	490	19	n/a	–	n/a	74	**583**	**0**	**583**
Simon Peckham	2019	520	3	375	–	n/a	78	**601**	**375**	**976**
	2018	490	19	466	–	n/a	74	**583**	**466**	**1,049**
Geoffrey Martin	2019	419	10	302	–	n/a	63	**492**	**302**	**794**
	2018	392	28	373	–	n/a	59	**479**	**373**	**852**
Total	**2019**	**1,979**	**20**	**677**	**–**	**n/a**	**297**	**2,296**	**677**	**2,973**
	2018	**1,862**	**77**	**839**	**–**	**n/a**	**281**	**2,220**	**839**	**3,059**

(1) 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 2019.
(2) All amounts attributable to pension contributions were paid as a supplement to base salary in lieu of pension arrangements.

Comparison to Peers

The total remuneration of £976,000 paid to the Melrose Chief Executive in 2019 was approximately 7% lower than last year's total. The Committee benchmarked Melrose Chief Executive's pay against the most recent available remuneration information from 2018 with our FTSE 100 peers.(3)

As the table below shows, the single total figure of remuneration for the Melrose Chief Executive was less than half, or over £1 million less than, the lower quartile of FTSE 100 peers. This demonstrates in practice the Committee's policy of deliberately setting salary, benefits and annual bonus for the executive Directors low, with the opportunity for significant reward being heavily weighted towards the long-term incentive plan, which is entirely performance based and ensures that executive Directors only receive substantial rewards when they have outperformed and created very significant value for shareholders.

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Total	1,049	2,147	2,766	3,735

Each of the elements in the single figure table is set out in more detail below, along with the benchmark for the Melrose Chief Executive to the most recent available information for our FTSE 100 peers (being 2018).

Base Salary

Salaries are fixed at a level which is well below the lower quartile of FTSE 100 peers. Each executive Director received an inflationary increase in base salary of approximately 3% effective from 1 January 2019.

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Annual Salary	490	720	858	1,098

Pensions

Executive Directors receive the same 15% of base salary pension contribution(4) as the rest of the Melrose employees, which the Committee notes is well below the lower quartile of pension contributions in the FTSE 100 (as set out in the table below) and is also within the range of the wider workforce contributions. This contribution rate has not changed since Melrose was founded and no executive Director participates or has ever participated in a Group defined benefit or final salary pension scheme.

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Pension Contribution	74	122	195	283
Pension Contribution %	15%	17%	25%	27%

(3) For comparison purposes, this excludes payments under long-term incentive arrangements, as none were payable to the Melrose Chief Executive in 2018.
(4) All of the amounts attributable to pension contributions were paid as supplements to base salary in lieu of pension arrangements.

Directors' Remuneration report
Continued

Benefits
Executive Directors receive the same non-pension benefits as the rest of the Melrose employees, being generally a fuel allowance, private medical insurance, life insurance and group income protection. The Group Finance Director also received paid train travel to and from London.

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Benefits	19	19	33	69

Annual Bonus
Annual bonuses are entirely performance driven and are calculated by the Committee using two elements: 80% being based on audited diluted earnings per share growth; and 20% based on the achievement of strategic elements. The maximum bonus opportunity is set at 100% of base salary, which is significantly below the lower quartile maximum annual bonus opportunity for other FTSE 100 companies as set out in the table below. Neither of the executive Vice-Chairmen participate in the annual bonus scheme.

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Annual Bonus	466	1,286	1,680	2,285
Max bonus opportunity %	100%	150%	200%	225%

2019 Annual Bonus (audited)
The 2019 Annual Bonus has applied a consistent approach to previous years, in line with the current Directors' Remuneration Policy.
The Committee awarded participating executive Directors a bonus of 72% of base salary, based on 2019 performance, with the full breakdown of the award calculation set out below:

Financial Objectives (80%)					Percentage of maximum bonus earned
	Threshold	**Target**	**Maximum**	**Actual Performance**	
EPS Growth	**5%**	**10%**	**20%**	**13%**	
% award	20%	40%	80%	52%	
EPS Growth sub-total:					**52%**

Strategic Objectives (20%)		Percentage of maximum bonus earned
• Launch of One Aerospace restructuring – maximum 4%	Management have supported GKN Aerospace's decision to commence a major restructuring of its organisation, announced in September, to create a 'One Aerospace' organisation. Management have been heavily involved in all aspects of the planning and implementation of the restructuring, which will result in the GKN Aerospace businesses being restructured along customer rather than product lines, creating significant efficiencies and further improving performance.	4%
• Install new GKN Automotive executive team and update strategy – maximum 4%	Management have reorganised the GKN Automotive division, supported the establishment of the new executive team, and worked with them to update the business's improvement strategy and move to its implementation that successfully mitigated the margin impact from the global automotive downturn.	4%
• Delivery of joint procurement and working capital improvement exercise, improvement on loss-making contracts – maximum 4%	The GKN Aerospace and GKN Automotive joint procurement initiative delivered substantial savings in 2019, while significant improvements were secured on the GKN loss-making contracts. The Group-wide working capital efficiency programme was initiated that has already delivered over £90 million of savings in 2019, with more to come.	4%
• Pursue targeted M&A and sales wins at GKN Powder Metallurgy – maximum 2%	Management have supported GKN Powder Metallurgy in securing the acquisition of FORECAST 3D, a leading US plastic 3D printing business, and Sintec, a European sinter business. GKN Powder Metallurgy is already seeing the benefits of this business combination. While recognising that the automotive downturn led to a decline in sales, GKN Powder Metallurgy was able to make some targeted market share gains.	2%
• Establishment of ESG reporting – maximum 2%	In response to requested additional disclosure on ESG factors by investors and other stakeholders, management have established a framework that sets Group expectations and supports the businesses in their pursuits of these aims, whilst monitoring and reporting on progress. The executive Directors have produced Melrose's inaugural standalone ESG report, included as part of this Annual Report, which details the actions, initiatives and progress in these areas.	2%
• Execution of StatePoint Technology® contract – maximum 2%	Having invested heavily in its development, HVAC celebrated the completion of its first StatePoint Technology® liquid cooling system, signed a significant new contract for its industry leading new proprietary StatePoint Technology® with a global technology leader, and developed a significant pipeline of future sales. This has been a significant milestone in the improvement strategy for HVAC, as well as the ESG strategy for the Group.	2%
• Mitigation of tariff impacts and rebuild of executive teams for Ergotron and Security – maximum 2%	Both Ergotron and Security endured a difficult 2019, in particular challenged by US tariffs given the location of their operations. With recent departures, management secured appointments to rebuild the executive teams and worked closely with them to minimise the impact of these challenges through production initiatives, commercial discussion and regulatory applications.	2%
Strategic Objectives sub-total:		**20%**
Total annual bonus for 2019:		**72%**

All bonus payments for 2019 will be made in cash, as both participating executive Directors have exceeded their minimum shareholding requirements. See page 96 and 97 for details of the requirements.

Long-term incentive arrangements (audited)

The third and final tranche of options under the 2017 Incentive Plan were allocated to executive Directors on 8 March 2019, with Christopher Miller and David Roper each being granted 2,584 options, and Simon Peckham and Geoffrey Martin each being granted 2,834 options. The 2017 Incentive Plan is due to crystallise on 31 May 2020 and therefore no long-term incentives crystallised during the 2019 financial year.

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 2019 instead of the actual crystallisation date of 31 May 2020.

As the table demonstrates, as at 31 December 2019, no value had accrued to the 2017 Incentive Plan.

Theoretical value under the 2017 Incentive Plan if crystallised on 31 December 2019 rather than on the 2020 scheduled payment date
2017
Invested capital from (and including) May 2017 up to (and including) December 2019 £10,460,434,993 Index adjustment/minimum return £1,065,155,536
Indexed capital £11,525,590,529
2019
Number of issued ordinary shares on 31 December 2019 4,858,254,963
Average price of an ordinary share for 40 business days prior to 31 December 2019 £2.29395
Deemed market capitalisation of Melrose based on average price of an ordinary share for 40 business days prior to 31 December 2019 £11,144,593,972
Overall change in value for shareholders since 31 May 2017 £(380,996,557)

Theoretical value to management and shareholder dilution calculated at 31 December 2019
7.5% of change in value 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 2019 for the 2017 Incentive Plan to deliver value 237p

As at 31 December 2019 the minimum return hurdle of £1,065,155,536 had not been achieved, although Melrose management had created a significant amount of value compared with the position as at 31 December 2018. Management would need to create at least an additional £380,996,557 of value for shareholders by 31 May 2020 in order for the 2017 Incentive Plan to begin to accrue value for participants.

Should this shortfall in value not be created prior to 31 May 2020, no value will vest to the 2017 Incentive Plan. Because executive Directors only participate in the excess above this threshold, there are unlikely to be significant awards even if the threshold is met. In a remuneration structure so heavily and deliberately weighted to the variable LTIP award, this will mean that the executive Directors will receive modest reward for the hard work and success over the past three years. Nonetheless, this is how the Melrose remuneration strategy was deliberately structured and the Committee do not intend to make any change to the 2017 Incentive Plan to compensate for this.

The Committee did not adjust any incentive plan share outcome due to share price appreciation as none crystallised during the year being reported on, nor does it intend to adjust the incentive plan share outcome on the crystallisation date of the 2017 Incentive Plan.

Directors’ Remuneration report

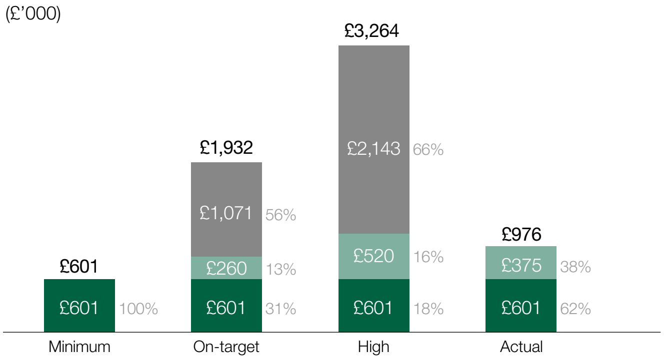
Continued

Illustration and application of the Directors’ Remuneration Policy in 2019

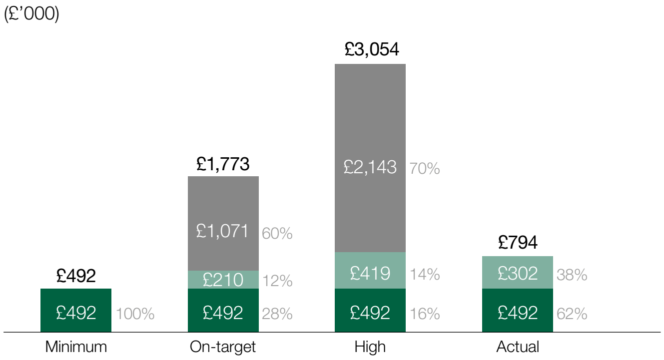
The charts set out below are updated versions of charts which appeared in the Directors’ Remuneration Policy shareholder circular approved in May 2017. These set out an illustration of the current Directors’ Remuneration Policy compared to the actual executive Director remuneration paid in 2019.

The executive Directors’ options under the 2017 Incentive Plan may 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 of Association). 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).

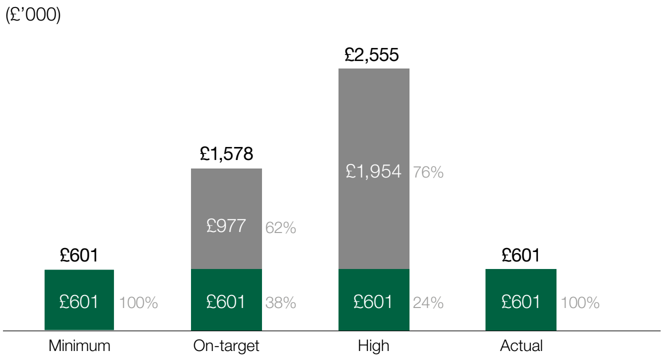
Simon Peckham



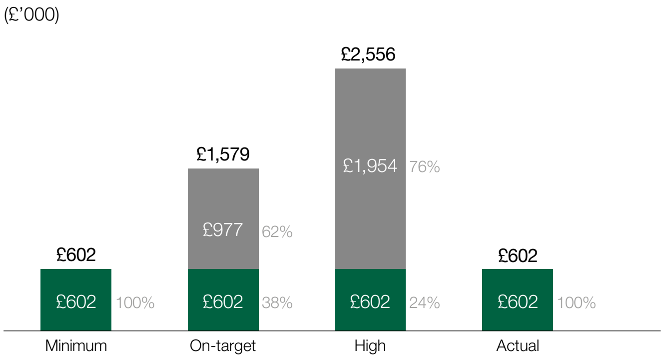
Geoffrey Martin



Christopher Miller



David Roper



● Fixed ● Annual variable ● LTI

● Fixed ● Annual variable ● LTI

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 2019, the following assumptions have been made:

- **Minimum performance:** fixed elements of remuneration only. Base salary effective from 1 January 2019, and benefits and pension rate as set out in the single figure table for the year ended 31 December 2019 on page 93.
- **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.

Minimum shareholding requirements and equity exposure of the Board (audited)

Executive Directors are subject to two concurrent minimum shareholding requirements. The first is to hold at least half of the shares acquired pursuant to the crystallisation of the 2012 Incentive Plan, after satisfying tax obligations following the crystallisation of that plan and subject to capital adjustments. This was increased under the current 2017 Incentive Plan, that will require executive Directors to hold all the shares they acquire pursuant to the crystallisation in May 2020 for a two-year holding period, which will also apply to the proposed 2020 Incentive Plan. The second obligation is for executive Directors to always hold at least an amount of shares equal to 200% of salary, which under the new Directors’ Remuneration Policy (the “2020 Directors’ Remuneration Policy”) will be increased to 300% of salary.

In reality, all executive Directors hold well in excess of these minimum amounts, which reflects their long-term stewardship of the Company and long-term investment in the Company's shares. This is demonstrated by the following table which sets out all subsisting interests in the equity of the Company held by the executive Directors as at 31 December 2019:

Executive Directors	Minimum number of ordinary shares to be held by executive Directors as at 31 December 2019[1]	Additional shareholding requirement (% salary)[2]	Current shareholding (% salary)[3]	Ordinary shares held	Unvested interests under share schemes (2017 Incentive Plan): Subject to performance conditions	Unvested interests under share schemes (2017 Incentive Plan): Not subject to performance conditions	Shareholding requirement met?
Christopher Miller	4,802,159	200%	12,536%	27,108,510[4]	7,750[5]	n/a	Yes
David Roper	4,802,159	200%	7,572%	16,373,732	7,750[5]	n/a	Yes
Simon Peckham	4,627,535	200%	7,984%	17,265,565	8,500[5]	n/a	Yes
Geoffrey Martin	4,627,535	200%	4,242%	7,395,256	8,500[5]	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 obligation in (1), the shareholding requirement under the current Directors' Remuneration Policy is 200% of base salary. Under the 2020 Directors' Remuneration Policy this will be increased to 300% of base salary.
(3) For these purposes, the value of a share is 240.1 pence, being the closing mid-market price on 31 December 2019, the last business day of the 2019 financial year.
(4) As at 31 December 2019, 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 Companies Act 2006.
(5) Each executive Director was granted options over Incentive Shares (2017) in three equal tranches over the three-year performance period. The first tranche was exercised on 29 June 2017. As a result, Christopher Miller and David Roper each hold 2,583 Incentive Shares (2017) and 5,167 options, and Simon Peckham and Geoffrey Martin each hold 2,833 Incentive Shares (2017) and 5,667 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.

No executive Director may dispose of any ordinary shares without the consent of the Chairman 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. There have been no changes in the shareholdings of the executive Directors between 31 December 2019 and 5 March 2020.

Please see page 101 for a table setting out the equity interests of the Non-executive Directors as at 31 December 2019.

Key decisions and statement of implementation for 2020

Salary review

The executive Directors' base salaries have received an inflationary increase of 3% with effect from 1 January 2020, consistent with the wider Melrose head office population. The overall framework for the executive Directors' annual bonus arrangements for 2020 will remain the same as in 2019, as set out on page 94. Non-executive Directors' basic fees for 2020 have also been increased by 3%, with effect from 1 January 2020, which is consistent with the increase for the executive Directors, with the additional Audit Chairman fee being the only other fee that has been increased, recognising the additional responsibilities of the position.

Pensions and benefits

For current executive Directors in 2020, standard benefits will be provided in line with the Directors' Remuneration Policy and the pension contribution rate will be 15% of salary, the same percentage of salary as the rest of the Melrose employees.

Annual bonus

The overall framework for the executive Director annual bonus arrangements for 2020 will remain the same as in 2019, with a maximum bonus opportunity of 100% of salary, based on financial and strategic performance metrics. The Committee considers that the strategic performance measures are commercially sensitive but will disclose the nature of those measures on a retrospective basis, where appropriate, on a similar basis to the disclosure on page 94 in respect of the annual bonus for the year ending 31 December 2019.

Renewal of the Directors' Remuneration Policy

Melrose is also due to renew its Directors' Remuneration Policy (including its annual bonus plan) at the 2020 AGM, including its long-term incentive plan ("LTIP"), which is due to be renewed on 31 May 2020. As set out in my Annual Statement on pages 90 to 91, the Committee is proposing two key changes to the LTIP at renewal: an increase in the annual charge rate to 6% and the introduction of a rolling annual cap for each executive Director on the vesting of awards. We are also proposing to increase both the minimum shareholding requirements for executive Directors to 300% of salary, and the post-cessation minimum shareholding requirements to 300% of salary for two years post-cessation. The terms of the 2020 Directors' Remuneration Policy will otherwise be consistent with the current successful Directors' Remuneration policy, full details of which are set out on pages 103 to 111.

Directors' Remuneration report

Continued

Regulatory disclosures

Chief Executive remuneration for previous ten years

In accordance with the regulations governing the reporting of executive Director remuneration, the total figure of remuneration set out in the table below includes the value of long-term incentive vesting in respect of the relevant 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 the year ended 31 December 2017, although these each represent reward earned over the previous five years.

Financial year	Chief Executive	Non-LTIP £	LTIP £	Total remuneration £	Annual bonus as a percentage of maximum opportunity	Long-term incentives as a percentage of maximum opportunity
Year ended 31 December 2019	Simon Peckham	976,000	0	976,000	72%	–
Year ended 31 December 2018	Simon Peckham	1,049,000	0	1,049,000	95%	–
Year ended 31 December 2017	Simon Peckham	994,000	41,770,000	42,764,000(1)	90%	n/a(2)
Year ended 31 December 2016	Simon Peckham	987,725	0	987,725	95%	–
Year ended 31 December 2015	Simon Peckham	928,541	0	928,541	88%	–
Year ended 31 December 2014	Simon Peckham	773,167	0	773,167	58%	–
Year ended 31 December 2013	Simon Peckham	927,276	0	927,276	100%	–
Year ended 31 December 2012(3)	Simon Peckham	489,372	19,791,212	20,280,584(4)	64%	n/a(5)
	David Roper	259,040	10,656,806	10,915,846(4)	64%	n/a(5)
Year ended 31 December 2011	David Roper	811,152	0	811,152	84%	–
Year ended 31 December 2010	David Roper	849,341	0	849,341	100%	–

(1) 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.

(2) 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.

(3) 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, 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.

(4) The value derived in 2012 from the 2009 Incentive Shares represents the relevant 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.

(5) 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.

CEO Pay Ratio

Our median CEO to employee pay ratio for 2019 was 24:1. The following table provides pay ratio data in respect of the Chief Executive's total remuneration compared to the 25th, median and 75th percentile UK employees.

Financial year	Method	25th percentile pay ratio	Median pay ratio	75th percentile pay ratio
Year ended 31 December 2019	Option A	30:1	24:1	19:1

The employees used for the purposes of the table above were those employed on 31 December 2019 and remuneration figures were determined with reference to the financial year to 31 December 2019. Option A was chosen as it is considered to be the most accurate way of identifying the relevant employees. This captures all relevant pay and benefits and aligns to how the single figure table is calculated. The value of each employee's total pay and benefits was calculated using the single figure methodology consistent with the Chief Executive, with the exception of the annual bonus, which was calculated using 2018 financial year bonuses (which were paid during 2019) where the 2019 financial year data was not available at the last practical date before the finalisation of this report. No elements of pay have been omitted. Where required, remuneration was approximately adjusted to reflect full-time and full-year equivalents based on the employees' contracted hours and the proportion of the year they were employed.

The following table provides salary and total remuneration information in respect of the employees at each quartile.

Financial year	Element of pay	25th percentile pay employee	Median employee	75th percentile employee
Year ended 31 December 2019	Salary and wages(1)	£31,000	£36,000	£45,000
	Total pay and benefits	£32,000	£40,000	£50,000

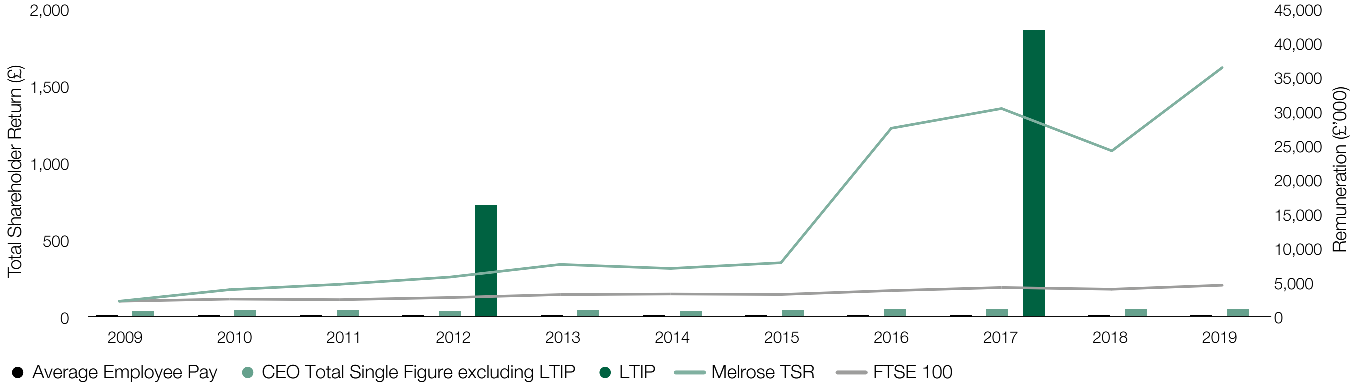
(1) Base salary includes overtime and shift allowances/premiums. The individual at the median received overtime and shift premium during the year.

The Committee considers that the median pay ratio is consistent with the relative role and responsibilities of the Chief Executive and the identified employee. Base salaries of all employees, including our executive Directors, are set with reference to a range of factors, including market practice, experience and performance in role. The Chief Executive's remuneration package is weighted towards variable pay due to the nature of the role, and this means that the ratio is likely to fluctuate depending on the outcomes of incentive plans in each year.

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 team at Melrose (and noting that the executive Vice-Chairmen do not participate in the annual bonus plan).

	2018 CEO to executive Director pay ratio	2019 CEO to executive Director pay ratio
Christopher Miller	1.8:1	1.6:1
David Roper	1.8:1	1.6:1
Geoffrey Martin	1.2:1	1.2.1

To give context to the Chief Executive remuneration for the previous ten years and the CEO pay ratio, we have included an illustrative chart tracking CEO pay and average employee pay over the last ten financial years alongside Melrose's TSR performance and the FTSE 100'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.



Percentage change in Directors' remuneration

The table below sets out, in relation to base 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 and the divisional CEOs, managing directors and finance directors of the Group's business units. The percentages shown relate to the financial year ended 31 December 2019 as a percentage comparison to the financial year ended 31 December 2018. 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.

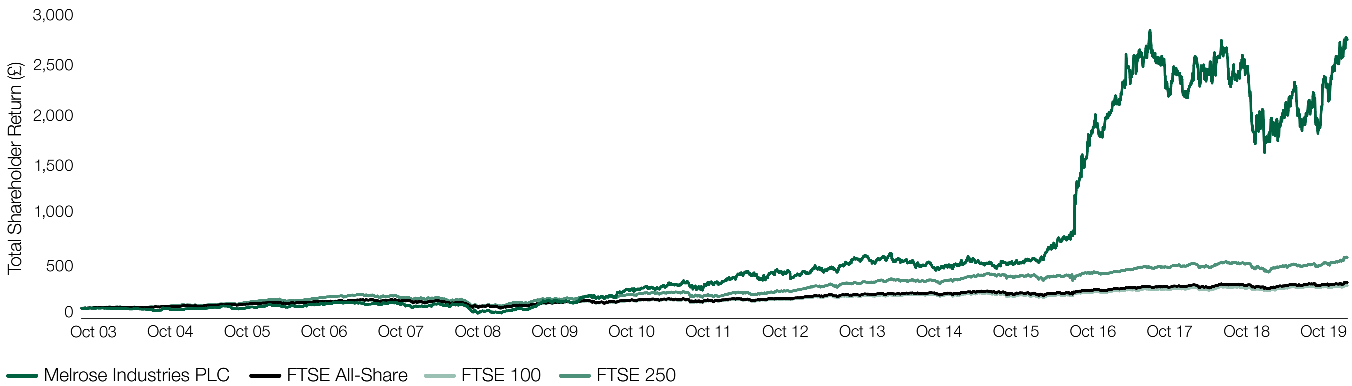
Element of remuneration	Chief Executive percentage change	Senior employees percentage change(1)
Basic salary	6%(2)	5%
Benefits	-84%	73%
Annual bonus	-20%	-23%

(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.
(2) From 1 January 2019, the payroll for executive Directors and Melrose employees was simplified by including (where relevant) the car allowance in base salary. The increase represents a 3% inflationary review and the addition of the car allowance. As this table and the table on page 93 indicate, there has been an equivalent reduction in benefits.

Total Shareholder Return

The total shareholder return graph below shows the value as at 31 December 2019 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. This shows a TSR of 2,645% and demonstrates very clearly the long-term performance of the Company.

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 2019 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

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 to ensure that the incentives operated by the Company align with its culture and strategy.

The Committee does not have responsibility for setting and managing the remuneration of Melrose senior management or divisional executive teams, which remain the responsibility of the Chief Executive, or the pay policies of the business units, responsibility for which sits with businesses themselves. The Committee has determined that such an approach is appropriate in light of Melrose's decentralised business model. The Committee does, however, have oversight of workforce pay, policies and incentives at both a Melrose level and a business unit executive level, which enables it to ensure that the approach to executive remuneration is consistent with those workforces. This alignment is evidenced by the fact that the CEO pay ratio for 2019 remains low, and the 15% pension contribution and other benefits are equal to those for Melrose employees and within the range of the benefits of the wider group workforce.

Given the differing nature of our businesses, the Committee does not expect a standardised approach to remuneration. However, when conducting its review, it pays particular attention to whether each element of remuneration is consistent with the Company's remuneration philosophy. The Committee also receives confirmation from each business unit that the remuneration provided to its executive team is consistent with its wider workforce and that the incentives operated by that business unit align with its culture and strategy. Based on these disclosures, the Committee is satisfied that the approaches to remuneration at all levels are consistent with the Company's remuneration philosophy.

Long-term incentives

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 are 15% of an employee's salary for members of the Melrose pension scheme (including the executive Directors) and these contributions are within the range of pension provisions across our various business unit pension schemes.

In line with the "Improve" aspect of Melrose's "Buy, Improve, Sell" strategy, we have continued to improve funding levels in the pension plans of our business units. As further detailed on page 7, 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 Schemes (1-4) using a discount rate of Gilts +75bps and for the GKN 2016 Pension Scheme using a discount rate of Gilts +25bps.

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 31 December 2018 £ million	Year ended 31 December 2019 £ million	Percentage change
Remuneration paid to all employees(1)	2,064(2)	2,868	39%
Distributions to shareholders by way of dividend and share buy back	129	231	79%

(1) The figure for the year ended 31 December 2018 is the total staff costs as stated in note 7 to the financial statements and the figure for the year ended 31 December 2019 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 2019 costs, which include 12 months. 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 and share interests (audited)

The following table sets out the single figure of remuneration for 2019 in comparison with 2018 for the Company's Non-executive Directors, along with the subsisting interests in the equity of the Company held by them:

Non-executive Directors	Period	Total salary and fees £000	Other (bonus, pension, LTIP, taxable benefits) £000	Total Fixed £000	Total Variable £000	Total £000	Ordinary shares held as at 31 December
Justin Dowley (Chairman)	2019	350[(1)]	n/a	**350**	**0**	**350**	1,423,395
	2018	85	n/a	**85**	**0**	**85**	1,387,509
Liz Hewitt	2019	110	n/a	**110**	**0**	**110**	188,377
	2018	80	n/a	**80**	**0**	**80**	188,377
David Lis	2019	95	n/a	**95**	**0**	**95**	458,947
	2018	72	n/a	**72**	**0**	**72**	458,947
Archie G. Kane	2019	85	n/a	**85**	**0**	**85**	50,000
	2018	69	n/a	**69**	**0**	**69**	50,000
Charlotte Twyning	2019	75	n/a	**75**	**0**	**75**	36,000
	2018	17[(2)]	–	**17**	**0**	**17**	36,000
Funmi Adegoke[(3)]	2019	19	n/a	**19**	**0**	**19**	0
	2018	–	–	**–**	**–**	**–**	–
Total	**2019**	**734**	**n/a**	734	0	734	**2,156,719**
	2018	**323**	**n/a**	323	0	323	**2,120,833**

(1) Justin Dowley assumed the inaugural role of Non-executive Chairman of the Board on 1 January 2019. His fee was 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.
(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 for 2018 reflect her fees for the period 1 October 2018 to 31 December 2018.
(3) Funmi Adegoke was appointed as a Non-executive Director of the Company with effect from 1 October 2019 and the fees referred to above for 2019 reflect her fees for the period 1 October 2019 to 31 December 2019.

Non-executive Directors' fees (audited)

Basic fees for Non-executive Directors and the Non-executive Chairman's fee have been increased by 3% with effect from 1 January 2020, in keeping with increases made to executive Directors and other Melrose employees in previous years (other than for 2018, which was considered an exceptional year given the acquisition of GKN). The additional fee for holding the Chairmanship of the Audit Committee was increased by £10,000, to better reflect the increased scope and complexity of the role given the diversity of our businesses and combined profile. The Non-executive Director fee levels for 2019 and 2020 are set out in the table below.

Fee element	Previous fee with effect from 1 January 2019	Fee with effect from 1 January 2020
Non-executive Chairman fee	£350,000	£360,500
Basic Non-executive Director fee	£75,000	£77,250
Additional fee for holding the Chairmanship of the Remuneration Committee	£20,000	£20,000
Additional fee for holding the Chairmanship of the Audit Committee	£20,000	£30,000
Additional fee for holding the Chairmanship of the Nomination Committee	£10,000	£10,000
Additional fee for holding the position of Senior Independent Director	£15,000	£15,000

Service contracts and letters of appointment

Consistent with the best practice guidance provided by the 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 Code and the Company's Articles of Association.

There is no unexpired term as each of the executive Directors' contracts is on a rolling basis.

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 Code's recommendation that all directors of FTSE 350 companies be subject to annual re-election by shareholders. 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.

Details of the Non-executive Directors' terms of appointment are set out below:

Non-executive Directors	First appointment	Expires*
Justin Dowley (Chairman)	1 September 2011	AGM 2023
Liz Hewitt	8 October 2013	AGM 2022
David Lis	12 May 2016	AGM 2022
Archie G. Kane	5 July 2017	AGM 2020
Charlotte Twyning	1 October 2018	AGM 2021
Funmi Adegoke	1 October 2019	AGM 2022

* Subject to annual re-election.

Directors' Remuneration report

Continued

Governance

Responsibilities

The Board has delegated to the Committee responsibility for overseeing the remuneration of the Chairman of the Board and the executive Directors.

The 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 policy for the executive Directors.
- Setting and managing remuneration packages of the executive Directors and the Chairman of the Board in accordance with the Directors' Remuneration Policy.
- Overseeing the 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 long-term incentive arrangements.

As described on page 100, although they retain oversight, the Committee is not responsible for setting and managing the remuneration of Melrose senior management and divisional executive teams, nor is it responsible for determining wider business unit employee pay, which are the responsibility of the Chief Executive and the relevant business unit, respectively. Responsibility for determining the remuneration of the Non-executive Directors (other than the Chairman) sits with the Board. No Director plays a part in any decision about his or her own remuneration.

The Committee's terms of reference, which were last revised in November 2019, are available on our website, www.melroseplc.net, and from the Company Secretary at Melrose's registered office.

Attendance at meetings

The attendance of the Non-executive Directors at the scheduled meetings of the Committee in 2019 was as follows:

Member	No. of meetings(1)
David Lis (Chairman)	2/2
Justin Dowley	2/2
Liz Hewitt(2)	1/1
Archie G. Kane	2/2
Charlotte Twyning	2/2
Funmi Adegoke(3)	1/1

(1) Reflects regularly scheduled meetings. No other meetings of the Committee took place in 2019.
(2) Retired as a member of the Committee prior to the second scheduled meeting taking place.
(3) Appointed to the Committee with effect from 1 October 2019 and attended all Committee meetings held during the period 1 October 2019 to 31 December 2019.

Compliance with legislation and the Code

In 2019 we were already compliant with the key provisions of the new Code and the Financial Conduct Authority's Listing Rules and Disclosure Guidance and Transparency Rules, including in relation to minimum shareholding requirements, post-cessation minimum shareholding requirements, pension alignment, malus and clawback, and discretion to override formulaic outcomes. This will continue into the 2020 Directors' Remuneration Policy, as set out on pages 103 to 111.

The Directors confirm that this report has also 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.

Committee membership

All members of the Committee are independent Non-executive Directors within the definition of the 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.

Advisors to the Remuneration Committee

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 £83,230 excluding VAT, which were charged on a time/cost basis. During the year, PwC LLP also provided the Company with reward, tax, accounting, and consulting advice.

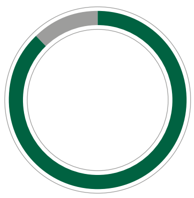
PwC LLP was appointed by the Committee. PwC LLP is a member of the Remuneration Consultants Group, and as such chooses to operate pursuant to a code of conduct that requires remuneration advice to be given objectively and independently. The Committee is satisfied that the advice provided by PwC LLP in relation to remuneration matters is objective and independent.

The Company Secretary acts as secretary to the Committee and attends Committee meetings.

Statement of voting at general meeting

The charts below set out the votes on the Annual Report on Remuneration at the 2019 AGM and on the Directors' Remuneration Policy at the 2017 general meeting.

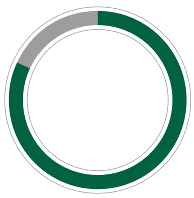
Resolution to approve the Directors' Remuneration Report for the year ended 31 December 2018



Percentage of votes cast for the resolution	87.83%
Percentage of votes cast against the resolution	12.17%

Votes withheld 180,597,947

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%

Votes withheld 35,787,047

This Annual Report on Remuneration will be put to an advisory vote and the 2020 Directors' Remuneration Policy on pages 103 to 111 will be put to a binding vote at the AGM, on 7 May 2020.

2020 Directors' Remuneration Policy

This Directors' remuneration policy (the "2020 Directors' Remuneration Policy") shall, subject to shareholder approval at the 2020 AGM, take binding effect from the conclusion of that meeting. The Company's current Directors' Remuneration Policy was approved by shareholders in 2017 and the Remuneration Committee made adjustments to its implementation for 2019. The 2020 Directors' Remuneration Policy is proposed to take account of the introduction of the 2020 Incentive Plan, which will be on equivalent economic principles to the 2017 Incentive Plan, but with certain additional shareholder focused features, including the application of a rolling annual cap and an increased penalty charge. The differences between the current Directors' Remuneration Policy and the 2020 Directors' Remuneration Policy set out below are the inclusion of the 2020 Incentive Plan, the increases to the minimum shareholder requirements and post-cessation minimum shareholding requirements, and the extension of the malus and clawback trigger events.

The proposal seeks to balance the desire to maintain a very successful Melrose remuneration structure that is critical to its "Buy, Improve, Sell" model, with the certainty of further shareholder protections. This remuneration structure and the Directors' Remuneration Policy is based around four key principles as set out on page 92 – namely, that executive remuneration should be simple, transparent, support the value creation strategy and pay only for performance. Details are set out below.

To place the current Directors' Remuneration Policy in context, the table below shows that the single total figure of remuneration for the Chief Executive in 2018 was less than half, or over £1 million less than, the lower quartile of FTSE 100 peers.(1) This demonstrates in practice the Company's policy of deliberately setting salary, benefits and annual bonus for the executive Directors low, with the opportunity for significant reward being heavily weighted towards the long-term incentive plan, which is entirely performance based and ensures that executive Directors only receive substantial rewards when they have outperformed and created very significant value for shareholders. This will continue to be the case under the 2020 Directors' Remuneration Policy.

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Total	1,049	2,147	2,766	3,735

How did the Remuneration Committee determine the 2020 Directors' Remuneration Policy?

In determining the 2020 Directors' Remuneration Policy, the Remuneration Committee:

- considered the Company's strategy, how the current Directors' Remuneration Policy related to and supported the strategy, and formed its own views on the changes (if any) required to the current Directors' Remuneration Policy to align with the strategy;
- considered feedback from shareholders and investor bodies on the 2017 and 2018 Annual Remuneration Reports;
- sought advice from its independent remuneration consultant on the impact of the UK Corporate Governance Code, applicable law and regulations and current investor sentiment in formulating the 2020 Directors' Remuneration Policy;
- considered the disclosures it receives on wider workforce remuneration to ensure the approach to executive remuneration is consistent;
- consulted with the executive Directors and other relevant members of Melrose senior management on the proposed changes to the current Directors' Remuneration Policy; and
- conducted a full consultation exercise with key shareholders and investor bodies on the changes.

The Remuneration Committee was mindful in its deliberations on the 2020 Directors' Remuneration Policy of any potential conflicts of interest and sought to minimise them through an open and transparent internal consultation process, by seeking independent advice from its external advisors and by undertaking a full shareholder consultation exercise.

Salary, bonus and benefits

Base Salary

Purpose and link to strategy

Core element of fixed remuneration, reflecting the size and scope of the role, designed to attract and retain executive Directors of the calibre required for the Group.

Operation

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 Remuneration Committee determines this to be appropriate. The individual's contribution and overall performance is one of the considerations in determining the level of any salary increase.

Salaries are paid in cash and levels are determined by the Remuneration Committee taking into account a range of factors including:

- role, experience and performance;
- prevailing market conditions;
- external benchmarks for similar roles at comparable companies; and
- salary increases awarded for other employees in the Group.

Opportunity

To avoid setting expectations of executive Directors and other employees, no maximum has been set under the 2020 Directors' Remuneration Policy. Salary increases will take into account the average increase awarded to other Melrose employees and the wider Group workforce.

Increases may be made to salary levels in certain circumstances as required, for example to reflect:

- an increase in scope of role or responsibility; and
- performance in role.

(1) For comparison purposes, this excludes payments under long-term incentive arrangements, as none were payable to the Melrose Chief Executive in 2018.

Directors' Remuneration report

Continued

Operation of the Directors' Remuneration Policy in 2018 as compared to FTSE 100 peers

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Annual Salary	490	720	858	1,098

Annual Bonus

Purpose and link to strategy

Rewards performance against annual targets which support the strategic direction of the Company.

Operation

Targets are set annually and payout is determined by the Remuneration Committee after the year-end based on performance against those targets. The Remuneration 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. The treatment of bonus payments upon cessation of employment is described on pages 109 to 110.

Annual bonus awards are discretionary and, accordingly, are subject to a "malus" provision over the course of the relevant year. The annual bonus award is also subject to a clawback arrangement that may be applied by the Remuneration Committee at any time up until the Annual General Meeting held in the second year following the payment of the bonus.

The Remuneration Committee may apply these malus or clawback provisions in the event of: (1) material misstatement of financial results that, in the reasonable opinion of the Remuneration Committee, has a material negative effect; (2) material miscalculation of any performance measure on which the bonus earned was calculated; (3) gross misconduct by the relevant executive Director; (4) events or behaviour of an executive Director that have led to the censure of the Company by a significant regulatory authority or have had a significant detrimental impact on the reputation of the Company, provided that the Board is satisfied that the relevant executive Director was responsible for the censure or reputational damage and that the censure or reputational damage is attributable to them; and/or (5) the Company becoming insolvent or otherwise suffering a corporate failure so that the bonus earned is materially reduced, provided that the Board determines, following an appropriate review of accountability, that the executive Director should be held responsible (in whole or in part) for that insolvency or corporate failure.

If an executive Director does not satisfy the minimum shareholding requirement (see below), up to 50% of any bonus award may be deferred into shares for up to two years.

Opportunity

Maximum opportunity is 100% of base salary.

Performance metric

The Remuneration Committee will have regard to various performance metrics (which will be determined by the Remuneration Committee) measured over the relevant financial year, when determining bonuses. 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 Remuneration Committee.

- **Financial metrics:** The element of the bonus subject to a financial metric will be determined between 0% and 100% for performance between "threshold" performance (the minimum level of performance that results in any level of payout), "target" performance, and "maximum" performance, with a linear line for achievement between the threshold and the maximum.
- **Strategic element:** The strategic element of an award will be determined to the extent assessed by the Remuneration Committee between 0% and 100% based on the Remuneration Committee's assessment of a range of financial and non-financial metrics and/or personal objectives.

Annual bonus performance measures: stretching performance targets are set each year for the annual bonus, to reflect the key financial and strategic objectives of the Company and to reward for delivery against these targets. When setting the targets, the Remuneration Committee will take into account a number of different reference points, including the Company's plans and strategy and the market environment.

Operation of the Directors' Remuneration Policy in 2018 as compared to FTSE 100 peers

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Annual Bonus	466	1,286	1,680	2,285
Max bonus opportunity %	100%	150%	200%	225%

Retirement benefits

Purpose and link to strategy

Provides market competitive post-employment benefits (or cash equivalent) to recruit and retain executive Directors of the calibre required for the Group.

Operation

The 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. Any new executive Director will be entitled to receive an equivalent pension contribution.

Opportunity

15% of base salary, the same percentage of salary as the rest of the Melrose employees and within the range of the wider Group workforce. This percentage contribution has remained unchanged since the Company was floated in 2003.

Operation of the Directors' Remuneration Policy in 2018 as compared to FTSE 100 peers

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Pension Contribution	74	122	195	283
Pension Contribution %	15%	17%	25%	27%

Other benefits

Purpose and link to strategy

Ensures the overall package is competitive to enable the Company to recruit and retain executive Directors of the calibre required for the Group.

Operation

Executive Directors receive benefits consistent with other Melrose employees and market practice, which may include a 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.

Opportunity

Whilst the Remuneration Committee has not set an absolute maximum on the level of benefits that executive Directors may receive, the value of benefits is set at a level that the Remuneration Committee considers appropriate against the market and to support the ongoing strategy of the Company.

Operation of the Directors' Remuneration Policy in 2018 as compared to FTSE 100 peers

Metric (GBP '000) 2018	Melrose Chief Executive	FTSE 100 Lower Quartile	FTSE 100 Average	FTSE 100 Upper Quartile
Benefits	19	19	33	69

Long-term incentive arrangements

The Company only operates one incentive plan for executive Directors, which is directly linked to the value created for shareholders. This will continue to be the case upon renewal of the long-term incentive arrangements in May 2020.

2017 Incentive Plan

The 2017 Incentive Plan takes the form of options granted in 2017, 2018 and 2019, following approval by a special resolution of shareholders on 11 May 2017. In the event that management have generated sufficient value creation over a three-year performance period from 31 May 2017 to 31 May 2020, those options will be exercised in exchange for 2017 Incentive Shares (or cancelled in exchange for a cash payment). Although no further options will be granted to executive Directors under the 2017 Incentive Plan, the Company may, under this policy, satisfy the exercise of any option to acquire 2017 Incentive Shares (or cancel any such option in exchange for a cash payment as described in the shareholder circular dated 7 April 2017 and approved in May 2017 available at www.melroseplc.net/media/1728/21347274-_-1-_circular.pdf) and may deliver value to any holder of 2017 Incentive Shares in accordance with the Company's Articles of Association that are in effect as at the date that such value is to be delivered.

2020 Incentive Plan

Subject to the approval of shareholders at the 2020 AGM, the 2020 Incentive Plan will commence on 31 May 2020, being the crystallisation date of the 2017 Incentive Plan, and shall be governed by the scheme rules tabled at the 2020 AGM (the "Scheme Rules"). Although it is now a contractual plan, rather than contained within the Articles of Association, the 2020 Incentive Plan is a continuation of the long-term incentive arrangements for executive Directors that have applied since the Company was established in 2003. It incentivises executive Directors over the longer-term and aligns their interests with those of shareholders by linking the level of reward to the value delivered to shareholders.

Purpose and link to strategy

Incentivises executive Directors over the longer term and drives the Company's value creation strategy. It aligns the interests of executive Directors with those of shareholders by linking the level of reward to the value delivered. Incentive plans are regularly renewed on consistent terms to provide continuity and to incentivise long-term performance.

Operation

Awards

Conditional awards under the 2020 Incentive Plan ("Conditional Awards") are to be granted on the commencement date of 31 May 2020 (the "Commencement Date") and performance will be measured by the increase in value of invested capital over a three-year period to the crystallisation date (the "Crystallisation Date") on 31 May 2023 or, where an exceptional corporate event affecting the Company occurs prior to that event (such as a change of control or winding up), an earlier date as determined in accordance with the Scheme Rules (the "Performance Period").

On the Crystallisation Date, the Conditional Awards will convert into a share award (a "Share Award") with an entitlement to ordinary shares in the Company ("Ordinary Shares") and, in circumstances where the cap based on the Maximum Annual Share Entitlement (as defined below) applies (the "Cap"), an option or options carrying a right to acquire Ordinary Shares for no payment shall be issued in addition to the Share Award, which option or options shall also be subject to the Cap (a "Nil Cost Option").

To determine the application of the Cap, on the Commencement Date, the Remuneration Committee shall calculate the maximum number of Ordinary Shares (subject to adjustment in accordance with the Scheme Rules) that an executive Director is able to receive in any calendar year under the 2020 Incentive Plan, by dividing £10 million by the average closing mid-market price of an Ordinary Share for the 40 business days prior to the Commencement Date, such resulting number being the "Maximum Annual Share Entitlement" or the "MASE".

If, on the Crystallisation Date, the calculation to convert the Conditional Award would result in an executive Director becoming entitled to receive a Share Award for more Ordinary Shares than the Maximum Annual Share Entitlement, then his entitlement to receive Ordinary Shares in respect of the conversion shall be reduced to the MASE, and the executive Director shall be issued with a Nil Cost Option exercisable in the first calendar year following the Crystallisation Date or at any time thereafter during the period of 10 years from the Crystallisation Date for the balance of his entitlement under the Share Award, PROVIDED THAT if the number of Ordinary Shares the subject of the Nil Cost Option exceeds the MASE, then such number of Ordinary Shares shall be reduced to the MASE and the executive Director will be issued with a second Nil Cost Option on the Crystallisation Date for the balance of his entitlement to Share Award, such second Nil Cost Option being exercisable in the second calendar year following the Crystallisation Date or at any time thereafter during the period of 10 years from the Crystallisation Date, PROVIDED FURTHER THAT that if the number of Ordinary Shares the subject of the second Nil Cost Option exceeds the MASE, then such number of shares shall be reduced to the MASE and the executive Director shall not be entitled to any further shares to which he would otherwise have been entitled under the Share Award on the Crystallisation Date, which entitlement shall be permanently cancelled.

At each date when shares subject to awards under the 2020 Incentive Plan are capable of vesting and becoming exercisable, the Remuneration Committee shall conduct a performance assessment to ensure that the number of shares vesting and becoming exercisable does not appear anomalous or where there is quantified material information known to the Remuneration Committee in relation to the current financial position of the Company that is not in the public domain, the result would not be anomalous if the information were in the public domain. The Remuneration Committee will disclose its assessment in the relevant Annual Report on Remuneration covering the period which includes the date when the shares subject to awards vest and become exercisable.

Notwithstanding the above provisions, where the executive Director is resident in the United States for tax purposes the MASE applicable on the Crystallisation Date shall (where applicable) be increased by the Remuneration Committee to a number equal to 50% of such executive Director's total entitlement to the Company's Ordinary Shares on crystallisation as if the Cap did not apply or such lesser percentage as shall enable the executive Director to use the proceeds of the sale of an increased entitlement to the Company's Ordinary Shares (or the cash settlement proceeds in lieu of receiving such shares) to settle any taxes arising in respect of the crystallisation. Where this provision applies, the MASE applicable in the first and, if relevant, second calendar year following the Crystallisation Date shall be reduced by an amount equal to the amount by which the MASE applicable on the Crystallisation Date was increased.

The above provisions related to the Cap are without prejudice to the Company's ability to settle any entitlement to Ordinary Shares under the Share Award or a Nil Cost Option by way of a cash payment calculated in accordance with the Scheme Rules, to the provisions of the Scheme Rules permitting the early exercise of the Nil Cost Options in the circumstances specified in those rules, and to the provisions of the Scheme Rules giving the Remuneration Committee the power to adjust the number of shares the subject of the Nil Cost Options.

The Remuneration Committee recognises that corporate events that are rare for other companies are a standard and regular part of the Company's "Buy, Improve, Sell" model, and that executive Directors should not be penalised for them. Therefore, if there is any variation of the share capital of the Company (whether by rights issue, open offer, consolidation, subdivision, demerger, reduction of capital or otherwise), the Remuneration Committee shall adjust the application of the Cap in the manner that it considers to be fair and reasonable.

Holding Period

Any Ordinary Shares awarded pursuant to the 2020 Incentive Plan, excluding any sold to fund the amount of tax payable in respect of the receipt of such shares, must be held by executive Directors for two years after the Crystallisation Date (the "Holding Period").

Malus

In the event of (1) material misstatement of financial results that, in the reasonable opinion of the Remuneration Committee, has a material negative effect; (2) gross misconduct by the relevant executive Director; (3) events or behaviour of an executive Director that have led to the censure of the Company by a significant regulatory authority or have had a significant detrimental impact on the reputation of the Company, provided that the Remuneration Committee is satisfied that the relevant executive Director was responsible for the censure or reputational damage and that the censure or reputational damage is attributable to them; and/or (4) the Company becoming insolvent or otherwise suffering a corporate failure so that the value of the Company's Ordinary Shares is materially reduced, provided that the Remuneration Committee determines, following an appropriate review of accountability, that the executive Director should be held responsible (in whole or in part) for that insolvency or corporate failure prior to the Crystallisation Date, the Conditional Awards held by the executive Director may be cancelled in whole or in part for nil consideration.

Clawback

In the event of (1) material misstatement of financial results that, in the reasonable opinion of the Remuneration Committee, has a material negative effect; (2) material miscalculation of any performance measure on which the crystallisation of the Conditional Awards was based; (3) gross misconduct by the relevant executive Director; (4) events or behaviour of an executive Director that have led to the censure of the Company by a significant regulatory authority or have had a significant detrimental impact on the reputation of the Company, provided that the Remuneration Committee is satisfied that the relevant executive Director was responsible for the censure or reputational damage and that the censure or reputational damage is attributable to them; and/or (5) the Company becoming insolvent or otherwise suffering a corporate failure so that the value of the Company's Ordinary Shares is materially reduced, provided that the Remuneration Committee determines, following an appropriate review of accountability, that the executive Director should be held responsible (in whole or in part) for that insolvency or corporate failure, following the Crystallisation Date but prior to 31 May 2025, the executive Director may be required to transfer (for nil consideration) the number of Ordinary Shares arising from the crystallisation, less the number of Ordinary Shares sold to fund the tax liability arising from crystallisation, and/or to pay to the Company the amount of any cash received on or following crystallisation less the amount of any tax paid in relation to that cash, and any Nil Cost Options held by such executive Director may be cancelled in whole or in part for no payment to the executive Director.

The Scheme Rules provide that the Remuneration Committee may, with the agreement of the executive Director, cash settle all or part of the participant's entitlement to Ordinary Shares on the conversion of a Conditional Award or the exercise of a Nil Cost Option in full and final settlement of the executive Director's rights under the relevant Award.

The treatment of an executive Director's participation in the 2020 Incentive Plan if he is a 'leaver' is described on page 110.

The other operative provisions of the 2020 Incentive Plan are set out in the Scheme Rules and will be available for inspection at the 2020 AGM.

Opportunity

Participants in the 2020 Incentive Plan share in 7.5% of the increase in invested capital between the Commencement Date and the Crystallisation Date in excess of a 6% annual charge, calculated in accordance with the Scheme Rules.

Each individual's Conditional Awards granted in respect of the 2020 Incentive Plan shall be determined by reference to a percentage entitlement to the overall available amount (which shall be subject to adjustment in accordance with the Scheme Rules). Initial Conditional Awards with the following percentage entitlements shall be granted to the executive Directors on the Commencement Date:

- Christopher Miller: 15.5% of total
- Simon Peckham: 17% of total
- Geoffrey Martin: 17% of total

For the avoidance of doubt, David Roper will not be eligible to receive a Conditional Award given his imminent retirement.

The maximum number of new Ordinary Shares in the Company that may be issued in relation to the 2020 Incentive Plan is 5% of the aggregate number of Ordinary Shares in issue on 31 May 2020, plus 5% of any additional Ordinary Shares issued or created by the Company after that date and prior to the Crystallisation Date. However, this limit will not apply in the event of a change of control or winding up of the Company, as provided for in the Scheme Rules. Further, to the extent it would be exceeded on crystallisation, the excess shall be paid to participants in cash, subject always to the Cap.

Performance metric

The value that may be delivered under the 2020 Incentive Plan will be determined by reference to the growth in value of the Company from and including the Commencement Date of 31 May 2020 to and excluding the Crystallisation Date of 31 May 2023 (or an earlier date in the event of acceleration because of an exceptional corporate event affecting the Company), calculated in accordance with the Scheme Rules.

Discretion

The Committee may make such adjustments as it deems to be fair and reasonable so far as the holders of Ordinary Shares are concerned (having taken such advice that it deems appropriate in the circumstances, including from an investment bank of repute) to the calculation of the number of Ordinary Shares and/or cash to which the holders of Conditional Awards or Nil Cost Options shall be entitled in certain circumstances where the application of a provision of the Scheme Rules produces, or is likely to produce, an anomalous result or where there is quantified material information known to the Remuneration Committee in relation to the current financial position of the Company that is not in the public domain that would, in the reasonable opinion of the Remuneration Committee, produce an anomalous result if such information were in the public domain.

Shareholding obligations

Executive Directors are subject to minimum and post-cessation shareholding requirements as set out below.

Component of remuneration	Purpose and link to strategy	Operation
Minimum shareholding requirements	To align the interests of executive Directors with shareholders	There is a minimum shareholding requirement for executive Directors of 300% of salary. New executive Directors will be given a period of five years from appointment to build up this shareholding.
Post-cessation minimum shareholding requirements	To ensure alignment of interests following the departure of an executive Director	The executive Directors are required to retain a shareholding equal to 300% of base salary for a period of two years after cessation of employment.
Shareholding guidelines in respect of 2017 Incentive Plan	To align the interests of executive Directors with shareholders	On crystallisation of the 2017 Incentive Plan, Executive Directors will be required to retain any Ordinary Shares acquired pursuant to the crystallisation of the 2017 Incentive Plan, other than any Ordinary Shares sold in order to make adequate provision for any tax liability arising in connection with the crystallisation, for a period of two years. The number of Ordinary Shares required to be retained will be adjusted as determined by the Remuneration Committee to reflect any subsequent variations in the capital of the Company, including share capital consolidations, sub-divisions or bonus issues.

Non-executive Directors

Non-executive Director fees are set out as follows:

Purpose and link to strategy	Operation	Opportunity
Set at a level that reflects market conditions and is sufficient to attract individuals with appropriate knowledge and expertise.	Fees are reviewed periodically and amended to reflect market positioning and any change in responsibilities. Fees for Non-executive Directors are determined by the executive Directors.	Fees are based on the level of fees paid to non-executive directors serving on boards of similar-sized UK-listed companies and the time commitment and contribution expected for the role. Non-executive Directors receive a basic fee and a further fee for the Chairmanship of a Board Committee or for holding the office of Senior Independent Director. Non-executive Directors may be eligible to receive benefits such as use of secretarial support, reimbursement of travel costs and other benefits that may be appropriate.

Directors' Remuneration report

Continued

Illustration of the application of the 2020 Directors' Remuneration Policy

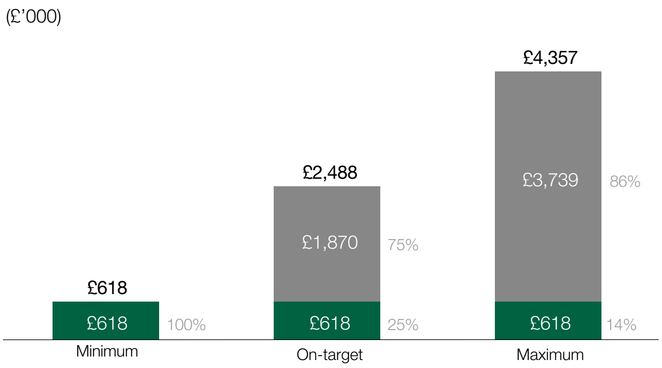
In illustrating the potential reward under the 2020 Directors' Remuneration Policy, the following assumptions have been made:

- **Minimum performance:** fixed elements of remuneration only (base salary effective from 1 January 2020, benefits as set out in the single figure table in the Company's Directors' Remuneration Report for that year, and a pension contribution of 15% of base salary).
- **Performance in line with expectations:** fixed elements of remuneration as above, plus bonus of 50% of salary (other than in the case of Christopher Miller, who does not participate in the annual bonus arrangements), plus an amount in relation to the executive Directors' entitlements under the 2020 Incentive Plan, as described below.
- **Maximum performance:** fixed elements of remuneration as above, plus bonus of 100% of salary (other than in the case of Christopher Miller, who does not participate in the annual bonus arrangements), plus an amount in relation to the executive Directors' entitlements under the 2020 Incentive Plan, as described below.
- **Maximum performance +50% share price growth:** fixed elements of remuneration as above, plus bonus of 100% of salary (other than in the case of Christopher Miller, who does not participate in the annual bonus arrangements), plus an amount in relation to the executive Directors' entitlements under the 2020 Incentive Plan, as described below. This is no different from the maximum performance scenario because the 2020 Incentive Plan is based on shareholder returns and therefore share price growth is inbuilt in its value for any given level of performance.

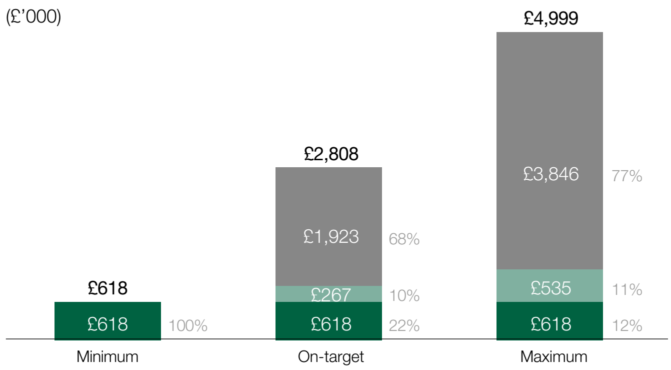
The executive Directors' Conditional Awards under the 2020 Incentive Plan will deliver to them part of the growth in value of the Company from May 2020 to May 2023 (or an earlier trigger date determined in accordance with the Scheme Rules). Accordingly, the value of participation in the 2020 Incentive Plan cannot be expressed as a multiple of salary. Therefore, for each executive Director below we have included a value based on the annualised estimated Black Scholes option pricing model value per Conditional Award granted (as at the last practical date before the finalisation of the policy). For "performance in line with expectations", 50% of this value is shown. For "maximum performance", 100% of this value is shown.

Total remuneration

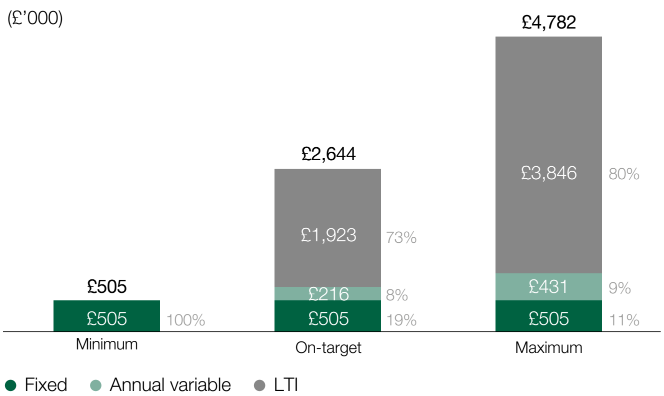
Christopher Miller



Simon Peckham



Geoffrey Martin



Recruitment remuneration policy

When agreeing a remuneration package for the appointment of a new executive Director, the Remuneration Committee will apply the following principles:

- the package will be sufficient to attract the calibre of executive Director required to deliver the Company's strategy;
- the Remuneration Committee will seek to ensure that no more is paid than is necessary; and
- in the next Annual Report on Remuneration after an appointment, the Remuneration Committee will explain to shareholders the rationale for the arrangements implemented.

In addition to the policy elements set out in this 2020 Directors' Remuneration Policy, the Remuneration Committee retains discretion to make appropriate remuneration decisions outside the standard policy to meet the individual circumstances of the recruitment, including discretion to include any other remuneration component or award, with the intention that the outcome of the relevant remuneration package for the new executive Director be broadly equivalent in all material respects to the remuneration packages of existing executive Directors who are governed by the policy. The Remuneration Committee has never used this discretion since the Company was founded in 2003, and does not intend to use this discretion to make a non-performance related incentive payment (for example, a "golden hello") during the period covered by this 2020 Directors' Remuneration Policy, but considers it important to retain the ability to do so in exceptional circumstances. In this regard, elements that the Remuneration Committee may consider for the purposes of a remuneration package for the recruitment of a new executive Director include but are not limited to the following:

Element	Approach
Incentive remuneration opportunity	The Remuneration Committee's intention is that a new executive Director's incentive remuneration opportunity will consist of: • an annual bonus opportunity of up to a maximum of 100% of base salary (i.e. in line with the ordinary opportunity under the policy); and • a pro-rata award of awards under the 2020 Incentive Plan in proportion to the date of joining to the crystallisation date, at a level up to the level that applies to other executive Directors under the policy. If a new executive Director did not participate in the 2020 Incentive Plan, the Remuneration Committee may award a maximum annual bonus opportunity of up to 300% of salary until such time as that new executive Director participated in a long-term incentive arrangement.
Compensation for forfeited remuneration arrangements	The Remuneration Committee may make awards on hiring an external candidate to buy out remuneration arrangements forfeited on leaving a previous employer. In doing so, the Remuneration Committee will have regard to relevant factors, including any performance conditions attached to such arrangements, the form of those awards (e.g. cash or shares) and the time frame of such awards. While such awards are excluded from the maximum level of variable remuneration referred to on page 109, the Remuneration Committee's intention is that the value awarded (as determined by the Remuneration Committee on a fair and reasonable basis) would be no higher than the expected value of the forfeited arrangements. Where considered appropriate, buyout awards will be subject to forfeiture or clawback on early departure.
Notice period	The notice period will be the same as the Company's ordinary policy of 12 months.
Relocation costs	Where necessary, the Company will pay appropriate relocation costs. The Remuneration Committee will seek to ensure that no more is paid than is necessary.
Retirement benefits	The maximum contribution of 15% of salary referred to on pages 104 to 105 will apply to any new executive Director. This is the same level provided to the rest of the Melrose employees and is the level received by the incumbent executive Directors.

Incentive awards and "buyout" awards may be granted under new plans as permitted under the Listing Rules, which allow for the grant of awards to facilitate, in unusual circumstances, the recruitment of a Director. Where a position is filled internally, any ongoing remuneration obligations or outstanding variable pay elements shall be allowed to continue in accordance with their subsisting terms.

The remuneration package for a newly appointed non-executive Director would normally be in line with the structure set out in the policy table for non-executive Directors.

Service contracts and policy on payments for cessation of employment

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). The principles on which the determination of payments for cessation of employment will be approached are summarised below.

Certain treatment is dependent on whether an executive Director is classified as a 'Good Leaver' on cessation of employment, which will occur if that executive Director ceases employment in the following circumstances: death; permanent ill-health; permanent disability; retirement at or over 65 years of age or otherwise with the agreement of the Company; resignation in connection with a change of control; or otherwise at the discretion of the Remuneration Committee. An executive Director will be a 'Bad Leaver' if they cease employment other than as a Good Leaver.

Payment in lieu of notice

If the Company terminates an executive Director's employment with immediate effect, a payment in lieu of notice may be made. This may include base salary, pension contributions and benefits.

Annual bonus

Bonus in year of cessation

Performance conditions will be measured at the bonus measurement date for Good Leavers only, with the bonus normally to be pro-rated for the period worked during the financial year and paid in cash. No bonus will be payable to any executive Director other than a Good Leaver for the year of cessation.

Bonus from prior years deferred into shares

Good Leavers will be entitled to retain those shares awarded in prior years for a deferral of an annual bonus. For an executive Director other than a Good Leaver, any shares awarded for a deferral of a prior year's annual bonus and still subject to restrictions will be forfeited.

Directors' Remuneration report

Continued

Discretion

The Remuneration Committee has the following elements of discretion with respect to the annual bonus and deferred share awards in the event of cessation of employment:

- to determine whether to pro-rate a cash bonus to time. The Remuneration Committee's normal policy is that it will pro-rate for time. It is the Remuneration 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
- 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 Remuneration Committee will make this determination depending on the type of Good Leaver reason resulting in the cessation.

2020 Incentive Plan

If an executive Director ceases to be employed by the Company before the Crystallisation Date, the treatment of the Conditional Awards held by such executive Director will be determined depending on their classification as a 'Good Leaver' or a 'Bad Leaver' as defined and summarised above and below.

Good Leavers

If an executive Director holding Conditional Awards ceases employment in circumstances where he is a 'Good Leaver' before the Crystallisation Date, unless the Remuneration Committee decides otherwise, the participation percentage under his Conditional Award shall be reduced on a pro-rata basis to reflect the period from 31 May 2020 to the date on which he ceased employment as a proportion of the Performance Period, and the Remuneration Committee may award such amount to other eligible employees in accordance with the Scheme Rules.

Bad Leavers

If an executive Director holding Conditional Awards ceases employment in circumstances where he is a 'Bad Leaver' before the Crystallisation Date, every Conditional Award he holds shall lapse and, thereafter may be awarded to other eligible employees in accordance with the Scheme Rules.

If an executive Director ceases to be employed by the Company after the Crystallisation Date for whatever reason, they shall be entitled to retain any outstanding Nil Cost Options held by them pursuant to the Scheme Rules, which shall become exercisable in accordance with their terms and remain subject to the recovery provisions set out on pages 106 to 107.

Other payments

The Remuneration Committee reserves the right to make additional exit payments where such payments are made in good faith in discharge of an existing legal obligation (or by way of damages for breach of such an obligation) or by way of settlement or compromise of any claim arising in connection with the termination of an executive Director's employment. In appropriate circumstances, payments may also be made in respect of legal fees.

The overall amount of any payment made in respect of a loss of office will not exceed the aggregate of any payment in lieu of notice and any payment made in respect of annual bonus, as referred to above. Entitlements in respect of the 2017 Incentive Plan and the 2020 Incentive Plan will be dealt with in accordance with their terms and, were the Company to make an award on recruitment of an executive Director to buy out remuneration arrangements forfeited on leaving a previous employer, the leaver provisions for that award would be determined at the time of grant.

Other elements

The 2020 Directors' Remuneration Policy is based on the four key Melrose principles as set out above, but is also wholly aligned with the Code factors of clarity, simplicity, risk, predictability, proportionality and alignment to culture, as set out in the table below. The Remuneration Committee ensures it takes all these elements into account when establishing the Directors' Remuneration Policy, as well as its application to executive Directors.

Factor	How the Remuneration Committee has addressed and link to strategy
Clarity	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. The Company seeks to present its remuneration arrangements to investors in the clearest and most transparent way possible. We also remain committed to maintaining an open and transparent dialogue with our investors, both through formal engagement processes, ad hoc discussions, and through the disclosures in our annual reports.
Simplicity	The fixed elements of remuneration are limited to base salary, pension contribution and benefits, all below the lower quartile of peers and in the case of pension contributions, the same as other Melrose employees. There are only two variable elements of remuneration: the annual bonus and the 2020 Incentive Plan, both of which are based on simple and transparent metrics. The operation of the Annual Bonus Plan is linked to an earnings-based target (at least 50%) and the achievement of strategic factors. The Company operates a single long-term incentive scheme, which simply rewards the creation of shareholder value over a three-year period above a minimum level of return for shareholders. In the Remuneration Committee's view, this provides a very simple incentive framework which can be understood by all of the Company's stakeholders.
Risk	The 2020 Directors' Remuneration Policy includes the following elements to mitigate against the risk of target-based incentives: • Setting defined limits on the maximum award which can be earned, including capping the annual bonus to a maximum of 100% of base salary and the application of the annual rolling cap to the 2020 Incentive Plan. • Requiring the deferral of up to 50% of annual bonus award into Ordinary Shares in certain circumstances and all of the Ordinary Shares awarded in relation to the 2020 Incentive Plan to be held for a two-year holding period following the crystallisation date. • The post-cessation minimum shareholding requirements, which require executive Directors to maintain the minimum shareholding for a period of two years after leaving the Company. • Aligning the performance conditions with the "Buy, Improve, Sell" strategy of the Company. • Ensuring there is sufficient flexibility for the Remuneration Committee to adjust payments through malus and clawback and an overriding discretion to depart from formulaic outcomes.

Factor	How the Remuneration Committee has addressed and link to strategy
Predictability	Fixed remuneration for the executive Directors is set below the lower quartile of FTSE peers to limit fixed costs for the Group, to provide certainty and to incentivise executive Directors. Variable remuneration is limited to the annual bonus, which is capped at 100% and performance-driven based on financial growth and strategic factors, and the 2020 Incentive Plan. The Remuneration Committee sets out the possible values that may be earned under the 2020 Incentive Plan upon approval of the plan by shareholders, and updates this every year. The method of calculation, limits and discretions under the 2020 Directors' Remuneration Policy are clearly set out. For the 2020 Incentive Plan, the two proposed changes will lead to greater certainty for investors: • The annual charge rate will be increased from RPI+2% to a fixed rate of 6%. • A rolling annual cap will be introduced, which will cap the award that an executive Director can receive under the 2020 Incentive Plan on crystallisation to a number of shares equivalent to £10 million divided by the share price on the commencement date in May of this year.
Proportionality	The restricted fixed remuneration and capped Annual Bonus Plan is compensated by the opportunity for potentially significant reward entirely dependent on performance pursuant to the 2020 Incentive Plan that supports the Company's value creation strategy.
Alignment to culture	The focus on responsible stewardship and long-term sustainable performance is a key part of the Company's culture. This is supported by the 2020 Directors' Remuneration Policy, which (i) facilitates Remuneration Committee oversight of workforce pay, policies and incentives; (ii) aligns executive Director contributions to those provided to the rest of the Melrose employees; and (iii) deliberately restricts the annual salaries, bonuses and benefits for the executive Directors well below the lower quartile of the FTSE 100.

Differences between the Company's policy on Directors' remuneration and its policy on remuneration for other employees

Remuneration arrangements throughout the Group are determined based on the same principle that rewards should be sufficient as is necessary to attract and retain high calibre talent, without paying more than is necessary and should be achieved for delivery of the Company's strategy.

The Company has operations in various countries, with Group employees of differing levels of seniority. Accordingly, though based on the over-arching principle above, reward policies vary to take account of these factors.

The Company has also implemented divisional long-term incentive plans for senior managers of businesses within the Group to incentivise them to create value for the Company and its shareholders.

As with the 2017 Incentive Plan, the Remuneration Committee considers it appropriate for participation in the 2020 Incentive Plan to be extended to those members of senior management beyond the executive Directors necessary to develop the business further.

Statement of consideration of employment conditions elsewhere in the Company

Salary, benefits and performance-related awards provided to employees are taken into account when setting policy for executive Directors' remuneration. There is no consultation with employees on Directors' remuneration.

Statement of consideration of shareholder views

The Company is committed to regular and ongoing engagement and seeks the views of key shareholders and other stakeholders on the application of the Directors' Remuneration Policy and in advance of amending its Directors' Remuneration Policy. The Chairman's Annual Statement at page 91 details how this was done in practice for the 2020 Directors' Remuneration Policy. The policy is set to reflect the Company's commercial strategy.

Payments outside the policy in this report

The Remuneration Committee retains discretion to make any remuneration payments and payments for termination of employment outside this policy:

- where the terms of the payment were agreed before the policy came into effect;
- where the terms of the payment were agreed at a time when the relevant individual was not a Director of the Company and, in the opinion of the Remuneration Committee, the payment was not in consideration of the individual becoming a Director of the Company; and/or
- to satisfy contractual commitments under legacy remuneration arrangements.

For these purposes, "payments" includes the satisfaction of awards of variable remuneration and, in relation to an award over shares, the terms of the payment are "agreed" at the time the award is granted. Any such payment shall include the conversion of any Conditional Award or the satisfaction of the exercise of any Nil Cost Option under the Scheme Rules (or the cancellation of any such Conditional Award or Nil Cost Option in exchange for a cash payment, as described in the Scheme Rules) and the delivery of the value attributable to the Ordinary Shares issued upon the conversion of any Conditional Award or the exercise of any Nil Cost Option in accordance with the Scheme Rules.

This report was approved by the Board and signed on its behalf by:

David Lis
Chairman, Remuneration Committee
5 March 2020

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.

Under applicable law and regulations, the Directors are also responsible for preparing a strategic report, directors' report, directors' remuneration report and corporate governance statement, each of which complies with law and regulation.

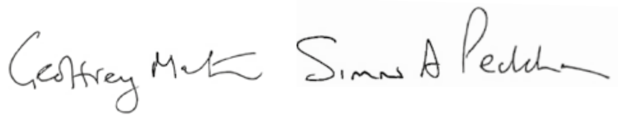
The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

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 position and performance, business model and strategy.

This responsibility statement was approved by the Board of Directors on 5 March 2020 and is signed on its behalf by:



Geoffrey Martin
Group Finance Director
5 March 2020

Simon Peckham
Chief Executive
5 March 2020

Independent auditor's report to the members of Melrose Industries PLC

Report on the audit of the financial statements

1. Opinion

In our opinion:

- the financial statements of Melrose Industries PLC (the 'Company') and its subsidiaries (the 'group') give a true and fair view of the state of the group's and of the Company's affairs as at 31 December 2019 and of the group's profit 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 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 and Company Balance Sheets;
- the Consolidated and Company Statements of Changes in Equity;
- the Consolidated Statement of Cash Flows; and
- the related notes 1 to 31 to the consolidated financial statements and the related notes 1 to 14 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 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).

2. 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 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. The non-audit services provided to the group for the year are disclosed in note 7 to the financial statements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the Company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independent auditor's report to the members of Melrose Industries PLC

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Impairment of goodwill and acquired intangibles • Classification of adjusting items • Revenue recognition • Loss-making contract provisions; and • Valuation of inventory Within this report, key audit matters are identified as follows: ! Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used for the group financial statements was £42 million (FY 18: £29 million) which was determined on the basis of adjusted profit before tax. The approach to materiality was different in 2018, when the materiality was a judgement based on a range of benchmarks (including revenue, net assets and adjusted profit before tax) due to the effects of the mid-year acquisition of GKN. More details on this are provided in application of materiality section of this report.
Scoping	We selected 34 reporting units representing 59% of the Group's 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 ("SAP") on certain account balances and transactions at a further 34 reporting units. Coverage from full scope and SAP scope components totals 79% of the Group's revenue and 93% of operating profit.
Significant changes in our approach	Following the acquisition of GKN plc in 2018, last year we identified a key audit matter in relation to recognition and measurement of intangible assets, provisions and contingent liabilities acquired. Following the completion of the accounting for the acquisition during 2019, and given the scale of the adjustments recorded upon completion, this was not considered to be a key audit matter for the 2019 audit. Valuation of Loss-making contract provisions recognised upon acquisition was a part of the acquisition accounting key audit matter in 2018, and continues as a separate key audit matter in the current year, which reflects changes to our risk assessment for the ongoing group. Our approach to scoping has remained consistent with prior year.

4. Conclusions relating to going concern, principal risks and viability statement

4.1. 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 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.

Going concern is the basis of preparation of the financial statements that assumes an entity will remain in operation for a period of at least 12 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.

4.2. 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:

- the disclosures on pages 46 to 55 that describe the principal risks, procedures to identify emerging risks, and an explanation of how these are being managed or mitigated;
- the directors' confirmation on page 47 that they have carried out a robust assessment of the principal and emerging risks facing the group, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on page 45 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.

Viability means the ability of the group to continue over the time horizon considered appropriate by the directors.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

5. 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.

5.1. Impairment of Goodwill and Acquired Intangibles

Key audit matter description	Total goodwill on the balance sheet at 31 December 2019 is £3,653 million, and total acquired intangible assets is £5,689 million. As required by IAS 36 Impairment of assets 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 is limited and sensitive to changes in key assumptions: • Driveshafts – Automotive division (goodwill £688 million, other intangible assets £719 million); • Security and Smart Technologies (goodwill £172 million following a recorded impairment of £179 million, other intangible assets £124 million); • Powder Metallurgy ("PM") (goodwill £503 million, other intangible assets £654 million) The impairment in the Security and Smart Technologies CGU was recorded in the first half of the year, following deterioration in its performance due to a combination of both external and internal factors, including the impact of US tariffs and trading headwinds. 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 (taking into account the current downturn in the automotive market and the impact of restructuring activity in PM and Driveshafts and planned product launches in Security) and determination of the correct discount and growth rates to be used in the model. Further details are included 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. Refer also to page 85 of the Audit Committee report.
How the scope of our audit responded to the key audit matter	We assessed the design and implementation of management's controls covering the valuation of goodwill and other intangible assets, in particular the key controls over the forecasts that underpin the value in use models and controls around management's preparation of impairment models. We assessed management's impairment paper, underlying analysis and supporting financial models, and challenged the reasonableness of the assumptions which underpin management's forecasts. Specifically, our work included, but was not limited to: • challenging management's key assumptions relating to the 2020 forecast and later forecast periods with reference to historical performance and our knowledge of the businesses, in particular pricing assumptions, restructuring activity in the year and the status of the end-markets, as well as the current order book and external market data; • considering the extent to which the possible effects of Brexit, climate change and coronavirus should be included in the impairment models; • benchmarking long-term growth rates to applicable macro-economic and market data; • 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; • 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; • performing sensitivity analysis to identify the key assumptions which have a significant effect on the model; and • reviewing the sensitivity disclosures included by management in note 11 to the financial statements, challenging management's choice regarding the assumptions to be sensitised, and re-performing the underpinning calculations. 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.
Key observations	The results of the impairment tests revealed that the recoverable amount is dependent on the success of new product launches for Security, and the recovery of the automotive market and effect on margin of recent restructuring activity for Driveshafts and PM. We determined that the assumptions applied in the impairment model were within an acceptable range, that the overall position adopted was reasonable and that the disclosures in respect of sensitivity to reasonably possible changes to key assumptions are appropriate.

Independent auditor's report to the members of Melrose Industries PLC

Continued

5.2. Classification of adjusting items

Key audit matter description	In addition to the statutory results, the Group continues to present adjusted profit measures which are before the impact of adjusting items. Judgements made by management regarding the classification of adjusting costs and income therefore have a significant impact on the presentation of the Group's results. In total, adjustments of £783 million have been made to the statutory profit before tax of £106 million to derive adjusted profit before tax of £889 million. Adjusting items included: • Amortisation of acquisition intangible assets (£534 million); • Restructuring costs (£238 million); • Impairment of assets (£179 million); • Equity accounted investments adjustments (£28 million); • Equity settled compensation scheme charges (£17 million); • Income from releases and changes in discount rate of fair value items (£153 million credit); • Gain on movement in fair value of derivatives (£55 million); and • Acquisition and disposal costs (£4 million). Explanations of each adjustment are set out in note 6 to the financial statements. Refer also to page 85 (of the Audit Committee report). 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.
How the scope of our audit responded to the key audit matter	We assessed the design and implementation of management's controls around the classification of adjusting items in the financial statements. We evaluated the appropriateness of the inclusion of items, both individually and in aggregate, within adjusted results. Specifically, we: • assessed the consistency of items included year on year and the application of management's accounting policy, challenging the nature of these items in comparison to ESMA guidance and latest FRC guidance, and challenging in particular the inclusion of those items that recur annually. • tested a sample of adjusting items by agreeing to source documentation and evaluating 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. • focused our challenge on certain categories within adjusted items where we assessed that increased level of judgement had been applied by management, and there was increased opportunity for fraud or error. These included restructuring costs and movements in fair value adjustments. • agreed the amounts recorded through to underlying financial records and other audit support to test that the amounts disclosed were complete and accurate. • where management recognised releases to fair value adjustments, we challenged this classifcation and assessed whether events and conditions existed to cause a release of the provision recognised as part of acquisition accounting. • for the restructuring costs, ascertained that the recognised costs meet the recognition criteria set out in IAS 37 'Provisions'. • 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.
Key observations	The value of adjusting items results in a material difference between the statutory and adjusted results. Whilst we note that the majority of adjusting items recur from period to period, their classification and presentation is consistent with the Group's policy.

5.3. Revenue Recognition in respect of RRSPs

Key audit matter description	The group has recognised total revenue of £10,967 million in 2019. There are judgements taken within the revenue recognition of material Risk and Revenue Sharing Partnerships (“RRSPs”) in the Aerospace division (where revenue totals £3,852 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 on application of principles set out in IFRS 15 *Revenue from contracts with customers*. 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. The amount of revenue recognised from RRSP contracts during the year was £679 million, which includes variable consideration of £45 million (2018: £415 million, which included variable consideration of £16 million). Furthermore, the revenue recognition models used by management for RRSPs involve a number of significant assumptions based on historical data and trends, such as engineering requirements to support programmes and the expected life of mature engines. Any changes to these assumptions requires a higher level of judgement and estimation. This increases the risk that revenue recognition may not be appropriate. Refer to page 83 (of the Audit Committee report) and page 140 (note 3 significant accounting policies) and pages 140 to 141 (note 4).
How the scope of our audit responded to the key audit matter	We assessed the design and implementation of controls around the recognition of revenue for RRSP contracts. For each RRSP contract with material variable consideration, we recalculated the amount of revenue recognised to verify that it has been calculated in accordance with IFRS 15, the contractual agreement and the latest correspondence with the customer. In particular, we have: • agreed the percentage of revenue entitlement to the customer contract; • reviewed correspondence with the customer in the period, in particular entitlement reports; • challenged estimations made by management at the year end by taking account of historical settlements and reviewing previous estimation accuracy; • challenged the assumptions used in arriving at the element of variable consideration recognised; • 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; • obtained and reviewed contract modifications, including programme share or changes in pricing, and tested that they have been appropriately included in the RRSP models; and • tested underlying data included in the trend analysis above and performed independent industry research for evidence that may contradict management’s assumptions on margin and engine life. For the changes in the key assumptions in the revenue recognition model, we performed specific procedures that included: • consideration and challenge of the position papers prepared by management, and the updated model prepared to reflect the changed assumptions; • audit of the underlying data that has been used in the determination of the assumptions including usage profiles, industry data and customer correspondence. We also assessed the processes and controls in place within the Aerospace business to review the underlying data; and • assessment of the disclosure provided in the financial statements in relation to the changes in these assumptions against the requirements of IFRS 15.
Key observations	We are satisfied that the key assumptions made in determining the value of revenue recognised on RRSP contracts with variable consideration were within an acceptable range and the overall position was reasonable. We consider the disclosure provided in the financial statements in relation to the changes in the key assumptions is appropriate and consistent with the requirements of IFRS 15.

Independent auditor's report to the members of Melrose Industries PLC
Continued

5.4. Valuation of Loss-making contracts provision

Key audit matter description	In 2018, upon acquisition of GKN, the group recognised provisions of £629 million in relation to loss-making contracts. At 31 December 2019, following utilisation and release during the year, £384 million remained unutilised. The methodology supporting the provisions is inherently complex and involves a high level of management judgement and estimation. We consider the following to be the key judgements and estimates in relation to these provisions: • accounting for the effect of negotiations and correspondence with customers on the existing loss-making contracts provision; • forecast cost projections including the level of material, direct labour and contract-related overheads; • calculation of utilisation for the year; • assessing changes in inputs and assumptions to ascertain the correct timing of releases; and • the classification of provision utilisation and release. Refer to page 84 (of the Audit Committee report) and page 139 (note 3 significant accounting policies) and page 162 (note 21).
How the scope of our audit responded to the key audit matter	We assessed the design and implementation of key controls over the review and estimation of loss-making contract provisions. For a sample of loss-making contract provision balances (including all material provisions) our work included, but was not limited to: • obtaining and validating supporting documentation for key assumptions and inputs, for example: – price data from corresponding contracts; – volumes from independent and recognised industry reports; – invoice and supplier documentation that supports costs; and – executed agreements for changes to pricing or early termination of contracts and other terms; • making enquiry of legal, commercial, operational, programme and engineering management to understand any changes to the relevant programmes that would impact valuation (e.g. new tooling, manufacturing improvements and efficiencies, changes in raw material costs); • reviewing relevant third party correspondence (with customers and suppliers) and assessed the impact on the valuation of the provision; • recalculating the amount of the provision utilised in the year, and testing assumptions and inputs used to calculate utilisation; • for any releases of provisions, challenging the judgements applied by management and examined appropriate audit evidence supporting the release (new commercial agreements, price amendments, support for cost reductions); and • ascertaining that the releases and utilisation are classified in accordance with the accounting policy.
Key observations	We are satisfied that the loss-making contracts provision at 31 December 2019 is valued appropriately, that releases and utilisation recorded during the year were appropriate, and that key estimates formed by management are reasonable.

5.5. Valuation of inventory

Key audit matter description	The group has recorded inventory amounts (net of provisions) of £1,332 million. We have identified a key audit matter in respect of inventory valuation across the group, due to the level of judgement required in determining provisions for obsolete items and the appropriate point at which to recognise permanent write downs. We paid particular regard to those former GKN businesses (Aerospace division) where there is a history of inventory writedowns and rework stock. Net inventory for these sites totals £99 million. We consider this to be a potential risk of fraud. Refer to page 85 (of the Audit Committee report), note 3: Critical accounting judgements and key sources of estimation uncertainty and note 16: Inventory.
How the scope of our audit responded to the key audit matter	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. We have evaluated the valuation of inventory by: • evaluating the appropriateness of the inventory provisioning policy with reference to stock count results and recalculating its application to the year-end inventory balance; • 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; and • performing testing of net realisable value of finished goods and subsequent sales; For the inventory held with in GKN businesses (Aerospace division), we the performed the following additional procedures: • assessing the design and implementation of inventory provisioning controls both at the local plant level and at the divisional and group level; • performing detailed sample tests of inventory identified at the stock count, making for those GKN Aerospace businesses where there is a fraud risk, making direct enquires of engineers and programme managers where applicable to understand the nature of the stock and its realisable value; and • performing an analytical review of levels of scrap year on year, relative to programme, nature of inventory and any other site specifics.
Key observations	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.

6. Our application of materiality

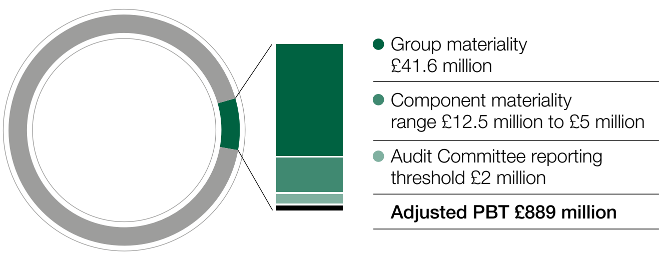
6.1. Materiality

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	Company financial statements
Materiality	£42 million (2018: £29 million). The increase was driven by an increased profit for the year, with GKN being owned for the full year.	£8.7 million (2018: £14.5 million)
Basis for determining materiality	5% of adjusted pre-tax profit. We consider the adjusted pre-tax profit to be the appropriate benchmark. This has been reconciled at page 144 of the financial statements. In prior year, 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.	We determined materiality based on net assets, which was then capped at 35% of Group materiality in order to address the risk of aggregation when combined with other businesses.
Rationale for the benchmark applied	Adjusted profit before tax is a key measure used by management in monitoring the Group's performance and in communication to shareholders. This approach differs from the prior year where we considered a range of benchmarks, including revenue, underlying profit and net assets, due to the impact of the timing of the acquisition of GKN Plc. and the resulting focus on the balance sheet.	In our professional judgement we believe that use of a balance sheet measure is appropriate for a holding company. Materiality has been capped at 35% of Group materiality. This is with reference to the net asset position of the Company when compared to the net asset position of the Group.

Adjusted PBT and Group materiality



6.2. Performance materiality

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 for the 2019 audit (2018: 60%). In determining performance materiality, we considered the following factors:

- our assessment of the complexity of the group and nature of the group's business model; and
- the de-centralised nature of the group's control environment and its variation across the group.

6.3. Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £2 million (2018: £1 million), 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.

Independent auditor's report to the members of Melrose Industries PLC

Continued

7. An overview of the scope of our audit

7.1. Identification and scoping of components

There has been significant change in the structure of the Group over the past two years following the acquisition of GKN Plc. There are now five operating segments in the continuing operations of the group:

- Aerospace;
- Automotive;
- Powder Metallurgy;
- Nortek Air Management; and
- Other Industrial (which consists of Brush, Security, and Ergotron).

In addition to the operating segments above, the group has a number of central cost centres which report to the Board and include head office companies for corporate functions and costs.

Discontinued operations includes the Walterscheild Powertrain business for the 6 months it was part of the group, and the Wheels business for the full year. The scoping discussed below is based on consolidated group results including continuing and discontinued operations.

Each division consists of a number of reporting units, and manages operations on a geographical and functional basis. There are 326 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 68 components (2018: 72), of which

- 19 relate to components that form part of the Aerospace segment;
- 23 relate to components that form part of the Automotive segment;
- 7 relate to components that form part of the Powder Metallurgy segment;
- 4 relate to components that form part of the Nortek Air management;
- 5 relate to components that form part of the Other Industrial segment;
- 2 related to discontinued operations; and 8 relate to corporate cost centres.

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 million to £12.5 million.

Overall scope

Full scope audit work was completed on 34 components and the head office function, and audit procedures have also been performed over certain balances within 34 other components. In total our scope represented 79% of Group revenue, 93% of the operating profit and 89% of Group net assets.

Aerospace

In respect of the Aerospace division, 9 components were subject to a full audit and 10 components were subject to the audit of specified account balances. These 19 components together accounted for 85% of the Aerospace division's revenue and 96% of the Aerospace division's operating profit and divisional costs.

Automotive

In respect of the Automotive division, 9 components were subject to a full audit and 14 components were subject to the audit of specified account balances. These 23 components accounted for 88% of the Automotive division's revenue and 97% of the Automotive division's operating profit and divisional costs.

Powder Metallurgy

In respect of the Powder Metallurgy division, 3 components were subject to a full audit and 4 components were subject to the audit of specified account balances. These 7 components together accounted for 63% of the Powder Metallurgy division's revenue and 92% of the Powder Metallurgy division's operating profit and divisional costs.

Nortek Air Management

In respect of the Nortek Air Management division, 3 components were subject to a full audit and 1 component was subject to an audit of specified account balances. These 4 components together accounted for 62% of the Nortek Air Management division's revenue and 76% of the Nortek Air Management division's adjusted operating profit and divisional costs.

Other Industrial

In respect of the Other Industrial division, 4 components were subject to a full audit and 1 components were subject to the audit of specified account balances. These 5 components together accounted for 80% of the Other Industrial division's revenue and 90% of the Other Industrial division's operating profit and divisional costs.

Company

The audit of the Company was performed by the group engagement team based at the Company's head office.

Residual balances

All entities not subject to the audit procedures above were subject to analytical procedures by the group engagement team.

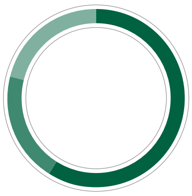
7.2 How we worked with other auditors

The Group engagement team visited 28 of the Group's largest and most complex businesses during 2019 with a particular focus on locations where work was performed on significant audit risks. These visits, together with central analytics and enquiries of management and visits performed in previous years, informed our risk assessment.

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 division has a dedicated senior member of the group audit team responsible for the supervision and direction of components, including where appropriate sector-specific expertise. 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. Where we were unable to visit components after the year end due to the effects of coronavirus, we performed alternative procedures to supervise and direct their work.

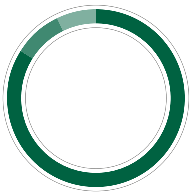
In total, as set out in the chart below we performed audit work on site at locations which together contributed 79% of Group revenue. 93% of operating profit and net assets of 89%.

Revenue



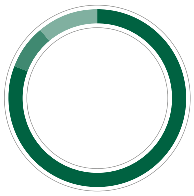
Full audit scope	59%
Audit of specified balances	20%
Review at group level	21%

Profit before tax



Full audit scope	84%
Audit of specified balances	9%
Review at group level	7%

Net assets



Full audit scope	81%
Audit of specified balances	8%
Review at group level	11%

8. 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.

9. 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 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 Company or to cease operations, or have no realistic alternative but to do so.

Independent auditor's report to the members of Melrose Industries PLC

Continued

10. 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 and non-compliance with laws and regulations 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. This description forms part of our auditor's report.

11. 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.

11.1. 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, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the group's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- results of our enquiries of management, internal audit, legal counsel, operational staff and the audit committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the group's documentation of their 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 of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team including significant component audit teams and involving relevant internal specialists, including tax, valuations, pensions and IT regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas: impairment of goodwill and intangibles, classification of adjusted items, revenue recognition, valuation of loss-making contracts provisions, inventory and the finalisation of the acquisition accounting for GKN plc. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory frameworks that the group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act and Listing Rules, UK Bribery Act as well as pensions legislation and tax legislation. In addition, we considered environment legislation in the jurisdictions the group operates in as having a fundamental effect on the operations of the group.

11.2. Audit response to risks identified

As a result of performing the above, we identified the following key audit matters: impairment of goodwill and intangibles, classification of adjusted items, revenue recognition, valuation of inventory and valuation of loss-making contracts provision as key audit matters related to the potential risk of fraud. The key audit matters section of our report explains the matters in more detail and also 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 provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the audit committee and in-house legal counsel concerning actual and potential litigation and claims;
- 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, reading correspondence with HMRC and reviewing internal audit reports; 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

12. 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 the 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.

13. Matters on which we are required to report by exception

13.1. 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 Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

13.2. 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.

14. Other matters

14.1. 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 17 years, covering the years ending 31 December 2003 to 31 December 2019.

14.2. 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).

15. 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.

Edward Hanson (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom
5 March 2020

Consolidated Income Statement

Continuing operations	Notes	Year ended 31 December 2019 £m	Restated[1] Year ended 31 December 2018 £m
Revenue	4, 5	**10,967**	8,152
Cost of sales		**(8,732)**	(6,573)
Gross profit		**2,235**	1,579
Share of results of equity accounted investments	15	**38**	34
Net operating expenses	7	**(1,955)**	(2,000)
Operating profit/(loss)	5, 6	**318**	(387)
Finance costs	7	**(221)**	(160)
Finance income	7	**9**	5
Profit/(loss) before tax		**106**	(542)
Tax	8	**(51)**	75
Profit/(loss) after tax for the year from continuing operations		**55**	(467)
Discontinued operations			
Loss for the year from discontinued operations	13	**(106)**	(8)
Loss after tax for the year		**(51)**	(475)
Attributable to:			
Owners of the parent		**(60)**	(475)
Non-controlling interests		**9**	–
		(51)	(475)
Earnings per share			
Continuing operations			
– Basic	10	**0.9p**	(11.8)p
– Diluted	10	**0.9p**	(11.8)p
Continuing and discontinued operations			
– Basic	10	**(1.2)p**	(12.0)p
– Diluted	10	**(1.2)p**	(12.0)p
Adjusted[2] results from continuing operations			
Adjusted revenue	5	**11,592**	8,645
Adjusted operating profit	5, 6	**1,102**	813
Adjusted profit before tax	6	**889**	672
Adjusted profit after tax	6	**699**	517
Adjusted basic earnings per share	10	**14.3p**	12.7p
Adjusted diluted earnings per share	10	**14.3p**	12.7p

(1) Results for the year ended 31 December 2018 have been restated for discontinued operations (note 1).
(2) Defined in the summary of significant accounting policies (note 2).

Consolidated Statement of Comprehensive Income

	Notes	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Loss after tax for the year		**(51)**	(475)
Items that will not be reclassified subsequently to the Income Statement:			
Net remeasurement loss on retirement benefit obligations	24	**(32)**	(36)
Income tax credit relating to items that will not be reclassified	8	**15**	9
		(17)	(27)
Items that may be reclassified subsequently to the Income Statement:			
Currency translation on net investments		**(346)**	625
Share of other comprehensive (expense)/income from equity accounted investments	15	**(23)**	9
Transfer to Income Statement from equity of cumulative translation differences on disposal of foreign operations	13	**(13)**	–
Losses on hedge relationships		**(17)**	(97)
Transfer to Income Statement on hedge relationships		**–**	(2)
Income tax (charge)/credit relating to items that may be reclassified	8	**(19)**	29
		(418)	564
Other comprehensive (expense)/income for the year		**(435)**	537
Total comprehensive (expense)/income for the year		**(486)**	62
Attributable to:			
Owners of the parent		**(494)**	44
Non-controlling interests		**8**	18
		(486)	62

Consolidated Statement of Cash Flows

	Notes	Year ended 31 December 2019 £m	Restated[1] Year ended 31 December 2018 £m
Operating activities			
Net cash from operating activities from continuing operations	27	**769**	330
Net cash (used in)/from operating activities from discontinued operations	27	**(20)**	43
Net cash from operating activities		**749**	373
Investing activities			
Disposal of businesses, net of cash disposed	13	**169**	(4)
Purchase of property, plant and equipment		**(465)**	(328)
Proceeds from disposal of property, plant and equipment		**24**	18
Purchase of computer software and capitalised development costs		**(54)**	(35)
Dividends received from equity accounted investments	15	**67**	66
Purchase of investments	12	**(50)**	–
Settlement of derivatives used in net investment hedging		**(100)**	–
Equity accounted investment additions	15	**–**	(3)
Acquisition of subsidiaries, net of cash acquired		**–**	(1,009)
Interest received		**9**	5
Net cash used in investing activities from continuing operations		**(400)**	(1,290)
Net cash used in investing activities from discontinued operations	27	**(15)**	(14)
Net cash used in investing activities		**(415)**	(1,304)
Financing activities			
Purchase of non-controlling interests		**–**	(224)
Costs of issuing shares		**–**	(1)
Repayment of borrowings		**(456)**	(820)
New bank loans raised		**350**	2,558
Costs of raising debt finance		**–**	(51)
Repayment of principal under lease obligations		**(70)**	–
Dividends paid to non-controlling interests		**(6)**	(1)
Dividends paid to owners of the parent	9	**(231)**	(129)
Net cash (used in)/from financing activities from continuing operations		**(413)**	1,332
Net cash used in financing activities from discontinued operations	27	**(2)**	–
Net cash (used in)/from financing activities		**(415)**	1,332
Net (decrease)/increase in cash and cash equivalents		**(81)**	401
Cash and cash equivalents at the beginning of the year	27	**415**	16
Effect of foreign exchange rate changes	27	**(17)**	(2)
Cash and cash equivalents at the end of the year	18, 27	**317**	415

(1) Amounts for the year ended 31 December 2018 have been restated for discontinued operations (notes 1 and 27).

As at 31 December 2019, the Group had net debt of £3,283 million (31 December 2018: £3,482 million). A reconciliation of the movement in net debt is shown in note 27.

Consolidated Balance Sheet

	Notes	31 December 2019 £m	Restated[1] 31 December 2018 £m
Non-current assets			
Goodwill and other intangible assets	11	**9,784**	11,098
Property, plant and equipment	14	**3,432**	3,171
Investments	12	**48**	–
Interests in equity accounted investments	15	**436**	492
Deferred tax assets	22	**160**	132
Derivative financial assets	25	**38**	26
Trade and other receivables	17	**424**	504
		14,322	15,423
Current assets			
Inventories	16	**1,332**	1,489
Trade and other receivables	17	**1,970**	2,328
Derivative financial assets	25	**19**	15
Current tax assets		**20**	74
Cash and cash equivalents	18	**317**	415
Assets classified as held for sale	13	**65**	–
		3,723	4,321
Total assets	5	**18,045**	19,744
Current liabilities			
Trade and other payables	19	**2,461**	2,583
Interest-bearing loans and borrowings	20	**89**	377
Lease obligations	28	**71**	5
Derivative financial liabilities	25	**106**	204
Current tax liabilities		**106**	137
Provisions	21	**412**	391
Liabilities associated with assets held for sale	13	**46**	–
		3,291	3,697
Net current assets		**432**	624
Non-current liabilities			
Trade and other payables	19	**444**	762
Interest-bearing loans and borrowings	20	**3,464**	3,378
Lease obligations	28	**511**	52
Derivative financial liabilities	25	**216**	227
Deferred tax liabilities	22	**772**	874
Retirement benefit obligations	24	**1,121**	1,413
Provisions	21	**675**	1,080
		7,203	7,786
Total liabilities	5	**10,494**	11,483
Net assets		**7,551**	8,261
Equity			
Issued share capital	26	**333**	333
Share premium account		**8,138**	8,138
Merger reserve		**109**	109
Other reserves		**(2,330)**	(2,330)
Translation and hedging reserve	26	**78**	495
Retained earnings		**1,197**	1,492
Equity attributable to owners of the parent		**7,525**	8,237
Non-controlling interests		**26**	24
Total equity		**7,551**	8,261

(1) Amounts at 31 December 2018 have been restated for the finalisation of acquisition accounting for GKN (note 1).

The Financial Statements were approved and authorised for issue by the Board of Directors on 5 March 2020 and were signed on its behalf by:

Geoffrey Martin

Geoffrey Martin
Group Finance Director
5 March 2020

Simon A Peckham

Simon Peckham
Chief Executive
5 March 2020

Consolidated Statement of Changes in Equity

	Issued share capital £m	Share premium account £m	Merger reserve £m	Other reserves £m	Translation and hedging reserve £m	Retained earnings £m	**Equity attributable to owners of the parent £m**	Non-controlling interests £m	**Total equity £m**
At 1 January 2018	133	1,493	109	(2,330)	(58)	2,538	**1,885**	–	**1,885**
Loss for the year	–	–	–	–	–	(475)	**(475)**	–	**(475)**
Other comprehensive income/(expense)	–	–	–	–	553	(34)	**519**	18	**537**
Total comprehensive income/(expense)	–	–	–	–	553	(509)	**44**	18	**62**
Acquisition of GKN	169	5,631	–	–	–	–	**5,800**	857	**6,657**
Purchase of non-controlling interests	31	1,014	–	–	–	(419)	**626**	(850)	**(224)**
Implementation of IFRS 9	–	–	–	–	–	(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)	495	1,492	**8,237**	24	**8,261**
(Loss)/profit for the year	–	–	–	–	–	(60)	**(60)**	9	**(51)**
Other comprehensive expense	–	–	–	–	(417)	(17)	**(434)**	(1)	**(435)**
Total comprehensive (expense)/income	–	–	–	–	(417)	(77)	**(494)**	8	**(486)**
Dividends paid	–	–	–	–	–	(231)	**(231)**	(6)	**(237)**
Equity–settled share–based payments	–	–	–	–	–	13	**13**	–	**13**
At 31 December 2019	**333**	**8,138**	**109**	**(2,330)**	**78**	**1,197**	**7,525**	**26**	**7,551**

Further information on issued share capital and reserves is set out in note 26.

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 16 to 35.

The Consolidated Financial Statements of the Group for the year ended 31 December 2019 were authorised in accordance with a resolution of the Directors of Melrose Industries PLC on 5 March 2020.

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.

Prior year information

The results for the year ended 31 December 2018 include GKN for eight months only.

The Consolidated Income Statement and Consolidated Statement of Cash Flows have been restated for discontinued operations. The Consolidated Balance Sheet has been restated for the finalisation of acquisition accounting for the purchase of GKN.

Discontinued operations

On 25 June 2019, the Group completed the disposal of the Walterscheid Powertrain Group to One Equity Partners. Additionally, during the second half of the year the Group formally commenced a disposal process, aligned to its strategic priority, to dispose of the Wheels & Structures business, with a high expectation this process will conclude within one year. Both the Walterscheid Powertrain Group and Wheels & Structures businesses were previously reported within the Other Industrial operating segment and are shown as discontinued operations in these Consolidated Financial Statements, with the Income Statement, the Statement of Cash Flows and their associated notes restated accordingly. Further detail is shown in note 13.

Finalisation of acquisition accounting for the purchase of GKN

There were a small number of final adjustments to the fair value of assets and liabilities acquired that were identified in the first half of the year up to 18 April 2019, being 12 months since the acquisition, that have impacted the restated Balance Sheet at 31 December 2018, as follows:

- Provisions and non-current trade and other payables have increased by £10 million;
  - Provisions increased by £26 million, including a £16 million reclassification from trade and other payables;
  - Trade and other payables decreased by £16 million due to a reclassification to provisions;
- Deferred tax assets have reduced by £17 million;
- Acquisition intangible assets have increased by £21 million; and
- Goodwill has correspondingly increased by £6 million.

There has been no restatement of the Income Statement or Statement of Comprehensive Income for the year ended 31 December 2018 as a result of the finalisation of fair values on acquisition accounting.

1.1 New Standards, Amendments 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, Amendments and Interpretations. Their adoption has not had a significant impact on the comparative amounts reported in these Financial Statements but IFRS 16 has had a significant impact on the current year:

- 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
- Amendments to IFRS 9, IAS 39 and IFRS 7: Modification of specific hedge accounting requirements as a result of the ongoing interest rate benchmark reforms

The Group adopted IFRS 16 "Leases" on 1 January 2019 using the modified retrospective approach, resulting in no adjustments to the prior year comparatives. IFRS 16 superseded the previous lease guidance, including IAS 17: "Leases" and related interpretations. IFRS 16 requires all leases, except where exemptions are applied, to be recognised on the Balance Sheet as a lease liability with a corresponding right-of-use asset presented within property, plant and equipment. As a result of the transition to IFRS 16, the Group recognised right-of-use assets of £589 million and lease liabilities of £589 million.

As part of the initial application of IFRS 16, the Group has applied the following exemptions available: IFRS 16 guidance has not been applied to leases with a lease term which ends within 12 months of the date of initial application or to leases of low value assets. Payments relating to these leases are recognised as an expense in the Income Statement over the lease term and no right-of-use asset or lease liability is recognised.

The Group opted to apply the relief option available under IFRS 16, which permits any right-of-use asset to be adjusted by the value of any associated onerous lease provision recognised in the Balance Sheet as at 31 December 2018, as an alternative to performing an impairment review. As a result onerous lease liabilities, previously held within property related cost provisions, of £20 million have been transferred to the IFRS 16 right-of-use asset following adoption of IFRS 16 on 1 January 2019.

The lease liabilities were measured at the present value of the remaining lease payments discounted at the incremental borrowing rate as at 1 January 2019. On transition, the right-of-use assets were measured at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments.

Notes to the Financial Statements
Continued

1. Corporate information continued

1.1 New Standards, Amendments and Interpretations affecting amounts, presentation or disclosure reported in the current year continued

In order to calculate the incremental borrowing rate, reference interest rates were derived for corporate bonds, for a period of up to 15 years. Interest rates were obtained for all key currencies and were subsequently adjusted to reflect the country risk premium and a leasing risk premium. The leasing risk premium derived was adjusted to reflect whether the lease was deemed to be secured or unsecured. The Group applied a single discount rate to a portfolio of leases with similar characteristics, in line with the practical expedient available under IFRS 16.

For leases that were classified as finance leases under IAS 17, the carrying amount of the right-of-use asset and the corresponding lease liability at 1 January 2019 was determined to be the carrying amount of the lease asset and lease liability under IAS 17 immediately before that date.

The following explains the difference between operating lease commitments disclosed, applying IAS 17, at 31 December 2018 and the lease liability recognised on adoption of IFRS 16 at 1 January 2019.

	£m
Total minimum lease payments reported at 31 December 2018 under IAS 17	710
Change in assessment of lease term under IFRS 16	32
Leases outside the scope of IFRS 16	(11)
Impact of discounting lease liability under IFRS 16	(142)
Lease liability recognised on transition to IFRS 16 at 1 January 2019	**589**

1.2 New Standards, Amendments and Interpretations in issue but not yet effective

At 31 December 2019, the following Standards, Amendments and Interpretations were in issue but not yet effective (and in some cases have not been adopted by the EU):

- IFRS 17: Insurance contracts
- IFRS 10 and IAS 28 (amendments): Sale or contribution of assets between an investor and an associate or joint venture
- Amendments to IFRS 3: Definition of a business
- Amendments to IAS 1 and IAS 8: Definition of material

The Directors do not expect that the adoption of the above Standards, Amendments and Interpretations will have a material impact on the Financial Statements of the Group in future periods.

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.

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 191 to 195 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 ("EAIs").

Adjusted profit measures exclude items which are significant in size or volatility or by nature are non-trading or non-recurring, any item released to the Income Statement that was previously a fair value item booked on an acquisition, and include adjusted profit from EAIs.

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 related 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") in 2018 for occupational schemes; and
- The net release of fair value items booked on acquisitions.

2. Summary of significant accounting policies continued

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:

- The net effect on tax of significant restructuring from strategy changes that are not considered by the Group to be part of the normal operating costs of the business; 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 44 of the Finance Director's review.

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.

Notes to the Financial Statements

Continued

2. Summary of significant accounting policies continued

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.

Sale of products and services

This revenue stream accounts for the majority of Group sales. Contracts in the Automotive, Powder Metallurgy, Nortek Air Management 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.

2. Summary of significant accounting policies continued

Generally, during the design and development phase of a typical RRSP contract, the Group performs contractually agreed-upon tasks for a customer. It is usual for the Intellectual Property Rights ("IPRs") that underpin technology advancement or know-how to remain with the Group such that the customer cannot benefit from the IPRs either on their own or together with other resources that are readily available to the customer. Where IPRs are transferred to the customer the Group has determined this is not separately identifiable from other promises in the contract due to an exclusivity clause for the supply of product. Accordingly, it has been determined that the Group's promise to transfer goods to its customer is a performance obligation that is separately identifiable and this uses development and know-how as an input.

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.

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 any of 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.

2. Summary of significant accounting policies continued

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. 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.

Right-of-use assets arise under IFRS 16 and are depreciated over the shorter of the estimated life and the lease term.

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 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.

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.

2. Summary of significant accounting policies continued

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, where there is a legal right of offset and an intention to net settle.

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.

Leases

Where a lease arrangement is identified, a liability to the lessor is included in the Balance Sheet as a lease obligation calculated at the present value of minimum lease payments. A corresponding right-of-use asset is recorded in property, plant and equipment. Lease payments are apportioned between finance costs and reduction of the lease liability so as to reflect the interest on the remaining balance of the liability.

Finance charges are recorded in the Income Statement within finance costs. Right-of-use assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases with a term of 12 months or less and leases for low value are not recorded on the Balance Sheet and lease payments are recognised as an expense in the Income Statement on a straight-line basis over the lease term.

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 and contract assets, 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.

Investments

The Group has an investment in unlisted shares that are not traded in an active market, but are classified as financial assets, measured at fair value. Fair value is determined by assessment of expected future dividends discounted to net present value. Any changes in fair value are recognised in Other Comprehensive Income and accumulated in retained earnings. Dividends from investments are recognised in the Income Statement when the Group's right to receive the dividend is established.

Trade and other receivables

Trade 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. In measuring the expected credit losses, the Group considers all reasonable and supportable information such as the Group's past experience at collecting receipts, any increase in the number of delayed receipts in the portfolio past the average credit period, and forward looking information such as forecasts of future economic decisions.

2. Summary of significant accounting policies continued

Financial instruments – liabilities

Recognition and derecognition of financial 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. The Group derecognises financial liabilities when the Group's obligations are discharged, significantly modified, cancelled or they expire.

Classification and measurement

Non-derivative financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective interest rate 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 gross carrying amount of the financial liability.

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 25 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 and are designated as such.

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.

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 cash flow hedges or hedges of net investments in foreign operations.

The Group has chosen to early adopt the amendments to IFRS 9 for the reporting period ending 31 December 2019, which are mandatory for annual reporting periods on or after 1 January 2020. Adopting these amendments allows the Group to continue hedge accounting during the period of uncertainty arising from interest rate benchmark reforms. Further disclosure is set out in note 25.

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 equity. If the hedged item is time-period related, then the amount accumulated in equity is reclassified to profit or loss on an appropriate basis.

Gains and losses accumulated in equity are recognised immediately in the Income Statement when the foreign operation is disposed.

2. Summary of significant accounting policies continued

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: "Revenue from contracts with customers".

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.

2. Summary of significant accounting policies continued

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.

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 disposal groups

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.

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.

Critical judgements

In the course of preparing the Financial Statements, a critical judgement within the scope of paragraph 122 of IAS 1: "Presentation of Financial Statements" is made during the process of applying the Group's accounting policies:

Adjusting items

Judgements are required as to whether items are disclosed as adjusting, with consideration given to both quantitative and qualitative factors. Further information about the determination of adjusting items in the year ended 31 December 2019 is included in note 2.

There are no other critical judgements other than those involving estimates, that have had a significant effect on the amounts recognised in the Financial Statements. Those involving estimates are set out below.

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 2019 was £3,653 million (31 December 2018: £4,058 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.

Security & Smart Technology ("SST") group of CGUs

During the first half of the year ended 31 December 2019, a full impairment review was performed and an impairment charge of £179 million was recorded in respect of the goodwill held in the SST group of CGUs. At 31 December 2019, goodwill and other intangible assets (not including computer software and development costs) in the SST group of CGUs had a carrying value of £297 million, and no further impairment charge was required. Should the business experience further unforeseen deterioration of results a future impairment may be required for these assets. Further details and sensitivity disclosures are included in note 11.

Automotive Driveline and Powder Metallurgy groups of CGUs

The GKN businesses were acquired and recorded at fair value on 19 April 2018 and subsequently there has been a global automotive market decline, naturally reducing the headroom, when testing goodwill and intangible assets in respect of the Automotive Driveline and Powder Metallurgy groups of CGUs, at this point in the cycle.

The carrying amount of goodwill and other intangible assets (not including computer software and development costs) at the balance sheet date was £1,407 million (31 December 2018: £1,530 million) for Automotive Driveline.

The carrying amount of goodwill and other intangible assets (not including computer software and development costs) at the balance sheet date was £1,156 million (31 December 2018: £1,265 million) for Powder Metallurgy.

No impairment loss has been recognised in respect of these assets. Further information including sensitivity analysis on the key assumptions is provided in note 11.

b) 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 and inflation rates to be used when valuing the plan's defined benefit obligations. At 31 December 2019, the Group's retirement benefit obligation was a deficit of £1,121 million (31 December 2018: £1,413 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 24.

c) Loss-making contracts

Loss-making contract provisions represent 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 2019, the carrying value of the loss-making contract provision in the Group was £384 million (31 December 2018: £616 million). If the margin of these contracts were to improve by one percentage point, the impact on the loss-making contract provision would be £36 million.

Notes to the Financial Statements
Continued

3. Critical accounting judgements and key sources of estimation uncertainty continued

d) 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 2019, there were provisions of £292 million (31 December 2018: £358 million) against gross inventory of £1,624 million (31 December 2018: £1,847 million). A one percentage point increase in the proportion of gross inventory provided would increase the provision by £16 million. An analysis of inventory is in note 16.

e) Estimates of future revenues and costs of long-term contractual arrangements
The Group has certain large, complex contracts where significant judgements and estimates are required in order to identify the performance obligations and associated consideration.

A key judgement is the recognition and measurement of variable consideration, in particular relating to risk and revenue sharing partnerships ("RRSPs"). A detailed review of the Group's RRSP contracts determined where terms and conditions result in variable consideration and this is further set out in note 17. Distinguishing between a contractual right and the economic compulsion of partners with regard to the sale of original equipment ("OE") components and aftermarket activities relies on an interpretation of complex legal agreements. This specific point governs whether variable consideration is recognised on the sale of OE components and this can significantly impact the level of profitability from one period to the next. Further disclosure is set out in note 4.

The forecast revenues and costs in respect of RRSP contracts are inherently imprecise and significant estimates are required to assess the pattern of future maintenance activity, the costs to be incurred and escalation of revenue and costs. The estimates take account of the uncertainties, constraining the expected level of revenue as appropriate. Measurement of variable consideration is driven by forecasting aftermarket revenue per delivered engine which is in turn contingent on overall programme success, levels of discounting that might be offered by the engine manufacturers (the Group's customers), engineering requirements needed for optimal performance of the engine and the allocation of revenue to individual units. In addition, where programmes are at an early stage the wider implications of any competing engines as well as complications outside of the Group can be difficult to assess. Any of these inputs could change in the next year as programmes evolve and due to the size and scale of these contracts, almost any modification could result in material changes in future periods.

The variable consideration asset calculated is the best estimate of revenue allocated to completed performance obligations using input assumptions and constraints as detailed further in note 17. A reasonably possible change in assumptions, such as engineering requirements to support programmes and the expected life of certain engines could have led to the variable consideration asset on the Balance Sheet of £242 million (2018: £206 million) increasing to between £258 million and £263 million. This would have led to additional profit of between £16 million and £21 million.

4. Revenue
An analysis of the Group's revenue is as follows:

Continuing operations	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Revenue recognised at a point in time	**9,751**	7,149
Revenue recognised over time	**1,216**	1,003
Revenue	**10,967**	8,152

As set out in the accounting policies in note 2, the Group has four primary revenue streams. There is little judgement or estimation in the revenue recognition of three of these areas; (i) sale of products and services, (ii) design and build and (iii) construction contracts. However, in the fourth area, as disclosed in note 3e, there is estimation involved in accounting for certain RRSP contracts, which arise exclusively in the Aerospace business. RRSP contracts generally include the sale of products and services as well as certain aspects of design and build arrangements. Further details are set out below.

Risk and revenue sharing partnerships
The Group has approximately £9 billion (2018: £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 2019. These performance obligations will be satisfied and revenue will be recognised over a period of up to 29 years (2018: 30 years).

The amount of revenue recognised from RRSP contracts during the year was £679 million, which includes variable consideration of £45 million (2018: £415 million, which included variable consideration of £16 million). Within this there is revenue from the delivery of product which is recognised at a point in time of £637 million (2018: £393 million) and revenue from provision of service which is recognised over time of £42 million (2018: £22 million). Due to the nature of certain of these RRSP arrangements, there is associated variable consideration and the contract asset, including movements during the year, is disclosed in note 17.

4. Revenue continued

The nature of products and services delivered in RRSP contracts varies depending on the individual terms. Typically, they include a design and development phase (which has been determined not to be a distinct performance obligation and so no revenue is recognised) and two other phases where the Group does have performance obligations and earns revenue:

i) Sale of structural OE engine components, such as turbine cases, principally to engine manufacturers, where revenue is recognised at a point in time; and

ii) Aftermarket support which can include: sale of spare parts where revenue is recognised at a point in time and stand ready services for life of engine obligations to maintain permanent technical, and other programme related, support functions. Obligations can occur at any time during the engine life and include; engineering and technical support for engine configuration changes and provision of aftermarket inventory support solutions.

RRSP revenue recognised over time

The nature of these RRSP contracts on long-term engine programmes means that, as a partner, the Aerospace business can share revenue earned from maintenance, repair and overhaul services which are provided by the engine manufacturers (the Group's customers) or their sub-contractors, but not the Group. The Group has a stand ready obligation to contribute to certain of the partnerships which typically results in the provision of services such as technical and other programme support activities over the whole life of the engine. These services occur over the life of the engine and due to the nature of compensation from customer arrangements, which is often flight hour based, as well as costs which are less predictable, revenue is recognised over time using the engine manufacturer's actual overhaul costs as an input method. This method is considered appropriate as it best reflects the customers' receipt and consumption of benefit from the Group's stand ready performance obligation.

The total contract revenue includes amounts from: expected sales of OE engine components, expected sales of spare parts and aftermarket revenue per delivered engine for stand ready services for the life of engine obligations. The total contract revenue is allocated to all of the performance obligations.

During the year £3 million (2018: £nil) of revenue has been recognised relating to performance obligations satisfied by the Group in the previous year, as risks have been reduced and the constraint reassessed. There has been a further £7 million (2018: £nil) of revenue recognised from changes in assumptions which will also impact the revenue allocation between future years. Assumption changes were made following operational progress with customers.

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.

Following a decision to explore strategic options for the Nortek Air Management business separate to the Security & Smart Technology business, internal reporting provided to the CODM was revised. As a consequence, the Nortek Air & Security operating segment was revised with the Security & Smart Technology business now included in the Other Industrial operating segment. Other Industrial has also been impacted by the removal of the Walterscheid Powertrain and Wheels & Structures businesses, which have been included in discontinued operations (note 13). Comparative results have been restated accordingly.

The operating segments are as follows:

Aerospace – a multi-technology global tier one supplier of both civil and defence airframes and engine structures, including Aerostructures and Engine Systems.

Automotive – comprises 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 precision powder metal parts for the automotive and industrial sectors, as well as the production of powder metal.

Nortek Air Management – comprises the Group's Air Management businesses, which includes the Air Quality and 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. 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 data centres and non-residential applications.

Other Industrial – comprises the Group's Ergotron, Brush and Security & Smart Technology businesses.

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.

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.

Notes to the Financial Statements
Continued

5. Segment information continued
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 2019.

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 segment 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 2019 Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air Management £m	Other Industrial £m	Total £m
Adjusted revenue	**3,852**	**4,739**	**1,115**	**1,178**	**708**	**11,592**
Equity accounted investments	(16)	(593)	(16)	–	–	(625)
Revenue	**3,836**	**4,146**	**1,099**	**1,178**	**708**	**10,967**
Timing of revenue recognition						
At a point in time	2,644	4,146	1,099	1,157	705	9,751
Over time	1,192	–	–	21	3	1,216
Revenue	**3,836**	**4,146**	**1,099**	**1,178**	**708**	**10,967**

Year ended 31 December 2018 – restated Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air Management £m	Other Industrial £m	Total £m
Adjusted revenue	**2,521**	**3,382**	**851**	**1,140**	**751**	**8,645**
Equity accounted investments	(42)	(446)	(5)	–	–	(493)
Revenue	**2,479**	**2,936**	**846**	**1,140**	**751**	**8,152**
Timing of revenue recognition						
At a point in time	1,483	2,936	846	1,140	744	7,149
Over time	996	–	–	–	7	1,003
Revenue	**2,479**	**2,936**	**846**	**1,140**	**751**	**8,152**

b) Segment operating profit

Year ended 31 December 2019 Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air Management £m	Other Industrial £m	Corporate[2] £m	Total £m
Adjusted operating profit/(loss)	**409**	**367**	**117**	**175**	**86**	**(52)**	**1,102**
Items not included in adjusted operating profit[1]:							
Amortisation of intangible assets acquired in business combinations	(261)	(148)	(48)	(36)	(41)	–	(534)
Restructuring costs	(79)	(83)	(19)	(11)	(37)	(9)	(238)
Impairment of assets	–	–	–	–	(179)	–	(179)
Equity accounted investments adjustments	(1)	(27)	–	–	–	–	(28)
Melrose equity-settled compensation scheme charges	–	–	–	–	–	(17)	(17)
Release and changes in discount rate of fair value items	34	79	28	11	1	–	153
Movement in derivatives and associated financial assets and liabilities	2	(2)	–	–	–	55	55
Acquisition and disposal costs	–	–	(1)	–	–	5	4
Operating profit/(loss)	**104**	**186**	**77**	**139**	**(170)**	**(18)**	**318**
Finance costs							(221)
Finance income							9
Profit before tax							**106**
Tax							(51)
Profit for the year from continuing operations							**55**

5. Segment information continued

Year ended 31 December 2018 – restated Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air Management £m	Other Industrial £m	Corporate[2] £m	Total £m
Adjusted operating profit/(loss)	**250**	**231**	**98**	**158**	**104**	**(28)**	**813**
Items not included in adjusted operating profit[1]:							
Amortisation of intangible assets acquired in business combinations	(176)	(103)	(34)	(34)	(44)	–	(391)
Restructuring costs	(56)	(46)	(11)	(19)	(65)	(32)	(229)
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)	–	–	–	(103)
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 and changes in discount rate of fair value items	15	–	–	4	1	–	20
Operating (loss)/profit	**(44)**	**15**	**38**	**109**	**(137)**	**(368)**	**(387)**
Finance costs							(160)
Finance income							5
Loss before tax							**(542)**
Tax							75
Loss for the year from continuing operations							**(467)**

(1) Further details on adjusting items are discussed in note 6.
(2) Corporate adjusted operating loss of £52 million (2018: £28 million), includes £6 million in respect of remaining GKN central costs (2018: £6 million) and £20 million (2018: £2 million) of costs in respect of divisional long-term incentive plans.

c) Segment total assets and liabilities

	Total assets		Total liabilities	
	31 December 2019 £m	Restated 31 December 2018 £m	**31 December 2019 £m**	Restated 31 December 2018 £m
Aerospace	**7,478**	7,725	**3,089**	3,040
Automotive	**5,391**	5,685	**2,304**	2,330
Powder Metallurgy	**1,906**	2,070	**472**	521
Nortek Air Management	**1,415**	1,476	**362**	390
Other Industrial	**1,237**	1,574	**259**	301
Corporate	**553**	628	**3,962**	4,601
Total continuing operations	**17,980**	19,158	**10,448**	11,183
Discontinued operations	**65**	586	**46**	300
Total	**18,045**	19,744	**10,494**	11,483

Notes to the Financial Statements
Continued

5. Segment information continued

d) Segment capital expenditure and depreciation

	Capital expenditure[1]		Depreciation of owned assets[1]		Depreciation of leased assets	
	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m	**Year ended 31 December 2019 £m**	Restated Year ended 31 December 2018 £m	**Year ended 31 December 2019 £m**	Year ended 31 December 2018 £m
Aerospace	**178**	105	**139**	88	**30**	–
Automotive	**231**	198	**194**	116	**16**	–
Powder Metallurgy	**55**	53	**59**	37	**8**	–
Nortek Air Management	**37**	35	**23**	20	**11**	–
Other Industrial	**8**	15	**11**	12	**6**	–
Corporate	**–**	–	**–**	–	**1**	–
Total continuing operations	**509**	406	**426**	273	**72**	–
Discontinued operations	**11**	16	**12**	9	**1**	–
Total	**520**	422	**438**	282	**73**	–

(1) Including computer software and development costs. Capital expenditure excludes 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 the rest of 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[1] from external customers		Segment assets	
	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m	**31 December 2019 £m**	Restated 31 December 2018 £m
UK	**1,048**	794	**2,319**	2,400
Rest of Europe	**2,426**	1,799	**5,136**	5,489
North America	**6,073**	4,490	**4,917**	5,056
Other	**1,420**	1,069	**1,328**	1,430
Continuing operations	**10,967**	8,152	**13,700**	14,375
Discontinued operations	**423**	453	**–**	386
Total	**11,390**	8,605	**13,700**	14,761

(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 2019 £m**	Restated Year ended 31 December 2018 £m
Operating profit/(loss)		**318**	(387)
Amortisation of intangible assets acquired in business combinations	a	**534**	391
Restructuring costs	b	**238**	229
Impairment of assets	c	**179**	152
Equity accounted investments adjustments	d	**28**	25
Melrose equity-settled compensation scheme charges	e	**17**	13
Release and changes in discount rate of fair value items	f	**(153)**	(20)
Movement in derivatives and associated financial assets and liabilities	g	**(55)**	143
Acquisition and disposal costs	h	**(4)**	153
Reversal of uplift in value of inventory	i	**–**	103
Impact of GMP equalisation on UK pension schemes	j	**–**	11
Total adjustments to operating profit/(loss)		**784**	1,200
Adjusted operating profit		**1,102**	813

6. Reconciliation of adjusted profit measures continued

a. The amortisation charge on intangible assets acquired in business combinations of £534 million (2018: £391 million) 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 excluded from adjusted results.

b. Restructuring and other associated costs in the year totalled £238 million (2018: £229 million). Restructuring costs are shown as adjusting items due to their size and non-trading nature and during the year ended 31 December 2019 included:

- A charge of £83 million (2018: £46 million) within the Automotive division, including: costs associated with headcount reduction programmes addressing the high cost base inherited with the business and ensuring a more flexible cost structure; costs incurred closing two loss-making factories; costs associated with further footprint consolidation opportunities; and costs incurred separating the Automotive business from other GKN businesses.
- A charge of £79 million (2018: £56 million) within the Aerospace division which included: costs associated with initial headcount reductions following the commencement of a global integration process to create "One Aerospace" and achieve a simpler, more competitive, customer focused business; costs within the North America Aerostructures business relating to two factory closures; and costs relating to footprint rationalisation projects within the Special Technologies business.
- A charge of £19 million (2018: £11 million) within the Powder Metallurgy division including costs associated with headcount reductions and the commencement of footprint consolidation actions.
- A charge of £11 million (2018: £19 million) within Nortek Air Management primarily relating to continued factory consolidation within the HVAC business.
- A charge of £37 million (2018: £65 million) within Other Industrial businesses, predominantly relating to the closure of the Chinese manufacturing facility and switching to a third party contract manufacturing model in the Security & Smart Technology business. Restructuring charges also included the finalisation of the restructuring activities announced in Brush last year.
- A charge of £9 million (2018: £32 million) within central activities, mainly relating to the separation of the GKN business.

c. The 2018 Annual Report disclosed that the determination of the recoverable amount in respect of the Security & Smart Technology group of cash generating units ("CGUs") involved management estimation of the impact of highly uncertain matters at that time. Enhanced disclosures, including sensitivity analysis in respect of the key assumptions used in the forecast models, were shown at the 2018 year end. During the first half of the year ended 31 December 2019, there was further deterioration in both the performance and forecast future prospects of the business, particularly following increases in US tariffs for goods being imported from China. This along with the increased level of competition and technological change in the market resulted in the necessity to impair goodwill allocated to the Security & Smart Technology group of CGUs by £179 million. The impairment charge is shown as an adjusting item due to its non-trading nature and size.

d. The Group has a number of equity accounted investments ("EAIs") 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 EAIs generated £625 million (2018: £493 million) of revenue in the period, 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 EAIs is included.

   In addition, the profits and losses of EAIs, which are shown after amortisation of acquired 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 EAIs are adjusted because they are considered to be significant in size and are important in assessing the performance of the business.

e. The charge for the Melrose equity-settled Incentive Scheme, including its associated employer's tax charge, of £17 million (2018: £13 million) is excluded from adjusted results due to its size and 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.

f. Certain items previously recorded as fair value items on acquisitions, have been resolved for more favourable amounts than first anticipated. The net release of fair value items recognised on acquisitions in the year of £153 million (2018: £20 million) includes a credit of £122 million in respect of the release of certain loss-making contracts, recognised on the acquisition of GKN, where either contractual terms have been renegotiated with the relevant customer or operational efficiencies have been identified and demonstrated for a sustained period. The net release of fair value items are shown as an adjusting item, avoiding positively distorting adjusted results.

g. Hedge accounting is not applied within the GKN businesses for transactional foreign exchange exposure. Consequently, for consistency and because of their volatility and size, the movements in the fair 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 in the GKN businesses, along with foreign exchange movements on the associated financial assets and liabilities, are shown as an adjusting item. These movements totalled a credit of £55 million (2018: charge of £143 million), in the year.

h. A net acquisition and disposal related credit of £4 million (2018: costs of £153 million), that arose in the year, includes a profit on the sale of a small business and transaction costs in respect of acquisition and disposal activities. These items are excluded from adjusted results due to their non-trading nature.

i. In the prior year, finished goods and work in progress inventory which were present in the GKN businesses when acquired, in accordance with IFRS 3, were required to be uplifted in value to closer to their selling price. As a result, in the early months of the acquisition, reduced profits were generated as this inventory was sold. The one-off effect in 2018, relating to GKN's acquired inventory was a charge of £103 million and was excluded from adjusted results due to its size and non-recurring nature.

j. 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 in the year ended 31 December 2018, with a corresponding past service cost in the Income Statement. This cost is excluded from adjusted results in the prior year due to its non-trading and non-recurring nature.

Notes to the Financial Statements
Continued

6. Reconciliation of adjusted profit measures continued
b) Profit before tax

Continuing operations	Notes	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Profit/(loss) before tax		**106**	(542)
Adjustments to operating profit/(loss) as above		**784**	1,200
Fair value changes on cross-currency swaps	k	**(1)**	8
Write-off previous debt facility unamortised fees	l	**–**	7
Equity accounted investments – interest	m	**–**	(1)
Total adjustments to profit/(loss) before tax		**783**	1,214
Adjusted profit before tax		**889**	672

k. The fair value changes on cross-currency swaps relating to cost of hedging which are not deferred in equity, is shown as an adjusting item because of its volatility and non-trading nature.

l. To enable the acquisition of GKN in 2018, 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. This prior year charge is shown as an adjusting item because of its one-off non-trading nature.

m. As explained in paragraph d above, the profits and losses of EAIs 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

Continuing operations	Notes	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Profit/(loss) after tax		**55**	(467)
Adjustments to profit/(loss) before tax as above		**783**	1,214
Tax effect of adjustments to profit/(loss) before tax	8	**(123)**	(221)
Tax effect of significant restructuring	8	**(9)**	–
Equity accounted investments – tax	m	**(7)**	(9)
Total adjustments to profit/(loss) after tax		**644**	984
Adjusted profit after tax		**699**	517

7. Expenses

Continuing operations	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Net operating expenses comprise:		
Selling and distribution costs	**(224)**	(205)
Administration expenses(1)	**(1,731)**	(1,795)
Total net operating expenses	**(1,955)**	(2,000)

(1) Includes £756 million (2018: £1,072 million) of adjusting items (note 6).

7. Expenses continued

Continuing operations	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Operating loss is stated after charging/(crediting):		
Cost of inventories	**8,732**	6,573
Amortisation of intangible assets acquired in business combinations	**534**	391
Depreciation and impairment of property, plant and equipment	**448**	243
Impairment of goodwill (note 11)	**179**	123
Amortisation and impairment of computer software and development costs	**64**	59
Lease expense[(1)]	**3**	63
Staff costs	**2,868**	2,064
Research and development costs[(2)]	**283**	195
Profit on disposal of property, plant and equipment	**(6)**	(4)
Expense of writing down inventory to net realisable value	**66**	64
Reversals of previous write-downs of inventory	**(38)**	(19)
Impairment recognised on trade receivables	**21**	31
Impairment reversed on trade receivables	**(6)**	(11)

(1) Lease expense impacted by the adoption of IFRS 16 on 1 January 2019 (note 1).
(2) Includes staff costs totalling £195 million (2018: £152 million).

The analysis of auditor's remuneration is as follows:

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**7.6**	6.9
Fees payable to the Company's auditor for the audit of the GKN acquisition Balance Sheet	**–**	1.9
Total fees payable for the audit of the Company's annual accounts	**7.6**	8.8
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**	1.2
Total audit fees	**8.7**	10.0
Audit-related assurance services:		
Review of the half year interim statement	**0.4**	0.3
Non-statutory audit of certain of the Company's businesses	**0.4**	0.7
Total audit-related assurance services	**0.8**	1.0
Total audit and audit-related assurance services	**9.5**	11.0
Tax compliance services	**0.1**	–
Other tax advisory services	**0.1**	–
Corporate finance services	**–**	0.3
Total audit and non-audit fees	**9.7**	11.3

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 86 to 87. No services were provided pursuant to contingent fee arrangements.

An analysis of staff costs and employee numbers is as follows:

Continuing operations	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Staff costs during the year (including executive Directors)		
Wages and salaries	**2,373**	1,705
Social security costs[(1)]	**388**	263
Pension costs (note 24)		
– defined benefit plans[(2)]	**8**	20
– defined contribution plans	**86**	63
Share based compensation expense[(3)] (note 23)	**13**	13
Total staff costs	**2,868**	2,064

(1) Includes an employer's tax charge of £4 million (2018: £nil) 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 £nil (2018: £11 million) in respect of GMP equalisation on UK pension schemes, shown as an adjusting item (note 6).
(3) Shown as an adjusting item (note 6).

Notes to the Financial Statements

Continued

7. Expenses continued

Continuing operations	Year ended 31 December 2019 Number	Restated Year ended 31 December 2018 Number(1)
Average monthly number of persons employed (including executive Directors)		
Aerospace	**17,050**	16,302
Automotive	**22,596**	24,365
Powder Metallurgy	**6,934**	7,369
Nortek Air Management	**5,571**	5,622
Other Industrial	**3,894**	4,985
Corporate – Melrose	**47**	37
Corporate – GKN	**–**	32
Total average number of persons employed	**56,092**	58,712

(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.

An analysis of finance costs and income is as follows:

Continuing operations	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Finance costs and income		
Interest on bank loans and overdrafts	**(152)**	(103)
Amortisation of costs of raising finance(1)	**(11)**	(18)
Net interest cost on pensions	**(31)**	(21)
Lease interest	**(21)**	–
Unwind of discount on provisions	**(7)**	(10)
Fair value changes on cross–currency swaps(2)	**1**	(8)
Total finance costs	**(221)**	(160)
Finance income	**9**	5
Total net finance costs	**(212)**	(155)

(1) In 2018 there was £7 million in respect of accelerated future year charges following the repayment of debt facilities as a result of the acquisition of GKN. This cost was excluded from adjusted finance costs (note 6).
(2) These costs are excluded from adjusted finance costs (note 6).

8. Tax

Continuing operations	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Analysis of tax charge/(credit) in the year:		
Current tax		
Current year tax charge	**156**	55
Adjustments in respect of prior years	**(10)**	(21)
Total current tax charge	**146**	34
Deferred tax		
Origination and reversal of temporary differences	**(89)**	(33)
Adjustments in respect of prior years	**5**	(6)
Tax on the change in value of derivative financial instruments	**(10)**	(31)
Adjustments to deferred tax attributable to changes in tax rates	**(2)**	(34)
Non-recognition of deferred tax	**17**	–
Recognition of previously unrecognised deferred tax assets	**(16)**	(5)
Total deferred tax credit	**(95)**	(109)
Tax charge/(credit) on continuing operations	**51**	(75)
Tax charge on discontinued operations	**3**	–
Total tax charge/(credit) in year	**54**	(75)
Analysis of charge/(credit) on continuing operations in the year:	**£m**	£m
Tax charge in respect of adjusted profit before tax	**190**	155
Tax credit recognised as an adjusting item	**(139)**	(230)
Total tax charge/(credit) on continuing operations	**51**	(75)

The tax charge of £190 million (2018: £155 million) arising on adjusted profit before tax of £889 million (2018: £672 million), results in an effective tax rate of 21.4% (2018: 23.1%).

8. Tax continued

The £139 million (2018: £230 million) tax credit recognised as an adjusting item includes £123 million (2018: £221 million) in respect of tax credits on adjustments to profit/(loss) before tax of £783 million (2018: £1,214 million), £7 million (2018: £9 million) in respect of the tax charge on equity accounted investments and £9 million (2018: £nil) in respect of net tax credits on restructuring, being a £1 million (2018: £nil) tax charge on the legal separation of the GKN Aerospace and Automotive divisions and a £10 million (2018: £nil) tax credit on other internal Group restructuring.

The tax charge for the year for continuing and discontinued operations can be reconciled to the profit/(loss) before tax per the Income Statement as follows:

	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Profit/(loss) before tax:		
Continuing operations	**106**	(542)
Discontinued operations (note 13)	**(82)**	(8)
	24	(550)
Tax charge/(credit) on profit/(loss) before tax at the weighted average rate of 21.0% (2018: 20.0%)	**5**	(110)
Tax effect of:		
Disallowable expenses and other permanent differences within adjusted profit	**6**	10
Disallowable items included within adjusting items	**54**	57
Temporary differences not recognised in deferred tax	**17**	14
Recognition of previously unrecognised deferred tax assets	**(16)**	(5)
Tax credits, withholding taxes and other rate differences	**4**	10
Adjustments in respect of prior years	**(5)**	(27)
Tax (credit)/charge classified within adjusting items	**(9)**	10
Effect of changes in tax rates	**(2)**	(34)
Total tax charge/(credit) for the year	**54**	(75)

The reconciliation has been performed at a blended Group tax rate of 21.0% (2018: 20.0%) which represents the weighted average of the tax rates applying to profits and losses in the jurisdictions in which those results arose.

Tax charges/(credits) included in Other Comprehensive Income are as follows:

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Deferred tax on retirement benefit obligations	**(15)**	(9)
Deferred tax on hedge relationship gains and losses	**16**	(24)
Deferred tax on foreign currency gains and losses	**3**	(5)
Total charge/(credit) for the year	**4**	(38)

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 and obtained leave to appeal on various aspects of the case. The hearings will take place in 2020.

The continuing complexity of the case and uncertainty over the issues raised (and in particular the points HMRC have been granted leave to appeal) means that it is not possible to predict the final outcome of the litigation with any reasonable degree of certainty.

9. Dividends

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
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
Final dividend for the year ended 31 December 2018 of 3.05p	**148**	–
Interim dividend for the year ended 31 December 2019 of 1.7p	**83**	–
	231	129

Proposed final dividend for the year ended 31 December 2019 of 3.4p per share (2018: 3.05p per share) totalling £165 million (2018: £148 million).

The final dividend of 3.4p was proposed by the Board on 5 March 2020 and, in accordance with IAS 10: "Events after the reporting period", has not been included as a liability in these Consolidated Financial Statements.

Notes to the Financial Statements
Continued

10. Earnings per share

Earnings attributable to owners of the parent	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Earnings for basis of earnings per share	**(60)**	(475)
Less: loss for the year from discontinued operations	**106**	8
Earnings for basis of earnings per share from continuing operations	**46**	(467)

	Year ended 31 December 2019 Number	Year ended 31 December 2018 Number
Weighted average number of ordinary shares for the purposes of basic earnings per share (million)	**4,858**	3,959
Further shares for the purposes of diluted earnings per share (million)	**–**	–
Weighted average number of ordinary shares for the purposes of diluted earnings per share (million)	**4,858**	3,959

Earnings per share	Year ended 31 December 2019 pence	Restated Year ended 31 December 2018 pence
Basic earnings per share		
From continuing and discontinued operations	**(1.2)**	(12.0)
From continuing operations	**0.9**	(11.8)
From discontinued operations	**(2.1)**	(0.2)
Diluted earnings per share		
From continuing and discontinued operations	**(1.2)**	(12.0)
From continuing operations	**0.9**	(11.8)
From discontinued operations	**(2.1)**	(0.2)

Adjusted earnings from continued operations	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Adjusted earnings for the basis of adjusted earnings per share(1)	**693**	504

(1) Adjusted earnings for the year ended 31 December 2019 comprises adjusted profit after tax of £699 million (2018: £517 million) (note 6), net of an allocation to non-controlling interest of £6 million (2018: £13 million).

Adjusted earnings per share from continuing operations

	Year ended 31 December 2019 pence	Restated Year ended 31 December 2018 pence
Adjusted basic earnings per share	**14.3**	12.7
Adjusted diluted earnings per share	**14.3**	12.7

11. Goodwill and other intangible assets

	Restated Goodwill £m	Restated Customer relationships and contracts £m	Brands and intellectual property £m	Other[1] £m	Computer software £m	Development costs £m	Restated Total £m
Cost							
At 1 January 2018	1,528	571	375	29	20	3	2,526
Acquisition of businesses	2,544	4,289	473	999	24	444	8,773
Additions	–	–	–	–	11	24	35
Disposals	–	–	–	–	(5)	(1)	(6)
Exchange adjustments	205	366	23	29	3	26	652
At 31 December 2018	4,277	5,226	871	1,057	53	496	11,980
Additions	–	–	–	–	6	48	54
Transfer to held for sale[3]	–	(10)	(8)	(3)	(2)	–	(23)
Disposal of businesses[4]	(92)	(65)	(68)	–	(5)	–	(230)
Disposals	–	–	–	–	(1)	(1)	(2)
Exchange adjustments	(147)	(190)	(19)	(17)	(3)	(30)	(406)
At 31 December 2019	**4,038**	**4,961**	**776**	**1,037**	**48**	**513**	**11,373**
Amortisation and impairment							
At 1 January 2018	(96)	(87)	(77)	(14)	(14)	–	(288)
Charge for the year:							
Adjusted operating profit	–	–	–	–	(11)	(33)	(44)
Adjusting items	–	(275)	(44)	(82)	–	–	(401)
Impairments[2]	(123)	–	–	–	–	(15)	(138)
Disposals	–	–	–	–	4	1	5
Exchange adjustments	–	(10)	(3)	(2)	(1)	–	(16)
At 31 December 2018	(219)	(372)	(124)	(98)	(22)	(47)	(882)
Charge for the year:							
Adjusted operating profit	–	–	–	–	(12)	(52)	(64)
Adjusting items	–	(383)	(48)	(109)	–	–	(540)
Impairments[2]	(179)	–	–	–	–	–	(179)
Transfer to held for sale[3]	–	1	1	1	2	–	5
Disposal of businesses[4]	–	5	11	–	4	–	20
Disposals	–	–	–	–	1	1	2
Exchange adjustments	13	23	4	3	4	2	49
At 31 December 2019	**(385)**	**(726)**	**(156)**	**(203)**	**(23)**	**(96)**	**(1,589)**
Net book value							
At 31 December 2019	**3,653**	**4,235**	**620**	**834**	**25**	**417**	**9,784**
At 31 December 2018	4,058	4,854	747	959	31	449	11,098

(1) Other includes technology and order backlog intangible assets acquired with the Nortek and GKN businesses.
(2) The impairment in 2019 relates to goodwill in Security & Smart Technology and in 2018 relates to goodwill in Brush and development costs in Aerospace, shown as adjusting items (note 6).
(3) Transfers to held for sale relate to the Wheels & Structures business (note 13), which is shown as a discontinued operation.
(4) Disposal of businesses relates to the sale of the Walterscheid Powertrain Group (note 13), which is shown as a discontinued operation.

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, knowhow, market share and geographical advantages afforded to the Group.

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").

There has been no change in the CGU structure in 2019. Following the GKN Aerospace reorganisation, announced on 3 September 2019, the Aerostructures, Aerospace Engine Systems and Aerospace Special Technologies groups of CGUs will be reorganised into Aerospace Engine Systems and Aerostructures effective 1 January 2020.

Notes to the Financial Statements

Continued

11. Goodwill and other intangible assets continued

Goodwill	31 December 2019 £m	Restated 31 December 2018 £m
Nortek businesses:		
AQH	**355**	370
HVAC	**237**	246
Security & Smart Technology	**172**	357
Ergotron	**418**	435
GKN businesses:		
Aerostructures	**545**	558
Aerospace Engine Systems	**346**	360
Aerospace Special Technologies	**50**	51
Automotive Driveline	**688**	715
Automotive ePowertrain	**339**	345
Powder Metallurgy	**503**	529
Walterscheid Powertrain Group(1)	**–**	92
	3,653	4,058

(1) Disposed on 25 June 2019.

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 forecasts extrapolated to perpetuity using growth rates shown below, which do not exceed the long-term growth rate for the relevant market.

An impairment charge of £179 million was recorded in respect of the Security & Smart Technology group of CGUs during the first half of the year as a result of further deterioration in both the performance and forecast future prospects, particularly following increases in US tariffs for goods being imported from China. The impairment charge recorded in the Consolidated Income Statement, is shown as an adjusting item (note 6) and has not changed in value in the second half of the year. Sensitivity analysis has been provided in respect of reasonably possible changes to key assumptions.

Based on impairment testing completed at the year-end no further impairment was identified in respect of the Nortek and GKN businesses. No reasonably possible change in key assumptions would result in an impairment in the AQH, HVAC and Ergotron groups of CGUs. Due to the proximity of the recent acquisition of GKN, the recoverable amounts for GKN businesses will be close to carrying values. There is no reasonably possible change in the key assumptions for the three Aerospace and Automotive ePowertrain groups of CGUs that could result in an impairment. There is also no reasonably possible change in the key assumptions for the revised two Aerospace groups of CGUs that are effective from 1 January 2020 that could result in an impairment.

The Automotive Driveline and Powder Metallurgy groups of CGUs, impacted by the automotive market downturn, are mitigating reductions in demand through cost and efficiency actions. No impairment of goodwill is required within these businesses, but sensitivity analysis has been provided in respect of reasonably possible changes to key assumptions.

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:

	31 December 2019			31 December 2018		
Group of CGUs	Pre-tax(1) discount rates	Long-term growth rates	Period of forecast	Pre-tax discount rates	Long-term growth rates	Period of forecast
AQH	**11.0%**	**3.3%**	**3**	11.8%	3.3%	3
HVAC	**11.2%**	**3.1%**	**3**	11.8%	3.1%	3
Security & Smart Technology	**11.5%**	**3.5%**	**3**	12.0%	3.3%	3
Ergotron	**10.9%**	**3.4%**	**3**	11.8%	3.3%	3
Aerostructures	**9.4%**	**2.9%**	**5**	10.2%	2.0%	5
Aerospace Engine Systems	**9.4%**	**3.0%**	**5**	10.1%	2.5%	5
Aerospace Special Technologies	**9.8%**	**2.9%**	**5**	9.7%	2.5%	5
Automotive Driveline	**13.5%**	**2.5%**	**5**	11.6%	0.0%	5
Automotive ePowertrain	**10.0%**	**2.8%**	**5**	12.0%	3.0%	5
Powder Metallurgy	**11.8%**	**2.5%**	**5**	12.0%	2.0%	5

(1) Adjusted for the impact of IFRS 16.

11. Goodwill and other intangible assets continued

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.

The Group adopted IFRS 16: "Leases" on 1 January 2019 which has affected the calculation of pre-tax discount rates. The change in accounting standard does not affect impairment conclusions.

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 macro-economic 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 cars 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 macro-economic 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 macro-economic factors.

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 macro-economic 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 macro-economic 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 macro-economic factors influence demand for these products.

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 long-term growth rate forecasts that take into account the international presence and the markets in which each business operates.

Security & Smart Technology group of CGUs

The 2018 Annual Report disclosed that the determination of the recoverable amount in respect of the Security & Smart Technology group of CGUs involved management estimation of the impact of highly uncertain matters at that time. Enhanced disclosures, including sensitivity analysis in respect of the key assumptions used in the forecast models, were shown at the 2018 year end. Subsequently, in the first half of 2019 there was further deterioration in both the performance and forecast future prospects, particularly following increases in US tariffs for goods being imported from China. This along with the increased level of competition and technological change in the market resulted in the necessity to impair goodwill allocated to the Security & Smart Technology group of CGUs by £179 million. The impairment charge is shown as an adjusting item (note 6) due to its non-trading nature and size and is unchanged in value from the first half of the year.

Sensitivity analysis

The forecasts are prepared using the methodology required by IAS 36 and show headroom of £43 million above the carrying amount for the Security & Smart Technology group of CGUs. Sensitivity analysis has been carried out and a reasonably possible change in the discount rate and long-term growth rate from 11.5% to 12.5% or from 3.5% to 2.4% respectively would reduce headroom to £nil. A reduction in the terminal operating margin from 10.8% to 9.5% would also reduce headroom to £nil.

Notes to the Financial Statements
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11. Goodwill and other intangible assets continued

Powder Metallurgy and Automotive group of CGUs

The GKN businesses were acquired and recorded at fair value on 19 April 2018 and subsequently there has been a global automotive market decline, naturally reducing the headroom when testing goodwill and intangible assets in respect of the Automotive and Powder Metallurgy businesses at this point in the cycle.

Powder Metallurgy group of CGUs – sensitivity analysis

The forecasts are prepared using the methodology required by IAS 36 and show headroom of £90 million above the carrying amount for the Powder Metallurgy group of CGUs. Sensitivity analysis has been carried out and a reasonably possible change in the discount rate and long-term growth rate from 11.8% to 12.3% or from 2.5% to 1.7% respectively would reduce headroom to £nil. A reduction in the terminal operating margin from 14.2% to 13.2% would also reduce headroom to £nil.

Automotive Driveline group of CGUs – sensitivity analysis

The forecasts are prepared using the methodology required by IAS 36 and show headroom of £103 million above the carrying amount for the Automotive Driveline group of CGUs. Sensitivity analysis has been carried out and a reasonably possible change in the discount rate and long-term growth rate from 13.5% to 14.0% or from 2.5% to 1.7% respectively would reduce headroom to £nil. A reduction in the terminal operating margin from 10.0% to 9.4% would also reduce headroom to £nil.

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 2019 years	31 December 2018 years	**31 December 2019 £m**	Restated 31 December 2018 £m	**31 December 2019 years**	31 December 2018 years	**31 December 2019 £m**	31 December 2018 £m
Brush	**–**	–	**–**	–	**9**	10	**48**	55
AQH	**11**	12	**155**	176	**12**	13	**49**	55
HVAC	**8**	9	**79**	93	**12**	13	**63**	71
Security & Smart Technology	**11**	12	**95**	108	**12**	13	**30**	40
Ergotron	**7**	8	**74**	88	**15**	16	**74**	83
Aerostructures	**9**	10	**554**	625	**19**	20	**469**	529
Aerospace Engine Systems	**19**	20	**1,761**	1,960	**19**	20	**188**	203
Aerospace Special Technologies	**9**	10	**50**	53	**19**	20	**54**	61
Automotive Driveline	**11**	12	**604**	693	**19**	20	**115**	122
Automotive ePowertrain	**8**	9	**285**	334	**19**	20	**289**	329
Powder Metallurgy	**16**	17	**578**	651	**19**	20	**75**	85
Walterscheid Powertrain Group	**–**	15	**–**	63	**–**	8	**–**	62
Wheels & Structures	**–**	20	**–**	10	**–**	20	**–**	11
			4,235	4,854			**1,454**	1,706

12. Investments

Investments, carried at fair value	**Year ended 31 December 2019 £m**	Year ended 31 December 2018 £m
Shares	**48**	–

The investment in shares acquired in the year, represents the Group's 4% investment in PW1100G-JM Engine Leasing LLC, an engine leasing business. The Group paid £50 million for this investment and incurred a foreign exchange translation loss of £2 million in the year. This investment is classified as a level 3 fair value under the IFRS 13 fair value hierarchy.

13. Assets held for sale and discontinued operations

Wheels & Structures

During the second half of the year, following a strategic review, the Board formally commenced a disposal process aligned to its strategic priority, to dispose of the Wheels & Structures business, with a high expectation that this process will conclude within one year. In accordance with IFRS 5: "Non-current assets held for sale and discontinued operations", associated assets and liabilities have been classified as held for sale and are separately shown on the Balance Sheet, having been remeasured to the fair value less costs of disposal.

Walterscheid Powertrain Group

On 25 June 2019, the Group completed the sale of the Walterscheid Powertrain Group for cash consideration of £185 million. The costs charged to the Income Statement associated with the disposal were £7 million. The loss on disposal was £21 million after the recycling of a net favourable cumulative translation difference of £13 million.

The results of the Walterscheid Powertrain Group and Wheels & Structures business were previously included within the Other Industrial operating segment and are classified as discontinued operations, in accordance with IFRS 5.

Financial performance of discontinued operations:

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Revenue	**423**	453
Operating costs(1)	**(503)**	(458)
Operating loss	**(80)**	(5)
Finance costs	**(2)**	(3)
Loss before tax	**(82)**	(8)
Tax	**(3)**	–
Loss after tax	**(85)**	(8)
Loss on disposal of businesses	**(21)**	–
Loss for the year from discontinued operations	**(106)**	(8)

(1) The operating loss in the year includes a £64 million charge on remeasurement to fair values less costs of disposal relating to the Wheels & Structures business on reclassification to assets held for sale.

The major classes of assets and liabilities held for sale or disposed of during the year were as follows:

	Wheels & Structures			Waltersheid Powertrain
	Reclassified £m	Remeasurement £m	Held for sale £m	Group disposed £m
Goodwill and other intangible assets	18	(18)	–	210
Property, plant and equipment	60	(49)	11	110
Interests in equity accounted investments	–	–	–	4
Inventories	22	–	22	74
Deferred tax assets	6	–	6	25
Trade and other receivables	26	–	26	67
Cash and cash equivalents	–	–	–	9
Total assets	132	(67)	65	499
Trade and other payables	(36)	–	(36)	(54)
Lease obligations	(2)	–	(2)	(34)
Retirement benefit obligations	–	–	–	(155)
Provisions	(3)	–	(3)	(10)
Current and deferred tax	(8)	3	(5)	(34)
Total liabilities	(49)	3	(46)	(287)
Net assets	**83**	**(64)**	**19**	**212**
Cash consideration, net of costs(1)				178
Cumulative translation difference recycled on disposals				13
Loss on disposal of businesses				**(21)**
Net cash inflow arising on disposal:				
Consideration received in cash and cash equivalents, net of costs(1)				178
Less: cash and cash equivalents disposed				(9)
				169

(1) Cash consideration of £185 million net of £7 million of disposal costs charged to the Income Statement.

Notes to the Financial Statements
Continued

14. Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Total £m
Cost			
At 1 January 2018	130	202	332
Acquisition of businesses	715	1,904	2,619
Additions	57	369	426
Disposals	(10)	(41)	(51)
Disposal of businesses	–	(8)	(8)
Exchange adjustments	51	145	196
At 31 December 2018	943	2,571	3,514
Recognition of right-of-use assets	486	103	589
Additions	89	458	547
Disposals	(25)	(65)	(90)
Transfer to held for sale	(21)	(65)	(86)
Disposal of businesses	(62)	(68)	(130)
Exchange adjustments	(75)	(129)	(204)
At 31 December 2019	**1,335**	**2,805**	**4,140**
Accumulated depreciation and impairment			
At 1 January 2018	(31)	(82)	(113)
Charge for the year	(26)	(212)	(238)
Disposals	–	36	36
Impairments	(3)	(11)	(14)
Exchange adjustments	(2)	(12)	(14)
At 31 December 2018	(62)	(281)	(343)
Charge for the year	(90)	(357)	(447)
Disposals	1	57	58
Transfer to held for sale	3	23	26
Disposal of businesses	1	19	20
Impairments(1)	(27)	(7)	(34)
Exchange adjustments	6	6	12
At 31 December 2019	**(168)**	**(540)**	**(708)**
Net book value			
At 31 December 2019	**1,167**	**2,265**	**3,432**
At 31 December 2018	881	2,290	3,171

(1) Includes £14 million of impairments, treated as a restructuring cost within adjusting items (note 6) and £20 million of onerous lease liabilities transferred from property related cost provisions (note 21).

Property, plant and equipment includes the net book value of right-of-use assets as follows:

Right-of-use asset	Land and buildings £m	Plant and equipment £m	Total £m
At 1 January 2019(1)	57	–	57
IFRS 16 transition adjustment	486	103	589
Additions	59	22	81
Depreciation and impairments(2)	(79)	(26)	(105)
Disposal of businesses	(28)	(6)	(34)
Transfer to held for sale	–	(2)	(2)
Exchange adjustments	(17)	(3)	(20)
At 31 December 2019	**478**	**88**	**566**

(1) The balance at 1 January 2019 represents finance lease assets held within property, plant and equipment prior to the adoption of IFRS 16.
(2) Includes a £20 million reduction in right-of-use assets following the transfer of onerous lease liabilities from property related cost provisions.

15. Equity accounted investments

	31 December 2019 £m	31 December 2018 £m
Aggregated amounts relating to equity accounted investments:		
Share of current assets	**278**	382
Share of non-current assets	**386**	420
Share of current liabilities	**(205)**	(231)
Share of non-current liabilities	**(23)**	(79)
Interests in equity accounted investments	**436**	492

Group share of results from continuing operations	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Revenue	**625**	493
Operating costs	**(559)**	(434)
Adjusted operating profit	**66**	59
Adjusting items	**(21)**	(15)
Net finance costs	**–**	(1)
Profit before tax	**45**	43
Tax	**(7)**	(9)
Share of results of equity accounted investments	**38**	34

Group share of equity accounted investments	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
At 1 January	**492**	–
Acquisition of businesses	**–**	512
Share of results of equity accounted investments	**38**	34
Additions	**–**	3
Dividends paid to the Group	**(67)**	(66)
Disposal of businesses	**(4)**	–
Exchange adjustments	**(23)**	9
At 31 December	**436**	492

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 year of £1,158 million (2018: £839 million), adjusted operating profit of £123 million (2018: £108 million), adjusting items of £39 million (2018: £30 million), statutory operating profit of £84 million (2018: £78 million), an interest charge of £nil (2018: £nil) and a tax charge of £13 million (2018: £16 million), leaving retained profit of £71 million (2018: £62 million).

Total net assets of SDS at 31 December 2019 were £816 million (2018: £937 million). These comprised non-current assets of £710 million (2018: £805 million), current assets of £488 million (2018: £464 million), current liabilities of £382 million (2018: £319 million) and non-current liabilities of £nil (2018: £13 million). During 2019, SDS paid a dividend to the Group of £65 million (2018: £58 million). Further information about SDS can be found in note 3 to the Melrose Industries PLC Company Financial Statements.

16. Inventories

	31 December 2019 £m	31 December 2018 £m
Raw materials	**597**	659
Work in progress	**329**	328
Finished goods	**406**	502
	1,332	1,489

In 2019 the write-down of inventories to net realisable value amounted to £68 million (2018: £65 million), of which £6 million (2018: £18 million) related to restructuring activities and is included within adjusting items. The reversal of write-downs amounted to £38 million (2018: £20 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 net book value of inventories and their replacement cost.

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17. Trade and other receivables

Current	31 December 2019 £m	31 December 2018 £m
Trade receivables	**1,473**	1,877
Allowance for doubtful receivables	**(47)**	(42)
Other receivables	**298**	256
Prepayments	**71**	37
Contract assets	**175**	200
	1,970	2,328

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.

Non-current	31 December 2019 £m	31 December 2018 £m
Other receivables	**2**	108
Contract assets	**422**	396
	424	504

As described in note 25, 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 2019, 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.

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, an analysis of which is as follows:

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air Management £m	Other Industrial £m	Discontinued Operations £m	Total £m
At 1 January 2018	–	–	–	6	9	–	15
Adoption of IFRS 9	–	–	–	2	–	–	2
Income Statement charge/(credit)	13	6	3	(2)	–	3	23
Utilised	–	–	–	(1)	(1)	(1)	(3)
Exchange adjustments	2	–	–	2	1	–	5
At 31 December 2018	15	6	3	7	9	2	42
Income Statement charge/(credit)	1	7	2	–	5	1	16
Utilised	(3)	–	–	–	(2)	–	(5)
Disposal of businesses	–	–	–	–	–	(2)	(2)
Transfer to assets held for sale	–	–	–	–	–	(1)	(1)
Exchange adjustments	(1)	(1)	–	(1)	–	–	(3)
At 31 December 2019	**12**	**12**	**5**	**6**	**12**	**–**	**47**

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 2019 £m	31 December 2018 £m
0 – 30 days	**15**	12
31 – 60 days	**1**	1
60+ days	**31**	29
	47	42

Included in the Group's trade receivables balance are overdue trade receivables with a carrying amount of £154 million (31 December 2018: £208 million) against which a provision of £47 million (31 December 2018: £42 million) is held.

17. Trade and other receivables continued

The balance deemed recoverable of £107 million (31 December 2018: £166 million) is past due as follows:

	31 December 2019 £m	31 December 2018 £m
0 – 30 days	**72**	124
31 – 60 days	**24**	33
60+ days	**11**	9
	107	166

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value.

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
At 31 December 2018	213	145	206	32	596
Additions	10	1,192	60	25	1,287
Utilised	(12)	(1,227)	(15)	(6)	(1,260)
Exchange adjustments	(9)	(5)	(9)	(3)	(26)
At 31 December 2019	**202**	**105**	**242**	**48**	**597**

Participation fees

Participation fees are described in the accounting policies (note 2) and 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 work completed 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 has a material impact on one entity in the Group, exclusively relating to certain RRSP arrangements in the Aerospace business. RRSP contracting is a feature of the aircraft engine market and typically reflects the engine manufacturer's economic model where discounts are given on the sale of original equipment ("OE") and generally a higher value is associated with the subsequent maintenance, repair and overhaul services. The nature of RRSP arrangements is covered further in the accounting policies (note 2) and the impact on the Group is that OE products sold to engine manufacturers are at a lower margin with more favourable pricing in the aftermarket phase. As a partner in the arrangements, the Aerospace business' cash compensation profile often reflects that of the OE engine manufacturer.

Where the Group has a contractual right to aftermarket revenue, IFRS 15 requires that the total contract revenue is allocated to the performance obligations. The principal contractual term that determines the existence of variable consideration is the absence of a termination clause that the customer can unilaterally exercise and which results in future purchases being considered optional. Where there is such a termination clause and the Group commercially relies on economic compulsion of the contracting parties, the two phases of activity are treated as distinct and no variable consideration is recognised. In the absence of such a term, there is a contractual link between the sale of OE components and aftermarket, which results in variable consideration, and the total contract revenue is allocated to the distinct performance obligations.

Variable consideration is measured using a weighted average unit method, taking account of an estimate of stand-alone selling price for individual performance obligations and is recognised when control of the OE component passes to the customer (the engine manufacturer). Due to the long-term nature of agreements, calculation of the total programme revenues is inherently imprecise and as set out in note 3e requires significant estimates, including an assessment of the aftermarket revenue per engine which reflects the pattern of future maintenance activity and associated costs to be incurred. In order to address the future uncertainties, risk adjustments as well as constraints have been applied to the expected level of revenue as appropriate. This approach best represents the value of goods and services supplied taking account of the performance obligations, risk and overall contract revenues.

As a consequence of allocating additional revenue to the sale of OE components, a variable consideration contract asset has been recognised which will be satisfied through cash receipt during the aftermarket phase. The constraint applied to variable consideration is reassessed at each period end, and will unwind as risks reduce and when uncertainties are resolved. This is expected to lead to additional revenue recognition in future periods in relation to items sold in the current and preceding periods.

Notes to the Financial Statements

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18. Cash and cash equivalents

	31 December 2019 £m	31 December 2018 £m
Cash and cash equivalents	**317**	415

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.

19. Trade and other payables

Current	31 December 2019 £m	31 December 2018 £m
Trade payables	**1,223**	1,307
Other payables	**387**	568
Customer advances and contract liabilities	**343**	190
Other taxes and social security	**74**	64
Government refundable advances	**7**	8
Accruals	**413**	434
Deferred government grants	**14**	12
	2,461	2,583

As at 31 December 2019, and as described in note 25, included within trade payables were drawings on supplier finance facilities of £75 million (2018: £97 million).

Trade payables are non-interest-bearing. Normal settlement terms vary by country and the average credit period taken for trade and other payables is 78 days (2018: 81 days).

Non-current	31 December 2019 £m	Restated 31 December 2018 £m
Other payables	**11**	78
Customer advances and contract liabilities	**352**	552
Other taxes and social security	**2**	23
Government refundable advances	**59**	73
Accruals	**2**	28
Deferred government grants	**18**	8
	444	762

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 2020 and 2055.

Customer advances and contract liabilities include 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 £132 million, two to five years £154 million and over five years £66 million (2018: one to two years £241 million, two to five years £136 million and over five years £175 million).

20. 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 25.

	Current		Non-current		Total	
	31 December 2019 £m	31 December 2018 £m	**31 December 2019 £m**	31 December 2018 £m	**31 December 2019 £m**	31 December 2018 £m
Floating rate obligations						
Bank borrowings – US Dollar loan	**–**	–	**2,199**	1,118	**2,199**	1,118
Bank borrowings – Sterling loan	**–**	–	**520**	1,139	**520**	1.139
Bank borrowings – Euro loan	**–**	–	**–**	363	**–**	363
Fixed rate obligations						
2019 £350 million bond	**–**	350	**–**	–	**–**	350
2022 £450 million bond	**–**	–	**450**	450	**450**	450
2032 £300 million bond	**–**	–	**300**	300	**300**	300
Other loans	**78**	13	**3**	6	**81**	19
	78	363	**3,472**	3,376	**3,550**	3,739
Unamortised finance costs	**–**	–	**(30)**	(41)	**(30)**	(41)
Non-cash acquisition fair value adjustment	**11**	14	**22**	43	**33**	57
Total interest-bearing loans and borrowings	**89**	377	**3,464**	3,378	**3,553**	3,755

Committed bank funding consists of a multi-currency term loan denominated £100 million and US$960 million that matures in April 2021 and a multi-currency revolving credit facility, denominated £1.1 billion, US$2.0 billion and €0.5 billion that matures in January 2023. The term loan was amended on 31 December 2019 to provide the Group with the option at its request to extend the loan for a further three years to April 2024, if required. Loans drawn under this facility are guaranteed by Melrose Industries PLC and certain of its subsidiaries, and there is no security over any of the Group's assets in respect of this facility.

At 31 December 2019 the term loan was fully drawn. There was a significant amount of headroom on the multi-currency committed revolving credit facility, as at 31 December 2019. Applying the exchange rates at 31 December 2019 the headroom equated to £1,136 million. There are also a number of uncommitted overdraft, guarantee and borrowing facilities made available to the Group.

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 2019 the margin was 1.4% (31 December 2018: 1.4%) on the term loan and 1.65% (31 December 2018: 1.65%) on the revolving credit facility.

The bond maturing in 2022 has associated cross-currency swaps. Details of the bonds are in the table below:

Maturity date	Notional amount £m	Coupon % p.a.	Cross-currency swaps million	Interest rate on swaps % p.a.
September 2022	450	5.375%	US $373	5.70%
			€284	3.87%
May 2032	300	4.625%	n/a	n/a

The coupon rate on the £300 million bond, maturing in 2032, increased from 3.375% to 4.625% in May 2019.

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20. Interest-bearing loans and borrowings continued

Maturity of financial liabilities (excluding currency contracts and lease obligations)

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 25, and lease obligations which are shown in note 28). 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	198	11	2,030	2,239
In one to two years	929	14	33	976
In two to five years	2,495	35	21	2,551
After five years	411	–	18	429
Effect of financing rates	(480)	–	–	(480)
31 December 2019	**3,553**	**60**	**2,102**	**5,715**
Within one year	502	1	2,317	2,820
In one to two years	122	3	106	231
In two to five years	3,285	14	18	3,317
After five years	425	–	55	480
Effect of financing rates	(579)	(4)	–	(583)
31 December 2018 – restated	3,755	14	2,496	6,265

21. Provisions

	Loss-making contracts[1] £m	Property related costs £m	Environmental and litigation £m	Warranty related costs £m	Restructuring £m	Other £m	Total £m
At 1 January 2019 – restated	616	74	218	397	116	50	1,471
Utilised	(83)	(5)	(87)	(54)	(190)	(6)	(425)
Net (credit)/charge to operating profit[2]	(122)	(1)	35	(2)	193	25	128
Unwind of discount[3]	20	–	1	–	–	1	22
Transfers[4]	(10)	(20)	(2)	–	–	–	(32)
Transfer to held for sale	(1)	–	(2)	–	–	–	(3)
Disposal of businesses	(1)	(1)	(1)	(1)	(2)	(4)	(10)
Exchange adjustments	(35)	(2)	(7)	(16)	(3)	(1)	(64)
31 December 2019	**384**	**45**	**155**	**324**	**114**	**65**	**1,087**
Current	70	9	86	114	110	23	412
Non-current	314	36	69	210	4	42	675
	384	45	155	324	114	65	1,087

(1) Utilisation of loss-making contracts includes £81 million shown within continuing adjusted operating profit and £2 million within discontinued operating profit.
(2) Includes £36 million of adjusting items and £92 million recognised in adjusted operating profit.
(3) Includes £7 million within finance costs relating to the time value of money and £15 million relating to changes in discount rates on loss-making contract provisions recognised as fair value items on the acquisition of GKN, which has been included as an adjusting item within operating profit (note 6).
(4) Onerous lease liabilities of £20 million have been transferred to the 'right-of-use asset' following the adoption of IFRS 16 on 1 January 2019 (note 14). Other transfers have occurred due to developments in commercial matters where the expected value and timing of cash outflow have become more certain.

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.

21. Provisions continued

Property related costs

The provision for property related costs represents dilapidation costs for ongoing leases and is expected to result in cash expenditure over the next eight years. Calculation of dilapidation obligations 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.

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 7% (31 December 2018: 0% and 9%) depending on the territory in which the provision resides and the length of its expected utilisation.

22. 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			
	Tax losses and other assets £m	Accelerated capital allowances and other liabilities £m	Deferred tax on intangible assets £m	Total deferred tax liabilities £m	Total net deferred tax £m
At 1 January 2018	49	(12)	(57)	(69)	(20)
Acquisition of businesses (restated)	695	(188)	(1,285)	(1,473)	(778)
(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(1)	(605)	8	597	605	–
At 31 December 2018 (restated)	132	(166)	(708)	(874)	(742)
Transfer to held for sale	(6)	2	–	2	(4)
Disposal of businesses	(25)	1	33	34	9
(Charge)/credit to income	(13)	(15)	124	109	96
Charge to equity	(4)	–	–	–	(4)
Exchange adjustments	(19)	1	51	52	33
Movement in set off of assets and liabilities(1)	95	3	(98)	(95)	–
At 31 December 2019	**160**	**(174)**	**(598)**	**(772)**	**(612)**

(1) Set off of deferred tax assets and liabilities in accordance with IAS 12 within territories with a right of set off.

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Continued

22. Deferred tax continued

As at 31 December 2019, the Group had gross unused corporate income tax losses of £2,036 million (31 December 2018: £1,991 million) available for offset against future profits. A deferred tax asset of £204 million (31 December 2018: £192 million) has been recognised in respect of £1,052 million (31 December 2018: £978 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 £46 million (31 December 2018: £42 million) has been recognised on tax credits (primarily US) and US state tax losses.

Deferred tax assets have also been recognised on Group retirement benefit obligations at £122 million (31 December 2018: £170 million) and on other temporary differences at £447 million (31 December 2018: £481 million). The gross deferred tax assets therefore amount to £819 million (31 December 2018: £885 million).

Deferred tax liabilities have been recognised on intangible assets at £1,243 million (31 December 2018: £1,450 million) and accelerated capital allowances and other temporary differences at £188 million (31 December 2018: £177 million). The gross deferred tax liabilities therefore amount to £1,431 million (31 December 2018: £1,627 million).

There are no material unrecognised deferred tax assets at 31 December 2019, 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 £51 million (31 December 2018: £59 million) would be payable. As at the balance sheet date the EU (withdrawal agreement) Act had not been enacted and as such withholding taxes have been measured at rates assuming EU membership. Following the UK's exit from the EU, the Group will rely on withholding tax rates as set out in Double Taxation Conventions agreed between the UK and other countries. The unrecognised deferred tax would be higher as a result, primarily on dividend receipts from Germany and Italy.

23. 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 were to be issued to Directors and Senior Management in three annual tranches and 48,250 options had been issued at 31 December 2019 (31 December 2018: 31,203). 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 95.

During 2017, 12,831 of the incentive plan options were converted to incentive shares with a nominal value of £1 each. The number of unexercised incentive plan options at 31 December 2019 is therefore 37,169 (31 December 2018: 37,169).

The estimated value of the 2017 Melrose Incentive Plan at 31 December 2019 was £nil (31 December 2018: £nil). Using a Black-Scholes option pricing model, the projected value of this plan at 31 May 2020 will be £39 million (31 December 2018: projected value of £13 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 a charge of £17 million (2018: £13 million) in the year ended 31 December 2019 in respect of the 2017 Melrose Incentive Plan, including a £4 million (2018: £nil) associated national insurance charge.

24. 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 £86 million (2018: £63 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 2019 were:

GKN Group Pension Schemes (Numbers 1 – 4)

On 1 July 2019 the GKN UK 2012 Pension Plan was split into four separate pension schemes which have been allocated to the Aerospace and Automotive segments resulting in no change to the benefits accrued by members or to the amounts recognised by the Group. The four new plans are called the GKN Group Pension Schemes (Numbers 1 – 4). All four schemes are funded plans, closed to new members and were closed to future accrual in 2017. The valuation of the plans was based on a full actuarial valuation as of 5 April 2016, updated to 31 December 2019 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 2019 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 2019, updated to 31 December 2019 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.

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 2019 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.

During the year, an enhanced transfer value ("ETV") exercise has been carried out in the GKN UK 2012 Pension Plan prior to its split into four separate schemes. This has resulted in a settlement credit of £6 million. In addition, the liabilities of the Broan Aftermarket North America, Inc. Group Pension Plan have been settled resulting in a settlement charge of £7 million.

Contributions

The Group committed to contribute and has subsequently now fully paid £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 Group Pension Schemes (Numbers 1 – 4).

The Group contributed £185 million (2018: £102 million) to defined benefit pension plans and post-employment plans in the year ended 31 December 2019, including £94 million (2018: £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. Furthermore, in July 2019 the Group contributed £17 million following the disposal of the Walterscheid Powertrain Group.

The Group expects to contribute £105 million to defined benefit pension plans and post-employment plans in 2020.

Notes to the Financial Statements
Continued

24. Retirement benefit obligations continued
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
31 December 2019			
GKN Group Pension Schemes (Numbers 1 – 4)	**2.8**	**2.0**	**2.1**
GKN UK – 2016 Pension Plan	**2.8**	**2.0**	**2.1**
GKN US plans	**n/a**	**3.1**	**2.1**
GKN Europe plans	**1.5**	**1.1**	**1.5**
Brush UK Pension Plan	**2.8**	**2.0**	**2.1**
31 December 2018			
GKN UK – 2012 Pension Plan	3.1	2.9	2.1
GKN UK – 2016 Pension 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 Pension Plan	3.2	2.9	2.1

Mortality
GKN Group Pension Schemes (Numbers 1 – 4), GKN UK 2016 Pension Plan and the Brush UK Pension Plan
Mortality assumptions for the Brush UK pension plan as at 31 December 2019 was based on the Self Administered Pension Scheme ("SAPS") "S2" base tables, using a scaling factor of 110%. The GKN Group Pension Schemes (Numbers 1 – 4) and the GKN UK 2016 Pension Plan use the SAPS "S3PA" base tables with adjustments. The base table mortality assumption for each of the UK plans reflects best estimate results from the most recent mortality experience analyses for each scheme-weighting factors vary by scheme.

Future improvements for all UK plans are in line with the 2018 Continuous Mortality Investigation ("CMI") core projection model (SK = 7.0, A = 0%) with a long-term rate of improvement of 1.25% p.a. for both males and females.

GKN US Consolidated Pension Plan
All plans use base mortality in line with the PR1-2012 tables. Future improvements for all US plans are in line with MP2019.

GKN Germany Pension Plans
All German plans use the Richttafein 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 Group Pension Schemes (Numbers 1 – 4) years	GKN UK 2016 Pension Plan years	GKN US Consolidated Pension Plan years	GKN Germany Pension Plans years	Brush UK Pension Plan years
Male today	21.1	21.2	19.6	20.2	20.8
Female today	24.0	23.6	21.6	23.7	22.7
Male in 20 years' time	22.4	22.5	21.2	23.0	22.1
Female in 20 years' time	25.5	25.1	23.1	25.9	24.3

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 2019 £m	31 December 2018 £m
Present value of funded defined benefit obligations	**(3,899)**	(3,937)
Fair value of plan assets	**3,412**	3,273
Funded status	**(487)**	(664)
Present value of unfunded defined benefit obligations	**(634)**	(749)
Net liabilities	**(1,121)**	(1,413)

24. Retirement benefit obligations continued

The plan assets and liabilities at 31 December 2019 were as follows:

	UK Plans[1] £m	US Plans £m	European Plans £m	Other Plans £m	Total £m
Plan assets	3,082	262	28	40	**3,412**
Plan liabilities	(3,502)	(417)	(561)	(53)	**(4,533)**
Net liabilities	(420)	(155)	(533)	(13)	**(1,121)**

(1) Includes a net liability in respect of the GKN Group Pension Schemes (Numbers 1 – 4) (formerly GKN UK 2012 plan), GKN post-employment medical plans, and the Nortek UK plan and a net asset in respect of the Brush UK Pension Plan and the GKN UK 2016 Pension 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 2019 £m	31 December 2018 £m
Equities	**749**	639
Government bonds	**1,051**	802
Corporate bonds	**437**	524
Property	**97**	147
Insurance contracts	**174**	181
Multi-strategy/Diversified growth funds	**432**	781
Private equity	**177**	140
Other	**295**	59
Total	**3,412**	3,273

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.

Movements in the present value of defined benefit obligations during the year:

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
At 1 January	**4,686**	542
Acquisition of businesses	**–**	4,216
Current service cost	**12**	10
Past service cost[1]	**(4)**	11
Interest cost on obligations	**125**	96
Remeasurement gains – demographic	**(157)**	(7)
Remeasurement losses/(gains) – financial	**569**	(77)
Remeasurement gains – experience	**(1)**	(1)
Benefits paid out of plan assets	**(181)**	(159)
Benefits paid out of Group assets for unfunded plans	**(28)**	(17)
Settlements	**(261)**	(1)
Disposal of businesses	**(175)**	–
Exchange adjustments	**(52)**	73
At 31 December	**4,533**	4,686

(1) A credit of £4 million was recorded as a past service cost during the year following a curtailment gain on a GKN Germany pension scheme. An expense of £11 million was 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. Both were treated as adjusting items (note 6).

The defined benefit plan liabilities were 27% (31 December 2018: 31%) in respect of active plan participants, 26% (31 December 2018: 23%) in respect of deferred plan participants and 47% (31 December 2018: 46%) in respect of pensioners.

The weighted average duration of the defined benefit plan liabilities at 31 December 2019 was 17.1 years (31 December 2018: 16.6 years).

Notes to the Financial Statements
Continued

24. Retirement benefit obligations continued
Movements in the fair value of plan assets during the year:

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
At 1 January	**3,273**	524
Acquisition of businesses	**–**	2,847
Interest income on plan assets	**93**	72
Return on plan assets, excluding interest income	**379**	(121)
Contributions	**157**	85
Benefits paid out of plan assets	**(181)**	(159)
Plan administrative costs	**(15)**	(12)
Settlements	**(262)**	(1)
Disposal of businesses	**(20)**	–
Exchange adjustments	**(12)**	38
At 31 December	**3,412**	3,273

The actual return on plan assets was a gain of £472 million (2018: loss of £49 million).

Income Statement disclosures
Amounts recognised in the Consolidated Income Statement in respect of these defined benefit plans were as follows:

Continuing operations	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Included within operating profit/(loss):		
– current service cost	**12**	9
– past service (credit)/cost[1]	**(4)**	11
– plan administrative costs	**15**	12
Included within net finance costs:		
– interest cost on defined benefit obligations	**124**	93
– interest income on plan assets	**(93)**	(72)

Discontinued operations	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Included within operating profit/(loss):		
– current service cost	**–**	1
Included within net finance costs:		
– interest cost on defined benefit obligations	**1**	3

(1) A credit of £4 million was recorded as a past service cost during the year following a curtailment gain on a GKN Germany pension scheme. Furthermore, an expense of £11 million was 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. Both were treated as adjusting items (note 6).

24. Retirement benefit obligations continued

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 2019 £m	Year ended 31 December 2018 £m
Return on plan assets, excluding interest income	**379**	(121)
Remeasurement gains arising from changes in demographic assumptions	**157**	7
Remeasurement (losses)/gains arising from changes in financial assumptions	**(569)**	77
Remeasurement gains arising from experience adjustments	**1**	1
Net remeasurement loss on retirement benefit obligations	**(32)**	(36)

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	76	1
	Decrease by 0.1 ppts	(78)	(1)
Inflation assumption(1)	Increase by 0.1 ppts	(59)	n/a
	Decrease by 0.1 ppts	57	n/a
Assumed life expectancy at age 65 (rate of mortality)	Increase by 1 year	(186)	n/a
	Decrease by 1 year	180	n/a

(1) The inflation sensitivity encompasses the impact on pension increases, where applicable.

The sensitivity analysis above was determined based on reasonably 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 2019 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.

Notes to the Financial Statements
Continued

25. 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 2019 and 31 December 2018:

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Restated Nortek Air Management £m	Restated Other Industrial £m	Corporate £m	Discontinued Operations £m	**Total £m**
31 December 2019								
Financial assets								
Classified as amortised cost:								
Cash and cash equivalents	–	–	–	–	–	317	–	**317**
Net trade receivables	626	402	155	141	102	–	–	**1,426**
Classified as fair value:								
Investments	48	–	–	–	–	–	–	**48**
Derivative financial assets								
Foreign currency forward contracts	–	–	–	2	1	37	–	**40**
Interest rate swaps	–	–	–	–	–	1	–	**1**
Embedded derivatives(1)	16	–	–	–	–	–	–	**16**
Assets classified as held for sale(2)	–	–	–	–	–	–	65	**65**
Financial liabilities								
Classified as amortised cost:								
Interest-bearing loans and borrowings	–	–	–	–	–	(3,553)	–	**(3,553)**
Government refundable advances	(66)	–	–	–	–	–	–	**(66)**
Lease obligations	(287)	(117)	(59)	(89)	(26)	(4)	–	**(582)**
Other financial liabilities	(741)	(842)	(138)	(154)	(115)	(46)	–	**(2,036)**
Classified as fair value:								
Derivative financial liabilities								
Foreign currency forward contracts	–	(2)	–	(1)	(1)	(170)	–	**(174)**
Interest rate swaps	–	–	–	–	–	(60)	–	**(60)**
Cross-currency swaps	–	–	–	–	–	(80)	–	**(80)**
Embedded derivatives(1)	(8)	–	–	–	–	–	–	**(8)**
Liabilities associated with assets held for sale(2)	–	–	–	–	–	–	(46)	**(46)**
31 December 2018								
Financial assets								
Classified as amortised cost:								
Cash and cash equivalents	–	–	–	–	–	415	–	415
Net trade receivables	837	458	177	156	125	–	82	1,835
Classified as fair value:								
Derivative financial assets								
Foreign currency forward contracts	–	–	–	2	1	12	–	15
Interest rate swaps	–	–	–	–	–	8	–	8
Embedded derivatives(1)	18	–	–	–	–	–	–	18
Financial liabilities								
Classified as amortised cost:								
Interest-bearing loans and borrowings	–	–	–	–	–	(3,755)	–	(3,755)
Government refundable advances	(81)	–	–	–	–	–	–	(81)
Lease obligations	(21)	(35)	–	(1)	–	–	–	(57)
Other financial liabilities (restated)	(832)	(909)	(153)	(166)	(144)	(80)	(131)	(2,415)
Classified as fair value:								
Derivative financial liabilities								
Foreign currency forward contracts	–	–	–	(2)	(2)	(205)	–	(209)
Interest rate swaps	–	–	–	–	–	(14)	–	(14)
Cross-currency swaps	–	–	–	–	–	(199)	–	(199)
Embedded derivatives(1)	(9)	–	–	–	–	–	–	(9)

(1) The embedded derivative is classified as a level 3 fair value under the IFRS 13 fair value hierarchy.
(2) Details of the assets and liabilities classified as held for sale are disclosed in note 13.

25. 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 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. 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 17 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 2019 consists of net debt, as disclosed in note 27, 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

Committed bank funding consists of a multi-currency term loan denominated £100 million and US$960 million that matures in April 2021 and a multi-currency revolving credit facility, denominated £1.1 billion, US$2.0 billion and €0.5 billion that matures in January 2023. The term loan was amended on 31 December 2019 to provide the Group with the option at its request to extend the loan for a further three years to April 2024, if required. Loans drawn under this facility are guaranteed by Melrose Industries PLC and certain of its subsidiaries, and there is no security over any of the Group's assets in respect of this facility.

As at 31 December 2019 the term loan was fully drawn. During October 2019, the 2019 GKN bond reached maturity and the revolving credit facility was utilised to repay this bond amounting to £350 million, together with the associated cross currency swap which was out of the money by £100 million. There remains a significant amount of headroom on the multi-currency committed revolving credit facility at 31 December 2019. Applying the exchange rates at 31 December 2019, the headroom equated to £1,136 million (31 December 2018: £1,352 million).

Cash, deposits and marketable securities amounted to £317 million at 31 December 2019 (31 December 2018: £415 million) and are offset to arrive at the Group net debt position of £3,283 million (31 December 2018: £3,482 million). The combination of this cash and the headroom on the revolving credit 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

The 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 2019 it was 2.25x (31 December 2018: 2.28x), 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 10.8x at 31 December 2019 (31 December 2018: 11.6x), affording comfortable headroom compared to the covenant test.

Bonds

Capital market borrowings as at 31 December 2019, inherited as part of the GKN acquisition, consist of a £450 million bond maturing September 2022 and a £300 million bond maturing May 2032. During the year, a £350 million bond was repaid. Details of the bonds outstanding at 31 December 2019 are shown in note 20.

To simplify corporate reporting requirements of the Group, the bonds were transferred to the Professional Securities Market in March 2019 with the approval of the bond holders. In exchange for this concession, the bondholders now have the same guarantees from the Melrose Group companies as those provided to the banks lending in the committed bank facility.

The £450 million bond was fully swapped into US$373 million and €284 million by GKN in September 2014 by using a number of cross-currency swaps. At 31 December 2019, the fair value liability of these cross-currency swaps was £74 million (31 December 2018: £199 million, including a liability of £102 million on the cross-currency swap linked to the £350 million bond that matured in October 2019). The coupon rate on the £300 million bond maturing in 2032 increased by 1.25% to 4.625% from May 2019.

In respect of the cross-currency swaps on the £450 million bond, during the year there was a charge of £1 million (2018: £6 million) recognised within the cost of hedge reserve related to the cost of hedging. At 31 December 2019, the cumulative value of the cost of hedging recognised within the cost of hedge reserve is £7 million (2018: £6 million).

25. Financial instruments and risk management continued

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.

GKN businesses which participate in these customer related finance programmes 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 2019, the drawings on these facilities were £200 million (31 December 2018: £206 million).

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 on the credit 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 2019, total facilities were £161 million (31 December 2018: £204 million) with drawings of £75 million (31 December 2018: £97 million). The arrangements do not change the timing of the Group's cash outflows.

Hedge of net investments in foreign entities using loans and derivatives

Interest-bearing loans and borrowings together with cross-currency swaps are designated as hedges of net investments in the Group's subsidiaries in the USA and Europe to reduce the exposure to the related foreign exchange risks.

The value of these were as follows:

	31 December 2019 £m	31 December 2018 £m
Local borrowing:		
US Dollar	**1,731**	1,118
Euro	**473**	363
GKN cross-currency swaps:		
US Dollar	**281**	746
Euro	**241**	255

The Euro borrowings consist of US Dollar debt that was swapped into Euros using cross-currency swaps. The fair value of these cross-currency swaps was a liability of £6 million (2018: £nil).

The foreign exchange movement on these borrowings, which is recorded in currency translation on net investments within other comprehensive income was a gain of £83 million (2018: loss of £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 2019 the margin was 1.40% on the term loan and 1.65% on the revolving credit facility (31 December 2018: 1.40% on the term loan and 1.65% on the revolving credit facility).

The policy of the Board is to hedge approximately 70% of the interest rate exposure of the Group. In addition to the fixed rate bonds inherited as part of the GKN acquisition, the Group holds interest rate swap instruments to fix the cost of LIBOR on borrowings under the bank facility. Under the terms of the swaps on the bank borrowings 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 Group is expected to be approximately 3.7% over the next 12 months.

The interest rate swaps are designated as cash flow hedges and were highly effective throughout 2019. The fair value of the contracts as at 31 December 2019 was a net liability of £59 million (31 December 2018: £6 million). The net charge of £36 million for the year ended 31 December 2019 (2018: £14 million) being the movement in the year, excluding accrued interest, was booked to gains/losses on hedge relationships within Other Comprehensive Income.

Due to some of the 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 2019 (2018: £nil).

25. Financial instruments and risk management continued

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 2019 £m	Year ended 31 December 2018 £m
Sterling	**(4)**	(10)
US Dollar	**(3)**	(4)
Euro	**(1)**	(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 Group 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 the Group will hedge 100%. For forecast cash flows, the Group 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 that are not denominated in Sterling 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 utilises its multi-currency revolving credit facility and uses cross-currency swaps, where relevant, to maintain an appropriate mix of debt in each currency. 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 the Group, 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 and, if appropriate, hedged at the time.

As at 31 December 2019, 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. The fair value of all foreign exchange forward contracts across the Group was a liability at 31 December 2019 of £134 million (31 December 2018: £194 million). A small proportion of these contracts have been designated as cash flow hedges within the Nortek Air Management and Other Industrial reporting segments. Contracts where hedge accounting was applied had a fair value asset as at 31 December 2019 of £2 million (31 December 2018: liability of £2 million). These contracts all mature between January 2020 and December 2020.

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 credit of £1 million (2018: charge of £1 million).

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 2019, and could also do so in future reporting periods.

In respect of the cross-currency swaps designated as net investment hedges, for the year ended 31 December 2019, £7 million (31 December 2018: £16 million) was booked through the Income Statement in finance costs, of which a credit of £1 million (31 December 2018: charge of £8 million) has been treated as an adjusting item (note 6). In addition, there is a £24 million credit (31 December 2018: charge of £84 million) 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 foreign currency translation reserve (note 26).

Notes to the Financial Statements
Continued

25. Financial instruments and risk management continued
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
Year ended 31 December 2019					
Foreign exchange forward contracts	1,104	552	703	42	**2,401**
Cross-currency swaps	499	25	547	–	**1,071**
Year ended 31 December 2018					
Foreign exchange forward contracts	1,203	624	918	43	2,788
Cross-currency swaps	511	27	603	–	1,141

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 below:

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
US Dollar	**3**	10
Euro	**(3)**	6

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 2019 £m	31 December 2018 £m
US Dollar	**15**	32
Euro	**–**	1

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 £204 million (2018: £186 million) and for Euro, a decrease of £75 million (2018: £62 million). 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.

25. 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:

	Average fixed rate		Notional principal		Fair value assets/ (liabilities)	
Hedging Instruments	**2019 %**	2018 %	**2019 £m**	2018 £m	**2019 £m**	2018 £m
Pay fixed, receive floating interest rate swaps – assets						
Within one year	**0.96%**	0.96%	**259**	393	**–**	6
In one to two years	**0.92%**	0.99%	**223**	303	**1**	2
In two to five years	**–**	0.93%	**–**	228	**–**	–
After five years	**–**	–	**–**	–	**–**	–
Total					**1**	8
Pay fixed, receive floating interest rate swaps – liabilities						
Within one year	**2.04%**	1.81%	**1,523**	379	**(18)**	(1)
In one to two years	**2.06%**	2.37%	**1,617**	946	**(13)**	(3)
In two to five years	**2.02%**	2.27%	**1,889**	1,301	**(29)**	(10)
After five years	**–**	–	**–**	–	**–**	–
Total					**(60)**	(14)
Pay fixed, receive fixed cross-currency swaps						
Within one year	**4.86%**	5.65%	**522**	1,001	**(1)**	(101)
In one to two years	**4.86%**	4.85%	**522**	548	**(1)**	(3)
In two to five years	**4.86%**	4.85%	**522**	548	**(72)**	(95)
After five years	**–**	–	**–**	–	**–**	–
Total					**(74)**	(199)

The Group also has cross-currency swaps designated in net investment hedge accounting relationships which convert US Dollar borrowings to Euros. The fair value of these cross-currency swaps at 31 December 2019 was a liability of £6 million (31 December 2018: £nil), repayable within one year. The movement on these cross-currency swaps of £6 million (2018: £nil) has been recorded in Other Comprehensive Income.

The Group is exposed to the following interest rate benchmarks within its hedge accounting relationships, which are subject to interest rate benchmark reform: GBP LIBOR, USD LIBOR, EURIBOR ("IBORs"). The hedged items are Sterling, US Dollar and Euro floating rate debt.

The Group has closely monitored the market and the output from various industry working groups managing the transition to new benchmark interest rates. This includes announcements made by LIBOR regulators (including the Financial Conduct Authority ("FCA") and the US Commodity Trading Futures Commission) regarding the transition away from LIBOR to the Sterling Overnight Indexed Average Rate ("SONIA"), Secured Overnight Financing Rate ("SOFR") and Euro Short-Term Rate ("ESTR") respectively. The FCA has made it clear that, at the end of 2021, it will no longer seek to persuade, or compel banks to submit to LIBOR.

In response to the announcements, the Group will begin dialogue with its banking group in respect of IBOR reform, with the expectation that the banking facility will transition to updated referenced benchmarked rates prior to the end of 2021.

Notes to the Financial Statements
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25. Financial instruments and risk management continued

Below are the details of the hedging instruments and hedged items in scope of the IFRS 9 amendments due to interest rate benchmark reform by hedge type. The terms of hedged items listed match those of the corresponding hedging instruments.

Hedge type	Instrument type	Maturing	Notional	Hedged item
Cash flow hedges	Interest rate swaps, pay Sterling fixed annually, receive 1 month GBP LIBOR	July 2021	£95 million	Sterling floating rate debt linked to LIBOR
	Interest rate swaps, pay Sterling fixed annually, receive 1 month GBP LIBOR	January 2023	Variable (£30 million – £110 million)	
	Interest rate swaps, pay US Dollar fixed annually, receive 3 month US Dollar LIBOR	July 2021	Variable ($170 million – $265 million)	US Dollar floating rate debt linked to US LIBOR
	Interest rate swaps, pay 3 month US Dollar LIBOR, receive 1 month US Dollar LIBOR	July 2021	Variable ($170 million – $265 million)	
	Interest rate swaps, pay US Dollar fixed annually, receive 1 month US Dollar LIBOR	January 2023	Variable ($1,100 million – $1,500 million)	
	Interest rate swaps, pay US Dollar fixed annually, receive 1 month US Dollar LIBOR	January 2023	Variable ($450 million – $500 million)	
	Interest rate swaps, pay Euro fixed annually, receive 1 month EURIBOR	January 2023	Variable (€160 million – €400 million)	Euro floating rate debt linked to EURIBOR
	Interest rate 0% caps, pay Euro fixed annually, receive 1 month EURIBOR	January 2023	€220 million	

The Group will continue to apply the amendments to IFRS 9 until the uncertainty arising from the interest rate benchmark reforms with respect to the timing and the amount of the underlying cash flows that the Group is exposed to ends. The Group has assumed that this uncertainty will not end until the Group's contracts that reference IBORs are amended to specify the date on which the interest rate benchmark will be replaced, the cash flows of the alternative benchmark rate and the relevant spread adjustment. This will, in part, be dependant on the introduction of fallback clauses which have yet to be added to the Group's contracts and the negotiation with lenders.

Derivative and financial assets and liabilities are presented within the Balance Sheet as:

	31 December 2019 £m	31 December 2018 £m
Non-current assets	**38**	26
Current assets	**19**	15
Non-current liabilities	**(216)**	(227)
Current liabilities	**(106)**	(204)

The change in fair value of interest rate swaps, excluding accrued interest, was a £36 million charge (2018: £14 million) 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:

	Change in fair value for calculating ineffectiveness		Balance in translation and hedging reserve for continuing hedges	
	2019 £m	2018 £m	**2019 £m**	2018 £m
Hedged items				
Floating rate borrowings – interest risk	**36**	14	**42**	6
Net assets of designated investments	**27**	237	**60**	84

There is no balance held in cash flow hedge reserve from hedging relationships for which hedge accounting is no longer applied.

26. Issued share capital and reserves

Share Capital	31 December 2019 £m	31 December 2018 £m
Allotted, called-up and fully paid		
4,858,254,963 (31 December 2018: 4,858,254,963) Ordinary Shares of 48/7p each (31 December 2018: 48/7p each)	**333**	333
12,831 (31 December 2018: 12,831) 2017 Melrose Incentive Plan Shares of £1 each	**–**	–
	333	333

The rights of each class of share are described in the Directors' Report.

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.

Translation and hedging reserve
In order to provide more useful information about the Group's hedging arrangements, the translation reserve and hedging reserve have been combined for the current and prior year. With the different components of hedging in one place it enables a clearer explanation of the three components of hedging. These components are provided below with movements within other comprehensive income during the year shown below and further explanation provided in note 25.

	Cost of hedge reserve £m	Cash flow hedge reserve £m	Foreign currency translation reserve £m	Translation and hedging reserve £m
At 1 January 2018	–	8	(66)	(58)
Movements within other comprehensive income/(expense):				
Retranslation of net assets	–	–	677	677
Foreign exchange differences on borrowings hedging net assets	–	–	(54)	(54)
Associated deferred tax	–	–	5	5
Change in fair value of derivatives designated in net investment hedges	–	–	(78)	(78)
Associated deferred tax	–	–	22	22
Change in fair value of derivatives designated in cash flow hedges	–	(13)	–	(13)
Amounts reclassified to the Income Statement	–	(2)	–	(2)
Associated deferred tax	–	2	–	2
Net movement in cost of hedging	(6)	–	–	(6)
At 31 December 2018	(6)	(5)	506	495
Movements within other comprehensive income/(expense):				
Retranslation of net assets	–	–	(451)	(451)
Foreign exchange differences on borrowings hedging net assets	–	–	83	83
Associated deferred tax	–	–	(3)	(3)
Change in fair value of derivatives designated in net investment hedges	–	–	19	19
Associated deferred tax	–	–	(22)	(22)
Change in fair value of derivatives designated in cash flow hedges	–	(35)	–	(35)
Amounts reclassified to the Income Statement	–	–	(13)	(13)
Associated deferred tax	–	6	–	6
Net movement in cost of hedging	(1)	–	–	(1)
At 31 December 2019	**(7)**	**(34)**	**119**	**78**

The cost of hedge reserve was previously reported as part of the hedging reserve and has been disaggregated.

The cash flow hedge reserve was previously reported as part of the hedging reserve and represents the cumulative fair value gains and losses on derivatives for which cashflow hedge accounting has been applied. Movements and balances on derivatives designated in net investment hedges were previously reported as part of the hedging reserve and are shown as part of the foreign currency translation reserve.

The foreign currency translation reserve contains exchange differences on the translation of subsidiaries with a functional currency other than Sterling, together with gains and losses on the translation of liabilities and cumulative fair value gains and losses on derivatives that hedge the Company's net investment in foreign subsidiaries.

Notes to the Financial Statements
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27. Cash flow statement

	Notes	Year ended 31 December 2019 £m	Restated Year ended 31 December 2018 £m
Reconciliation of operating profit to cash generated by continuing operations			
Operating profit/(loss)		**318**	(387)
Adjusting items	6	**784**	1,200
Adjusted operating profit	6	**1,102**	813
Adjustments for:			
Depreciation of property, plant and equipment		**434**	229
Amortisation of computer software and development costs		**64**	44
Share of adjusted operating profit of equity accounted investments	15	**(66)**	(59)
Restructuring costs paid and movements in provisions		**(320)**	(198)
Defined benefit pension contributions paid[1]		**(183)**	(99)
Change in inventories		**(12)**	(108)
Change in receivables		**72**	172
Change in payables		**(2)**	(160)
Acquisition costs and associated transaction taxes		**(16)**	(125)
Tax paid		**(117)**	(68)
Interest paid on loans and borrowings		**(166)**	(111)
Interest paid on lease obligations		**(21)**	–
Net cash from operating activities		**769**	330

(1) The Group committed to contribute £150 million in total to the GKN UK 2012 and GKN UK 2016 plans in the first 12 months of ownership, £56 million was contributed in the year ended 31 December 2018 and £94 million was contributed in the year ended 31 December 2019. Furthermore, in July 2019 the Group contributed £17 million to the GKN UK plans following the disposal of the Walterscheid Powertrain Group.

Cash flow from discontinued operations	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Net cash (used in)/from discontinued operations	**(16)**	44
Defined benefit pension contributions paid	**(2)**	(3)
Interest paid on lease obligations	**(1)**	–
Tax (paid)/received	**(1)**	2
Net cash (used in)/from operating activities from discontinued operations	**(20)**	43
Purchase of property, plant and equipment	**(12)**	(16)
Disposal costs	**(3)**	–
Proceeds from disposal of property, plant and equipment	**–**	2
Net cash used in investing activities from discontinued operations	**(15)**	(14)
Repayment of principal under lease obligations	**(2)**	–
Net cash used in financing activities from discontinued operations	**(2)**	–

27. Cash flow statement continued

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. A reconciliation from the most directly comparable IFRS measure to net debt is given below:

	31 December 2019 £m	31 December 2018 £m
Interest-bearing loans and borrowings – due within one year	**(89)**	(377)
Interest-bearing loans and borrowings – due after one year	**(3,464)**	(3,378)
External debt	**(3,553)**	(3,755)
Less:		
Cash and cash equivalents	**317**	415
	(3,236)	(3,340)
Adjustments:		
Impact of cross-currency swaps	**(80)**	(199)
Non-cash acquisition fair value adjustments	**33**	57
Net debt	**(3,283)**	(3,482)

The table below shows the key components of the movement in net debt:

	At 31 December 2018 £m	Cash flow £m	Acquisitions and disposals £m	Other non-cash movements £m	Effect of foreign exchange £m	**At 31 December 2019 £m**
External debt	(3,755)	106	–	13	83	**(3,553)**
Cross-currency swaps	(199)	100	–	(5)	24	**(80)**
Non-cash acquisition fair value adjustments	57	–	–	(24)	–	**33**
	(3,897)	206	–	(16)	107	**(3,600)**
Cash and cash equivalents	415	(234)	153	–	(17)	**317**
Net debt	(3,482)	(28)	153	(16)	90	**(3,283)**

28. Commitments

Amounts payable under lease obligations:

Minimum lease payments	**31 December 2019 £m**	31 December 2018 £m
Amounts payable:		
Within one year	**91**	8
After one year but within five years	**235**	28
Over five years	**375**	48
Less: future finance charges	**(119)**	(27)
Present value of lease obligations	**582**	57
Analysed as:		
Amounts due for settlement within one year	**71**	5
Amount due for settlement after one year	**511**	52
Present value of lease obligations	**582**	57

The Group recognised £589 million of lease liabilities on adoption of IFRS 16 on 1 January 2019. There was a corresponding right-of-use asset, shown in property, plant and equipment in note 14. Further details on the adoption of IFRS 16 are shown in note 1.

It is the Group's policy to lease certain of its property, plant and equipment. The average lease term is 10 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.

The Group's obligations under lease arrangements are secured by the lessors' rights over the leased assets.

Capital commitments

At 31 December 2019, there were commitments of £164 million (31 December 2018: £137 million) relating to the acquisition of new plant and machinery.

Notes to the Financial Statements
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29. 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 2019 totalled £12 million (2018: £28 million). Purchases by subsidiaries from equity accounted investments in the year ended 31 December 2019 totalled £7 million (2018: £14 million). At 31 December 2019, amounts receivable from equity accounted investments totalled £5 million (31 December 2018: £6 million) and amounts payable to equity accounted investments totalled £1 million (31 December 2018: £2 million).

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 pages 93 and 101.

	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Short-term employee benefits	**4**	3
Share-based payments	**9**	9
	13	12

30. Post Balance Sheet events
On 2 January 2020 GKN Powder Metallurgy completed the acquisition of FORECAST 3D, a leading US specialist in plastic additive manufacturing and 3D printing services offering a full range of services from concept to series production, for a total consideration of up to £29 million, of which £20 million was paid on 2 January 2020. The acquisition furthers GKN Powder Metallurgy's ambition to achieve global market leadership in industrialising additive manufacturing. In the year ended 31 December 2019 FORECAST 3D achieved sales of approximately £17 million.

31. 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 21.

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 2019 £m	31 December 2018 £m
Fixed assets			
Investment in subsidiaries	3	**10,573**	10,569
Debtors:			
Amounts falling due within one year	4	**413**	400
Amounts falling due after one year	4	**25**	25
Creditors:			
Amounts falling due within one year	5	**(2,016)**	(1,773)
Net current liabilities		**(1,578)**	(1,348)
Total assets less current liabilities		**8,995**	9,221
Provisions	6	**(3)**	(1)
Net assets		**8,992**	9,220
Capital and reserves			
Issued share capital	7	**333**	333
Share premium account		**8,138**	8,138
Merger reserve		**109**	109
Retained earnings		**412**	640
Shareholders' funds		**8,992**	9,220

The Company reported a loss for the financial year ended 31 December 2019 of £10 million (2018: profit of £445 million).

The financial statements were approved by the Board of Directors on 5 March 2020 and were signed on its behalf by:

Geoffrey Martin
Group Finance Director
5 March 2020

Simon Peckham
Chief Executive
5 March 2020

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 2018	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(1)	200	6,645	–	–	6,845
Equity-settled share-based payments	–	–	–	13	13
At 31 December 2018	333	8,138	109	640	9,220
Loss for the year (note 2)	–	–	–	(10)	(10)
Total comprehensive expense	–	–	–	(10)	(10)
Dividends paid	–	–	–	(231)	(231)
Equity-settled share-based payments	–	–	–	13	13
At 31 December 2019	**333**	**8,138**	**109**	**412**	**8,992**

(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.

Refer to the Section 172 statement in the Strategic Report on pages 56 to 57 for further details on the Company's Distribution Policy.

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 4 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 44 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.

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. 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.

1. Significant accounting policies continued

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 loss for the financial year ended 31 December 2019 of £10 million (2018: profit of £445 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 90 to 111. There were no other employees of the Company in the year.

3. Investment in subsidiaries

	£m
At 1 January 2019	10,569
Additions	4
At 31 December 2019	**10,573**

A £4 million investment from equity-settled share-based payments for subsidiaries is included as an addition to investments in subsidiaries at 31 December 2019.

The following subsidiaries and significant holdings were owned by the Company as at 31 December 2019:

	Equity interest %	Class of Share held
Argentina		
Avenida Del Libertador 602, 4' Piso, Buenos Aires		
Transmisiones Homocineticas Argentinas SA *(in liquidation)*	49	Ordinary B[1]
Australia		
Unit 6, 256-258 Leitchs Road, Brendale, Queensland, 4500		
Bristol Meci Australasia Pty Limited	100	Ordinary
Hawker Siddeley Switchgear Pty Limited	100	Ordinary
45-49 McNaughton Road, Clayton Victoria, 3168		
Unidrive Pty Ltd	100	Ordinary
7 Eden Park Road, Level 5, Macquarie Park, NSW 2113		
Ergotron Australia Pty Ltd	100	Ordinary
Belgium		
Jean en Maurits, Sabbestraat 130A/A000, 8930 Menen		
Nortek Global HVAC Belgium NV	100	Ordinary
Brazil		
Cicada de Vitoria, Estado do Espirio Santo, na Av. Nossa, Senhora da Penha, 520, Sala 404, Praia do Canto, 29055-131		
Nordyne do Brasil Participações Ltda	100	Common
Av. Alfredo Ignácio Noqueira Penido, 335 – Sala 1103 – Edifício Madison Power, São José dos Campos, SP, 12246-000		
GKN Aerospace Transparency Systems do Brasil Ltda	100	Quota capital
Rua Joaquim Silveira 557, Parque Sao Sebastiao, 91060-320 Porto Alegre, RS		
GKN do Brasil Ltda	100	Common
Av. da Emancipacao no. 4.500, CEP 13.184-542, Bairro Santa Esmeralda, Hortolandia, Sao Paulo		
GKN Sinter Metals Ltda	99.99	Common

	Equity interest %	Class of Share held
British Virgin Islands		
Commerce House, Wickhams Cay 1, P.O. Box 3140, Road Town, Tortola VG1110		
Nortek Trading Limited	100	Ordinary
Canada		
1134 Grande Allée Ouest, bureau 600, Quebec, G1S 1E5		
Brush Canada Services Inc./Services Brush Canada Inc.	100	Common stock
Fokker Elmo Canada Inc.	100	Ordinary
330 Bay Street, 920, Toronto, Ontario, M5H2S8		
Nortek Air Solutions Quebec, Inc	100	Ordinary
55 Union Street, Suite 710, Saint John, New Brunswick, E2L 5B7		
2GIG Technologies Canada, Inc.	100	Class A Common
1300 – 1969 Upper Water Street, Purdy's Wharf Tower II, Halifax Nova Scotia, B3J 2VI		
Ergotron Canada Corporation	100	Ordinary
550, Lemire Blvd, Drummondville Québec J2C 7W9		
Innergy Tech, Inc.	100	Ordinary
Venmar Ventilation ULC	100	Common Class A Special
1500-1874 Scarth Street, Regina, Saskatchewan, S4P 4E9		
Nortek Air Solutions Canada, Inc.	100	Ordinary
7 Michigan Boulevard, St. Thomas, Ontario		
GKN Sinter Metals – St. Thomas, Ltd.	100	Common stock

Notes to the Company Balance Sheet
Continued

3. Investment in subsidiaries continued

	Equity interest %	Class of Share held
China		
No.8 Changhong Road, Changshu Economic Development Zone, Jiangsu Province, 21550		
Brush Electrical Machines (Changshu) Co. Limited	100	Registered investment
2025, 2031 2nd Floor, Tower C., 155 West Fute Road, Waigaoqi Bonded Zone Shanghai, 200131		
FKI Engineering Shanghai Limited	100	Ordinary
No. 6 Zone, Daxin Group, Zhongkai Hi-tech District, Huizhou		
Guangdong Broan IAQ Systems Co. Limited	100	Ordinary
The 3rd Industry Area, Juzhou Shijie, Dongguan, Guangdong, 523290		
Dongguan Ergotron Precision Technology Co Limited	100	Registered investment
Room 2913 and 2914, Taiwan Merchants Building, 11th Dongguan Avenue, Dongcheng, Dongguan, Guangdong Province		
Dongguan Ergotron Precision Technology Design Services Co., Limited	100	Registered investment
Building 5, 6, 7 and 8, No. 2 Industrial Park, Bao An District, Shenzhen		
Linear Electronics (Shenzhen) Co Limited	100	Ordinary
Room 22D2, 22D3, No.895 South Yan'an Rd, Changning District, Shanghai		
Nortek (Shanghai) Trading Co Limited	100	Ordinary
No 71 Xiangyun Road, Langfang Economic & Technical Development Zone, Langfang		
Fokker Elmo (Langfang) Electrical Systems Co. Ltd	100	Registered investment
On the north of 1500 meters, Wuping Dong Road, Shengfang Town, Bazhou City, Hebei Province		
GKN (Bazhou) Metal Powder Company Limited	40	Registered investment
Unit A, 6/F, Building A1#, No. 2555 Xiupu Road, Pudong New Area, Shanghai, 201315		
GKN China Holding Co Ltd	100	Registered investment
18 North Shitan Road, North Industrial Park, Development Zone, Danyang, Jiangsu, 212310		
GKN Danyang Industries Company Limited	100	Registered investment
No. 1 Cuigu, Northern New Zone, Chongqing, 401122		
GKN HUAYU Driveline Systems (Chongqing) Co. Ltd	9	Ordinary[2]
928 JingDu Road, Donghai Economic Development Zone, Jiangsu, 222300		
GKN (Lianyungang) Company Limited	100	Registered investment
1 Xinwang Road, Jingjiang Economic and Technic Development Zone, Jingjiang, Jiangsu		
GKN Aerospace (Jingjiang) Co., Ltd	100	Registered investment
No. 7 Liutai Road, Liuzhou, Guangxi, 545007		
GKN Power Solutions (Liuzhou) Company Limited	100	Registered investment
No.8 Kangmin Road, Yizheng		
GKN Sinter Metals Yizheng Co Ltd	100	Registered investment
Xiguo Industrial Zone, Mengzhou City, Henan Province, 454750		
GKN Zhongyuan Cylinder Liner Company Limited	59	Registered investment
Zijin Kechuang Center 4 Level, 416 Room, Economy Development Zone, Lishui, Nanjing		
Nanjing FAYN Piston Ring Company Limited	19.79	Registered investment
898 Kangshen Road, Pudong, Shanghai		
Shanghai GKN Driveline Sales Co Ltd	49	Ordinary
950 KangQiao Road, Pudong New Area, Shanghai		
Shanghai GKN HUAYU Driveline Systems Company Limited	50	Registered investment
Room 805, 8th floor, Building 2, No. 1859, Shibo Avenue, Shanghai		
GKN Aerospace (Shanghai) Co., Ltd	100	Ordinary

	Equity interest %	Class of Share held
Colombia		
1301, 13/F Bank of America Tower, 12 Harcourt Road, Central		
MiOS Colombia *(in liquidation)*	42	Ordinary
Calle 32 No. 15–23 Barrio Rincon de Girón, Girón Santander		
Transejes Transmisiones Homocineticas de Colombia SA	49	Ordinary
Czech Republic		
Edvarda Beneše 564/39, Doudlevce, 301 00 Plzen		
Brush SEM s.r.o.	100	Ordinary
Denmark		
Nagbølvej 31, 6640 Lunderskov		
GKN Wheels Nagbol A/S	100	Ordinary
France		
Boulevard De L Europe, BP 177 91006 Evry-Courcouronnes CEDEX		
Arianespace Participation S.A.	1.6110	Ordinary
12 Quai du Commerce 69009 Lyon		
Ergotron France SARL	100	Ordinary
ZI de Rosarge, 230 Rue de la Dombes, Les Echets, 01700, Mirabel		
Nortek Global HVAC France SAS	100	Ordinary
7 rue de la Briqueterie, 02240 Ribemont		
GKN Driveline Ribemont SARL	100	Ordinary
100 Avenue Vanderbilt, 78955 Carrieres-sous-Poissy		
GKN Automotive SAS	100	Ordinary
GKN Driveline SA	99.99	Ordinary
GKN Freight Services EURL	100	Ordinary
765 rue Albert Einstein, CS 70402, 13591 Aix-en-Provence Cedex 3		
NH Industries SAS	5.5	Ordinary
20 rue Lavoisier, 95300 Pontoise		
GKN Aerospace France SARL	100	Ordinary
Germany		
c/o Meier & Collegen GmbH, Teichhorn 4-6, 24119, Kronshagen		
Ergotron Deutschland GmbH	100	Ordinary
Brunhamstr. 21, 81249, Munich		
GKN Aerospace Deutschland GmbH	100	Ordinary
Carl-Legien-Strasse 10, 63073 Offenbach am Main		
GKN Driveline Deutschland GmbH	100	Ordinary
Hauptstrasse 130, 53797 Lohmar		
GKN Driveline International GmbH	100	Ordinary
Hafenstrasse 41, 54293 Trier		
GKN Driveline Trier GmbH	100	Ordinary
Nussbaumweg 19-21 51503, Rosrath, Germany		
GKN Driveline Service GmbH	100	Ordinary
Opelkreisel 1-9, 67663 Kaiserslautern		
GKN Gelenkwellenwerk Kaiserslautern GmbH	100	Ordinary
Krebsoege 10, 42477 Radevormwald		
GKN Powder Metallurgy Holding GmbH	100	Ordinary
Pennefeldsweg 11-15, 53177, Bonn		
GKN Sinter Metals Components GmbH	100	Ordinary
Krebsoege 10, 42477 Radevormwald		
GKN Sinter Metals Engineering GmbH	100	Ordinary
Dahlienstrasse 43, 42477 Radevormwald		
GKN Sinter Metals Filters GmbH Radevormwald	100	Ordinary
Industriestr. 1, 97769 Bad Brückenau		
GKN Sinter Metals & Forge Operations GmbH	100	Ordinary
Am Fliegerhorst 9, 99947 Bad Langensalza		
GKN Sinter Metals GmbH, Bad Langensalza	100	Ordinary
Peterstrasse 69, 42499, Hueckeswagen		
Hoeganaes Corporation Europe GmbH	100	Ordinary

3. Investment in subsidiaries continued

	Equity interest %	Class of Share held
Hong Kong		
Tricor Services Limited, 28/F, Bank of East Asia Harbour View Center, 56 Gloucester Road, Wanchai		
Broan-NuTone (HK) Limited *(in liquidation)*	100	Ordinary
31/F, Tower Two, Times Square, 1 Matheson Street, Causeway Bay		
Linear HK Manufacturing Limited	100	Ordinary
Citicorp Centre, STE 1607-8, 18 Whitfield Road, Causeway Bay		
MiOS Limited *(in liquidation)*	42	Ordinary
India		
Block 2A No. 311, NPR Complex. Survey No 197, Hoody Village, K R Puram Hobli, Whitefield Road, Bangalore – 560048, Karnataka		
Fokker Elmo SASMOS Interconnection Systems Limited	49	Ordinary
270, Sector-24, Faridabad 121 005, Haryana		
GKN Driveline (India) Limited	97.03	Ordinary
146 Mumbai Pune Road, Pimpri, Pune 411 018		
GKN Sinter Metals Private Limited	100	Ordinary
Shop No. 002, Lumkad Sky Vista, S. No. 230/AViman Naga/3/2, Viman Nagar, Pune, Maharashtra, 411014		
GKN Fokker Elmo India Private Limited	100	Ordinary
135, 2nd Floor, RMZ Titanium, Old Airport Road, Bengaluru, 560 017		
GKN Aerospace Engine Systems India Private Limited	100	Ordinary
Office No. 301-308, 3rd Floor, Pride Silicon Plaza Survey No 106A, Nr Chaturshringi Temple, S.B. Road, Pune, Maharashtra, 411016		
IntelliVision Technologies Private Limited	99.99	Ordinary
Ireland		
3rd Floor, Kilmore House, Park Lane, Spencer Dock, Dublin 1, Ireland		
Nortek Air Solutions (Ireland) Limited	100	Ordinary
Isle of Man		
c/o Willis Management (Isle of Man) Ltd, Tower House, Loch Promenade, Douglas, IM1 2LZ		
Ipsley Insurance Limited	100	Ordinary
Italy		
Corso Vercelli, Milan, 40 - 20145		
GKN Wheels Italy S.r.l	100	Ordinary
Via dei Campi della Rienza 8, 39031 Brunico, BZ, Italy		
GKN Driveline Brunico SpA	100	Ordinary
Via Fratelli Cervi 1, 50013 Campi Bisenzio, FI, Italy		
GKN Driveline Firenze SpA	100	Ordinary
Via dei Campi della Rienza 8, 39031 Brunico, BZ, Italy		
GKN Italia SpA	100	Ordinary
Via Delle Fabbriche 5, 39031 Brunico, BZ, Italy		
GKN Sinter Metals SpA	100	Ordinary
Japan		
c/o TA Lawyers GKJ, Shiroyama Trust Tower, 4-3-1, Toranomon, Minatuo-ku, Tokyo		
Ergotron Japan KK	100	Ordinary
2388 Ohmiya-cho, Tochigi City, 328-8502 Tochigi		
GKN Driveline Japan Ltd	100	Ordinary

	Equity interest %	Class of Share held
2388 Ohmiya-cho, Tochigi City, 328-8502 Tochigi		
GKN Driveline Tochigi Holdings KK	100	Ordinary
Senri Life Science Centre Building. 12F, 1-4-2 Shin Senri Higashi-machi, Toyonaka-shi, Osaka		
GKN Powder Metallurgy Japan K.K.	100	Ordinary
Jersey		
13 Castle Street, St Helier, JE4 5UT		
GKN Finance Limited	100	Ordinary
Korea		
53 3Gongdan2-ro, Seobuk-gu, CheonAn-si, Chungcheongnam-do		
GKN Driveline Korea Limited	100	Common stock
Malaysia		
Lot 6.05, Level 6 KPMG Tower 8, First Avenue, Bandar Utama, 47800 Petaling Jaya, Selangor		
GKN Engine Systems Component Repair Sdn Bhd	100	Ordinary
Suite A, Level 9, Wawasan Open University, 54, Jalan Sultan Ahmad Shah, Georgetown, Pulau, 10050, Penang		
GKN Driveline Malaysia Sdn Bhd	68.42	Ordinary
Malta		
A18b, Industrial Estate, Marsa, 3000		
Mediterranean Power Electric Company Limited	26	A Ordinary[3]
Mexico		
Avenue de los Olivos 100-A, Parque Industrial El Pajio, Tecata, Baja California, 21438		
Broan Building Products-Mexico S de RL de CV	100	Registered investment
Tabalaopa #8301, Parque Industrial, Chihuahua		
FAE Aerostructures SA de CV	100	Ordinary
Av. CFE No. 709, Parque Industrial Millennium, San Luis Potosi S.L.P 78395		
GKN Aerospace San Luis Potosi S. de R.L. de C.V. *(in liquidation)*	100	Fixed equity
Carretera Panamericana km 284, Celaya, Guanajuato, C.P. 38110		
GKN Driveline Celaya SA de CV	99.86	Ordinary
GKN Driveline Mexico Services SA de CV	98	Ordinary
GKN Driveline Mexico Trading SA de CV	98	Ordinary
Carretera Alterna Celaya Villagrán Km 11, Col. El Pintor, Villagrán, Guanajuato, C.P. 38260		
GKN Driveline Villagran SA de CV	98	Ordinary
Av. Constituyentes Pte. 206, El Jacal, Queretaro, C.P. 76187		
GKN Sinter Metals Mexico S. De. R.L. De. C.V.	100	Membership interest
GKN Sinter Metals Mexico (Services) S. De. R.L. De. C.V.	100	Membership interest
Calle Profesor Rodolfo Gonzalez 100, Colonia Jardines de la Victoria, Guadalupe, Nuevo Leon, CP 67119		
Manufactura e Innovacion Monterrey, S. de R.L. de C.V.	100	Membership interest
Herminia Castro de Aguirre 1805-8, Parque Industrial Amistad Aeropuerto, Ramos Arizpe, Coahuila, 25900		
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
The Netherlands		
Beeldschermweg 3, 3821 AH Amersfoort		
Ergotron Nederland BV	100	Ordinary
Ringdijk 390B, 2983 GS Ridderkerk		
Brush HMA BV	100	Ordinary
c/o Vistra, Atrium Building, 8th Floor, Strawinskylaan 3127, 1077, Amsterdam		
Nortek Holding BV	100	Ordinary
Nortek International Holdings BV	100	Ordinary
Aviolandalaan 37, 4631 RP, Hoogerheide		
Business Park Aviolanda B.V.	20	Ordinary
Industrieweg 4, 3351 LB, Papendrecht		
Cooperative Delivery of Retrokits (CDR) V.O.F.	50	Ordinary
Markt 22, 3351 PB, Papendrecht		
Fabriek Slobbengors Beheer B.V.	49	Ordinary
Fabriek Slobbengors C.V.	49	Ordinary[4]
Hoofdkantoor Slobbengors Beheer B.V.	49	Ordinary
Kantoor Industrieweg C.V.	49	Ordinary
Aviolandalaan 31, 4631 RP, Hoogerheide		
Fokker Aircraft Services B.V.	100	Ordinary
Fokker Techniek BV	100	Ordinary
Aviolandalaan 33, Hoogerheide, 4631 RP		
Fokker Elmo B.V.	100	Ordinary
Grasbeemd 28, 5705 DG, Helmond		
Fokker Landing Gear B.V.	100	A Ordinary
Industrieweg 4, 3351 LB, Papendrecht		
Fokker (CDR) B.V.	100	Ordinary
Fokker Aerospace B.V.	100	Ordinary
Fokker Aerostructures B.V.	100	Ordinary
Fokker Engineers & Contractors B.V.	100	Ordinary
Fokker Procurement Combination B.V.	100	Ordinary
Fokker Technologies Group B.V.	100	Ordinary
Fokker Technologies Holding B.V.	100	Ordinary
Fokker Technology B.V.	100	Ordinary
GKN Aerospace Netherlands B.V.	100	Ordinary
Structural Laminates Industries B.V.	100	Ordinary
Hoeksteen 40, 2132 MS, Hoofddorp		
Fokker Services B.V.	100	Ordinary
11th Floor, The Colmore Building, 20 Colmore Circus Queensway, Birmingham, B4 6AT		
GKN UK Holdings BV	100	Ordinary
Herikerbergweg 238, 1101CM, Amsterdam		
Ridderkerk Property 1 BV	100	Ordinary
Norway		
Kirkegårdsveien 45, 3616 Kongsberg		
GKN Aerospace Norway AS	100	Ordinary
Kongsberg Technology Training Centre AS	33.33	Ordinary
Kongsberg Terotech AS	50	Ordinary
Oman		
Street 14, Nizwa Industrial Estate, P.O Box 1896 PC112, Ruwi		
Brush Middle East LLC	70	Membership interest
Poland		
Ul. B. Krzywoustego 31 G, 56-400 Oleśnica,		
GKN Driveline Polska Sp z o o	100	Ordinary
Portugal		
Avenida Marechal Gomes da Costa, 1131, 4150-360, Porto		
GKN Automotive Portugal, Limitada	100	Quota

	Equity interest %	Class of Share held
Romania		
Str. Condorilor 9, 600302, Bacau		
FOAR S.R.L.	49	Ordinary
Hermes Business Campus, Dimitrie Pompeiu Blvd 5-7, Building 2, 3rd floor Bucharest 020337 RO, Bucureşti 077190		
Fokker Engineering Romania S.R.L.	100	Ordinary
33 Urziceni Street, Buzau 120226		
Hoeganaes Corporation Europe SA	100	Ordinary
Russian Federation		
The land plot No. 3, Building No. 4, Roadway No. 2, Territory of OEZ IPT, Podstepki Village, Stavropolsky District, Samara Region, Podstepki Village, 445143		
GKN Driveline Togliatti LLC	100	Ordinary
Nizhniy Novgorod, 77 Ulitsa Gorkogo, Premises P6		
IntelliVision Limited	100	Ordinary
Saudi Arabia		
P.O. Box 2091, Riyadh 11451		
Huntair Arabia	49	Ordinary
Singapore		
1800 West Camp Road, Seletar Aerospace Park		
Fokker Services Asia Pte Ltd	100	Ordinary
38 Beach Road #29-11, South Beach Tower, 189767		
Nortek Air Solutions Pte. Ltd	100	Ordinary
Slovenia		
Rudniska cesta 20, Zrece 3214		
GKN Driveline Slovenija d o o	100	Ordinary
Spain		
Pol. Ind. Can Salvatella, Avenida Arrahona 54-56, 08210 Barbera del Valles, Barcelona		
GKN Ayra Servicio, SA	100	Ordinary
Avenida de Citroen s/n, 36210 Vigo		
GKN Driveline Vigo, SA	100	Ordinary
Sagarbidea 2, 20750 Zumaia		
GKN Driveline Zumaia, SA	100	Ordinary
Polígono Industrial s/n, Maçanet de la Selva, 17412 Girona		
Stork Prints Iberia SA	100	Ordinary
Sweden		
SE – 461 81, Trollhättan		
GKN Aerospace Sweden AB	100	Ordinary
GKN Sweden Holdings AB	100	Ordinary
SE – 731 36, Köping		
GKN Driveline Köping AB	100	Ordinary
BRÖDERNA UGGLAS GATA, SE – 58254 Linköping		
Industrigruppen JAS AB	20	Ordinary
Taiwan		
14 Kwang Fu Road, Hsin-Chu Industrial Park, Hukou, Hsin Chu 30351		
Taiway Limited	36.25	Common stock
Thailand		
9/21 Moo 5, Phaholyothin Road Klong 1, Klong Luang, Patumthanee, 12120		
GKN Aerospace Transparency Systems (Thailand) Limited	100	Ordinary
Eastern Seaboard Industrial Estate, 64/9 Moo 4, Tambon Pluakdaeng, Amphur Pluakdaeng, Rayong 21140		
GKN Driveline (Thailand) Limited	100	Ordinary
GKN Driveline Manufacturing Ltd *(in liquidation)*	100	Ordinary

3. Investment in subsidiaries continued

	Equity interest %	Class of Share held
Turkey		
Ege Serbest Bölgesi, SADI Sok. No:10, 35410 Gaziemir, Izmir		
Fokker Elmo Havacilik Sanayi Ve Ticaret Limited Sirketi	100	Ordinary
Organize Sanayi Bolgesi 20, Cadde No: 17, 26110, Eskisehir		
GKN Eskisehir Automotive Products Manufacture and Sales A.S.	100	Ordinary
Yakuplu Mah. Haramidere Sanayi Sitesi, J Blok, No. 106-107-108, Beylikdüzü, Istanbul		
GKN Sinter Istanbul Metal Sanayi Ve Ticaret Anonim Şirketi	100	Ordinary
United Kingdom		
11th Floor, The Colmore Building, 20 Colmore Circus Queensway, Birmingham, B4 6AT		
Alcester Capricorn	100	Ordinary
Alcester EP1 Limited	100	Ordinary
Alcester Number 1 Limited	100	Ordinary
Alder Miles Druce Limited	100	Ordinary
Ambi-Rad Group Limited	100	Ordinary
Ball Components Limited	100	Ordinary
Birfield Limited	100	Ordinary
British Hovercraft Corporation Limited	100	Ordinary
Brush Electrical Engineering Company Limited	100	Ordinary
Brush Electrical Machines Limited	100	Ordinary
Brush Holdings Limited	100	Ordinary
Brush Properties Limited	100	Ordinary
Brush Scheme Trustees Limited	100	Ordinary
Brush Switchgear Limited	100	Ordinary
Brush Transformers Limited	100	Ordinary
Colmore Lifting Limited	100	Ordinary
Colmore Overseas Holdings Limited	100	Ordinary
Danks Holdings Limited	100	Ordinary
Eachairn Aerospace Holdings Limited	100	Ordinary
Eaton-Williams Holdings Limited	100	Ordinary
Ergotron UK Limited	100	Ordinary
FAD (UK) Limited	100	Ordinary
Falcon Works Property Limited	100	Ordinary
Firth Cleveland Limited	100	Ordinary
FKI Plan Trustees Limited	100	Ordinary
F.P.T Industries Limited	100	Ordinary
GKN Aerospace Holdings Limited	100	Ordinary
GKN Aerospace Transparency Systems (Kings Norton) Limited	100	Ordinary
GKN Aerospace Transparency Systems (Luton) Limited	100	Ordinary
GKN Automotive Holdings Limited	100	Ordinary
GKN Birfield Extrusions Limited	100	Ordinary
GKN Bound Brook Limited	100	Ordinary
GKN Building Services Europe Limited	100	Ordinary
GKN CEDU Limited	100	Ordinary
GKN Composites Limited	100	Ordinary
GKN Computer Services Limited	100	Ordinary
GKN Countertrade Limited	100	Ordinary
GKN Defence Holdings Limited	100	Ordinary
GKN Defence Limited	100	Ordinary
GKN Enterprise Limited	100	Ordinary
GKN Euro Investments Limited	100	Ordinary
GKN Export Services Limited	100	Ordinary
GKN Fasteners Limited	100	Ordinary
GKN Finance (UK) Limited	100	Ordinary
GKN Firth Cleveland Limited	100	Ordinary

	Equity interest %	Class of Share held
GKN Group Pension Trustee (No.2) Limited	100	Ordinary
GKN Group Pension Trustee Limited	100	Ordinary
GKN Group Services Limited	100	Ordinary and redeemable preference
GKN Hardy Spicer Limited	100	Ordinary
GKN Holdings Limited	100	Ordinary
G.K.N. Industries Limited	100	Ordinary
G.K.N. International Trading (Holdings) Limited	100	Ordinary
GKN Limited	100	Ordinary
GKN Marks Limited	100	Ordinary
GKN Overseas Holdings Limited	100	Ordinary
GKN Pistons Limited	100	Ordinary
G.K.N. Powder Met. Limited	100	Ordinary
GKN Quest Trustee Limited	100	Ordinary
GKN Sankey Finance Limited	100	Ordinary and deferred
GKN SEK Investments Limited	100	Ordinary
GKN Service UK Limited	100	Ordinary
GKN Sheepbridge Limited	100	Ordinary
GKN Sheepbridge Stokes Limited	100	Ordinary
GKN Sinter Metals Limited	100	Ordinary
GKN Technology Limited	100	Ordinary
GKN Thompson Chassis Limited	100	Ordinary
GKN Trading Limited	100	Ordinary
GKN UK Investments Limited	100	Ordinary
GKN U.S. Investments Limited	100	Ordinary
GKN USD Investments Limited	100	Ordinary
GKN Ventures Limited	100	Ordinary
GKN Westland Aerospace (Avonmouth) Limited	100	Ordinary
GKN Westland Aerospace Advanced Materials Limited	100	Ordinary and convertible preference
GKN Westland Aerospace Aviation Support Limited	100	Ordinary
GKN Westland Aerospace Holdings Limited	100	Ordinary
GKN Westland Design Services 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
Guest, Keen and Nettlefolds, Limited	100	Ordinary
Harrington Generators International Limited	100	Ordinary
Hawker Siddeley Switchgear Limited	100	Ordinary
Laycock Engineering Limited	100	Ordinary
McKechnie 2005 Pension Scheme Trustee Limited	100	Ordinary
Melrose Holdings Limited	100	Ordinary
Melrose Intermediate Limited	100	Ordinary
Melrose PLC	100	Ordinary
Melrose UK Holdings Limited *(in liquidation)*	100	Ordinary
Melrose USD 1 Limited	100	Ordinary
Nortek (UK) Limited	100	Ordinary
Nortek Global HVAC (UK) Limited	100	Ordinary
P.F.D. Limited	100	Ordinary
Raingear Limited	100	Ordinary
Rigby Metal Components Limited	100	Ordinary
Rzeppa Limited	100	Ordinary and redeemable preference

Notes to the Company Balance Sheet
Continued

3. Investment in subsidiaries continued

	Equity interest %	Class of Share held
Sageford UK Limited	100	Ordinary
Sheepbridge Stokes Limited	100	Ordinary
Westland Group PLC	100	Ordinary
Westland Group Services Limited	100	Ordinary
Westland System Assessment Limited	100	Ordinary
Whipp & Bourne Limited	100	Ordinary
15 Atholl Crescent, Edinburgh, Scotland, EH3 8HA		
A. P. Newall & Company Limited	100	Ordinary
GKN Investments II GP Limited	100	Ordinary
GKN Investments II LP	100	Membership interest
GKN Investments III GP Limited	100	Ordinary
GKN Investments III LP	100	Membership interest
26-28 Goodall Street, Walsall, West Midlands, WS1 1QL		
Chassis Systems Limited *(in liquidation)*	50	Ordinary
Hadley Castle Works, Telford, Shropshire, TF1 6AA		
GKN AutoStructures Limited	100	Ordinary
GKN Sankey Limited	100	Ordinary
GKN Wheels Limited	100	Ordinary
Chester Road, Erdington, Birmingham, B24 0RB		
GKN Driveline Birmingham Limited	100	Ordinary
Unit 5, Kingsbury Business Park, Kingsbury Road, Minworth, Sutton Coldfield, B76 9DL		
GKN Driveline Service Limited	100	Ordinary
30 Milbank, London, SW1P 4WY		
Hadfields Holding Limited	37.5	Ordinary
2nd Floor, One Central Boulevard Blythe Valley Park, Shirley, Solihull, B90 8BG		
GKN Aerospace Services Limited	100	Ordinary
2100 The Crescent, Birmingham Business Park, Birmingham, West Midlands, B37 7YE		
GKN Automotive Limited	100	Ordinary and preference
GKN Driveline UK Limited	100	Ordinary
GKN Driveline Mexico (UK) Limited	100	Ordinary
GKN EVO eDrive Systems Limited	100	Ordinary
GKN Freight Services Limited	100	Ordinary and cumulative preference
GKN Hybrid Power Limited	100	Ordinary
Unit 7 Chestnut Court, Jill Lane, Sambourne, Redditch, B96 6EW		
GKN Powder Metallurgy Holdings Limited	100	Ordinary
79 Caroline Street, Birmingham, B3 1UP		
Eaton-Williams Exports Limited *(in liquidation)*	100	Ordinary
Eaton-Williams Group Limited *(in liquidation)*	100	Ordinary
Eaton-Williams Limited *(in liquidation)*	100	Ordinary
Eaton-Williams (Millbank) Limited *(in liquidation)*	100	Ordinary
Eaton-Williams Products Limited *(in liquidation)*	100	Ordinary
Eaton-Williams Service Limited *(in liquidation)*	100	Ordinary
Edenaire Limited *(in liquidation)*	100	Ordinary
Electro Dynamic Limited *(in liquidation)*	100	Ordinary
GKN Aerospace Limited *(in liquidation)*	100	Ordinary
Melrose UK 4 Limited *(in liquidation)*	100	Ordinary
Precision Air Control Limited *(in liquidation)*	100	Ordinary
Precision House Management Services Limited *(in liquidation)*	100	Ordinary
Reznor (UK) Limited *(in liquidation)*	100	Ordinary
Vapac Humidity Control Limited *(in liquidation)*	100	Ordinary

	Equity interest %	Class of Share held
Uruguay		
Arq. Baldomiro, 2408, Montevideo		
GKN Driveline Uruguay SA *(in liquidation)*	100	Ordinary
USA		
601 Braddock Avenue, Turtle Creek, Pittsburgh, Pennsylvania, 15145		
Brush Aftermarket North America Inc.	100	Common stock
Generator and Motor Services of Pennsylvania, LLC	100	Membership interest
40 Technology Parkway, South #300, Norcross, GA, 30092		
Aerotron AirPower, Inc.	100	Common stock
Fokker Elmo Inc.	100	Common stock
421 West Main Street, Frankfort, Kentucky, 40601		
Barcom Asia Holdings, LLC	100	Membership interest
2345 Rice Street, Suite 230, Roseville MN, 55113		
Ergotron, Inc.	100	Common
1209 Orange Street, Wilmington, Delaware, 19801		
Melrose North America, Inc	100	Common
BBVA Tower 254 Munoz, Rivera Ave, 6th Floor, San Juan, 00918, Puerto Rico		
Nortek Global HVAC de Puerto Rico, LLC	100	Membership interest
601 Abbott Road, Ingham, East Lansing, Michigan, 48823		
Operator Specialty Company, Inc.	100	Common
300 Deschutes Way SW, Suite 304, Tumwater, WA, 98501		
Fokker Aerostructures Inc.	100	Common stock
2710 Gateway Oaks Drive, Suite 150 N, Sacramento, CA, 95833		
GENIL, Inc.	100	Ordinary
GKN Aerospace Camarillo, Inc.	100	Ordinary
GKN Aerospace Chem-tronics Inc.	100	Ordinary
GKN Aerospace Transparency Systems, Inc	100	Common
Nortek Security & Control LLC	100	Membership interest
Zephyr Ventilation, LLC	100	Membership interest
251 Little Falls Drive, Wilmington Delaware, 19808		
BNSS LP, Inc.	100	Common
Broan-NuTone LLC	100	Membership interest
GKN Driveline Newton LLC	100	Membership interest
GKN Aerospace Aerostructures, Inc	100	Common
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 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

3. Investment in subsidiaries continued

	Equity interest %	Class of Share held
USA continued		
GKN Cylinder Liners, 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 North America Services, Inc	100	Common
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
Huntair Middle East Holdings, Inc.	100	Common
IntelliVision Technologies Corp.	100	Ordinary
Linear H.K. LLC	100	Membership interest
Nevada Holdco Corp.	100	Ordinary
Nortek Air Solutions, LLC	100	Membership interest
Nortek Global HVAC, LLC	100	Membership interest
Nortek Global HVAC Latin America, Inc.	100	Common
Nortek Home Control Holdings LLC	100	Membership interest
Nortek, Inc.	100	Ordinary
Nortek International, Inc	100	Common
XIK, LLC	100	Membership interest
505 5th Avenue, Suite 729, Des Moines IA, 50309		
GKN Armstrong Wheels, Inc	100	Ordinary
50 West Broad Street, Suite 1330, Columbus, Ohio, 43215		
GKN Driveline Bowling Green, Inc.	100	Common stock
80 State Street, Albany New York, 12207		
GKN Aerospace Monitor, Inc.	100	Common
135 North Pennsylvania Street, Suite 1610, Indianapolis, Indiana, 46204		
GKN Aerospace Muncie, Inc.	100	Common
400 Main Street, East Hartford, CT, 06108		
PW1100G-JM Engine Leasing, LLC	4	Class C Unit

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.

Notes
(1) The Group owns 100% of the Ordinary Class B shares with a total effective ownership of 49% in the company.
(2) The Group owns 9% directly with a total effective ownership of 34.5% in the company.
(3) The Group owns 100% of the Ordinary Class A shares with a total effective ownership of 26% in the company.
(4) The Group owns 49% directly with a total effective ownership of 49.98% in the company.

Notes to the Company Balance Sheet
Continued

4. Debtors

	31 December 2019 £m	31 December 2018 £m
Amounts falling due within one year:		
Amounts owed by Group undertakings	**413**	400
Amounts falling due after one year:		
Deferred tax	**25**	25
	438	425

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 2019 £m	31 December 2018 £m
Tax losses available for carry forward	**25**	25

The tax losses may be carried forward indefinitely.

5. Creditors

	31 December 2019 £m	31 December 2018 £m
Amounts falling due within one year:		
Amounts owed to Group undertakings	**2,015**	1,772
Accruals and other creditors	**1**	1
	2,016	1,773

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
At 1 January 2019	1
Charge to profit and loss account	2
At 31 December 2019	**3**

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 one year.

7. Issued share capital

Share Capital	31 December 2019 £m	31 December 2018 £m
Allotted, called-up and fully paid		
4,858,254,963 (31 December 2018: 4,858,254,963) Ordinary Shares of 48/7 pence each (31 December 2018: 48/7 pence each)	**333**	333
12,831 (31 December 2018: 12,831) 2017 Melrose Incentive Plan Shares of £1 each	**–**	–
	333	333

The rights of each class of share are described in the Directors' Report.

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.

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 measures reported by other companies and they are not intended to be a substitute for, or superior to, IFRS measures. All Income Statement and cash flow measures are provided for continuing operations unless otherwise stated.

Income Statement Measures

APM
Adjusted revenue

Closest equivalent statutory measure
Revenue

Reconciling items to statutory measure
Share of revenue of equity accounted investments (note 5)

Definition and purpose
Adjusted revenue includes the Group's share of revenue of equity accounted investments ("EAIs"). This enables comparability between reporting periods.

Revenue	Year ended 31 December 2019 £m	Restated[1] Year ended 31 December 2018 £m
Revenue	10,967	8,152
Share of revenue of equity accounted investments	625	493
Adjusted revenue	**11,592**	8,645

APM
Adjusting items

Closest equivalent statutory measure
None

Reconciling items to statutory measure
Adjusting items (note 6)

Definition and purpose
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, any item released to the Income Statement that was previously a fair value item booked on an acquisition, and includes adjusted profit from EAIs.

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

Closest equivalent statutory measure
Operating profit/(loss)[2]

Reconciling items to statutory measure
Adjusting items (note 6)

Definition and purpose
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.

Operating profit	Year ended 31 December 2019 £m	Restated[1] Year ended 31 December 2018 £m
Operating profit/(loss)	318	(387)
Adjusting items (note 6)	784	1,200
Adjusted operating profit	**1,102**	813

APM
Adjusted operating margin

Closest equivalent statutory measure
Operating margin[3]

Reconciling items to statutory measure
Share of revenue of equity accounted investments (note 5) and adjusting items (note 6)

Definition and purpose
Adjusted operating margin represents Adjusted operating profit as a percentage of Adjusted revenue.

APM
Adjusted profit before tax

Closest equivalent statutory measure
Profit/(loss) before tax

Reconciling items to statutory measure
Adjusting items (note 6)

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.

Profit before tax	Year ended 31 December 2019 £m	Restated[1] Year ended 31 December 2018 £m
Profit/(loss) before tax	106	(542)
Adjusting items (note 6)	783	1,214
Adjusted profit before tax	**889**	672

Glossary
Continued

APM
Adjusted profit after tax

Closest equivalent statutory measure
Profit/(loss) after tax

Reconciling items to statutory measure
Adjusting items (note 6)

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.

Profit after tax	**Year ended 31 December 2019 £m**	Restated[1] Year ended 31 December 2018 £m
Profit/(loss) after tax	**55**	(467)
Adjusting items (note 6)	**644**	984
Adjusted profit after tax	**699**	517

APM
Adjusted EBITDA for leverage covenant purposes

Closest equivalent statutory measure
Operating profit/(loss)[2]

Reconciling items to statutory measure
Adjusting items (note 6), depreciation of property, plant and equipment and amortisation of computer software and development costs, imputed lease charge, share of non-controlling interests and other adjustments required for covenant purposes[5]

Definition and purpose
Adjusted operating profit for 12 months prior to the reporting date, before depreciation and impairment of property, plant and equipment and before the amortisation and impairment of computer software and development costs.

Adjusted EBITDA for covenant purposes is a measure used by external stakeholders to measure performance.

Adjusted EBITDA for leverage covenant purposes	**Year ended 31 December 2019 £m**	Year ended[4] 31 December 2018 £m
Adjusted operating profit	**1,102**	847
Depreciation of property, plant and equipment and amortisation of computer software and development costs	**498**	282
Full year impact of acquisitions	**–**	378
Imputed lease charge	**(91)**	(6)
Non-controlling interests	**(6)**	–
Other adjustments required for covenant purposes[5]	**2**	(9)
Adjusted EBITDA for leverage covenant purposes	**1,505**	1,492

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, 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.

Adjusted tax rate	**Year ended 31 December 2019 £m**	Restated[1] Year ended 31 December 2018 £m
Tax (charge)/credit per Income Statement	**(51)**	75
Tax impact of adjusting items	**(123)**	(221)
Tax impact of restructuring	**(9)**	–
Tax impact of EAIs	**(7)**	(9)
Adjusted tax charge	**(190)**	(155)
Adjusted profit before tax	**889**	672
Adjusted tax rate	**21.4%**	23.1%

APM
Adjusted basic earnings per share

Closest equivalent statutory measure
Basic earnings per share

Reconciling items to statutory measure
Adjusting items (note 6 and note 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.

APM
Adjusted diluted earnings per share

Closest equivalent statutory measure
Diluted earnings per share

Reconciling items to statutory measure
Adjusting items (note 6 and note 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
Interest cover

Closest equivalent statutory measure
None

Reconciling items to statutory measure
Not applicable

Definition and purpose
Adjusted EBITDA calculated for covenant purposes (including EBITDA of businesses disposed) as a multiple of net interest payable on bank loans and overdrafts.

This measure is used for bank covenant testing.

Interest cover	Year ended 31 December 2019 £m	Year ended[4] 31 December 2018 £m
Adjusted EBITDA for leverage covenant purposes	**1,505**	1,492
Adjusted EBITDA from businesses disposed in the year	**36**	–
Removal of full year impact of acquisitions	**–**	(378)
Other adjustments required for covenant purposes	**–**	18
Adjusted EBITDA for interest cover	**1,541**	1,132
Interest on bank loans and overdrafts (note 7)	**(152)**	(103)
Finance income (note 7)	**9**	5
Net finance charges for covenant purposes	**(143)**	(98)
Interest cover	**10.8x**	11.6x

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 27)

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
Bank covenant definition of net debt at average rates and leverage

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 previous 12 months.

Leverage is calculated as the bank covenant definition of net debt divided by adjusted EBITDA for leverage covenant purposes. This measure is used for bank covenant testing.

Net debt	31 December 2019 £m	31 December 2018 £m
Net debt at closing rates (note 27)	**3,283**	3,482
Impact of foreign exchange	**94**	(86)
Net debt at average rates	**3,377**	3,396
Other adjustments required for covenant purposes	**8**	11
Bank covenant definition of net debt at average rates	**3,385**	3,407
Leverage	**2.25x**	2.28x

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 27)

Definition and purpose
Adjusted operating cash flow (pre-capex) is calculated as adjusted profit before depreciation and amortisation attributable to subsidiaries less lease obligation payments, the positive non-cash impact from loss-making contracts and movements in working capital.

Adjusted operating cash flow (pre-capex) conversion is adjusted operating cash flow (pre-capex) divided by adjusted profit before depreciation and amortisation attributable to subsidiaries, less lease obligation payments and the positive non-cash impact from loss-making contracts.

This measure provides additional useful information in respect of cash generation and is consistent with how business performance is measured internally.

Adjusted operating cash flow	Year ended 31 December 2019 £m	Restated[1] Year ended 31 December 2018 £m
Adjusted operating profit	**1,102**	813
Share of adjusted operating profit of equity accounted investments (note 15)	**(66)**	(59)
Depreciation of owned property, plant and equipment and amortisation of computer software and development costs	**426**	273
Depreciation of leased property, plant and equipment and amortisation of leased computer software and development costs	**72**	–
Lease obligation payments	**(70)**	–
Positive non-cash impact from loss-making contracts	**(81)**	(63)
	1,383	964
Change in inventories	**(12)**	(108)
Change in receivables	**72**	172
Change in payables	**(2)**	(160)
Adjusted operating cash flow (pre-capex)	**1,441**	868
Adjusted operating cash flow conversion	**104%**	90%

APM
Movement in net trade working capital and percentage change

Closest equivalent statutory measure
Change in inventories, change in receivables and change in payables as included within net cash from operating activities (note 27)

Reconciling items to statutory measure
The year-on-year movement in non-trade working capital comprising movements in other receivables and other payables

Definition and purpose
Movement in net trade working capital represents the cash flow from inventories, net trade receivables and trade payables during the year. The percentage reduction in net trade working capital is the movement in net trade working capital divided by net trade working capital as at 31 December 2018.

Movement in net trade working capital	Year ended 31 December 2019 £m
Change in inventories (note 27)	**(12)**
Change in receivables (note 27)	**72**
Change in payables (note 27)	**(2)**
Movement in working capital	**58**
Removal of change in other receivables and change in other payables	**37**
Movement in net trade working capital	**95**
Net trade working capital at 31 December 2018 comprises:	
Inventories (note 16)	**1,489**
Trade receivables (note 17)	**1,877**
Allowance for doubtful receivables (note 17)	**(42)**
Trade payables (note 19)	**(1,307)**
Net trade working capital	**2,017**
Percentage reduction in net trade working capital	**5%**

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, discontinued operating cash flows and other non-cash movements

Definition and purpose
Free cash flow represents cash generated from trading from continuing businesses after all costs including restructuring, pension contributions, tax and interest payments.

Free cash flow	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Adjusted operating cash flow (pre-capex)	**1,441**	868
Net capital expenditure	**(495)**	(345)
Net interest and tax paid	**(295)**	(174)
Defined benefit pension contributions paid (note 27)	**(183)**	(99)
Restructuring costs paid	**(190)**	(113)
Dividends received from EAIs	**67**	66
Trading net other cash flows[6]	**(55)**	(36)
Free cash flow	**290**	167

APM
Adjusted free cash flow

Closest equivalent statutory measure
Net increase/decrease in cash and cash equivalents

Reconciling items to statutory measure
Free cash flow, as defined above, adjusted for special pension contributions and restructuring cash flows

Definition and purpose
Adjusted free cash flow represents free cash flow adjusted for special pension contributions and restructuring cash flows.

Adjusted free cash flow	Year ended 31 December 2019 £m	Year ended 31 December 2018 £m
Free cash flow	**290**	167
Special pension contributions(7)	**111**	56
Restructuring costs paid	**190**	113
Full year impact of acquisitions	**–**	(143)
Reversal of creditor stretch under previous ownership	**–**	150
Adjusted free cash flow	**591**	343
Increase in adjusted free cash flow	**72%**	

APM
Capital expenditure (capex)

Closest equivalent statutory measure
None

Reconciling items to statutory measure
Not applicable

Definition and purpose
Calculated as the purchase of owned 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.

Net capital expenditure is capital expenditure net of proceeds from disposal of property, plant and equipment.

APM
Capital expenditure to depreciation ratio

Closest equivalent statutory measure
None

Reconciling items to statutory measure
Not applicable

Definition and purpose
Net capital expenditure divided by depreciation of owned 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) Results for the year ended 31 December 2018 have been restated for discontinued operations (note 13).
(2) 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.
(3) Operating margin is not defined within IFRS but is a widely accepted profit measure being derived from operating profit/(loss)(2) divided by revenue.
(4) Year ended 31 December 2018 remains aligned to the original calculations supporting the Group's bank debt compliance certificate, and has not been restated for discontinued operations.
(5) Included within other adjustments required for covenant purposes are dividends received from equity accounted investments, the removal of adjusted operating profit of equity accounted investments and the inclusion of operating profit and depreciation in respect of businesses classified as held for sale.
(6) Trading net other cash flows include cash paid against provisions and dividends paid to non-controlling interests.
(7) Special pension contributions include £94 million of one-off payments, being the balance of the £150 million upfront commitment and a £17 million contribution following the disposal of the Walterscheid Powertrain Group.

Company and shareholder information

As at 31 December 2019, there were 17,930 holders of ordinary shares of 48/7 pence each in the Company. An analysis of these shareholdings as at 31 December 2019 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	13,544	75.54%	18,045,853	0.38%
5,001–50,000	3,427	19.11%	44,857,131	0.92%
50,001–500,000	515	2.87%	95,403,656	1.96%
Over 500,000	444	2.48%	4,699,948,323	96.74%
Total	**17,930**	**100.00%**	**4,858,254,963**	**100.00%**

Held by				
Individuals	14,878	82.98%	55,219,143	1.14%
Institutions	3,052	17.02%	4,803,035,820	98.86%
Total	**17,930**	**100.00%**	**4,858,254,963**	**100.00%**

Financial calendar 2020

Ex-dividend date for final dividend	2 April 2020
Record date for final dividend	3 April 2020
Annual General Meeting	7 May 2020
Payment date of final dividend	20 May 2020
Announcement of interim results	September 2020
Intended payment of interim dividend	October 2020
Preliminary announcement of 2020 results	March 2021

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Citizens Bank, N.A.

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A range of shareholder information is available at Equiniti's online portfolio service 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.

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Notes

Notes

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