MELROSE PLC
ANNUAL REPORT 2005

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Composite strut assembly manufactured by Hartwell and used on Boeing C-17 military transporters. Most strut assemblies are manufactured from alloys. This strut is manufactured using composite materials, which are engineering materials made from two or more components resulting in a strong and light-weight strut assembly.

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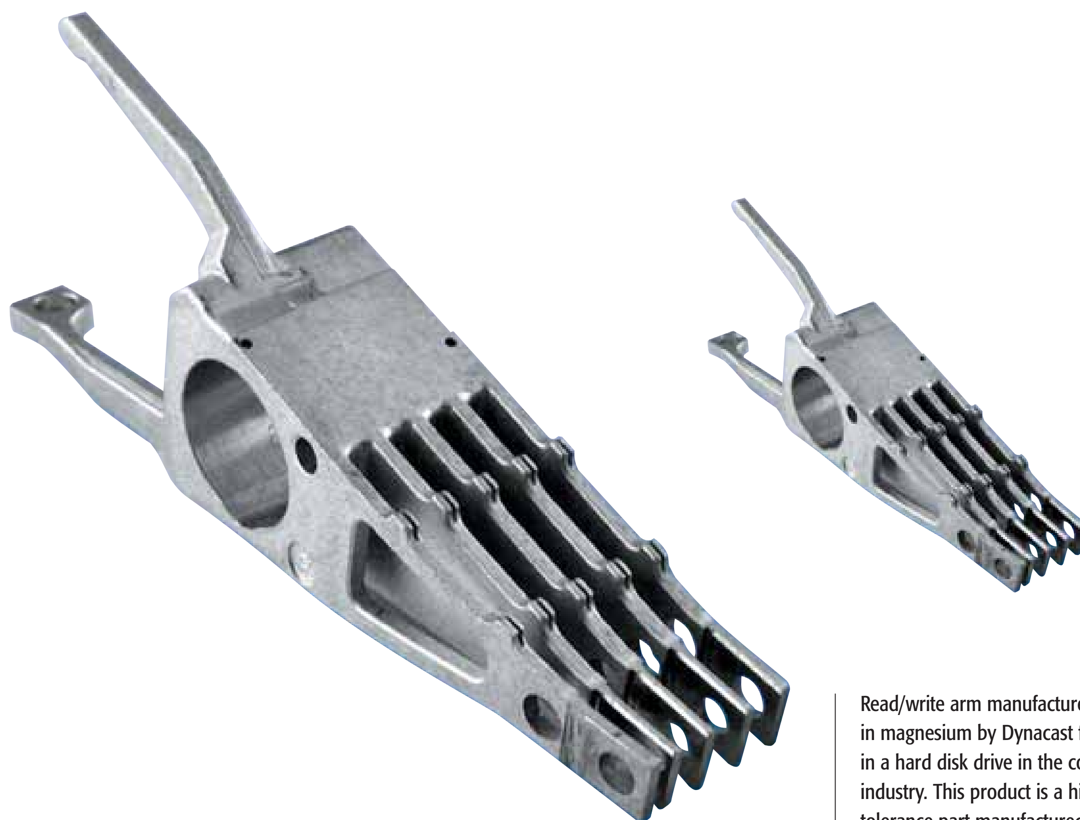
A FAA-PMA bearing assembly manufactured by Valley Todeco and distributed by Arger Enterprises for use on Boeing 747 aircraft.
B Complex zinc die-castings for a network cable connector manufactured by Dynacast. Critical issues for this component included adequate wall thickness, smooth surface parts and durability.

A	B



Read/write arm manufactured in magnesium by Dynacast for use in a hard disk drive in the computer industry. This product is a high-precision tolerance part manufactured using four-slide magnesium die-casting, a process developed by Dynacast.

Revenue	£269.9 million
Group headline operating profit[1]	£27.5 million
Group operating profit[2]	£8.1 million
Headline earnings per share[1]	9.1 pence
Loss per share[2]	(2.4) pence
Proposed dividend	3 pence per share

[1]Before exceptional costs and intangible asset amortisation other than computer software.
[2]After exceptional costs and intangible asset amortisation.

Melrose is an international engineering group with worldwide interests in the design, development and manufacture of specialist components for a wide range of markets, including aerospace, IT, telecommunications, consumer electronics, automotive, medical and consumer durables. Its businesses have forged long-standing partnerships with their customers around the globe – which include many household names – and have built on these partnerships to enhance profitability and thus create shareholder value.

Dynacast

	Year ended 31 Dec 2005
Revenue (£m)	105.0
Headline operating profit (£m)*	13.6
Number of employees as at 31 Dec 2005	2,222

Business units

Dynacast North America, Dynacast Europe, Dynacast Asia Pacific.

Business description

Global design and manufacture of die-cast metal components.

Key strengths

- Precision engineered die-cast zinc, aluminium and magnesium alloy components.
- Full service capability.
- Concept and design engineering.
- Rapid prototyping capability.

Sectors served

Consumer electronics, automotive, healthcare and telecommunications.

Major customers

Gillette, Hewlett Packard, Motorola, Procter & Gamble, Valeo and Autoliv.

Aerospace OEM

	Year ended 31 Dec 2005
Revenue (£m)	69.4
Headline operating profit (£m)*	14.6
Number of employees as at 31 Dec 2005	1,254

Business units

Structures: Hartwell, HASCO, Tyee, Technical Airborne Components.
Fasteners: Linread Northbridge, Valley Todeco.
Electromechanical: Electromech Technologies, Welco.

Business description

Global design and manufacture of aerospace components for airframes, engines and electromechanical applications.

Key strengths

- Supply of safety-critical components to the aerospace industry.
- Creation of value-added products, systems and services.
- Eight businesses serving different sectors.
- Culture based on speed, flexibility and continuous improvement.

Sectors served

Commercial, corporate, military, regional, rotorcraft and space.

Major customers

Boeing, Airbus, GE, Rolls Royce, Bombardier and Eclipse.

Aerospace Aftermarket

	Year ended 31 Dec 2005
Revenue (£m)	15.2
Headline operating profit (£m)*	0.3
Number of employees as at 31 Dec 2005	77

Business units

Aero Quality Sales (USA and UK), Arger Enterprises, Jesse Industries, PTMI.

Business description

Specialised distribution service for aerospace components and engineering services to the global aviation industry.

Key strengths

- Sale and distribution of engine, airframe and interior parts.
- Worldwide stocking facilities.
- Product compatibility includes major Boeing and Airbus aircraft types and General Electric and Pratt & Whitney engine types.
- Quality alternative parts.

Sectors served

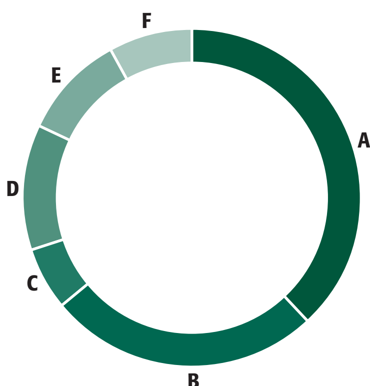
Commercial, corporate and general aviation.

Major customers

Lufthansa Technik, Japan Airlines, United Airlines, Iberia Airlines, Delta Airlines, American Airlines and KLM.

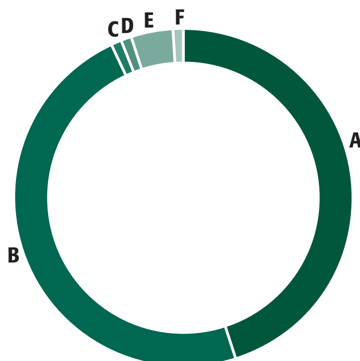
Revenue by division (%)

A	Dynacast	38
B	OEM	26
C	Aftermarket	6
D	MVC	12
E	MPC	10
F	PSM	8



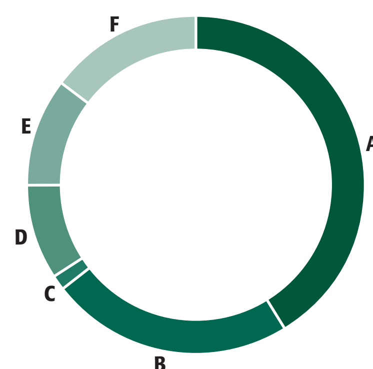
Headline operating profit by division (%)

A	Dynacast	45
B	OEM	48
C	Aftermarket	1
D	MVC	1
E	MPC	4
F	PSM	1



Employees by division (number)

A	Dynacast	2,222
B	OEM	1,254
C	Aftermarket	77
D	MVC	490
E	MPC	558
F	PSM	793



McKechnie Vehicle Components (MVC)

	Year ended 31 Dec 2005
Revenue (£m)	31.6
Headline operating profit (£m)*	0.3
Number of employees as at 31 Dec 2005	490

Business units
MVC Newberry, MVC Nicholasville, MVC Troy, and McKechnie Tool and Engineering.

Business description
Design and manufacture of decorative exterior wheel trim products for the US automotive industry.

Key strengths
- Manufacture of coated metal and plastic wheel trim products.
- Stamping in stainless steel for aluminium wheel market.
- Design and development capability.
- Focus on products which require technical expertise.

Sectors served
US automotive industry.

Major customers
Daimler-Chrysler, Ford, Toyota, Nissan and General Motors.

McKechnie Plastic Components (MPC)

	Year ended 31 Dec 2005
Revenue (£m)	27.1
Headline operating profit (£m)*	1.2
Number of employees as at 31 Dec 2005	558

Business units
MPC Pickering, MPC Stamford Bridge and Burnett Polymer Engineering.

Business description
Design and manufacture of engineered plastic and plastic injection-moulded components.

Key strengths
- In-house design and tool-making facilities.
- Leading edge technical development.
- Secondary operation capability including painting, printing, welding and packaging.
- Bespoke product testing.

Sectors served
Automotive, consumer packaging, IT hardware, personal care and lifestyle.

Major customers
Diageo, Scottish Courage, Wavin, Makita SSL International, Ford, Toyota and Honda.

McKechnie PSM (PSM)

	Year ended 31 Dec 2005
Revenue (£m)	21.6
Headline operating profit (£m)*	0.4
Number of employees as at 31 Dec 2005	793

Business units
PSM International, PSM Fasteners Asia, PSM Fasteners USA, PSM Canning Brett and PSM Threadlocking and Sealing.

Business description
Design and manufacture of industrial metal fasteners.

Key strengths
- Manufacturer and distributor of specialised fasteners and joining systems for metals and plastics.
- Sells direct to end user and through extensive distribution network.
- Significant capital investment in China.

Sectors served
Computing, consumer electronics, automotive and telecommunications.

Major customers
Visteon, General Motors, Mann and Hummel, Ford, Siemens and Infast.

*Before exceptional costs and intangible asset amortisation other than computer software.

"Since the acquisition of Dynacast and McKechnie last May, a huge amount of work has been done and is continuing. Order books are encouraging, particularly in our Aerospace OEM business and we expect good progress in 2006 from our businesses. Our aim in listing Melrose in 2003 was to enable public market shareholders to participate in value created from the acquisition and subsequent improvement of businesses as an alternative where appropriate to the successful private equity model. We are pleased that this strategy is bearing fruit."

Christopher Miller
Executive Chairman

Christopher Miller

I am pleased to report Melrose's first set of full year results following the acquisition of the Dynacast Group and the McKechnie Group in May last year for £429 million.

Results

The accounts for the 12 months to 31 December 2005 include the results of the Dynacast and McKechnie businesses for approximately seven months since their acquisition on 26 May 2005.

Turnover for the year was £269.9 million, operating profit before exceptional costs and intangible asset amortisation (other than computer software) was £27.5 million ('headline operating profit') and basic earnings per share before exceptional costs and intangible asset amortisation (other than for computer software) were 9.1p ('headline earnings per share'). After exceptional costs and intangible asset amortisation the operating profit was £8.1 million and the loss per share was 2.4p.

We are very pleased with the progress since acquisition and are confident we will be able to create significant shareholder value.

"We are devoting all our resources to increasing the value inherent in the businesses we have acquired. We are confident that this will be reflected in shareholder value over time and it remains our intention to seek an appropriate and efficient way of delivering this value for our shareholders in due course."

The successful move from an AIM listed cash shell company to a fully listed precision engineering group would not have been possible without the dedication and skills of our many employees around the world, and we are grateful to them for their support through this year of transition.

Following our post-acquisition reviews, we have initiated a number of actions in all of these businesses which we believe will lead to early enhancement of their profitability. These have included management changes, restructuring initiatives and a substantial investment programme, particularly in Aerospace OEM. We would expect to see the benefits of these actions beginning to flow through in the second half of this year but with more impact in 2007 and 2008. This is discussed in some detail in the Chief Executive's review and the Business review on pages 6 to 15.

Dividends

In the absence of unforeseen circumstances the Board intends to propose a final dividend of 3p per share at the Annual General Meeting in May. The dividend would be payable on 19 May 2006.

Board appointments

As previously noted, we were pleased to welcome Geoffrey Martin as Group Finance Director and Perry Crosthwaite as a non-executive Director to the Board during the year. We expect to appoint a third non-executive Director in due course.

Stock Exchange listing

Melrose successfully moved to a full listing on the London Stock Exchange on 9 December 2005 and is now more appropriately classified in the Engineering sector.

Strategy

Our core strategy remains unchanged. We are devoting all our resources to increasing the value inherent in the businesses we have acquired. We are confident that this will be reflected in shareholder value over time and it remains our intention to seek an appropriate and efficient way of delivering this value for our shareholders in due course.

"We are very pleased to have acquired these businesses. They each operate in different market sectors and provide their own challenges and opportunities. I am very encouraged by our acquisition and I am confident that the Group is well positioned to produce a good result in 2006."

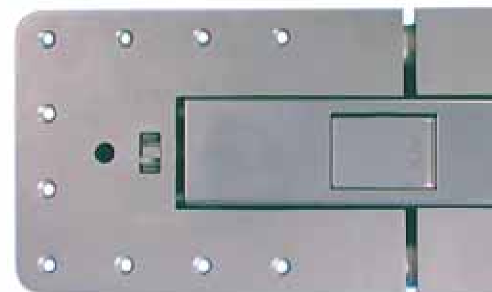
David Roper
Chief Executive

I set out on the following pages reports on the six operating divisions.

We are very pleased to have acquired these businesses. They each operate in different market sectors and provide their own challenges and opportunities.

In a relatively short time we have announced a major capital expenditure project at Hartwell, the closure of PSM's loss-making European operations, the closure of three Dynacast operations and the expansion of Dynacast's operations in China and Mexico. We have also made considerable changes to the head office operations, changed senior management and made good progress in significantly improving the Group's cash management.

In this period we also completed the listing of the Group on the London Stock Exchange which involved a considerable amount of time and expense.



Extra low profile latching system manufactured by Hartwell for use on a composite engine cowl for the Airbus A340. Being low profile, this latching system allows the customer to make the cowl size smaller and the fit tighter with the engine, thus reducing the drag on the aircraft and providing weight savings.

Many other projects to improve the Group's operations are underway and I am confident they will lead to an even better performance in the future.

The two largest businesses, Dynacast and Aerospace OEM, operate in very different markets, although both are manufacturers of highly specialised technically engineered products. The strategic challenge facing Dynacast is to meet the requirements of its multinational customers, many of whom have been, and will continue, moving their production to low cost countries. For Aerospace OEM the challenge is to continue to provide customer service at a time of very strong growth in the aerospace industry.

The four smaller businesses also operate in different market sectors. All four have strengths, but it has been necessary to refocus and reposition them in order to be able to maximise value in the future.

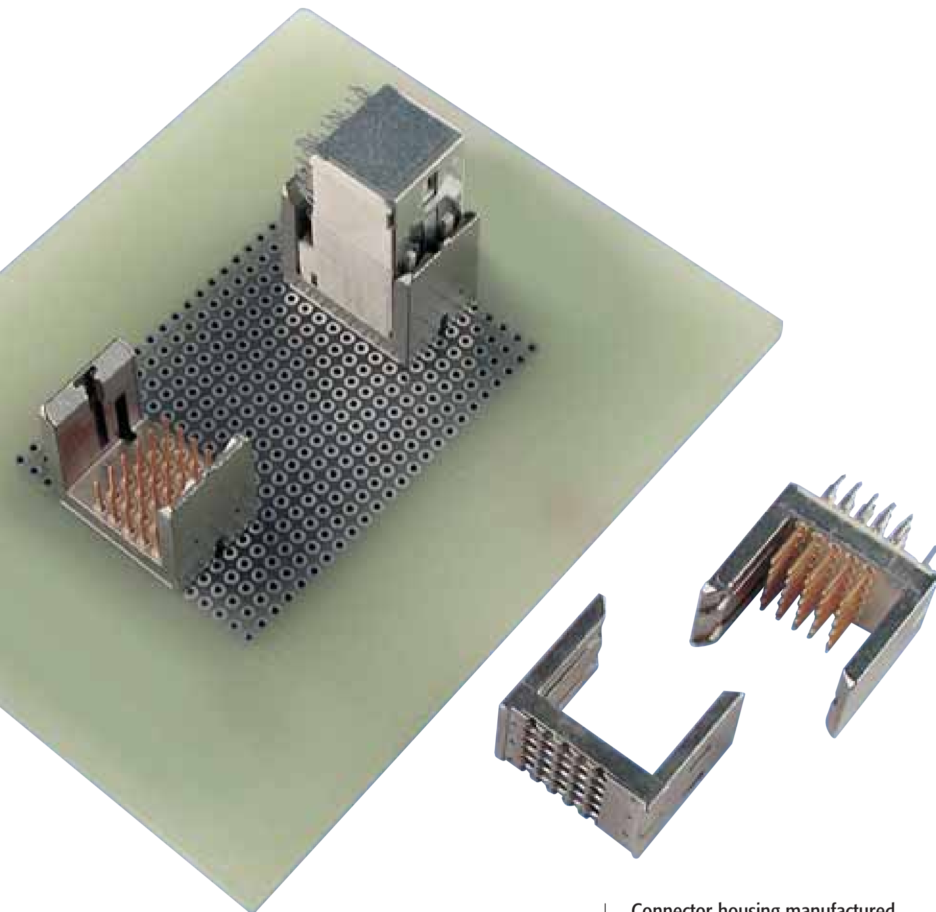
Outlook

Dynacast is well positioned to benefit from the strong growth in the Asia Pacific region and from sales of the new Gillette product. Nevertheless, as noted below, although Dynacast can fully pass on the impact of raw material price changes for the vast majority of its sales, the time lag in these times of rapid change can have an impact on profit – upwards and downwards. The ability to recover these costs is evidence of a high quality business with a strong market share, which is looking to the future with confidence.

Aerospace OEM is an excellent business operating in very favourable market conditions. I am looking forward to this division delivering a good performance this year.

Together with work in progress at the four smaller divisions, I am very encouraged by our acquisition and I am confident that the Group is well positioned to produce a good result in 2006.

"We believe Dynacast to be a high quality, well managed engineering group and remain confident that it will produce good returns for our investors."



Connector housing manufactured in zinc by Dynacast for a high-speed input/output connector for the telecommunications industry. This component exhibits extremely thin walls and very small holes and was awarded best small electroplated zinc die-casting by the North American Die-Casting Association.

	Year ended 31 Dec 2005
Revenue (£m)	105.0
Headline operating profit (£m)	13.6

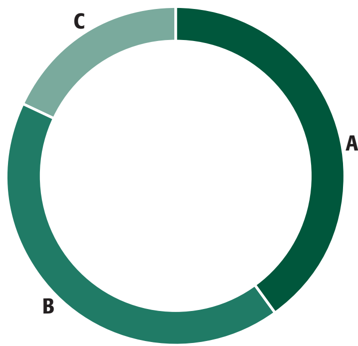
Dynacast is a global manufacturer of precision engineered, die-cast metal components. The products are manufactured using proprietary die-casting technology and are supplied to a wide range of end markets, including automotive, healthcare, telecommunications and consumer electronics.

Since the acquisition of Dynacast in May 2005, trading has been characterised by strong demand in Asia offset by slower demand in Europe and the US. Much of the new business in the Asian market has been generated from North American customers with operations in Asia. We are investing heavily in Asia in order to derive maximum benefit from these favourable conditions.

Dynacast benefits from the ability to fully pass on raw material prices for the vast majority of its sales. However, there is a time lag for this selling price recovery, and when raw material prices rise quickly, as they have been since our acquisition, there is a short term negative impact on profit. It should be emphasised that this is purely a timing effect and reverses if raw material prices fall. To put this in context, the price of zinc (three-quarters of Dynacast's sales are manufactured using zinc) rose by over 50% from the date

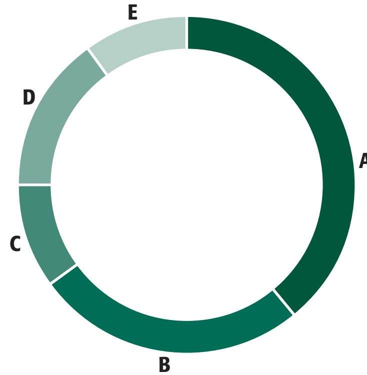
Dynacast revenue by geographical area (%)

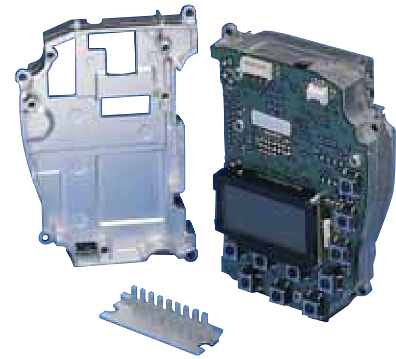
A	North America	40
B	Europe	42
C	Asia	18



Dynacast revenue by sector (%)

A	Automotive	39
B	Electronics, computers and telecoms	26
C	Healthcare	10
D	Hardware and tooling	15
E	Others	10





Precision die-cast housing manufactured by Dynacast using a conventional cold chamber die-cast machine. This part has been manufactured in aluminium for weight and strength.

of acquisition in May to the year end and has continued to rise since.

Dynacast is very pleased to have signed a long-term agreement with Gillette to be a key supplier to one of its latest products. This is an exciting development for Dynacast, which is manufacturing these products in a purpose built factory on its existing site in Austria. This is in addition to the manufacture of other significant product ranges for Gillette which continue to be made in Dynacast's facility in Montreal.

In China approximately £1.5 million is being invested to expand Dynacast's capacity in Shanghai. This involves investment in both conventional zinc and aluminium die-casting machines and the space in which to house them. When completed by the middle of this year, Dynacast Shanghai will be a 125,000 sq ft manufacturing facility.

This rapid expansion in China brings with it many logistical challenges, not the least of which is the general shortage of suitably qualified engineers. We view this as one of the many natural consequences that arise at times of rapid expansion in a developing region. In the circumstances Dynacast management has decided to institute a graduate recruitment programme.

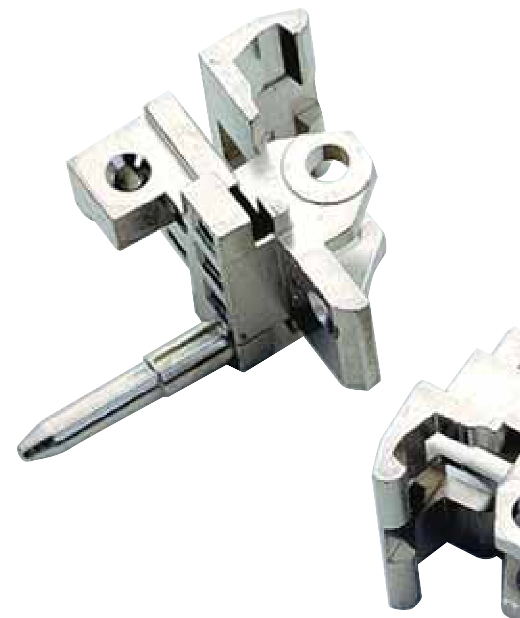
In common with global manufacturing trends, demand for Dynacast's products is shifting to these 'low cost countries'. As a result, we continue to review our operating cost base in order to achieve optimum efficiency, whilst at the same time meeting our customers' requirements. Since acquisition we have closed or announced the closure of three manufacturing plants in the UK, Turkey and Taiwan, and we have announced the expansion of our facilities in China and Mexico. This is an ongoing process and further announcements are likely from time to time.

In the past, whilst Dynacast's operations in North America and Asia have each been managed and operated on an integrated and coordinated basis, the European operations have tended to operate somewhat independently. There has now been a senior management reorganisation in Europe in order to achieve a more unified approach to the sales function.

A good indication of future revenue for Dynacast is the sales of tooling programmes to customers. We are pleased to report that during 2005 the level of tool sales has been most encouraging.

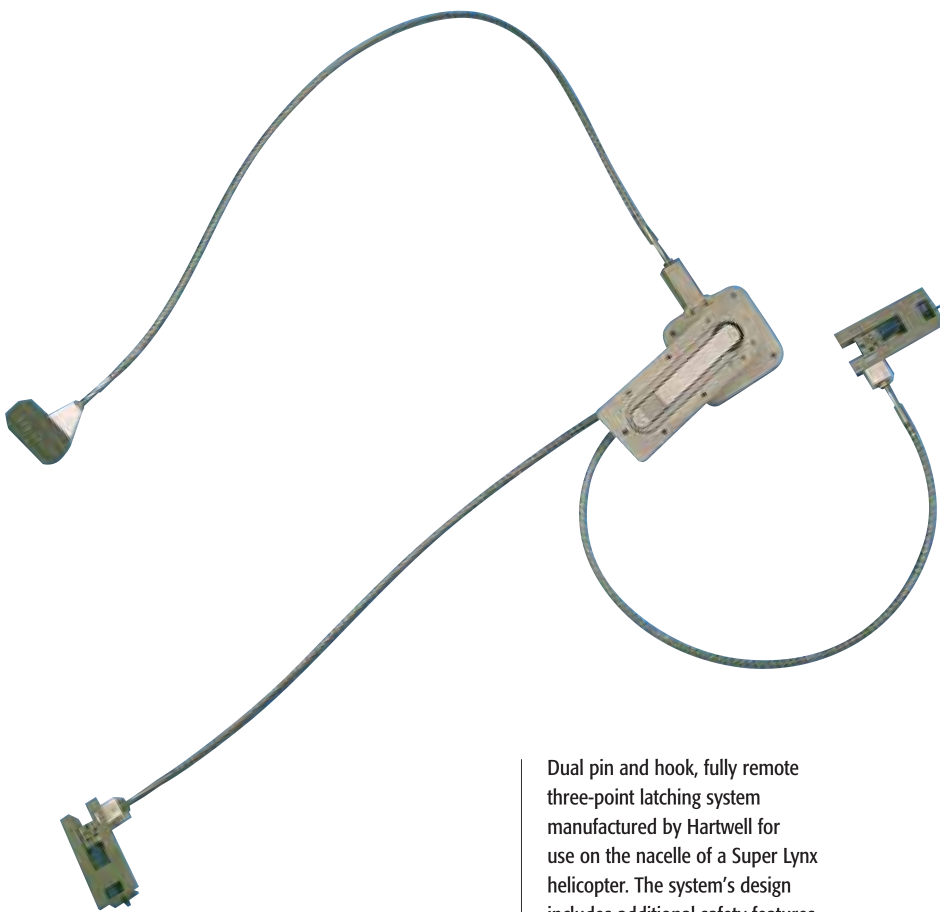
During the year a new divisional finance director was appointed.

We believe Dynacast to be a high quality, well managed engineering group and remain confident that it will produce good returns for our investors.



This complex award winning casting is an electronics card guide ejector bracket manufactured for a worldwide manufacturer of integrated enclosure systems.

"These are excellent businesses benefiting from an upturn in the aerospace market. The order books across the division are good and support our confidence for the year."



Dual pin and hook, fully remote three-point latching system manufactured by Hartwell for use on the nacelle of a Super Lynx helicopter. The system's design includes additional safety features that ensure proper functioning and can be operated by one mechanic instead of two, thus reducing man hours.

	Year ended 31 Dec 2005
Revenue (£m)	69.4
Headline operating profit (£m)	14.6

Aerospace OEM supplies safety critical components to the global aerospace industry and is based in the US and Europe. The business has excellent engineering skills, producing value added products selling into niche markets in which it has a strong market presence.

The Aerospace OEM Group had an excellent 2005 reflecting an extremely strong year for the industry. Both Boeing and Airbus achieved record numbers of orders with over 1,000 aircraft each. The Group's position as a key supplier to both of the 'big two' has continued with the development of applications and products in support of new platforms such as the Boeing 787 and the Airbus A380 and A350 programmes. These successes were the product of close collaboration and teamwork.

Against this backdrop, the Group embarked on a concerted effort to improve the operational performance of its business units in order to meet customer demand and improve margins. As part of this, significant capital investment in machine tool technology and other projects has been committed to provide a step change in productivity.

Titanium struts manufactured at TAC in Belgium, for use in the Airbus A340 500/600. These were developed to replace an aluminium strut, bringing a benefit of nearly 50% in weight reduction.

Externally threaded fasteners for gas turbine and critical airframe applications, manufactured by Linread Northbridge. The business supports leading aerospace OEMs worldwide with the development and manufacture of high-strength, low-weight fasteners in a wide range of exotic alloys. Linread Northbridge also supplies these fasteners on an urgent-need basis to more than half the fleet repair facilities in the world.

The most important of these is at Hartwell. Previous investments in Mori Seiki milling platforms and Linear Pallet Pool systems helped Hartwell to meet substantially increased orders in 2005. The new investment, amounting to approximately £4.5 million, will increase Hartwell's capabilities still further. This will reinforce a culture based on speed, flexibility and continuous improvement, helping the Company to consolidate its position as an industry leader.

During the year, Hartwell developed a new Bifurcation Latch System for both GE and Rolls Royce engine nacelles and is finalising the development of an extra low profile latch system for the Airbus A380, which is expected to go into production in the second half of 2006.

At Hasco, the aftermarket arm of Hartwell, attention was focused on improving forecasting models. As a result, the business was able to invest strategically in stocks, resulting in higher service levels to customers and increased sales. This improved forecasting had the knock-on benefit of smoothing production requirements in the Hartwell factories. In addition, this business was provided with dedicated resources to build its FAA certified repair station, which was strongly welcomed by customers and added a new revenue stream for the business.

Investment in increased production capacity at TAC led to a very significant rise in shipments to key customers. The resulting reduction in the level of sub-contracting led to an improvement in margins. As part of a focus on new products and markets, TAC developed a range of carbon fibre composite Hold Open Rods for the Airbus A380 and was successful in developing new business in the helicopter market and in supplying sub-assemblies to Asian customers.

Tyee's emphasis on, and investment in, lean manufacturing helped the business take on a large increase in business with minimum additional labour, thus resulting in higher margins, whilst at the same time leading to improvements in customer service levels. Tyee developed and patented a new swivel rod assembly which provides the customer with a more compact product that is lighter in weight and much easier to assemble. Tyee also entered into a new partnership with CASA EADS for the sale of its jointly developed, patented sensor rod products for the Coast Guard Deepwater programme.

Electromech Technologies made several improvements throughout the year. It upgraded its MRP system and improved product flow in its repair station business units to provide better focus on sales growth. Each of these initiatives

Cockpit door decompression-sensing latching system manufactured by Hartwell, developed to enable the cockpit door handles to withstand high impact and small arms fire, yet sense a decompression event and allow the hatch and panel to release within four milliseconds.

is yielding better business performance. Furthermore, Electromech Technologies is actively engaged in developing products for the evolving new 'very light jet' market, in particular the award winning Eclipse 500, which is an exciting development for the aerospace industry.

Valley Todeco has benefited from current buoyant market conditions in the fastener spot market. By not taking on longer term arrangements it has been able to benefit from the higher margin opportunities this excess demand in strong market conditions creates.

Linread has seen a substantial growth in European demand for its products for airframes and engines. Management's strategy of developing long term agreements with customers, primarily Airbus and Rolls Royce, has provided better order visibility. However, in particular at Linread Redditch this has created some challenges in recovering, from their customers, sharp increases in titanium prices, and has resulted in manufacturing issues.

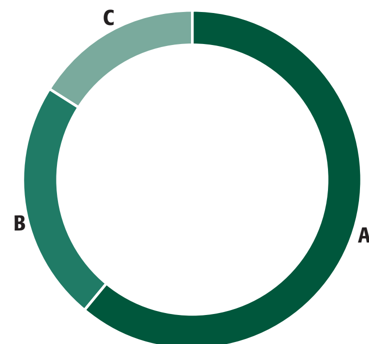
Aerospace OEM is constantly engaged in either negotiating new contracts with customers or renewing existing ones. During the year a major focus of these negotiations was to secure selling price increases to recover higher raw material costs, principally titanium, aluminium and stainless steel.

During the year a new divisional finance director and a new vice president of operations at Hartwell were appointed.

These are excellent businesses benefiting from an upturn in the aerospace market. The order books across the division are good and support our confidence for the year. We are working with their management to maximise their operational performance.

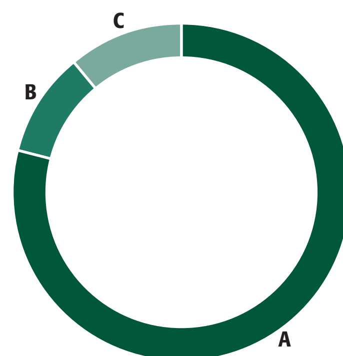
Aerospace OEM revenue by business unit (%)

A Structures	61
B Fasteners	23
C Electromechanical	16



Aerospace OEM headline operating profit by business unit (%)

A Structures	79
B Fasteners	10
C Electromechanical	11



"All four smaller businesses have strengths, but it has been necessary to refocus and reposition them in order to be able to maximise value in the future."

McKechnie Vehicle Components' first production wheel using the Urethane Foam Attachment Process. This process can be used to attach both plastic and stainless clads to any type of wheel. Developed by MVC at Troy, Michigan for the Dodge Durango.

Aerospace Aftermarket

	Year ended 31 Dec 2005
Revenue (£m)	15.2
Headline operating profit (£m)	0.3

Aerospace Aftermarket provides a 24 hours-a-day, seven days-a-week specialised distribution service offering a range of batteries, aeroplane components, related systems and engineering services to the aerospace aftermarket.

On acquisition this division underwent a major change in the top management team which promptly instituted a radical review of the business. The revitalised management team has made good progress. This has resulted in a more disciplined and focused approach to running the division, including a significant cost cutting programme. The results for 2005 have begun to show the effects of this improvement and we believe 2006 will see further progress towards more satisfactory operating margins.

The management team has rigorously sought out opportunities to utilise the division's engineering skills to identify and introduce to customers, mostly airlines, cheaper and more efficient access to replacement parts.

As well as achieving successes on the sales front, Aerospace Aftermarket also undertook significant internal changes, including a resizing of its organisational structure and the implementation of new IT systems to improve the management of both customer and principal accounts.

In addition to the buoyant state of the aerospace industry as a whole, significant opportunities exist for Aerospace Aftermarket to benefit from the growing acceptance by airlines, particularly in Europe and Asia, of PMA parts as a means of securing cheaper replacement parts.

McKechnie Vehicle Components ('MVC')

	Year ended 31 Dec 2005
Revenue (£m)	31.6
Headline operating profit (£m)	0.3

MVC manufactures decorated exterior trim products for the US automotive industry, principally coated metal and plastic wheel trims.

The difficulties of this industry are well publicised. At MVC a combination of weak sales, costs of introduction of new products and unrecovered raw material costs have led to a poor performance since our acquisition.

MVC as a business has, however, been successful in obtaining orders for the potentially high growth wheel-cladding products' from its customers. This development is exciting in sales terms but has led to costs in 2005 which will only start to be recovered in the second half of 2006 when the new cladding products' deliveries increase substantially. The growth in this market sector is also likely to place stress on parts of the supply chain (especially plating) which will pose challenges this year. However, it provides a good opportunity for MVC to utilise its undoubted engineering strength to improve its performance.

Since acquisition MVC has had only partial success in recovering raw material costs. It also has a current product base which includes a number of poorly performing older products. Management is currently engaged in a review of product profitability and further action will be taken to improve this position.

In summary we believe 2006 will be an important year for MVC. The outlook for its new products provides a good opportunity but management is fully aware that growth in profitability equally depends on successfully meeting the challenges posed by poorly performing legacy products and increased raw material prices.

McKechnie Plastic Components ('MPC')

	Year ended 31 Dec 2005
Revenue (£m)	27.1
Headline operating profit (£m)	1.2

MPC is a UK producer of engineered plastic and plastic injection moulded components for products used in a variety of industries, including power tools, IT hardware, food packaging, personal care and automotive.

Since acquisition, management has undertaken a thorough review of the business with a view to focusing on those products where it has a competitive advantage and ensuring that the costs of producing individual products are well understood. As a result some agreements with customers have already been renegotiated to secure more commercially acceptable terms. This is an ongoing process but successful progress to date indicates the high quality of MPC's technology and customer service. Management is also keeping a tight control on costs to ensure that resources are efficiently deployed.

In terms of new products and business development, MPC, from its Stamford Bridge facility, is very pleased to have signed a new five year exclusive contract with Diageo plc for the 'widget of tomorrow' for its canned beer products. In addition, our Pickering site has secured a major contract for the supply of interior trim panels for the highly successful Honda Civic.

McKechnie PSM ('PSM')

	Year ended 31 Dec 2005
Revenue (£m)	21.6
Headline operating profit (£m)	0.4

PSM manufactures and distributes specialised fasteners and joining systems primarily for the IT and automotive markets.

We stated in our Interim Report last September that we were working with PSM management to address the difficulties arising principally from the move of the bulk of PSM's UK production to the Czech Republic, which was carried out prior to our acquisition. At acquisition substantial further progress was required to justify this move. When this did not happen a decision was taken to close the loss-making European operations and this was announced in November last year.

PSM Threadlocking and Sealing apply sealing products to fasteners using special dosing equipment that supplies a bead of material in controlled volume. This bead is then heat cured to form a bond. Applications for this type of material include water-proof communication handsets and car door mounting screws.

This closure process is going to plan and we expect it will be finalised in the second quarter of 2006.

The result is a smaller, more focused and profitable business with approximately 60% of its sales in Asia. We believe this business will be well placed to benefit from growth in Asia and from Asian exports through its sales network in the US and European markets.

Significant capital investment has been made in China to increase capacity by investing in new machines and moving to a new 80,000 sq ft factory in Wuxi, near Shanghai.

In addition to the activities referred to above, there remain approximately £10 million of specialist fastener sales being manufactured in Europe. These are enjoying steady growth and will be managed separately from the Asia based business.

Makita cordless professional drill handle sets manufactured by McKechnie Plastic Components, Stamford Bridge, York. This production process uses two-shot injection moulding with a rigid shell moulding over-moulded with a soft grip.

"The Group made sales in 2005 of £269.9 million. This resulted in a headline operating profit of £27.5 million representing a 10.2% return on sales. After exceptional costs and intangible asset amortisation the operating profit was £8.1 million. All of the divisions made a headline operating profit during Melrose ownership."

Geoffrey Martin
Group Finance Director

2005 was a year of transition for Melrose PLC. In May 2005, Melrose completed the purchase of the McKechnie and Dynacast Groups for £429 million plus £14.6 million of fees. The split of this consideration was £244 million of equity and £199.6 million of cash.

Results for the year

The results for 2005 and 2004 have been compiled using International Financial Reporting Standards (IFRS). The 2005 twelve month results include the trading of the McKechnie and Dynacast Groups for the seven months post acquisition from 26 May 2005. Thus the 2004 information provided in the financial statements is not on a comparable basis. The performance for 2005 is examined in more detail below and in the Chief Executive's review. The terms 'headline operating profit', 'headline profit before tax' and 'headline earnings per share' are referred to in this section. These have the same definition as operating profit, profit before tax and earnings per share respectively except that they are calculated before charging exceptional costs and intangible asset amortisation other than computer software.

Melrose is divided into six divisions, namely Dynacast, Aerospace OEM (OEM), Aerospace Aftermarket (Aftermarket), McKechnie Vehicle Components (MVC), McKechnie Plastic Components (MPC), and McKechnie PSM (PSM). The table on page 17 analyses the performance of the Group using these six divisions as the key categories.

The Group made sales in 2005 of £269.9 million. This resulted in a headline operating profit of £27.5 million representing a 10.2% return on sales. After exceptional costs and intangible asset amortisation the operating profit was £8.1 million. Revenue for the year ended 31 December 2004 was nil and the operating loss was £4.7 million.

"The Group places the highest importance on managing cash. The conversion of profits into cash is maximised. In addition, capital and restructuring projects which have an acceptable payback are actively encouraged and invested in as an important driver to add value."

Split of sales and profit by division

	Sales £m	Headline operating profit £m	Return on sales %	Headline operating profit before depreciation and amortisation £m	Return on sales %
Dynacast	105.0	13.6	13.0	18.1	17.2
OEM	69.4	14.6	21.0	16.3	23.5
Aftermarket	15.2	0.3	2.0	0.4	2.6
MVC	31.6	0.3	0.9	1.4	4.4
MPC	27.1	1.2	4.4	2.3	8.5
PSM	21.6	0.4	1.9	1.5	6.9
Central costs	–	(2.9)	–	(2.8)	–
Group	**269.9**	**27.5**	**10.2**	**37.2**	**13.8**

All of the divisions made a headline operating profit during Melrose ownership. The return on sales for headline operating profit varied considerably by division from 21.0% in OEM to 0.9% in MVC. The return for the two largest divisions significantly outperformed the four smaller divisions.

Finance cost and pension charge

The Group incurred a total finance cost of £6.6 million in 2005. This consisted of £5.4 million of net bank interest, at an average cost of 4.6%, and £1.2 million for the net finance cost of pensions.

Taxation

The Group incurred a tax charge of £6.3 million on headline profit before tax of £20.9 million in 2005. This represents an effective tax rate of approximately 30%. A significant proportion of the Group's income is derived by entities subject to US Federal and State taxes, with a combined effective rate of over 38%. At the same time the Group benefits from significant profits being earned by entities subject to corporate income tax rates substantially less than 30%, including beneficial start up tax rates in China. The total tax charge for the Group after exceptional items and intangible asset amortisation was £5.4 million.

The Group incurred a cash tax rate of 23% in 2005, significantly below the rate charged in the income statement. A lower cash tax rate is incurred due to utilisation of tax losses available to the Group in the USA.

The Group continues to have confidence in its US businesses' ability to generate sustainable profits and consequently a deferred tax asset of approximately £29 million, in respect of US federal tax losses and other items, has been recognised in the balance sheet.

Currency effect on trading

The split of sales by major currency is shown in the table below.

	US$	Euro	Sterling	SG$	CHRMB	Other	Total
Sales £m	123.2	53.5	52.4	10.3	8.7	21.8	269.9
%	46	20	19	4	3	8	100

The Melrose PLC income statement is translated at the average rates of exchange for the period, and the balance sheet at the year end exchange rates. The key exchange rates used for translating the results in the period are as follows:

	Average rate for the period	Year end rate
US Dollar	1.77	1.72
Euro	1.47	1.46

Clearly the Group has a significant exposure to movements in exchange rates. The policy to hedge against these exposures is detailed below but for guidance the estimated net translation effect of a ten cent strengthening of either the US Dollar or Euro against Sterling would be an approximate £1 million increase in operating profit on an annualised basis.

Dividends and EPS

Reflecting the Group's performance, in the absence of unforeseen circumstances, the Board intends to propose a final dividend of 3p per share at the Annual General Meeting in May. This equates to a £7.7 million dividend payment and would be paid on 19 May 2006. Under International Financial Reporting Standards, this is not accrued for in the 2005 results but will be charged in the 2006 income statement.

The headline earnings per share was 9.1p. After charging exceptional costs and intangible asset amortisation a loss per share of 2.4p was incurred.

A diluted earnings per share for the year ended 31 December 2005 is also calculated to show the effect of the Melrose management incentive scheme which was approved by shareholders on flotation. The dilution effect was small and the diluted headline earnings per share remained at 9.1p.

Cash management and performance since acquisition

The Group places the highest importance on managing cash. The conversion of profits into cash is maximised, which ensures the quality of profit is high and working capital is managed to achieve the correct balance between financial efficiency and commercial growth. In addition, capital and restructuring projects which have an acceptable payback are actively encouraged and invested in as an important driver to add value.

The performance on cash during 2005 is summarised as follows:

Group cash flow

	£m
Headline operating profit	**27.5**
Depreciation and computer software amortisation	**9.7**
Working capital increase	**(5.5)**
Net capital expenditure	**(6.8)**
Cash generated from operations before exceptional costs	**24.9**
Exceptional costs and abortive acquisition fees	**(6.3)**
Interest and tax	**(8.6)**
Pension contribution	**(5.2)**
Other	**(1.3)**
Increase in cash and cash equivalents including exchange	**3.5**

The headline operating profit conversion to cash during the period was 91%. This performance was achieved despite moving from the highly leveraged financial structure under the previous ownership. This meant that some increases in working capital were justified to allow the divisions to maximise operational performance. Consequently the Group has increased the working capital investment by £5.5 million in total in the seven months of ownership. The continued close monitoring of working capital will ensure this is managed efficiently at all times. The £1.3 million 'other' cash outflow includes the net effect of the new bank loans and the acquisition of the businesses.

Capital investment and exceptional costs

During the year ended 31 December 2005, £7.1 million of gross capital expenditure has been spent. Asset disposal proceeds amounted to £0.3 million giving a net capital expenditure of £6.8 million. Gross capital expenditure represented 73% of depreciation and computer software amortisation. This ratio may rise in 2006 as capital is invested in projects with acceptable paybacks. The most significant capital project approved since the year end (and, therefore, not included in the gross capital spend for 2005) is an investment of approximately £4.5 million in the Hartwell unit of the OEM division to reduce cost, increase capacity and improve customer service. This investment is expected to start to produce returns in 2007.

A key part of the Melrose PLC strategy to add value to the acquisitions is to invest in restructuring projects which further improve efficiencies. In 2005 an exceptional charge of £14.2 million has been incurred to reflect the projects approved before the year end. These include the closure of certain Dynacast factories and the closure of the loss making European business in the PSM division. The charge consists of cash costs of £8.9 million and non cash charges of £5.3 million. This excludes the potential benefit of any asset disposals or working capital reductions. Additional restructuring costs may be incurred in 2006 if further projects are approved.

In addition, in 2005 Melrose PLC moved from an AIM listing to the main London Stock Exchange. Listing fees of £2.1 million were incurred in this process. This, together with the £14.2 million restructuring charge referred to above, means the full exceptional costs in 2005 were £16.3 million, as shown below.

	Total £m	Cash £m	Non cash £m
Dynacast			
Turkey	1.6	0.9	0.7
Taiwan	0.1	0.1	–
UK	2.0	1.7	0.3
Sub total	**3.7**	**2.7**	**1.0**
PSM			
Closure of the European business	10.0	6.1	3.9
Other	0.5	0.1	0.4
Sub total	**10.5**	**6.2**	**4.3**
Total restructuring costs	**14.2**	**8.9**	**5.3**
Listing fees	**2.1**	**2.1**	**–**
Total	**16.3**	**11.0**	**5.3**

Onerous contract

Prior to the acquisition by Melrose, the Linread Redditch unit of the OEM division entered into a four year customer contract. Production under this contract commenced in the first half of 2005. This contract contained pricing which, to make a profit, required operational improvements to be made and a certain titanium price to be achieved. After reviewing this contract a provision of £6.7 million was made against potential losses due to titanium prices and poor operational performance. During the last few months considerable progress has been made towards renegotiating improved terms with the customer and improving the operational performance. During 2005 £1.1 million of this provision was utilised and as at 31 December 2005 the remaining provision was £5.6 million.

Intangible assets

In compliance with International Financial Reporting Standards, the intangible assets of the Group have been valued and capitalised on the balance sheet. The total gross value of intangible assets (excluding computer software) is £61.5 million, which includes the Dynacast brand name and various long term relationships with customers. These are being amortised over their respective useful lives and a charge of £3.1 million has been incurred in 2005 to reflect this. In addition the Group has computer software with a gross book value of £2.7 million and goodwill of £348.4 million. Amortisation of computer software of £1.3 million was incurred in 2005 but there was no impairment to goodwill in the year.

Financial risk management

The different types of financial risk that the Group is exposed to have been considered and policies implemented to address them in the most efficient way. These are discussed in turn.

Liquidity and finance costs

The Group has a £200 million term loan and a further £30 million working capital facility. Group net debt at the year end was £198.7 million. This consisted of cash and short-term deposits of £15.2 million, and interest bearing loans and borrowings of £213.9 million. The debt facility has three covenants. In addition to a total debt covenant, the Group must comply with two further bank covenants, an interest cover covenant and an earnings before interest, tax, exceptional items, depreciation and amortisation to debt covenant. The Group remained comfortably within these at all times during 2005. In addition, the Directors consider that Melrose PLC has sufficient headroom within the agreed facilities for the current size and requirements of the Group.

The Group has taken out a two year fixed interest rate swap on its US Dollar debt. This was secured in July 2005 at a fixed rate of 4.1%. In addition, instruments were taken out on the Euro and Sterling interest rates capping them at 3% and 5% respectively.

Exchange rate exposure

The Group trades in many different currencies and consequently the Group is exposed to movements in exchange rates. The Group policy is to protect against the cash costs of currency movements but not the non cash costs. As a result the Group takes out forward cover against a proportion of its next 12 months' anticipated future cash flows where the transaction is not in the natural currency of the division. However, the Group does not protect against the translation risk of its profit and loss account and net assets, because this is a non cash cost, other than holding multi-currency debt which provides a partial hedge. The Group adopts hedge accounting which ensures that the exchange movements on the debt, which funds the Group's investments in foreign subsidiaries, are charged direct to reserves.

Commodity prices

In common with all engineering groups Melrose is exposed to the movement in base commodity costs. Prices rose on some commodities by a significant amount in 2005. For example, the zinc purchase price for Dynacast rose by 53% in the seven months of Melrose ownership. The Group protects itself against movements in these prices by a mixture of three actions. First by passing as many as possible of them on to customers (for example Dynacast has the ability over set time periods to do this on over 85% of its sales), second by using fixed price agreements with suppliers and third by appropriate inventory procurement.

Capital structure and debt facility

The acquisition of the McKechnie and Dynacast Groups was funded using the Group's £200 million five year committed term loan and £244 million of equity. Headroom for the ongoing operation of the Group was provided by a £30 million five year working capital facility.

At the year end the net debt was £198.7 million and had a weighted average financing cost of 4.6%. In June, the Sterling debt facilities were changed to multi-currency loans to provide a natural hedge against the net assets of the Group, some of which are held in foreign currency.

Pensions

The Group has numerous post-retirement benefit obligations which, in total, have assets of £85.0 million and liabilities of £145.5 million, giving a net deficit of £60.5 million. The McKechnie UK defined benefit scheme is the most material scheme for the Group. This scheme has been closed to new members and to future years' service but makes up £48.6 million of the £60.5 million IAS 19 deficit included in the Group balance sheet at the year end.

The assumptions used in calculating the pension deficit are of significant importance and are considered carefully by the Board of Directors. In line with best practice full disclosure of the assumptions used is made in the financial statements. Consistent with recent thinking in the actuarial profession, the assumption on mortality rates adds on an allowance for a lengthening in current life expectancy. An age rating of three years for each active and deferred member and one year for each pensioner has been added to current mortality tables. This represents a total increase in liabilities of approximately 8%.

All the assumptions are considered by the Directors and their advisers to give a fair estimate of the pension valuation for a scheme within this industry and geographical sector.

Geoffrey Martin
Group Finance Director
15 March 2006

BOARD OF DIRECTORS

The Board of Melrose, which combines commercial experience with financial expertise and a willingness to embrace innovative thinking, is dedicated to delivering shareholder value by fully exploiting the Group's core skills in engineering, product development and delivery of customer service.

Christopher Miller Executive Chairman
Age 54, he qualified as a chartered accountant with Coopers & Lybrand, following which he was an Associate Director of Hanson plc. In September 1988 he joined the Board of Wassall PLC as its Chief Executive. Between October 2000 and May 2003 he was involved in private investment activities. Mr Miller was appointed as an executive Director of Melrose on 29 May 2003. He is currently a Director of TMO Biotec Limited.

David Roper Chief Executive
Age 55, he qualified as a chartered accountant with Peat Marwick Mitchell, following which he worked in the corporate finance divisions of S.G. Warburg & Co. Ltd., BZW and Dillon Read. In September 1988 he was appointed to the Board of Wassall PLC and became its Deputy Chief Executive in 1993. Between October 2000 and May 2003 he was involved in private investment activities and served as a non-executive Director on the Boards of two companies. Mr Roper was appointed as an executive Director of Melrose on 29 May 2003.

Geoffrey Martin Group Finance Director
Age 38, he qualified as a chartered accountant with Coopers & Lybrand, where he worked within the corporate finance and audit departments. In 1996 he joined Royal Doulton PLC where he gained a wide range of experience. He was Group Finance Director of Royal Doulton from October 2000 until June 2005. During this time, he was heavily involved in major projects including public equity and debt refinancings and the restructuring and outsourcing of Royal Doulton's manufacturing and supply chain. Mr Martin was appointed as an executive Director of Melrose on 7 July 2005.

Simon Peckham Chief Operating Officer
Age 43, he qualified as a solicitor in 1986. In 1990 he joined Wassall PLC and became an executive Director of Wassall PLC in 1999. From October 2000 until May 2003 he worked for the equity finance division of The Royal Bank of Scotland and was involved in several high profile transactions. Mr Peckham was appointed as an executive Director of Melrose on 29 May 2003.

Miles Templeman Non-Executive Director
Age 58, he has been a director of several consumer goods and retailing companies. He was the Managing Director of Threshers Off-Licences between 1985 and 1988 and the Managing Director of Whitbread Beer Company between 1990 and 2001. Mr Templeman was Chief Executive Officer of HP Bulmer Holdings plc from January 2003 to July 2003. He has also held a number of other non-executive directorships and was appointed as a non-executive Director of Melrose on 8 October 2003. Since October 2004, Mr Templeman has held the position of Director General of the Institute of Directors. He is currently a director of Boehringer Ingelheim Limited, Shepherd Neame Limited, Start Talking Ideas Limited and Yo! Sushi Holdings Limited.

Perry Crosthwaite Non-Executive Director
Age 57, he has over 30 years' experience as a director in the City of London. He was a founding Director of Henderson Crosthwaite Institutional Brokers Limited, serving on the Board until its acquisition by Investec Group (UK) PLC in 1998. He became a Director of Investec Bank (UK) Limited and Chairman of the Investment Banking division until his retirement in 2004. Mr Crosthwaite was appointed as a non-executive Director of Melrose on 26 July 2005. He is currently a Director of CIDA Foundation and ToLuna Plc.

The Directors of Melrose PLC present their Report and the Audited Financial Statements of the Group for the year ended 31 December 2005.

Principal activities and business review

Melrose PLC was floated on AIM on 28 October 2003 with the stated strategy of acquiring companies and businesses whose performance the Melrose PLC Directors believe can be improved to create shareholder value and, on 26 May 2005, Melrose PLC completed the acquisition of the Dynacast Group and the McKechnie Group for a consideration of £429 million.

On 9 December 2005, the Ordinary Share capital of Melrose PLC was admitted to the Official List and to trading on the London Stock Exchange. Melrose PLC's listing on AIM was simultaneously cancelled.

The Chairman's statement on pages 4 and 5, together with the reviews on pages 6 to 20 describe the principal activities, operations, performance, financial position and likely future prospects of the Group. The results of the Group are set out in detail on pages 34 to 37 and in the accompanying notes.

The Group's financial risk management objectives and policies in relation to the use of financial instruments are described in the Financial Review on pages 16 to 20.

The subsidiary and associated undertakings principally affecting the profits or net assets of the Group in the year are listed in note 3 to the Company balance sheet.

The principal changes during the year were the acquisitions of the Dynacast Group and the McKechnie Group in May 2005 and the admission of the Ordinary Share capital of Melrose PLC to the Official List in December 2005 as mentioned above.

Financial results and dividend

The Group's loss for the financial year attributable to members was £3.9 million (2004: £4.2 million). Your Directors are pleased to recommend the payment on 19 May 2006, to Ordinary shareholders on the register at the close of business on 21 April 2006, of a final dividend of 3p per Ordinary Share.

It is the intention of the Board to maintain a progressive dividend policy going forward.

Directors

The Directors of Melrose PLC as at the date of this report, together with their biographical details, are given on page 21. No other person served as a Director during the year.

Mr Geoffrey Martin joined the Company on 4 July 2005 and was appointed as a Director on 7 July 2005. Mr Peregrine Crosthwaite joined the Company on 26 July 2005 as a non-executive Director. His appointment is governed by a letter of appointment and he has no service contract with the Company. As required by the Articles of Association of Melrose PLC, Mr Martin and Mr Crosthwaite will retire at the forthcoming Annual General Meeting and, being eligible, will offer themselves for election.

Directors' interests and remuneration

Information on Directors' beneficial interests, including those of connected persons (within the meaning of section 346 of the Companies Act 1985), in the shares of the Company is shown in the Remuneration Report on pages 29 to 31.

The Directors have the benefit of 'qualifying third party indemnity provisions' for the purposes of sections 309A to 309C of the Companies Act 1985.

Share capital

During the year the number of Ordinary Shares in Melrose PLC in issue changed as follows:

Number of Ordinary Shares in issue at 1 Jan 2005	13,120,000
Number of Ordinary Shares issued on 26 May 2005	243,999,989
Number of Ordinary Shares in issue at 31 Dec 2005	**257,119,989**

During the year the number of Convertible B Shares in Melrose PLC in issue changed as follows:

Number of Convertible B Shares in issue at 1 Jan 2005	50,000
Number of Convertible B Shares issued on 26 May 2005	9,170
Number of Convertible B Shares in issue at 31 Dec 2005	**59,170**

There were 9,170 Convertible B Shares issued to Ogier Employee Benefit Trustee Limited ('the Employee Benefit Trust') on 26 May 2005.

Substantial shareholdings

As at 14 March 2006 the Company has been advised of the following interests in the Ordinary Share capital of the Company, which are required to be notified in accordance with sections 198 to 208 of the Companies Act 1985.

	Shares	%
Fidelity International Limited	**25,774,498**	**10.02**
Legal & General Group plc	**13,076,589**	**5.09**
HBOS plc	**11,062,610**	**4.30**
SVG Capital plc	**8,166,609**	**3.18**
University Superannuation Scheme	**7,862,506**	**3.06**

Issue of shares

During the year, the Company did not issue any shares to employees. On 9 March 2006, the Board delegated authority to a committee to approve the grant of options to Mr Geoffrey Martin over 5,917 Convertible B Shares (representing 10% of the issued Convertible B Share capital) at an exercise price of £1 per share. These shares will continue to be held in the Employee Benefit Trust until Mr Martin's options are exercised.

Employees

The Group recognises its responsibilities for the fair treatment of all its employees in accordance with national legislation applicable to the territories within which it operates. Having regard to their skills and abilities, the Group gives full and fair consideration to applications for employment received from disabled persons, and so far as particular disabilities permit, will give employees disabled during their period of employment continued employment in the same job or, if this is not practicable, a suitable alternative job. Equal opportunities for appropriate training, career development and promotion are available to all employees regardless of any physical disability or their gender, religion, race or nationality.

Employee involvement and consultation

The Directors attach great importance to the maintenance and development of good labour relations and employee involvement and training. The results for the half year and for the financial year are discussed at meetings held with senior management and the opportunity is taken to inform them of Group developments. Employees everywhere are encouraged to be aware of the performance of their business. The nature of the Group's activities places the responsibility for such matters with local management in a manner appropriate to the particular circumstances of each business.

Employee involvement in the Group's profitability is encouraged through appropriate bonus schemes.

Pensions

Companies within the Melrose Group operate various pension schemes around the world. The only material scheme to the Group is the McKechnie Pension Plan (the 'Plan'), a UK defined benefit pension scheme with McKechnie Limited as its principal employer. The Plan closed to new members on 9 May 2003 and for future accrual as at 30 June 2005. The primary liability for funding the Plan rests with the participating employers, although Melrose PLC has guaranteed the payment of certain contributions. Members of the Plan were given the opportunity to join a defined contribution scheme when the Plan closed for future accrual. Further details on the Plan and other significant schemes in the Group are explained in note 21 to the accounts.

Research and development

The Group continues to invest in research and development into new products and activities as well as introducing new technology to improve service to customers and reduce manufacturing costs.

Social responsibility

Melrose PLC recognises the importance of social, environmental and ethical matters and the Directors endeavour to take into account the interests of all stakeholders, including investors, employees, customers, suppliers and business partners when operating the business.

Health, safety and the environment

The Directors seek to minimise risk to the health and safety of the Group's employees and to the environment by effective management of the Group's activities.

The Group uses an external auditor to carry out health and safety and environmental audits at the majority of sites on a cyclical basis. Any areas for improvement identified by the external auditor are monitored and audit reports quantify performance in key areas. These audit reports facilitate measurement of future improvements.

Businesses are required to continue to strive to increase their waste reduction and recycling initiatives.

Payments to suppliers

It is the Group's general policy to abide by the terms of payment agreed with its suppliers at the time of individual transactions and to ensure that suppliers are made aware of the terms of payment and abide by them. The nature of the Company's transactions is such that any calculation of creditor days is meaningless.

Charitable and political donations
The Group paid £2,276 (2004: £nil) to UK charities during the year, principally to local charities serving the communities in which the Group operates. There were no political donations made during the year (2004: £nil).

Auditors
Deloitte & Touche LLP have expressed their willingness to continue in office as auditors. Accordingly, a resolution will be proposed at the Annual General Meeting of the Company to re-appoint Deloitte & Touche LLP as auditors of the Company and to authorise the Directors to determine their remuneration.

Annual General Meeting
The Annual General Meeting of the Company will be held at the offices of Investec at 2 Gresham Street, London, EC2V 7QP at 11.30 am on 4 May 2006.

Resolutions dealing with the following special business will be proposed at the Annual General Meeting:

Resolution 8 will seek shareholder approval of the Remuneration Report.

Resolution 9 will seek shareholder approval to renew the Directors' authority to allot relevant securities pursuant to section 80 of the Companies Act 1985 (the 'Section 80 authority'). The authority contained in the resolution will be limited to an aggregate nominal amount of £85,710, representing the authorised but unissued share capital of the Company and approximately 28% of the Company's issued share capital as at 15 March 2006. The Company does not hold any treasury shares.

Resolution 10 will seek to renew the authority conferred on the Board to allot equity securities of the Company for cash without application of the pre-emption rights provided by section 89(1) of the Companies Act 1985 (the 'Section 89 authority'). It is limited to the allotment of equity securities which have been offered pro rata to Ordinary shareholders, subject to any arrangements the Directors consider appropriate to deal with fractions and overseas requirements, and otherwise in relation to the allotment of equity securities up to a maximum nominal value of £12,856, representing approximately 5% of the Company's issued Ordinary Share capital as at 15 March 2006, which is in accordance with the relevant guidelines for the Company.

If approved, the Section 80 authority and the Section 89 authority will expire at the conclusion of next year's Annual General Meeting or 15 months after the passing of the resolution, whichever is earlier. The Directors have no present intention of exercising the Section 80 authority or the Section 89 authority.

The Directors believe that it remains advantageous for the Company to be in a position to purchase its own Ordinary Shares. Resolution 11 will seek to grant power to the Company to purchase its own shares pursuant to section 166 of the Companies Act 1985. This authority is limited to an aggregate maximum number of 25,711,999 Ordinary Shares, representing approximately 10% of the Company's issued Ordinary Share capital as at 15 March 2006. This power will expire at the conclusion of next year's Annual General Meeting or 15 months after the passing of the resolution, whichever is earlier. The maximum price which may be paid for an Ordinary Share will be an amount which is not more than 5% above the average of the mid-market quotations of the Ordinary Shares as derived from the London Stock Exchange Daily Official List. The Directors have no present intention of exercising all or any of the powers conferred by this resolution and will only exercise this authority if it is in the interests of shareholders generally.

By order of the Board

Garry Barnes
Secretary
15 March 2006

Statement of compliance

The Company supports the principles of corporate governance contained in the Combined Code on Corporate Governance which is appended to the Listing Rules of the Financial Services Authority (the 'Combined Code').

The Board is accountable to the Company's shareholders for good governance. The Company has, since being admitted to the Official List of the London Stock Exchange on 9 December 2005, complied with the majority of the provisions of the Combined Code. The statements below describe how the Company has applied the principles identified in the Combined Code. Following admission to the Official List of the London Stock Exchange in December 2005 the Company is presently working towards compliance in the areas of Board balance, performance evaluation and membership of the Audit and Remuneration Committees.

The Board

The Board meets regularly during the year as well as on an ad-hoc basis as required by time critical business needs. The Board is responsible to shareholders for the effective and proper management and control of the Company and has a formal schedule of matters reserved for its decisions. Its primary roles are to determine and review Company strategy and policy, consider acquisitions and disposals, assess requests for major capital expenditure and give consideration to all other significant financial matters. This process is undertaken following discussions in conjunction with senior executive management who in turn are responsible for day to day conduct of the Group's operations and for reporting to the Board on the progress being made in meeting the objectives. The Board met 16 times during the year and the attendance of each of the Directors is shown on page 27.

As at 31 December 2005, the Board comprised six members, being the executive Chairman, Mr Christopher Miller, three other executive Directors and two non-executive Directors. Three executive Directors served throughout the year: Mr Christopher Miller, Chairman, Mr David Roper, Chief Executive and Mr Simon Peckham, Chief Operating Officer. During the year the Board appointed Mr Geoffrey Martin as Group Finance Director, effective 7 July 2005. One non-executive Director, Mr Miles Templeman, served throughout the year. A further non-executive Director, Mr Peregrine Crosthwaite, was appointed on 26 July 2005. The number of non-executive Directors (excluding the Chairman) does not represent at least half the Board. The Board intends to appoint a further non-executive Director in due course. The terms and conditions of the non-executive Directors' appointments are available for inspection at the Company's registered office.

The Board believes the Directors possess diverse business experience in spheres complementary to the activities of Melrose PLC, as well as other sectors. Biographies of the Directors are shown on page 21. These biographies identify any other appointments held by the Directors. None of the executive Directors receive any income from their appointment as non-executive Director elsewhere.

Neither the Audit Committee nor the Remuneration Committee comprises three independent non-executive Directors because the Company currently has only two independent non-executive Directors. In addition, Mr Christopher Miller, the Chairman (who is not independent) is currently a member of both the Audit Committee and the Remuneration Committee. However, as noted above, the Company aims to appoint a further non-executive Director in due course. This newly appointed non-executive Director will be appointed to the Audit and Remuneration Committees respectively, at which time Mr Christopher Miller will cease to be a member of those Committees.

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

Mr Peregrine Crosthwaite held the position of Director at Investec Investment Banking, the Company's sponsor, until his retirement in 2004. The Board believes that, notwithstanding the provisions of paragraph A.3.1 of the Combined Code, Mr Crosthwaite's previous position at Investec does not affect his independence as a non-executive Director of the Company as he had no direct involvement in advising the Company at any point during his time at Investec. The Board is therefore of the opinion that Mr Crosthwaite is an independent non-executive Director for the purposes of the Combined Code.

Mr Miles Templeman holds 1,478 Convertible B Shares, which were allotted to him on 13 October 2003 at the time when the Company was formed. The Board believes that, notwithstanding the provisions of paragraph A.3.1 of the Combined Code, Mr Templeman's holding of Convertible B Shares does not affect his independence as a non-executive Director of the Company.

Given the period for which the Company has been admitted to the Official List, a formal process of performance evaluation in relation to the Board has not been implemented. The Chairman has however held regular meetings with all the Directors individually. During the year, the Chairman met with the non-executive Directors, including the senior independent non-executive Director, Mr Miles Templeman, to discuss the performance of the executive Directors and the Board as a whole.

In accordance with the Company's articles of association, one third (or the number nearest to but not less than one third) of all Directors are required to retire and submit themselves for re-election at each Annual General Meeting of the Company. It is the policy of the Board that non-executive Directors are appointed for an initial term of three years, following which their appointment will be reviewed.

On appointment, all Directors are advised that they have access to the advice and services of the Company Secretary and, in addition, that they are entitled to seek independent professional advice in the furtherance of their duties, if necessary, at the Company's expense.

A comprehensive pack of briefing papers and an agenda is provided for each Director, normally seven days in advance of each meeting. The Directors are able to seek further clarification and information on any matter from any other Director or 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 and executive management.

Chairman and Chief Executive

The Board's policy is that the roles of Chairman of the Board and Chief Executive of the Company should be split.

The division of responsibilities of the Chairman and the Chief Executive is set out in writing and has been approved by the Board. The Board considers that the respective roles and responsibilities are clearly understood by both individuals and by the Board as a whole.

Committees of the Board

The Board has three standing Committees, Remuneration, Nomination and Audit, whose members comprise Mr Christopher Miller and two independent non-executive Directors. The duties of the Committees are set out in formal terms of reference. These are available from the Company Secretary. Membership of the Committees is shown below. The Company Secretary acts as Secretary of each of the Committees.

Remuneration Committee

The Remuneration Committee currently comprises Mr Christopher Miller and two independent non-executive Directors, Mr Peregrine Crosthwaite and Mr Miles Templeman. Mr Peregrine Crosthwaite chairs the Committee. The Company aims to appoint a further non-executive Director in due course. This newly appointed non-executive Director will be appointed to the Remuneration Committee, at which time Mr Christopher Miller will cease to be a member.

The function of the Committee is to establish and review the terms and conditions of employment of the executive Directors, and to make recommendations to the Board on the overall framework and broad policy for the remuneration of the Company's Directors and other senior executives within the Group.

The Committee met once during the year. The attendance of its members is shown in the table on page 27. The report to shareholders on how Directors are remunerated, together with details of each individual Director's remuneration are shown on pages 29 to 31.

Nomination Committee

The Nomination Committee currently comprises Mr Christopher Miller and two independent non-executive Directors, Mr Miles Templeman and Mr Peregrine Crosthwaite. Mr Miles Templeman is the Chairman of the Nomination Committee.

The Committee reviews the structure, size and composition of the Board, particularly in relation to the balance of skills, experience and knowledge, and seeks to ensure that both executive and non-executive Directors have the necessary skills and attributes for the future success of the Group. The Committee reviews succession plans for the Directors and makes recommendations to the Board on membership of the Board and of its Committees. The Committee retains external search consultants as appropriate.

The Committee is expected to meet not less than twice a year and during 2005 the Committee met twice.

Audit Committee

The Audit Committee currently comprises Mr Christopher Miller and two independent non-executive Directors, Mr Miles Templeman and Mr Peregrine Crosthwaite. Mr Miles Templeman is the Chairman of the Audit Committee.

Each member of the Committee brings relevant financial experience from senior executive and non-executive positions. Their biographies are shown on page 21.

The Committee is expected to meet not less than three times a year and during 2005 the Committee met three times. The attendance of its members is shown in the table on page 27. The Committee invites the Finance Director and senior representatives of the external auditors to attend meetings as appropriate to the business being considered. In addition, the Committee has the right to invite any other employees to attend meetings where this is considered appropriate.

The Committee is responsible for the development, implementation and monitoring of the Company's policy on external audit and for overseeing the objectivity and effectiveness of the Auditors. The Committee recommends the appointment and re-appointment of the Company's external auditors and considers the scope of their audit work and the cost effectiveness of their work. The Committee approved the audit and non-audit services which have been provided by Deloitte & Touche LLP during 2005. A significant proportion of the non-audit services related to non-recurring work in connection with the acquisition of the Dynacast Group and the McKechnie Group in May 2005, and the preparation and publication of the Company's listing particulars prior to full listing on the London Stock Exchange on 9 December 2005.

Deloitte & Touche LLP also advised on tax matters, which was considered to be appropriate, given their depth of knowledge of the affairs and financial practices in the Group. The Committee is satisfied that, notwithstanding this work, Deloitte & Touche LLP have retained objectivity and independence during the year.

The Committee monitors and reviews the effectiveness of the Group's internal control systems, accounting policies and practices, risk management procedures and compliance controls as well as the integrity of the Company's financial statements.

The Chairman of the Committee will attend the Company's Annual General Meeting to respond to any shareholder questions that might be raised concerning the Committee's activities.

Attendance at meetings

The table below shows the attendance of each of the Directors at meetings of the Board and its Committees held during the year. Briefing papers and a meeting agenda are provided to each Director in advance of each meeting. Decisions are taken by the Board, in conjunction, where appropriate, with the recommendations of its Committees and advice from external advisers and executive management. In addition, during those months when a Board meeting is not scheduled, a pack of management reports, including financial analysis, is sent to each of the Directors.

	Board	Audit	Remuneration	Nomination
Number of meetings	16[1]	3	1	2
J C Miller	7	3	1	2
D A Roper	13			
S A Peckham	14			
G P Martin[2]	6			
M H Templeman	6	3	1	2
P K O Crosthwaite[3]	3	2	1	

[1] These meetings comprise four regular quarterly meetings of the Board, together with twelve ad-hoc meetings, convened to consider specific items of business. Whilst all Directors were given due notice of these ad-hoc meetings, and received full briefing papers in advance of them, their attendance at such meetings was not required for the purpose of dealing with the business under consideration thereat.

[2] Appointed to the Board 7 July 2005.

[3] Appointed to the Board 26 July 2005.

Internal control and risk management

Philosophy and policy

The objective of the Directors and senior management is to safeguard and increase the value of the business and assets of the Group. Achievement of this objective requires the development of policies and appropriate internal controls to ensure the Group's resources are managed properly and any risks are identified.

The Board is ultimately responsible for the Company's system of internal control and for reviewing its effectiveness. The systems and processes established by the Board are designed to manage, rather than eliminate the risk of failure to achieve business objectives and cannot provide absolute assurance against material misstatement or loss. The Board has delegated responsibility for reviewing the suitability of practices and procedures to the Audit Committee.

The Company's senior management is responsible for the suitability of current systems and the Audit Committee ensures the effectiveness and efficiency of the processes implemented by senior management. This includes discussions with senior management of the Group. These findings are in turn discussed by the full Board. The Board is committed to satisfying the internal control guidance for Directors set out in the ICAEW Turnbull Report. Further, the Board is aware of the major risks facing the Company and the steps taken by the Company where possible to mitigate such risks.

Managing risks

A summary of the structures and processes in place to identify and manage risks across the Group is set out below. Divisional executives, plant managers and financial controllers are responsible for managing the business risks within their facility.

Risk profiling

There is an ongoing process to identify and evaluate risks faced by the Company, through the conduct of regular meetings and business reviews with the Group's senior management. The risk process is regularly reviewed by the Board.

Controlling risk

The Group has policies which address a number of key business risks, including financial, treasury and health and safety. The policies are made available to relevant employees through policy manuals and also via employee briefings on specific topics as appropriate. Senior management assume responsibility for managing risk in the businesses. Where appropriate, external advisers are appointed in order to support this process.

Accountability and audit

The Statement of Directors' responsibilities in relation to the consolidated and Company financial statements is set out on page 32.

Going concern
On the basis of current financial projections and facilities available, 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.

Internal financial controls
The Company has a comprehensive system for regular monitoring and reporting of financial performance and assessing the efficiency of the Group's systems of internal controls. A detailed budget is prepared by 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 also held involving senior management, at which the Company's overall performance is assessed. The results of these reviews are in turn reported to and discussed by the Audit Committee and the Board at each meeting.

The Audit Committee has considered whether there is a requirement for an internal audit function and based on the Group's strong financial controls and management, the Committee is satisfied that an internal audit function is not presently required. Instead, the audit of internal financial controls forms part of the responsibilities of the Company's finance function. This matter will be kept under regular review.

The Board confirms that it has reviewed the effectiveness of the system of internal controls for the year ended 31 December 2005.

Communications with shareholders
Principally via the executive Directors, the Company seeks to build on a mutual understanding of objectives with its institutional shareholders through regular meetings and presentations following announcements of annual and interim results. The senior independent Director, Mr Miles Templeman, is available to meet institutional shareholders should there be unresolved matters they wish to bring to his attention.

Institutional shareholders will be given the opportunity to meet with a new non-executive Director on request. The views of key analysts and shareholders are communicated back to the Board directly by individual Directors and via the Company's broker, ensuring all members of the Board develop an understanding of the views of major shareholders.

The attendance of all Directors is required at the Annual General Meeting. Corporate information is also available on the Company's website, www.melroseplc.net.

Constructive use of the Annual General Meeting
The Board welcomes the attendance of shareholders at the Annual General Meeting and the attendance of all Directors is required.

By order of the Board

Garry Barnes
Secretary
15 March 2006

Introduction and compliance
This report has been prepared by the Remuneration Committee on behalf of the Board in accordance with the requirements of section 234B of the Companies Act 1985 (as amended) (Directors' Remuneration Report regulations), the Combined Code ('the Code') and the Listing Rules of the Financial Services Authority. A resolution inviting shareholders to approve the report will be put to the Annual General Meeting on 4 May 2006.

The following sections have been subject to audit: Directors' emoluments and Directors' shareholdings.

Biographies of the Directors are shown on page 21. These biographies identify any other appointments held by the Directors. None of the executive Directors receive any income from their appointment as non-executive Director elsewhere.

Remuneration Committee
The Company has established a Remuneration Committee which is chaired by Mr Peregrine Crosthwaite, an independent non-executive Director. Other current members of the Committee are Mr Miles Templeman, an independent non-executive Director, and Mr Christopher Miller, the executive Chairman of Melrose PLC. The Company aims to appoint a further non-executive Director in due course. This newly appointed non-executive Director will be appointed to the Remuneration Committee, at which time Mr Christopher Miller will cease to be a member.

The function of the Remuneration Committee is set out on page 26 of the Corporate Governance Report. The terms of reference of the Committee are available from the Company Secretary.

Remuneration policy
The remuneration policy is established by the Board on the recommendation of the Remuneration Committee.

The policy for remuneration is that the package offered should be sufficient to attract, retain and motivate executive Directors and senior executives of the quality required, but not more than is necessary for this purpose. It is intended that variable pay should comprise a significant proportion of the total remuneration.

Remuneration is reviewed annually. The Committee and its advisers use a number of surveys of the employment market from which to obtain data.

The remuneration package
The remuneration package comprises base salary and benefits, annual bonus, long term incentive arrangements and pension contribution. All senior employees of the Group (including executive Directors) are remunerated using the policy described below.

Base salary and benefits: Base salary takes into account the performance of the individual and information from independent sources and consultants on market levels. An executive Director's basic salary is reviewed by the Committee prior to the beginning of each year and when an individual changes position or responsibility. Basic salaries were reviewed in December 2005 with increases taking effect from 1 January 2006. The executive Directors also receive a company car allowance and the benefit of private medical insurance.

Annual bonuses: Bonus scheme arrangements are in place for senior members of staff, including executive Directors. The intention is to link bonuses to Group performance. Bonuses are calculated based on personal and business performance.

Convertible B Shares ('Incentive Shares'): Melrose PLC has in place incentive arrangements which only reward participants if shareholder value is created, thereby aligning the interests of management with those of shareholders.

Under these incentive arrangements the participants hold Incentive Shares, which convert shortly after 31 May 2009 or, if earlier, on the takeover of the Company, into Ordinary Shares with an aggregate value at conversion equal to 10% of the increase in shareholder value. The number of Ordinary Shares arising on conversion will be determined by reference to the average market price of an Ordinary Share for 40 business days prior to conversion, or the takeover offer price (as the case may be).

The increase in shareholder value is calculated as the difference between the market capitalisation at conversion (determined by reference to the average market price of an Ordinary Share for 40 business days prior to conversion, or the offer price (as the case may be)), and the net invested capital in Melrose PLC, being the aggregate of the amounts paid on the Ordinary Shares up to conversion less all amounts paid by Melrose PLC by way of dividends or other distributions in respect of those shares, and where each such amount shall be adjusted in line with the movement in the RPI (plus 2% per annum) from the month of payment up to the month prior to the relevant trigger date.

With the consent of the Committee, participants may convert early up to one-third of their holdings in 2007 and in 2008.

As at 31 December 2005 the increase in shareholder value attributable to the Incentive Shares was calculated as £7,387,140. Details of the Directors' beneficial interests in the Incentive Shares are shown in the table of Directors' Shareholdings later in this report.

Pension: As at 31 December 2005, £109,072 had been set aside by the Company or its subsidiaries to provide pension, retirement or similar benefits to Directors. None of the Directors are members of any Group pension arrangement; the executive Directors receive a Company contribution to their individual pension arrangements.

Service contracts

The Company's policy on Directors' service contracts is that, in line with the best practice provisions of the Code, they should be terminable by the Company on one year's notice, and Directors' contracts do not provide for predetermined compensation in the event of termination. Any payments made would be determined by reference to normal contractual principles with mitigation being applied as appropriate.

The non-executive Directors do not have service contracts but have letters of appointment for an initial period of three years, which may be renewed by mutual agreement, normally for a maximum of two further three year terms. 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.

Details of the Directors' contracts and letters of appointment are as set out below:

Executive Directors	Date of contract	Notice period
Christopher Miller	15 Oct 2003	12 months
David Roper	15 Oct 2003	12 months
Simon Peckham	15 Oct 2003	12 months
Geoffrey Martin	5 Dec 2005	12 months

Non-executive Directors	Letter of appointment	End of period of appointment
Miles Templeman	15 Oct 2003	8 Oct 2006
Peregrine Crosthwaite	28 Nov 2005	25 Jul 2008

Non-executive Directors' fees

The executive Directors are responsible for proposing the non-executive Directors' fees. In proposing such fees they take account of similar fees paid to non-executive Directors in listed companies within the Group's listing sector and of similar size. Any decision on fee changes is taken by the Board as a whole. Individual non-executive Directors do not take part in discussion on their remuneration.

Non-executive Directors do not receive benefits or pension contributions from the Group.

Directors' emoluments	Salary/fees £	Bonus £	Benefits £	Pension contributions £	2005 Total emoluments £	2004 Total emoluments £
Executive Directors						
Christopher Miller	**189,501**	**60,000**	**12,195**	**28,309**	**290,005**	102,000
David Roper	**212,801**	**60,000**	**12,185**	**31,920**	**316,906**	141,000
Simon Peckham	**218,178**	**60,000**	**9,017**	**31,920**	**319,115**	141,000
Geoffrey Martin (appointed 7 July 2005)*	**112,821**	**60,000**	**8,417**	**16,923**	**198,161**	Nil
Non-executive Directors						
Miles Templeman	**25,615**	**–**	**–**	**–**	**25,615**	25,000
Peregrine Crosthwaite (appointed 26 July 2005)*	**11,417**	**–**	**–**	**–**	**11,417**	Nil

*Total emoluments represent period from appointment to 31 December 2005 only.

Directors' shareholdings

The Directors' beneficial interests, including interests of connected persons (within the meaning of section 346 of the Companies Act 1985), in the Ordinary Shares of the Company at the end of the financial year are shown below. None of the Directors had any non-beneficial interest at any time in the financial year. None of the Directors who held office at the end of the financial year had any beneficial interest in the shares of other Group Companies.

	Number of Ordinary Shares of Melrose PLC	
Director	**31 December 2005**	31 December 2004
Christopher Miller*	**4,950,000**	2,285,206
David Roper	**750,000**	385,206
Simon Peckham	**310,206**	260,206
Geoffrey Martin	**43,250**	Nil
Miles Templeman	**83,522**	33,522
Peregrine Crosthwaite	**150,000**	Nil

*The interest of Mr Christopher Miller includes 4,000,000 Ordinary Shares held by Harris & Sheldon Investments Limited, a company which is connected with Mr Christopher Miller within the meaning of the Companies Act 1985.

In addition, the Directors had a beneficial interest in the Convertible B Shares of £1 each ('Incentive Shares') of Melrose PLC at 31 December 2005 as follows:

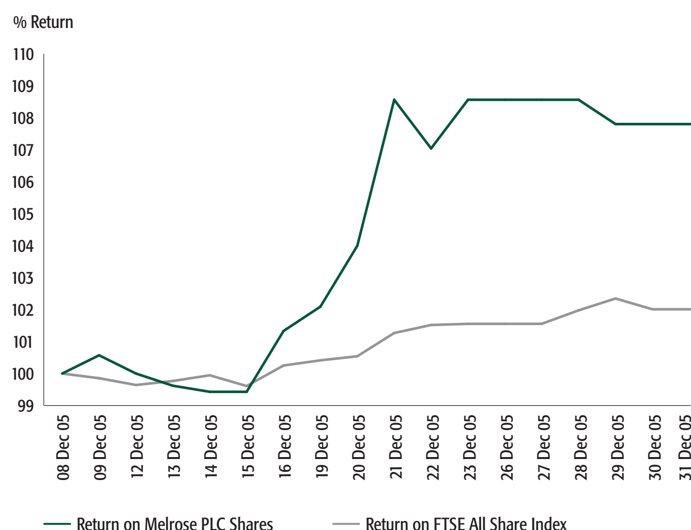
	Number of Incentive Shares of Melrose PLC	
Director	**31 December 2005**	31 December 2004
Christopher Miller	**14,794**	14,794
David Roper	**14,794**	14,794
Simon Peckham	**14,794**	14,794
Geoffrey Martin*	**Nil**	Nil
Miles Templeman	**1,478**	1,478
Peregrine Crosthwaite	**Nil**	Nil

*On 9 March 2006, the Board delegated authority to a committee to approve the grant of options to Mr Geoffrey Martin over 5,917 Incentive Shares (representing 10% of the issued Incentive Share capital) at an exercise price of £1 per share. These shares will continue to be held by Ogier Employee Benefit Trust Limited until Mr Martin's options are exercised.

Total shareholder return

The Ordinary Share capital of Melrose PLC was admitted to the Official List and to trading on the London Stock Exchange on 9 December 2005.

The performance of the Company's Ordinary Shares compared with the FTSE All Share Index for the period since the Company's listing and ended on 31 December 2005 is shown in the graph below.



This graph shows the value as at 31 December 2005 of £100 invested in Melrose PLC on 9 December 2005 compared with £100 invested in the FTSE All Share Index.

This report was approved by the Board on 15 March 2006 and signed on its behalf by:

Peregrine Crosthwaite
Chairman of the Remuneration Committee
15 March 2006

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report and the financial statements. The Directors are required to prepare financial statements for the Group in accordance with International Financial Reporting Standards (IFRS) and have chosen to prepare the Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP).

In the case of UK GAAP company financial statements, the Directors are required to prepare financial statements for each financial year which 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 these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable 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 the case of IFRS financial statements, company law requires the Directors to prepare such financial statements in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. International Accounting Standard 1 requires that financial statements present fairly for each financial year the Group's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards. Directors are also required to:

- 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 International Financial Reporting Standards is 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
- prepare the accounts on a going concern basis unless, having assessed the ability of the Company to continue as a going concern, management either intends to liquidate the entity or to cease trading, or have no realistic alternative but to do so.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' report and Directors' remuneration report which comply with the requirements of the Companies Act 1985.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MELROSE PLC ON THE GROUP FINANCIAL STATEMENTS

We have audited the Group financial statements of Melrose PLC for the year ended 31 December 2005 which comprise the consolidated income statement, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of recognised income and expenses and the related notes 1 to 30. These Group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

We have reported separately on the individual Company financial statements of Melrose PLC for the year ended 31 December 2005.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 Auditors' 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.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' remuneration report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted for use in the European Union are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the Group financial statements and the part of the Directors' remuneration report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view in accordance with the relevant financial reporting framework and whether the Group financial statements and the part of the Directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We report to you if, in our opinion, the Directors' report is not consistent with the Group financial statements. We also report to you if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' transactions with the Company and other members of the Group is not disclosed.

We also report to you if, in our opinion, the Company has not complied with any of the four directors' remuneration disclosure requirements specified for our review by the Listing Rules of the Financial Services Authority. These comprise the amount of each element in the remuneration package and information on share options, details of long term incentive schemes, and money purchase and defined benefit schemes. We give a statement, to the extent possible, of details of any non-compliance.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statement on internal control covers all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the Directors' report, and the other information contained in the Annual Report for the year as described in the contents section, and we consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements and the part of the Directors' remuneration report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements and the part of the Directors' remuneration report described as having been audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements and the part of the Directors' remuneration report described as having been audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union, of the state of the Group's affairs as at 31 December 2005 and of its loss for the year then ended; and
- the Group financial statements and the part of the Directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

Deloitte & Touche LLP

Chartered Accountants and Registered Auditors
London, United Kingdom
15 March 2006

CONSOLIDATED INCOME STATEMENT

	Notes	Before exceptional costs and intangible asset amortisation* £m	Exceptional costs and intangible asset amortisation* £m	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Continuing operations					
Revenue	4	269.9	–	269.9	–
Cost of sales		(207.2)	–	(207.2)	–
Gross profit		62.7	–	62.7	–
Selling and distribution costs		(14.5)	–	(14.5)	–
Administration expenses	6	(21.3)	(3.1)	(24.4)	(0.9)
Share of joint ventures' operating profits	12	0.6	–	0.6	–
Other operating costs	5	–	(16.3)	(16.3)	(3.8)
Operating profit/(loss)	4	27.5	(19.4)	8.1	(4.7)
Finance costs	6	(7.3)	–	(7.3)	–
Finance income	6	0.7	–	0.7	0.5
Profit/(loss) before tax		20.9	(19.4)	1.5	(4.2)
Tax	7	(6.3)	0.9	(5.4)	–
Profit/(loss) for the period from continuing operations	23	14.6	(18.5)	(3.9)	(4.2)
Attributable to:					
Equity holders of the parent				(3.9)	(4.2)
Minority interests				–	–
				(3.9)	(4.2)
Loss per share					
Basic	9			(2.4)p	(32.3)p
Diluted	9			(2.4)p	(32.3)p

*Other than computer software amortisation.

CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE

	Notes	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Currency translation on net investments in subsidiary undertakings	23	**17.5**	–
Gains on cash flow hedges	23	**1.5**	–
Actuarial adjustments on pension liabilities	21	**2.2**	–
Net income recognised directly in equity		**21.2**	–
Transferred to profit and loss account on cash flow hedges	23	**(0.1)**	–
Loss for the year	23	**(3.9)**	(4.2)
Total recognised income and expense for the year		**17.2**	(4.2)
Attributable to:			
Equity holders of the parent		**17.2**	(4.2)
Minority interests		**–**	–
		17.2	(4.2)

CONSOLIDATED BALANCE SHEET

	Notes	31 December 2005 £m	31 December 2004 £m
Non-current assets			
Goodwill and other intangible assets	10	**408.2**	–
Property, plant and equipment	11	**89.9**	–
Interests in joint ventures	12	**2.7**	–
Derivative financial instruments	22	**1.4**	–
Deferred tax assets	20	**29.1**	–
		531.3	–
Current assets			
Property held for re-sale	13	**1.6**	–
Inventories	14	**56.0**	–
Trade and other receivables	15	**86.3**	0.2
Cash and short term deposits	16	**15.2**	11.7
		159.1	11.9
Total assets		**690.4**	11.9
Current liabilities			
Trade and other payables	17	**94.1**	3.4
Interest-bearing loans and borrowings	18	**3.9**	–
Current tax liabilities		**8.7**	–
Provisions	19	**10.7**	–
		117.4	3.4
Net current assets		**41.7**	8.5
Non-current liabilities			
Interest-bearing loans and borrowings	18	**210.0**	–
Deferred tax liabilities	20	**19.9**	–
Retirement benefit obligations	21	**60.5**	–
Provisions	19	**12.0**	–
		302.4	–
Total liabilities		**419.8**	3.4
Net assets		**270.6**	8.5
Equity			
Issued share capital	23	**0.3**	0.1
Share premium account	23	**12.8**	12.8
Merger reserve	23	**243.8**	–
Hedging and translation reserves	23	**18.9**	–
Accumulated losses	23	**(6.1)**	(4.4)
Equity attributable to holders of the parent		**269.7**	8.5
Minority interest	23	**0.9**	–
Total equity		**270.6**	8.5

The financial statements were approved by the Board of Directors on 15 March 2006 and were signed on its behalf by:

Geoffrey Martin
Group Finance Director

Simon Peckham
Chief Operating Officer

CONSOLIDATED CASH FLOW STATEMENT

	Notes	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Net cash from/(used in) operating activities	25	**7.1**	(1.7)
Investing activities			
Interest received		**0.7**	0.6
Dividends received from joint ventures		**0.5**	–
Proceeds on disposal of property, plant and equipment		**0.3**	–
Purchases of property, plant and equipment	11	**(7.0)**	–
Purchases of computer software	10	**(0.1)**	–
Acquisition of subsidiaries	24	**(199.6)**	–
Net cash (used in)/from investing activities		**(205.2)**	0.6
Financing activities			
Repayments of obligations under finance leases		**(0.2)**	–
Loan notes repaid		**(0.3)**	–
New bank loans		**201.7**	–
Net cash from financing activities		**201.2**	–
Net increase/(decrease) in cash and cash equivalents		**3.1**	(1.1)
Cash and cash equivalents at beginning of year		**11.7**	12.8
Effect of foreign exchange rate changes		**0.4**	–
Cash and cash equivalents at end of year		**15.2**	11.7

1 Corporate information

The consolidated financial statements of Melrose PLC for the period ended 31 December 2005 were authorised in accordance with a resolution of the Directors of Melrose PLC on 15 March 2006.

Melrose PLC is a company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given on page 69. The nature of the Group's operations and its principal activities are set out in note 4.

These financial statements are presented in pounds Sterling because that is the currency of the primary economic environment in which the Company operates. Foreign operations are included in accordance with the policies set out in note 2.

At the date of authorisation of these financial statements, certain Standards and Interpretations are in issue but not yet effective.

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group except for additional disclosures on capital and financial instruments when the relevant Standards come into effect for periods commencing on or after 1 January 2007.

2 Summary of significant accounting policies

Statement of compliance

The general principle that should be applied on the first time adoption of International Financial Reporting Standards (IFRS) is that standards in force at the first reporting date should be applied retrospectively.

There were no differences between UK GAAP in respect of the Melrose Group results and IFRS at 31 December 2004.

Basis of preparation

The financial statements have been prepared in accordance with IFRS for the first time. The disclosures required by IFRS 1 concerning the transition from UK GAAP to IFRSs are given in note 30. The 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 a historical cost basis. The consolidated financial statements are presented in pounds Sterling.

Basis of consolidation

The Group financial statements include the results of the parent undertaking and all its subsidiary undertakings. The results of businesses acquired during the period are included from the effective date of acquisition and of those sold during the period to the effective date of disposal.

Where Group accounting policies are not adopted in the financial statements of subsidiary undertakings, appropriate adjustments are made in the Group financial statements.

All inter-company balances and transactions, including unrealised profits arising from intra-group transactions, have been eliminated in full.

Business combinations and goodwill

The acquisition of subsidiaries is accounted for using the purchase method. The cost of acquisition is measured as the cash paid, and the fair value of other assets given, and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. The acquired identifiable assets and liabilities are measured at their fair value at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (ie. discount on acquisition) is credited to the income statement in the period of acquisition.

Goodwill on acquisition is initially measured at cost, being the excess of the cost of the business combination 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.

As at the acquisition date, any goodwill acquired is allocated to each of 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. When there is a potential 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.

Joint ventures

A joint venture is an entity which is not a subsidiary undertaking but in which the interest of the Group is that of a partner in a joint venture over which the Group exercises joint control. The results, assets and liabilities of joint ventures are accounted for using the equity method of accounting.

Exceptional costs

Exceptional costs are those costs of a significant and non-recurring nature or those associated with significant restructuring programmes.

Operating profit

Operating profit is stated after charging exceptional costs and after the share of results of joint ventures but before investment income and finance costs.

Revenue

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods provided in the normal course of business, net of discounts, customs duties and sales taxes.

Borrowing costs

All borrowing costs are recognised as a finance cost in the income statement in the period in which they are incurred.

2 Summary of significant accounting policies continued

Issue costs of loans
The finance cost recognised in the income statement in respect of capital instruments is allocated to periods over the terms of the instrument at a constant rate on the carrying amount.

Use of estimates
The preparation of financial statements in conformity with generally accepted accounting practice requires management to make estimates and assumptions that affect the reported amount of assets and liabilities as well as the disclosure of contingent assets and liabilities at the balance sheet date and the reported amounts of revenues and expenses during the reporting period. Actual outcomes could differ from those estimates.

Property, plant and equipment
Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value.

The initial cost of an asset comprises its purchased price or construction cost, and any costs directly attributable to bring the asset into operation. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalised value of a finance lease is also included within property, plant and equipment.

For property, the deemed cost as at the date of transition to IFRS is the fair value at the date of the last valuation of these assets less accumulated depreciation until the date of transition.

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 but not exceeding 50 years
Short leasehold property	over the term of the lease
Plant and other equipment	3-12 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 for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists 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, the 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 and allocated proportionately.

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 and the carrying amount of the item) is included in the income statement in the year 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 determined in relation to the specific circumstances of the business acquired and are valued on an appropriate basis.

Access to the use of patented technology, trade names etc is 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 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 etc.

The estimated useful lives of intangible assets are:

Patented technology	5 years or less
Customer relationships	10 years or less
Trade names	20 years or less

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.

Computer software assets are amortised over their estimated useful lives (up to five years) on a straight-line basis.

As with property, plant and equipment, intangible assets 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.

Clearly defined and identifiable development projects in which the technical degree of exploitation, adequacy of resources and potential market or development possibility in the undertaking are recognisable, and where it is the intention to produce, market or execute the project, are capitalised when a correlation exists between the costs incurred and future benefits and the costs can be measured reliably. Costs not meeting such criteria are expensed as incurred.

Inventories
Inventories are valued at the lower of cost and net realisable value. 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. Provision has been made for obsolescence or other losses where necessary.

Trade and other receivables
Trade receivables are recognised and carried at original invoice amount less an allowance for doubtful debts. An allowance is recorded for the difference between the carrying amount and the estimated recoverable amount.

2 Summary of significant accounting policies continued

Cash and cash equivalents
Cash and short term deposits in the balance sheet comprise cash in hand and current balances with banks and similar institutions and short term deposits with an original maturity of three months or less which are subject to insignificant risks of changes in value.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Interest-bearing loans and borrowings
All loans and borrowings are initially recognised at cost, being the 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 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 net profit or loss when the liabilities are derecognised or impaired, as well as through the amortisation process.

Leases
Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the lease or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

Derivative financial instruments and hedging
Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently remeasured to their fair value. The method of recognising the resulting gain or loss is dependent on whether the derivative contract is designed to hedge a specific risk and qualifies for hedge accounting. On the date a derivative contract is entered into, the Group designates derivatives which qualify as hedges for accounting purposes as either a) a hedge of the fair value of a recognised asset or liability (fair value hedge), or b) a hedge of a forecast transaction or firm commitment (cash flow hedge) or c) a hedge of a net investment in a foreign entity.

Changes in the fair value of derivatives which are fair value hedges and that are highly effective are recognised in the income statement, along with any changes in the fair value of the hedged asset or liability that is attributable to the hedged risk. Changes in the fair value of derivatives in cash flow hedges are recognised in equity. Where the forecasted transaction or firm commitment results in the recognition of an asset or liability, the gains and losses previously included in equity are included in the initial measurement of the asset or liability. Otherwise, amounts recorded in equity are transferred to the income statement and classified as revenue or expense in the same period in which the forecasted transaction affects the income statement.

Hedges of net investments in foreign entities are accounted for similarly to cash flow hedges. The Group hedges certain net investments in foreign entities with foreign currency borrowings. All foreign exchange gains or losses arising on translation are recognised in equity and included in cumulative translation differences.

Certain derivative instruments, while providing effective economic hedges under the Group's policies, do not qualify for hedge accounting. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

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. Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain is the expense relating to any provision presented in the income statement, net of any reimbursement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax 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.

Environmental liabilities
Liabilities for environmental costs are recognised when environmental assessments or clean-ups are probable and the associated costs can be reasonably estimated. Generally, the timing of these provisions coincides with the commitment to a formal plan of action. The amount recognised is the best estimate of the expenditure required. Where the liability will not be settled for a number of years, the amount recognised is the present value of the estimated future expenditure.

Employee benefits
Wages, salaries, bonuses, social security contributions, paid annual leave and sick leave are accrued in the year in which the associated services are rendered by employees of the Group. The accounting policy for pensions and other post-retirement benefits is described below.

Pensions and other post-retirement benefits
The Group operates defined benefit pension schemes and defined contribution schemes, which require contributions to be made to administered funds separate from the Group. In some jurisdictions, funds are not administered separately from the Group but appropriate liabilities are recognised in the balance sheet.

For the defined benefit pension and post-retirement benefit plan, plans assets are measured at fair value and plan liabilities are measured on an actuarial basis, using the projected unit credit method 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.

The service cost of providing pension and other post-retirement benefits to employees for the period is charged to the income statement. The cost of making improvements to pension and other post-retirement benefits is recognised in the income statement on a straight-line basis over the period during which the increase in benefits vests. To the extent that the improvement in benefits vests immediately, the cost is recognised immediately. These costs are recognised as an expense.

A charge representing the unwinding of the discount on the plan liabilities during the period is included within other finance costs.

2 Summary of significant accounting policies continued

A credit representing the expected return on the plan assets during the period is included within other finance costs. This credit is based on the market value of the plan assets, and expected rates of return, at the beginning of the year.

Actuarial gains and losses may result from: differences between the expected return and the actual return on plan assets; differences between the actuarial assumptions underlying the plan liabilities and actual experience during the period; or changes in the actuarial assumptions used in the valuation of the plan liabilities. Actuarial gains and losses, and taxation thereon, are recognised in the statement of recognised income and expense.

For defined contribution plans, contributions payable for the year are charged to the income statement as an operating expense.

Foreign currency translation
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 statement 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.

In order to hedge its exposure to certain foreign exchange risks, the Group enters into forward contracts and options (see above for details of the Group's accounting policies in respect of such derivative financial instruments).

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 classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

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 closing rate.

Taxation
The tax expense represents the sum of the tax paid or currently payable and deferred tax.

The tax expense is based on the taxable profits for the period. 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 that have been enacted or substantially enacted by the balance sheet date.

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 goodwill that is not tax deductible or 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 taxable temporary differences associated with investments in subsidiaries and interests in joint ventures, except where the timing of the reversal of the temporary differences 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, associates and interests in joint ventures, 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 substantially enacted at the balance sheet date.

Tax relating to items recognised directly in equity are recognised in equity and not in the income statement.

2 Summary of significant accounting policies continued

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
- 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.

Non-current assets held for re-sale
Where non-current assets are held for re-sale, the assets are transferred to current assets and held in the balance sheet at their fair value.

Share-based payments
The Group has applied the requirements of IFRS 2 Share-based Payments. The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value 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.

3 Critical accounting judgements

In applying the Group's accounting policies as set out in note 2, management has made critical accounting judgements in the determination of the fair value of assets and liabilities acquired, valuation of intangible assets, the carrying value of deferred tax assets, the quantification of provisions and the impairment of goodwill. Due to the inherent uncertainty involved in making assumptions and estimates, actual outcomes will differ from those assumptions and estimates. An analysis of the key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities within the next financial year is provided below.

Intangible assets
The valuation of intangible assets requires management to estimate the net present value of the additional future cash flows arising from access to patented technology and to the use of the Dynacast name to determine the value of those intangible assets. Similarly, to determine the net present value of certain customer relationships management estimates the additional future cash flows arising from those relationships after estimating the attrition factor ('customer churn') relevant to the customer relationship and to other factors such as access to the workforce, which were appropriate to the determination of the additional cash flows.

Deferred tax assets
The carrying value of a significant deferred tax asset is dependent on sufficient taxable profits being generated in the USA in the next five years.

Provisions
The quantification of certain liabilities within provisions (for environmental remediation obligations and for future legal costs in relation to certain claims) have been estimated. However, such liabilities depend on the actions of third parties and on the specific circumstances pertaining to each obligation, neither of which is controlled by the Group.

Impairment of non-current assets
Goodwill and intangible assets are tested for impairment whenever events or circumstances indicate that their carrying amounts might be impaired. Such events and circumstances include the effects of restructuring initiated by management.

To determine whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires management to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value. The carrying amount of intangible assets at the balance sheet date was £408.2 million. At 31 December 2005, the Group recognised no impairment loss in respect of these assets but impairment losses could arise if changes are necessary to the assumptions underlying the estimates in future cash flows of cash-generating units or if there are changes in market interest rates which affect the discount rates applied to the cash flow.

Retirement benefit obligations
In assessing the Group's obligations relating to retirement benefits, management made key assumptions relating to current and future mortality, expected returns on plan assets and discount rates.

Fair value at acquisition
On the acquisition of the Dynacast and McKechnie Groups, management made assumptions regarding the fair value of assets and liabilities acquired in conjunction with professional advisers and applied hindsight, where appropriate to the circumstances of particular assets/liabilities. Estimations were made, in particular, of intangible assets, deferred tax assets, retirement benefit obligations, freehold property valuations and provisions.

4 Segment information

The Group's primary reporting format is business segments and its secondary format is geographical segments. The operating businesses are organised and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets. All reported turnover is derived from one activity, the sale of goods.

The Dynacast segment is a supplier of die-cast parts and components to a range of industries. The Aerospace OEM segment is a supplier of specialised quality components to the aerospace industry, the Aerospace Aftermarket segment is a supplier of replacement parts to the world's leading airlines, and McKechnie Vehicle Components ('MVC') supplies exterior trim products to major vehicle manufacturers in the USA. McKechnie Plastic Components ('MPC') is a UK supplier of plastic injection moulded and extruded components to the automotive, consumer durable, IT and other industries. The McKechnie PSM ('PSM') segment manufactures and distributes specialised fasteners globally to automotive and other industries.

Transfer prices between business segments are set 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 assets and operations.

Business segments
The following table presents revenue and profit information and certain asset and liability information regarding the Group's business segments for the period ended 31 December 2005. Inter-segment sales are not material and have not been included in the analysis below. All businesses were acquired in the period therefore no comparatives have been presented.

4 Segment information continued

Business segment	Dynacast £m	OEM £m	Aftermarket £m	MVC £m	MPC £m	PSM £m	Other £m	Total £m
Revenue								
Segment revenue	**105.0**	**69.4**	**15.2**	**31.6**	**27.1**	**21.6**	**–**	**269.9**
Operating profit/(loss)								
Segment result	**13.6**	**14.6**	**0.3**	**0.3**	**1.2**	**0.4**	**(2.9)**	**27.5**
Exceptional items and amortisation of other intangibles	**(4.9)**	**(1.8)**	**–**	**(0.1)**	**–**	**(10.5)**	**(2.1)**	**(19.4)**
Operating profit/(loss)	**8.7**	**12.8**	**0.3**	**0.2**	**1.2**	**(10.1)**	**(5.0)**	**8.1**
Assets and liabilities								
Segment assets	**299.5**	**218.6**	**11.9**	**42.7**	**38.0**	**44.0**	**31.4**	**686.1**
Interests in joint ventures	**–**	**–**	**–**	**–**	**–**	**2.7**	**–**	**2.7**
Property held for re-sale	**1.6**	**–**	**–**	**–**	**–**	**–**	**–**	**1.6**
Liabilities	**52.7**	**38.4**	**3.4**	**10.9**	**10.8**	**17.3**	**286.3**	**419.8**
Other segment information								
Capital expenditure including computer software	**3.7**	**1.0**	**0.1**	**0.6**	**0.5**	**1.0**	**0.2**	**7.1**
Depreciation and amortisation of computer software	**4.5**	**1.7**	**0.1**	**1.1**	**1.1**	**1.1**	**0.1**	**9.7**

Geographical area	North America £m	Europe £m	Asia £m	Total £m
Revenue				
Segment revenue	**133.9**	**108.2**	**27.8**	**269.9**
Operating profit				
Segment result	**13.4**	**7.2**	**6.9**	**27.5**
Exceptional items and amortisation of other intangibles	**(3.8)**	**(15.6)**	**–**	**(19.4)**
Operating profit	**9.6**	**(8.4)**	**6.9**	**8.1**
Assets and liabilities				
Assets	**395.2**	**235.2**	**55.7**	**686.1**
Interest in joint ventures	**–**	**1.7**	**1.0**	**2.7**
Property for re-sale	**–**	**1.6**	**–**	**1.6**
Liabilities	**61.1**	**343.2**	**15.5**	**419.8**
Other segment information				
Capital expenditure including computer software	**1.4**	**4.2**	**1.5**	**7.1**
Depreciation and amortisation of computer software	**3.8**	**5.0**	**0.9**	**9.7**

Other liabilities largely represent the Group's borrowing and the McKechnie Pension Plan.

5 Exceptional items

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Dynacast restructure	**3.7**	–
PSM restructure	**10.5**	–
Listing expenses	**2.1**	–
Abortive acquisition expenses	**–**	3.8
	16.3	3.8

In November 2005 the Group announced the closure of the loss making part of the European fastener business of PSM. The total cost of the closure is £10.5 million.

The Dynacast restructuring costs relate to the closure of the UK manufacturing facility, the Taiwan tool-making facility and the Turkish manufacturing facility. The total cost of these closures was £3.7 million.

On 9 December 2005 the Company was admitted to the Official List of the London Stock Exchange and expenses associated with the listing were £2.1 million.

6 Revenues and expenses

Finance costs	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Bank loans and overdrafts	(6.1)	–
Finance cost of pensions	(1.2)	–
Interest received	0.7	0.5
Total finance (costs)/income	(6.6)	0.5

The finance cost of pensions is the net of the interest cost on benefit obligations of £4.1 million and the expected return on plan assets of £2.9 million (2004: £nil and £nil respectively).

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Operating profit is stated after charging:		
Depreciation	8.4	–
Amortisation of other intangible assets	3.1	–
Amortisation of computer software	1.3	–
Minimum lease payments recognised as an operating lease expense	2.2	–
Impairment of property, plant and equipment	1.9	–
Staff costs (see below)	73.7	0.6
Research and development costs	0.8	–
Auditors' remuneration for audit services	0.8	–
Auditors' remuneration for other services:		
As reporting accountant on acquisitions	2.0	–
As reporting accountant on the step up to the Official List	1.5	–
For taxation advice	0.8	–

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Staff costs during the period (including Directors):		
Wages and salaries	62.4	0.5
Social security costs	8.7	–
Pension costs		
– UK defined benefit plan	0.2	–
– defined contribution schemes	2.4	0.1
	73.7	0.6

	Year ended 31 December 2005 Number	Year ended 31 December 2004 Number
Average number of persons employed		
Dynacast	1,290	–
OEM	649	–
Aftermarket	45	–
MVC	292	–
MPC	313	–
PSM	438	–
Corporate	16	6
	3,043	6

The average numbers shown above are calculated on a monthly basis. The number of employees at the year end was 5,416.

7 Income tax

Analysis of charge in period:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Current tax	**3.0**	–
Deferred tax (note 20)	**2.4**	–
Total income tax expense	**5.4**	–

The tax for the period is higher than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Profit/(loss) on ordinary activities before tax	**1.5**	(4.2)
Tax on profit/(loss) on ordinary activities at UK corporate tax rate (30%)	**0.5**	(1.3)
Expenses not deductible for tax purposes	**0.7**	–
Adjustment in respect of foreign tax rates	**0.7**	–
Excess losses not utilised	**4.3**	1.3
Deductible items not in profit and loss account	**(0.8)**	–
Total tax charge for the period	**5.4**	–

8 Dividends

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Proposed final dividend for the year ended 31 December 2005 of 3p (2004: nil) per share	**7.7**	–

The recommended final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as an expense or liability in these financial statements.

9 Earnings per share

Earnings	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	**(3.9)**	(4.2)
Exceptional items	**16.3**	3.8
Other intangible asset amortisation	**3.1**	–
Tax	**(0.9)**	–
Earnings for headline earnings per share	**14.6**	(0.4)

	Number	Number
Weighted average number of Ordinary Shares for the purposes of basic earning per share (million)	**160.2**	13.1
Further shares for the purposes of fully diluted earnings per share (million)	**0.2**	–

Earnings per share	Year ended 31 December 2005 Pence	Year ended 31 December 2004 Pence
Basic earnings per share	**(2.4)**	(32.3)
Fully diluted earnings per share	**(2.4)**	(32.3)
Headline earnings per share	**9.1**	(3.1)
Fully diluted headline earnings per share	**9.1**	(3.1)

Where basic earnings per share are a loss, the anti-dilutive effect of any further shares is ignored.

All earnings are derived from continuing operations.

10 Intangible assets

	Goodwill £m	Other intangible assets £m	Computer software £m	Total £m
Cost				
At 31 December 2004	–	–	–	–
Recognised on acquisition of a subsidiary (see note 24)	331.6	58.8	2.6	393.0
Additions	–	–	0.1	0.1
Exchange adjustments	16.8	2.7	–	19.5
At 31 December 2005	**348.4**	**61.5**	**2.7**	**412.6**
Amortisation				
At 31 December 2004	–	–	–	–
Charge for the period	–	(3.1)	(1.3)	(4.4)
At 31 December 2005	**–**	**(3.1)**	**(1.3)**	**(4.4)**
Net book value				
At 31 December 2005	**348.4**	**58.4**	**1.4**	**408.2**
At 31 December 2004	–	–	–	–

Other intangible assets include patented technology, customer relationships and trade names.

10 Intangible assets continued

Goodwill has been allocated to the business segments, each of which comprises several cash-generating units (CGU's) as follows:

	31 December 2005 £m	31 December 2004 £m
Dynacast	**174.7**	–
OEM	**128.3**	–
Aftermarket	**3.8**	–
MVC	**18.3**	–
MPC	**–**	–
PSM	**23.3**	–
	348.4	–

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

The recoverable amounts of the CGU's are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGU's. The growth rates are based on a prudent estimate of industry growth forecasts. Changes in selling prices and direct costs are based on past practices and expectations of future changes in the market.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management and extrapolates cash flows for the following 19 years (20 years in total) based on estimated growth rates of between 2% and 5%. This rate does not exceed the average long term growth rate for the relevant markets. The discount rate applied is 12%.

11 Property, plant and equipment

	Land and buildings £m	Plant and equipment £m	Total £m
Cost			
At 31 December 2004	–	–	–
Business acquired (see note 24)	35.5	56.9	92.4
Additions	0.2	6.8	7.0
Disposals	(0.2)	(0.5)	(0.7)
Transfer to current assets	(1.6)	–	(1.6)
Exchange adjustments	0.5	2.8	3.3
At 31 December 2005	**34.4**	**66.0**	**100.4**
Depreciation			
At 31 December 2004	–	–	–
Charge for the period	(0.8)	(7.6)	(8.4)
Disposals	0.1	0.1	0.2
Exchange adjustments	(0.1)	(0.3)	(0.4)
Impairment	–	(1.9)	(1.9)
At 31 December 2005	**(0.8)**	**(9.7)**	**(10.5)**
Net book value			
At 31 December 2005	**33.6**	**56.3**	**89.9**
At 31 December 2004	–	–	–

The net carrying amount of plant and equipment includes £1.5 million in respect of assets held under finance leases.

12 Interests in joint ventures

	31 December 2005 £m	31 December 2004 £m
Aggregated amounts relating to joint ventures:		
Total assets	**4.2**	–
Total liabilities	**(1.5)**	–
Revenues	**3.9**	–
Profit	**0.6**	–

A list of significant investments in joint ventures including the name, country of incorporation and proportion of ownership interest is given in note 3 of the Melrose PLC UK GAAP financial statements.

13 Property held for re-sale

The property owned and occupied by Dynacast (UK) Limited became available for sale following the closure of the Dynacast UK manufacturing facility. The carrying value of £1.6 million is equal to the sale proceeds and the sale was completed on 28 February 2006.

14 Inventories

	31 December 2005 £m	31 December 2004 £m
Raw materials	**14.1**	–
Work in progress	**20.4**	–
Finished goods	**21.5**	–
	56.0	–

15 Trade and other receivables

	31 December 2005 £m	31 December 2004 £m
Trade debtors	**74.7**	–
Other debtors	**7.4**	0.2
Prepayments	**4.2**	–
	86.3	0.2

Trade receivables are non-interest bearing and are generally on credit terms usual for the businesses and territories in which the Group operates.

16 Cash and short term deposits

	31 December 2005 £m	31 December 2004 £m
Cash at bank and in hand	**15.2**	11.7

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates. Short term deposits are made for varying periods of between one day and one month and earn interest at the respective short term deposit rates.

At 31 December 2005, the Group had available £27.0 million of undrawn committed borrowing facilities.

17 Trade and other payables

	31 December 2005 £m	31 December 2004 £m
Trade payables	**59.1**	–
Other payables	**10.2**	3.4
Interest payable	**1.6**	–
Other taxes and social security	**2.1**	–
Accruals	**21.1**	–
	94.1	3.4

Trade payables are non-interest bearing. Normal settlement terms vary by country, usually being between 30 and 90 days. Other payables are non-interest bearing and have an average term of approximately two months.

18 Interest-bearing loans and borrowings

	Effective interest rate %	Maturity	31 December 2005 £m
Current			
Finance leases	–	2006	**0.4**
Loan notes	LIBOR minus 1%	December 2005	**0.5**
Overdrafts	LIBOR plus 1%	On demand	**3.0**
			3.9
Non-current bank loans			
Denominated in the following currencies:			
US Dollar loan	5.21	May 2010	**127.5**
Euro loan	3.22	May 2010	**59.8**
Sterling loan	5.57	May 2010	**20.0**
Euro loan (Austria)	1.00	July 2011	**1.7**
			209.0
Finance leases		2007-2009	**1.0**
			210.0

The Group has entered into an interest rate swap on the US Dollar loan as detailed in note 22.

The interest rate re-pricing profile of financial liabilities, after taking into account hedging interest rate derivatives, is described in note 22.

There was no interest bearing debt at 31 December 2004.

The bank loans are repayable:

	Percentage of bank loan repayable
In the third year	15.0
In the fourth year	17.5
In the fifth year	67.5
	100.0

The Austrian loan is repayable in six equal monthly instalments between 2 January 2008 and 1 July 2011. The rate of interest increases to 1.5% on 1 January 2008. The loan is secured on the assets of the Austrian subsidiary.

19 Provisions

	Onerous contracts £m	Surplus leasehold property costs £m	Environ-mental remediation costs £m	Factory closure £m	Other £m	Total £m
At 31 December 2004	–	–	–	–	–	–
Acquisitions	6.7	2.9	3.2	0.3	3.0	16.1
Fair value adjustments	0.6	–	1.2	–	1.6	3.4
Utilised	(1.1)	–	(0.6)	(0.3)	(1.2)	(3.2)
Profit and loss account	–	–	–	6.2	–	6.2
Foreign exchange	–	–	–	–	0.2	0.2
At 31 December 2005	**6.2**	**2.9**	**3.8**	**6.2**	**3.6**	**22.7**
Current						10.7
Non-current						12.0
						22.7

The provision for onerous contracts relates to the losses arising from a long term supply arrangement and to a property lease.

The provision for surplus leasehold property costs is the estimated net rentals payable over the period of the leases together with any dilapidation costs discounted at 5%.

Environmental remediation provisions relate to the estimated clean up costs of pollution and legal costs at certain subsidiaries.

Factory closure costs relate to the closure of the Dynacast operations in the UK and Turkey and to the closure of the loss making part of PSM Europe's operations principally in the UK and the Czech Republic.

Other provisions relate mainly to the buyout of commission/agency agreements and estimated legal costs arising from claims for which no other liability is expected to crystallise.

20 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:

	Accelerated capital allowances and other liabilities £m	Tax losses and other assets £m	Post-retirement benefit obligations £m	Intangible assets £m	Total £m
At 1 January 2004	–	–	–	–	–
Charge to income	–	–	–	–	–
Charge to equity	–	–	–	–	–
Exchange differences	–	–	–	–	–
At 1 January 2005	–	–	–	–	–
Acquisition of subsidiary	(4.3)	30.2	1.9	(17.6)	10.2
Credit/(charge) to income	1.3	(4.4)	(0.2)	0.9	(2.4)
Exchange differences	(0.2)	1.6	–	–	1.4
At 31 December 2005	**(3.2)**	**27.4**	**1.7**	**(16.7)**	**9.2**

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2005 £m	2004 £m
Deferred tax liabilities	**(19.9)**	–
Deferred tax assets	**29.1**	–
	9.2	–

20 Deferred tax continued

At the balance sheet date, the Group has unused tax losses of £183 million (2004: £1.9 million) available for offset against future profits. A deferred tax asset has been recognised in respect of £29.1 million (2004: £nil) of such losses. No deferred tax asset has been recognised in respect of the remaining £153.9 million (2004: £1.9 million) due to the unpredictability of future profit streams. These losses may be carried forward indefinitely.

A significant part of the retirement benefit obligations recognised in the Group accounts relates to the McKechnie Pension Plan. No deferred tax asset has been recognised on this obligation due to the unpredictability of future profit streams in the United Kingdom.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £0.6 million (2004: £nil). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

Temporary differences arising in connection with interests in associates and joint ventures are insignificant.

21 Post-retirement benefit obligations

Prior to the acquisition, McKechnie and Dynacast had established a number of pension schemes covering many of their employees and operating in several jurisdictions.

The most significant schemes are:

1) The McKechnie Pension Plan ('the Plan') which provides defined benefit pensions for its members. The assets of the Plan are held in a fund administered by McKechnie Pension Trust Limited, an independent trustee company. An actuarial valuation of the Plan was carried out at 6 April 2004 and updated to 26 May 2005 and 31 December 2005 by a qualified independent actuary. Plan assets are stated at their bid value at 31 December 2005.
2) The Dynacast and MVC Pension Schemes in the US are funded schemes of a defined benefit type with assets held in separate trustee administered funds.
3) In Germany and Austria, unfunded defined benefit arrangements are operated.
4) There are also obligations to provide post-retirement healthcare to former employees of MVC and to provide termination indemnities in Italy, France, Mexico, Korea and Turkey.

The major weighted average assumptions used at 31 December 2005 by the actuaries in calculating the Group's pension scheme assets and liabilities together with details of the net pension assets or liabilities are as set out below:

	McKechnie Pension Plan (% p.a.)	Other schemes (% p.a.)
Rate of increase in salaries	3.3	3.0
Rate of increase in pensions in payment	2.7	1.5
Discount rate	4.8	4.9
Inflation assumption	2.8	2.1

The weighted average assumptions used at 26 May 2005 are set out below:

	McKechnie Pension Plan (% p.a.)	Other schemes (% p.a.)
Rate of increase in salaries	3.2	3.1
Rate of increase in pensions in payment	2.6	1.5
Discount rate	5.1	5.1
Inflation assumption	2.7	2.1

Current mortality

In the UK Plan, current mortality has been allowed for in the actuarial valuation by reference to the PA92 tables which are considered by our actuarial advisers to be appropriate given the Plan's geographic and industrial sector.

Future mortality improvements

In addition, an allowance has been made for future improvements in mortality by way of an age rating to the base tables. The allowance for non pensioners is three years and the allowance for pensioners is one year. This has the effect of increasing the calculated pension liabilities by approximately 8% from the amount calculated using the base tables for current mortality.

21 Post-retirement benefit obligations continued

The amount recognised in the balance sheet arising from obligations in respect of defined benefit schemes is as follows:

	31 December 2005 £m	31 December 2004 £m	31 December 2003 £m
Benefit scheme obligations	**145.5**	–	–
Benefit scheme assets	**85.0**	–	–
Benefit liabilities	**60.5**	–	–

This amount is presented in the balance sheet:

	31 December 2005 £m	31 December 2004 £m	31 December 2003 £m
Non-current liabilities			
– unfunded plans	**8.7**	–	–
– funded plans	**51.8**	–	–
	60.5	–	–

Expected returns and fair value of assets:

	Expected return			Fair value of assets		
	31 December 2005 %	26 May 2005 %	31 December 2004 %	31 December 2005 £m	26 May 2005 £m	31 December 2004 £m
Equity instruments	**7.1**	7.4	–	**61.4**	47.2	–
Debt instruments	**4.6**	4.8	–	**12.3**	11.6	–
Other assets	**4.1**	4.4	–	**11.3**	11.1	–
Weighted average/total	**6.3**	6.5	–	**85.0**	69.9	–

The expected return on scheme assets for 2006 is based on market expectations at 1 January 2006 for returns on assets over the entire life of the obligation.

There is no self investment (other than in tracker funds) either in the Group's own financial instruments or property or other assets used by the Group.

Amounts recognised in income in respect of these defined benefit schemes is as follows:

	31 December 2005 £m	31 December 2004 £m	31 December 2003 £m
In arriving at operating profit (included with cost of sales, selling and distribution costs and administrative expenses)	**0.6**	–	–
– current service cost	**0.6**	–	–
– past service cost	**–**	–	–
– effects of curtailments and settlements	**–**	–	–
Included in finance costs	**1.2**	–	–
– interest cost	**4.1**	–	–
– expected return on assets	**(2.9)**	–	–

The actual return on scheme assets was £10.6 million.

The amount recognised in the Consolidated Statement of Recognised Income and Expenses is as follows:

	31 December 2005 £m	31 December 2004 £m	31 December 2003 £m
Experienced losses on scheme liabilities	**(5.5)**	–	–
Experienced gains on scheme assets	**7.7**	–	–
	2.2	–	–

The cumulative amount of actuarial gains and losses recognised in the Consolidated Statement of Recognised Income and Expenses is a gain of £2.2 million.

21 Post-retirement benefit obligations continued

Movements in the benefit liabilities during the period:

	31 December 2005 £m	31 December 2004 £m	31 December 2003 £m
At beginning of period	–	–	–
Acquisition	136.3	–	–
Current service cost	0.6	–	–
Interest cost	4.1	–	–
Actuarial loss	5.5	–	–
Benefits paid	(1.8)	–	–
Currency loss	0.8	–	–
At end of period	145.5	–	–

Movements in the fair value of scheme assets during the period:

	31 December 2005 £m	31 December 2004 £m	31 December 2003 £m
At beginning of period	–	–	–
Acquisition	69.9	–	–
Expected return on assets	2.9	–	–
Actuarial gains	7.7	–	–
Employer contributions	5.8	–	–
Benefits paid	(1.8)	–	–
Currency gain	0.5	–	–
At end of period	85.0	–	–

The Company has agreed a schedule of contributions of £5 million per annum with the Trustee of the McKechnie Pension Plan. A contribution of £0.5 million to the Dynacast US Plan is expected in 2006.

22 Derivative financial instruments

Credit risk
The Group's principal financial assets are cash and short term deposits and trade and other receivables, which represent the Group's maximum exposure to credit risk in relation to financial assets.

The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables, estimated by the Group's management based on prior experience and their assessment of the current economic environment.

The credit risk on interest bearing loans and borrowings is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

Fair values
The Directors consider that the financial assets and liabilities have fair values not materially different to the carrying values.

Foreign exchange contracts
As at 31 December 2005, the Group held foreign exchange forward contracts to mitigate expected exchange fluctuations on future sales to customers and future purchases from suppliers. The terms of the contracts are as follows:

	Maturities	Exchange rates
Buy US dollar 2.0 million	31 Jan 2006-28 Dec 2006	1.7369-1.7145

22 Derivative financial instruments continued

Hedge of net investments in foreign entities
Included in interest bearing loans were the following amounts, which have been designated as hedges of net investments in the Group's subsidiaries in Europe and USA and are being used to reduce the exposure to foreign exchange risk.

Borrowings in local currency:

	31 December 2005 £m	31 December 2004 £m
US dollar	127.5	–
Euro	59.8	–

Losses on the retranslation of these borrowings of £7.3 million have been transferred to equity to offset any gains or losses on translation of the net investments in subsidiaries.

Interest rate swaps/caps
The Group uses interest rate swaps to manage its exposure to interest rate movements on its US dollar bank borrowings by swapping its borrowings from floating to fixed rates. Two contracts with total nominal values of $219 million (£127 million) and fair value of £1.2 million have fixed interest payments at an average rate of 4.09% for periods up to July 2007.

The Group also uses interest rate caps to manage the interest rate profile. Two caps with a notional principal amount of £20 million, cap level of 5% and fair value of £nil were held at 31 December 2005 to hedge exposure on the Group's Sterling borrowings up to July 2007. Two caps with a notional principal amount of €87 million (£60 million), cap level of 3% and fair value of £0.2 million were held at 31 December 2005 to hedge exposure on the Group's Euro borrowings up to July 2007. All swaps and caps have been designated as cash flow hedges.

Foreign currency risk
The Group's proposed policy for managing foreign currency risk is set out in the Financial Review.

23 Issued capital and reserves

Share capital

	31 December 2005 £m	31 December 2004 £m
Authorised		
342,830,000 (2004: 17,000,000) Ordinary Shares of 0.1p each	0.3	–
59,170 (2004: 59,170) £1 Convertible B Shares of £1 each	0.1	0.1
	0.4	0.1
Allotted, called up and fully paid		
257,119,989 (2004: 13,120,000) Ordinary Shares of 0.1p each	0.2	–
59,170 (2004: 50,000) Convertible B Shares of £1 each	0.1	0.1
	0.3	0.1

On 16 May 2005, the authorised share capital was increased from £76,170 to £402,000 by the creation of an additional 325,830,000 new Ordinary Shares of 0.1p each.

243,999,989 shares were issued on 26 May 2005 in connection with the acquisition of McKechnie and Dynacast (see note 24). The shares were issued at a premium of 99.9p. 9,170 Convertible B Shares were issued in the period at par.

The Convertible B Shares are non-voting and not entitled to any dividends. Under these arrangements the Directors and employees hold Convertible B Shares which convert shortly after 31 May 2009 or, if earlier, on a takeover of the Company, into Ordinary Shares with an aggregate value on conversion equal to 10% of the increase in shareholder value. The number of Ordinary Shares arising on conversion will be determined by reference to the average market price of an Ordinary Share for 40 business days prior to conversion or the takeover offer price (as the case may be).

The increase in shareholder value is calculated as the difference between the market capitalisation of the Company at conversion (determined by reference to the average market price of an Ordinary Share for 40 business days prior to conversion, or the offer price (as the case may be)), and the net invested capital in the Company, being the aggregate of the amounts paid on the Ordinary Shares up to conversion less all amounts paid by the Company by way of dividends or other distributions in respect of those shares, where each such amount shall be adjusted in line with the movement in the RPI (plus 2%, per annum).

Further details are given in the Remuneration Report.

23 Issued capital and reserves continued

Share premium

	£m
At 31 December 2004 and 31 December 2005	**12.8**

Merger reserve

	£m
At 31 December 2004	–
Premium arising on issue of 243,999,989 Ordinary Shares in connection with the acquisition of the Dynacast and McKechnie Groups	243.8
At 31 December 2005	**243.8**

Section 131 of the Companies Act 1985 has been applied to the share premium arising on the issue of Ordinary Shares in connection with the acquisition of 100% of the equity of the holding companies in the Dynacast and McKechnie Groups.

Own shares

On 16 September 2005, the Trustee of the Melrose PLC Employee Share Ownership Trust resolved to accept £9,170 from Melrose PLC as additional Trust funds and to use the funds to subscribe for 9,170 Convertible B Shares in Melrose PLC, ratified as effective 26 May 2005. These shares were still held by the Trust at 31 December 2005. The Trust has had no other transactions in the shares of Melrose PLC.

Reserves

	Hedging and translation reserve £m	Accumulated losses £m	Minority interests £m
At 31 December 2004	–	(4.4)	–
Currency translation adjustments	18.9	–	–
Profit for the period	–	(3.9)	–
Actuarial adjustments on pension liabilities	–	2.2	–
Acquired in the period	–	–	0.9
Total recognised income and expense for the period	18.9	(1.7)	0.9
At 31 December 2005	**18.9**	**(6.1)**	**0.9**

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. It is also used to record the net investments hedged in these subsidiaries.

Hedging and translation reserves

	Hedging reserve £m	Translation reserve £m	Total £m
Balance at 1 January 2004 and 1 January 2005	–	–	–
Exchange differences on translation of overseas operations	–	17.5	17.5
Increase in fair value of hedging derivatives	1.5	–	1.5
Transfer to income	(0.1)	–	(0.1)
Balance at 31 December 2005	**1.4**	**17.5**	**18.9**

24 Acquisition of subsidiaries

On 26 May, the Group acquired 100% of the issued share capital of the McKechnie Group and the Dynacast Group.

	Acquiree's carrying amount £m	Fair value adjustments £m	Fair value £m	Total £m
McKechnie				
Property, plant and equipment	43.8	8.4	52.2	
Intangible assets	2.4	32.4	34.8	
Joint ventures	2.7	–	2.7	
Inventories	36.4	(0.2)	36.2	
Trade receivables	49.7	(1.9)	47.8	
Trade payables	(46.2)	(0.7)	(46.9)	
Other payables	–	(3.0)	(3.0)	
Provisions	(16.1)	(2.3)	(18.4)	
Deferred tax	–	17.3	17.3	
Post-retirement benefit obligation	(54.2)	(0.7)	(54.9)	
Current tax	(2.7)	(0.8)	(3.5)	
Bank and cash balances	1.9	–	1.9	
Loan notes	(0.8)	–	(0.8)	
Overdraft	(5.4)	–	(5.4)	
Finance leases	(1.5)	–	(1.5)	
	10.0	48.5		58.5
Dynacast				
Property, plant and equipment	39.7	0.5	40.2	
Intangible assets	0.2	26.4	26.6	
Inventories	12.4	–	12.4	
Trade receivables	39.7	(2.8)	36.9	
Trade payables	(37.7)	–	(37.7)	
Other payables	–	(1.6)	(1.6)	
Provisions	–	(1.1)	(1.1)	
Post-retirement benefit obligation	(7.9)	(0.3)	(8.2)	
Minority interest	(0.9)	–	(0.9)	
Current tax	(7.0)	–	(7.0)	
Deferred tax	(2.6)	(7.1)	(9.7)	
Bank and cash balances	7.7	–	7.7	
Overdraft	(4.0)	–	(4.0)	
Finance leases	(0.1)	–	(0.1)	
	39.5	14.0		53.5
				112.0
Goodwill				331.6
Total consideration (including acquisition costs of £14.6 million)				443.6
Satisfied by:				
Shares issued				244.0
Cash consideration				199.6
				443.6
Net cash outflow in the period:				
Net cash acquired				0.2
Acquisition expenses paid				(14.6)
Proceeds of share issue applied				(244.0)
Cash consideration paid				(185.2)
				(443.6)

24 Acquisition of subsidiaries continued

Shares issued were at a fair value of £244.0 million as set out in note 23.

The fair value adjustments to property, plant and equipment relate to property valuations at the date of acquisition. The fair value adjustment to trade receivables relates to the write-off of bank fees not amortised on repayment of debt on acquisition. The fair value adjustment to provisions relates to an onerous lease.

The fair value adjustment to post-retirement benefit obligations relate mainly to the actuarial valuation of post-retirement healthcare obligation of MVC. Other fair value requirements relate to harmonisation of accounting policies.

The fair value adjustment to intangible assets relates to the valuation of patented technology, customer relationships and trade names.

The fair value adjustment to deferred tax assets arises on the valuation of US tax losses and other timing differences.

The goodwill arising on the acquisition of Dynacast and McKechnie is attributable to the anticipated profitability and cash flows arising from the businesses acquired.

25 Cash flow statement

	Notes	31 December 2005 £m	31 December 2004 £m
Operating profit/(loss) before exceptional costs and intangible asset amortisation*		**27.5**	(4.7)
Adjustments for:			
Depreciation of property, plant and equipment	11	**8.4**	–
Amortisation of computer software	10	**1.3**	–
Abortive acquisition expenses paid		**(3.4)**	–
Restructuring costs paid		**(2.9)**	–
Decrease in provisions		**(3.2)**	–
Profit of joint ventures		**(0.6)**	–
Operating cash flows before movements in working capital		**27.1**	(4.7)
Increase in inventories		**(7.0)**	–
Decrease/(increase) in receivables		**0.3**	(0.2)
Increase in payables		**1.2**	3.2
Cash generated by operations		**21.6**	(1.7)
Income taxes paid		**(4.8)**	–
Interest paid		**(4.5)**	–
Pension contribution paid		**(5.2)**	–
Net cash flow from operating activities		**7.1**	(1.7)

*Other than computer software amortisation.

26 Commitments and contingencies

Amounts due under finance leases and hire purchase contracts:

Future minimum lease payments under finance leases and hire purchase contracts were as follows:

	31 December 2005 £m	31 December 2004 £m
Amounts payable:		
Within one year	0.4	–
After one year but within five years	1.1	–
More than five years	–	–
Total minimum lease payments	1.5	–
Less amounts representing finance charges	(0.1)	–
	1.4	–

Future minimum rentals payable under non-cancellable operating leases as at 31 December 2005 were as follows:

	31 December 2005		31 December 2004	
	Land and buildings £m	Plant and machinery £m	Land and buildings £m	Plant and machinery £m
Amounts payable:				
Within one year	3.0	0.7	–	–
After one year but within five years	11.7	1.2	–	–
More than five years	5.7	–	–	–
	20.4	1.9	–	–

Capital commitments

At 31 December 2005 there were commitments of £1.5 million (2004: £nil) relating to the acquisition of new plant and machinery.

27 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.

During the period the Group entered into transactions in the ordinary course of business with related parties as follows:

	Sales of goods £m	Purchase of goods £m	Amounts owed by related parties £m
Joint ventures	4.1	0.3	1.4

Sales to and purchases from related parties are priced as arm's length transactions 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.

	31 December 2005 £000	31 December 2004 £000
Short term employee benefits	1,161	409
Post-employment benefits	–	–
Other long term benefits	–	–
Termination benefits	–	–
Share-based payments	–	–
	1,161	409

28 Post balance sheet events

There are no post balance sheet events.

29 Contingent liabilities

Prior to the acquisition of the Dynacast Group and the McKechnie Group, there were a number of legal and environmental claims outstanding. Whilst it is difficult to reasonably estimate the ultimate outcome of these claims, the Directors' best estimate of the outcome of these claims has been included in the balance sheet. The outcome could be different to that provided in the balance sheet.

30 Transition to IFRS

This is the first year that the Group has presented its financial statements under IFRS. The following disclosures are required in the year of transition:

- The last financial statements under UK GAAP were for the year ended 31 December 2004.
- The date of transition to IFRS was 1 January 2004.
- Reconciliation of equity – there were no differences to the equity of the Group under IFRS compared to UK GAAP at either 31 December 2004 or 1 January 2005.
- Reconciliation of loss – there were no differences to the loss reported in year ended 31 December 2004 under UK GAAP to that under IFRS.
- IFRS would require no adjustment to the cash flow to that reported under UK GAAP for the year ended 31 December 2004.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MELROSE PLC ON THE COMPANY FINANCIAL STATEMENTS

We have audited the individual Company financial statements of Melrose PLC for the year ended 31 December 2005 which comprise the balance sheet and the related notes 1 to 13. These individual Company financial statements have been prepared under the accounting policies set out therein.

The corporate governance statement and the Directors' remuneration report are included in the Group Annual Report of Melrose PLC for the year ended 31 December 2005. We have reported separately on the Group financial statements of Melrose PLC for the year ended 31 December 2005 and on the information in the Directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 Auditors' 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.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report and the individual Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the individual Company financial statements in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the individual Company financial statements give a true and fair view in accordance with the relevant financial reporting framework and whether the individual Company financial statements have been properly prepared in accordance with the Companies Act 1985. We report to you if, in our opinion, the Directors' report is not consistent with the individual Company financial statements. We also report to you if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read the Directors' report, and the other information contained in the annual report for the year as described in the contents section, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the individual Company financial statements.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the individual Company financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the individual Company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the individual Company financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the individual Company financial statements.

Opinion

In our opinion:

- the individual Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2005; and
- the individual Company financial statements have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London, United Kingdom
15 March 2006

COMPANY BALANCE SHEET FOR MELROSE PLC

	Notes	31 December 2005 £m	31 December 2004 £m
Fixed assets			
Investment in subsidiaries	3	**237.0**	–
Fixtures and fittings		**0.1**	–
		237.1	–
Debtors: Amounts falling due after one year			
Derivative financial instruments	4	**1.4**	–
Current assets			
Debtors	4	**403.2**	0.2
Cash at bank and in hand		**0.1**	11.7
		403.3	11.9
Creditors: Amounts falling due within one year			
Bank overdrafts	6	**(3.0)**	–
Other creditors	5	**(161.9)**	(3.4)
		(164.9)	(3.4)
Net current assets		**238.4**	8.5
Total assets less current liabilities		**476.9**	8.5
Creditors: Amounts falling due after more than one year			
Bank loans	5/6	**(207.3)**	–
Net assets		**269.6**	8.5
Capital and reserves			
Issued share capital	7	**0.3**	0.1
Share premium account	8	**12.8**	12.8
Merger reserve	9	**243.8**	–
Profit and loss account	10	**11.3**	(4.4)
Foreign currency hedging reserve	11	**1.4**	–
Shareholders' funds	12	**269.6**	8.5

The financial statements were approved by the Board of Directors on 15 March 2006 and were signed on its behalf by:

Geoffrey Martin
Group Finance Director

Simon Peckham
Chief Operating Officer

1 Significant accounting policies

Basis of accounting
The separate financial statements of the Company are presented as required by the Companies Act 1985. They have been prepared under the historical cost convention and in accordance with applicable United Kingdom Generally Accepted Accounting Practice ('UK GAAP') and law.

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

Investments
Fixed asset investments in subsidiaries and associates are shown at cost less provision for 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 only of the shares issued. Any premium is ignored.

Borrowing costs
All borrowing costs are recognised as interest payable 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 capital instruments is allocated to periods over the terms of the instrument at a constant rate on the carrying amount.

Property, plant and equipment
Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value.

The initial cost of an asset comprises its purchased price or construction cost, and any costs directly attributable to bring the asset into operation. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset. The capitalised value of a finance lease is also included within property, plant and equipment.

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 but not exceeding 50 years
Short leasehold property	over the term of the lease
Plant and other equipment	3-12 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 for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units 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, the 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 and the carrying amount of the item) is included in the income statement in the year the item is derecognised.

Cash and cash equivalents
Cash and short term deposits in the balance sheet comprise cash in hand and current balances with banks and similar institutions and short term deposits with an original maturity of three months or less which are subject to insignificant risks of changes in value.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Derivative financial instruments and hedging
Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently remeasured to their fair value. The method of recognising the resulting gain or loss is dependent on whether the derivative contract is designed to hedge a specific risk and qualifies for hedge accounting. On the date a derivative contract is entered into, the Group designates derivatives which qualify as hedges for accounting purposes as either a) a hedge of the fair value of a recognised asset or liability (fair value hedge), or b) a hedge of a forecast transaction or firm commitment (cash flow hedge) or c) a hedge of a net investment in a foreign entity.

Changes in the fair value of derivatives which are fair value hedges and that are highly effective are recognised in the income statement, along with any changes in the fair value of the hedged asset or liability that is attributable to the hedged risk. Changes in the fair value of derivatives in cash flow hedges are recognised in equity. Where the forecasted transaction or firm commitment results in the recognition of an asset or liability, the gains and losses previously included in equity are included in the initial measurement of the asset or liability. Otherwise, amounts recorded in equity are transferred to the income statement and classified as revenue or expense in the same period in which the forecasted transaction affects the income statement.

Hedges of net investments in foreign entities are accounted for similarly to cash flow hedges. The Group hedges certain net investments in foreign entities with foreign currency borrowings. All foreign exchange gains or losses arising on translation are recognised in equity and included in cumulative translation differences.

Certain derivative instruments, while providing effective economic hedges under the Group's policies, do not qualify for hedge accounting. Changes in the fair value of any derivative instruments that do not qualify for cash flow hedge accounting are recognised immediately in the income statement.

Interest-bearing loans and borrowings
All loans and borrowings are initially recognised at cost, being the 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 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 net profit or loss when the liabilities are derecognised or impaired, as well as through the amortisation process.

2 Profit for the year

As permitted by section 230 of the Companies Act 1985 the Company has elected not to present its own profit and loss account for the year. Melrose PLC reported a profit for the financial year ended 31 December 2005 of £15.7 million (2004: loss of £4.3 million).

The Auditors' remuneration for audit services to the Company was £0.1 million (2004: £nil).

Staff costs charged to operating profit comprise:

	31 December 2005 £m	31 December 2004 £m
Wages and salaries	**1.3**	0.5
Social security costs	**0.1**	–
Other pension costs	**0.1**	0.1
	1.5	0.6

The pension costs relate to payments made by the Company to individual employee personal pension arrangements.

3 Fixed asset investments

	31 December 2005 £m	31 December 2004 £m
Subsidiaries	**237.0**	–
Associates	**–**	–
	237.0	–

The Company has investments in the following subsidiaries and associates which principally affected the profits or net assets of the Group:

The following subsidiaries are directly owned by Melrose PLC and were acquired during the year:

Subsidiaries	Country of incorporation	Principal activity	Holding %
Dynacast Canada UK Limited	England & Wales	Hedging Company	100
Dynacast Holdings Limited	England & Wales	Holding Company	100
Dynacast International Limited	England & Wales	Holding Company	100
Melrose Management Resources Limited	England & Wales	Provision of management services	100
Melrose Overseas Holdings Limited	England & Wales	Holding Company	100
Melrose UK Holdings Limited	England & Wales	Holding Company	100
Mozart Jersey Holdings No. 1 Limited	Jersey	Holding Company	100
Mozart Jersey Holdings No. 2 Limited	Jersey	Holding Company	100

3 Fixed asset investments continued

Other indirectly owned subsidiaries and joint ventures of the Group are:

	Country of incorporation	Functional currency	% equity interest
Aero Quality Sales Limited	England & Wales	Sterling	100
Arger Enterprises, Inc	USA	US$	100
Dynacast (Melaka) Sdn Bhd	Malaysia	Ringgit	100
Dynacast (Shanghai) Limited	China	Chinese RMB	100
Dynacast (Singapore) PTE Limited	Singapore	SG$	100
Dynacast (UK) Limited	England & Wales	Sterling	100
Dynacast Beteiligungs GmbH	Germany	Euro	100
Dynacast Canada Inc	Canada	CN$	100
Dynacast Deutschland GmbH and Co KG	Germany	Euro	100
Dynacast Espana SA	Spain	Euro	97
Dynacast France SAS	France	Euro	100
Dynacast Holdings (France) SAS	France	Euro	100
Dynacast Inc	USA	US$	100
Dynacast Investments Limited	England & Wales	Sterling	100
Dynacast Italia S.r.l	Italy	Euro	100
Dynacast Korea Limited	Korea	Korean Won	90
Dynacast Loz d.o.o	Slovenia	Euro	70
Dynacast Österreich GmbH	Austria	Euro	100
Dynacast Taiwan Limited	Taiwan	NT$	100
Dynacast Teknik Dokum Sanayi Limited Sirketi	Turkey	US$	100
Dynacast US Holdings Inc	USA	US$	100
Dynacast Verwaltung GmbH	Germany	Euro	100
Fijaciones Industriales PSM SA	Spain	Euro	100
Hartwell Corporation	USA	US$	100
Japan PSM Company Limited	Japan	Yen	50
Jesse Industries, Inc	USA	US$	100
Linread Limited (trading as Linread Northbridge)	England & Wales	Sterling	100
McKechnie Aerospace Aftermarket Asia Limited	Hong Kong	Chinese RMB	51
McKechnie Aerospace Holdings Limited	England & Wales	Sterling	100
McKechnie Aerospace USA, Inc (trading as PTMI)	USA	US$	100
McKechnie Engineered Plastics Limited (trading as McKechnie Plastic Components (Stamford Bridge, Pickering and Burnett Polymer Engineering))	England & Wales	Sterling	100
McKechnie EP Holdings Limited	England & Wales	Sterling	100
McKechnie Holdings (UK) Limited	England & Wales	Sterling	100
McKechnie Investments Inc	USA	US$	100
McKechnie Management Services Limited	England & Wales	Sterling	100
McKechnie Specialist Products Limited (trading as PSM International, PSM Canning Brett and PSM Threadlocking and Sealing)	England & Wales	Sterling	100
McKechnie Vehicle Components USA Inc	USA	US$	100
Melrose Beteiligungs und Verwaltungs GmbH	Austria	Euro	100
Melrose Singapore 1 Pte Limited	Singapore	SG$	100
Melrose Singapore 2 Pte Limited	Singapore	SG$	100
Melrose Singapore Holdings Pte Ltd	Singapore	SG$	100
Melrose Spain SL	Spain	Euro	100
Melrose UK 1 Limited	England & Wales	Sterling	100
Melrose UK 1A Limited	England & Wales	Sterling	100
Melrose UK 2 Limited	England & Wales	Sterling	100
Melrose UK 2A Limited	England & Wales	Sterling	100
Melrose UK 3 Limited	England & Wales	Sterling	100
Melrose UK 3A Limited	England & Wales	Sterling	100
Melrose US 1 LLC	USA	US$	100
Melrose US 2 LLC	USA	US$	100
Melrose US 3 LLC	USA	US$	100

3 Fixed asset investments continued

	Country of incorporation	Functional currency	% equity interest
New Dynacast de Mexico SA de CV	Mexico	US$	100
Petcin France SA	France	Euro	100
PSM Celada Fasteners srl	Italy	Euro	50
PSM Fastener Corporation	USA	US$	100
PSM Fasteners (Asia) Ltd	Taiwan	NT$	100
PSM Fasteners (Pty) Limited	Australia	Australian $	50
PSM Fasteners (Singapore) PTE Co Ltd	Singapore	SG$	100
PSM Fasteners (Taiwan) Ltd	Taiwan	NT$	97
PSM Fasteners (Wuxi) Ltd	China	Chinese RMB	100
PSM Fasteners AB	Sweden	Swedish Kroner	50
PSM Fixation SA	France	Euro	100
PSM International SRO	Czech Republic	Koruna	100
PSM Threadlocking and Sealing GmbH	Germany	Euro	100
Sundaram Dynacast Limited	India	Rupee	49
Technical Airborne Components Industries Sprl	Belgium	Euro	100
Valley Todeco, Inc	USA	US$	100
Western Sky Industries LLC (trading as Tyee, Electromech, Welco and Aero Quality Sales)	USA	US$	100

Subsidiaries

	£m
Cost and net book value	
At 1 January 2005	–
Additions	237.0
Disposals	–
At 31 December 2005	**237.0**

4 Debtors

	31 December 2005 £m	31 December 2004 £m
Amounts falling due after one year:		
Derivative financial instruments	1.4	–

Details of the interest rate swaps/caps on which this amount arises are given in note 22 of the Group financial statements.

	31 December 2005 £m	31 December 2004 £m
Amounts falling due within one year:		
Amounts owed by Group undertakings	402.6	–
VAT recoverable	0.5	0.2
Prepayments	0.1	–
	403.2	0.2

5 Trade and other creditors

	31 December 2005 £m	31 December 2004 £m
Amounts falling due within one year:		
Trade creditors	–	–
Amounts owed to Group undertakings	156.1	–
Accruals	5.8	3.4
	161.9	3.4
Amounts falling due after one year:		
Bank loans and overdrafts	207.3	–
Trade creditors	–	–
	207.3	–

6 Bank loans

	Effective interest rate %	Maturity	31 December 2005 £m
Current			
Overdrafts	LIBOR plus 1%	On demand	**3.0**
Non-current bank loans			
Denominated in the following currencies:			
US Dollar loan	5.21	May 2010	**127.5**
Euro loan	3.22	May 2010	**59.8**
Sterling loan	5.57	May 2010	**20.0**
			207.3

There was no interest bearing debt at 31 December 2004.

The bank loans are repayable:

	Percentage of bank loan repayable
In the third year	15.0
In the fourth year	17.5
In the fifth year	67.5
	100.0

7 Called-up share capital

	31 December 2005 £m	31 December 2004 £m
Authorised:		
342,830,000 (2004: 17,000,000) Ordinary Shares of 0.1p each	**0.3**	–
59,170 (2004: 59,170) Convertible B Shares of £1 each	**0.1**	0.1
	0.4	0.1
Issued and fully paid:		
257,119,989 (2004: 13,120,000) Ordinary Shares of 0.1p each	**0.2**	–
59,170 (2004: 50,000) Convertible B Shares of £1 each	**0.1**	0.1
	0.3	0.1

On 16 May 2005, the authorised share capital was increased from £76,170 to £402,000 by the creation of an additional 325,830,000 new Ordinary Shares of 0.1p each.

On 16 September 2005, a further 9,170 Convertible B Shares of £1 each were issued and fully paid.

The Convertible B Shares are non-voting and not entitled to any dividend. Under these arrangements the Directors and employees hold Convertible B Shares which convert shortly after 31 May 2009 or, if earlier, on a takeover of the Company, into Ordinary Shares with an aggregate value on conversion equal to 10% of the increase in shareholder value. The number of Ordinary Shares arising on conversion will be determined by reference to the average market price of an Ordinary Share for 40 business days prior to conversion or the takeover offer price (as the case may be).

The increase in shareholder value is calculated as the difference between the market capitalisation of the Company at conversion (determined by reference to the average market price of an Ordinary Share for 40 business days prior to conversion, or the offer price (as the case may be)), and the net invested capital in the Company, being the aggregate of the amounts paid on the Ordinary Shares up to conversion less all amounts paid by the Company by way of dividends or other distributions in respect of those shares, where each such amount shall be adjusted in line with the movement in the RPI (plus 2%, per annum).

Own shares
On 16 September 2005, the Trustee of the Melrose PLC Employee Benefit Trust resolved to accept £9,170 from Melrose PLC as additional Trust funds and to use the funds to subscribe for 9,170 Convertible B Shares in Melrose PLC, ratified as effective 26 May 2005. These shares were still held by the Trust at 31 December 2005. The Trust has had no other transactions in the shares of Melrose PLC.

8 Share premium account

	£m
At 1 January and 31 December 2004	12.8
At 31 December 2005	**12.8**

9 Merger reserve

	Merger reserve £m
At 1 January 2005	–
Premium arising on issue of 243,999,989 Ordinary Shares in connection with the acquisition of the Dynacast and McKechnie Groups	243.8
At 31 December 2005	**243.8**

Section 131 of the Companies Act 1985 has been applied to the share premium arising on the issue of Ordinary Shares in connection with the acquisition of 100% of the equity of the holding companies in the Dynacast and McKechnie Groups.

10 Profit and loss account

	£m
At 1 January 2005	(4.4)
Dividends paid	–
Profit for the financial year	15.7
At 31 December 2005	**11.3**
At 1 January 2004	(0.2)
Dividends paid	–
Loss for the financial year	(4.2)
At 31 December 2004	(4.4)

11 Foreign currency hedging reserve

	£m
At 1 January 2005	–
Increase in fair value of hedging derivatives	1.5
Transfer to income	(0.1)
At 31 December 2005	**1.4**

12 Reconciliation of movements in equity shareholders' funds

	£m
At 1 January 2005	8.5
Dividends paid	–
Profit for the financial year	15.7
Increase in share capital	244.0
Increase in foreign currency hedging reserve	1.4
At 31 December 2005	**269.6**
At 1 January 2004	12.7
Dividends paid	–
Loss for the financial year	(4.2)
At 31 December 2004	8.5

13 Operating lease commitments

At the balance sheet date, the Company had outstanding commitments for future lease payments under non-cancellable operating leases which fall due as follows:

	31 December 2005 £m	31 December 2004 £m
Within one year	**0.3**	–
In the second to fifth years inclusive	**0.1**	–
After five years	**–**	–

As at 31 December 2005 there were 367 holders of Ordinary Shares in the Company. Their shareholdings are analysed as follows:

Size of shareholding	Number of shareholders	Percentage of total number of Ordinary shareholders	Number of Ordinary Shares	Percentage of Ordinary Shares
1-5,000	110	30.0	251,596	0.1
5,001-50,000	102	27.8	1,746,611	0.7
50,001-100,000	12	3.3	872,094	0.3
100,001-500,000	57	15.5	16,482,135	6.4
Over 500,000	86	23.4	237,767,553	92.5
Total	**367**	**100.0**	**257,119,989**	**100.0**

Financial calendar 2006

Annual General Meeting	4 May 2006
Payment of final dividend	19 May 2006
Announcement of interim results	September 2006
Intended payment of interim dividend	November 2006
Preliminary announcement of 2006 results	March 2007

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Bankers
Lloyds TSB Bank plc and Barclays Bank plc

Auditors
Deloitte & Touche LLP
Hill House
1 Little New Street
London EC4A 3TR

Legal advisers
Clifford Chance LLP
10 Upper Bank Street
London E14 5JJ

Notice is hereby given that the third Annual General Meeting of the Company will be held at the offices of Investec at 2 Gresham Street, London, EC2V 7QP at 11.30 am on 4 May 2006 for the following purposes:

ORDINARY BUSINESS

1. To receive the Company's audited financial statements for the financial year ended 31 December 2005, together with the Directors' report and the Auditors' report on those financial statements.
2. To declare a final dividend for the year ended 31 December 2005.
3. To re-elect Mr Christopher Miller, who retires by rotation, as a Director of the Company.
4. To re-elect Mr Miles Templeman, who retires by rotation, as a Director of the Company.
5. To elect Mr Geoffrey Martin, who has been appointed as a Director since the last Annual General Meeting, as a Director of the Company.
6. To elect Mr Peregrine Crosthwaite, who has been appointed as a Director since the last Annual General Meeting, as a Director of the Company.
7. To re-appoint Deloitte & Touche LLP as auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting of the Company at which accounts are laid and to authorise the Directors to determine their remuneration.

SPECIAL BUSINESS

To consider and, if thought fit, to pass the following resolutions which will be proposed, in the case of resolutions 8 and 9, as ordinary resolutions and, in the case of resolutions 10 and 11, as special resolutions:

8. That the Directors' remuneration report contained in the Company's Annual Report for the year ended 31 December 2005 be approved.
9. That, in substitution for all existing authorities the Directors be generally and unconditionally authorised in accordance with section 80 of the Companies Act 1985 (the 'Act') to exercise all the powers of the Company to allot relevant securities (within the meaning of that section) up to an aggregate nominal amount of £85,710. This authority will expire (unless previously renewed, varied or revoked by the Company in general meeting) 15 months after the date of the passing of this resolution or at the conclusion of the next Annual General Meeting of the Company following the passing of this resolution, whichever first occurs, save that the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after expiry of this authority and the Directors may allot relevant securities in pursuance of that offer or agreement as if the authority conferred by this resolution had not expired.
10. That, in substitution for all existing powers, and subject to the passing of resolution 9, the Directors be generally empowered pursuant to section 95 of the Act to allot equity securities (within the meaning of section 94(2) of the Act) for cash pursuant to the general authority conferred by resolution 9 as if section 89(1) of the Act did not apply to the allotment, provided that the power conferred by this resolution:

    a) will expire (unless previously renewed, varied or revoked by the Company in general meeting) 15 months after the date of the passing of this resolution or at the conclusion of the next Annual General Meeting of the Company following the passing of this resolution, whichever first occurs, save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after expiry of this power and the Directors may allot equity securities in pursuance of that offer or agreement as if the power conferred by this resolution had not expired;

    b) is limited to:

        i. allotments of equity securities in connection with a rights issue; and

        ii. allotments of equity securities for cash otherwise than pursuant to paragraph (i) up to an aggregate nominal value of £12,856.

    For the purposes of this resolution 10, 'rights issue' means an offer of equity securities, open for acceptance for a period fixed by the Directors, to holders of Ordinary Shares made in proportion (as nearly as may be) to their respective existing holdings of Ordinary Shares but subject to the Directors having a right to make such exclusions or other arrangements in connection with the offer as they deem necessary or expedient:

    a) to deal with equity securities representing fractional entitlements; and

    b) to deal with legal or practical problems arising in any overseas territory or by virtue of shares being represented by depositary receipts, the requirements of any regulatory body or stock exchange, or any matter whatsoever.

    The power conferred on the Directors by this resolution 10 shall also apply to a sale of Treasury Shares, which is an allotment of equity securities by virtue of section 94(3A) of the Act but with the omission of the words 'pursuant to the general authority conferred by resolution 9'.

11. That the Company be generally and unconditionally authorised to make one or more market purchases (within the meaning of section 163(3) of the Act) of Ordinary Shares of 0.1p each in the capital of the Company ('Ordinary Shares') provided that:

    a) the maximum aggregate number of Ordinary Shares authorised to be purchased is 25,711,999;

    b) the minimum price which may be paid for an Ordinary Share is 0.1p;

    c) the maximum price which may be paid for an Ordinary Share is an amount equal to 105% of the average of the middle market quotations for an Ordinary Share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which that Ordinary Share is purchased;

    d) this authority will expire 15 months after the date of the passing of this resolution or at the conclusion of the next Annual General Meeting of the Company following the passing of this resolution, whichever first occurs;

    e) the Company may make a contract to purchase Ordinary Shares under this authority before expiry of the authority which will or may be executed wholly or partly after the expiry of that authority, and may make a purchase of Ordinary Shares in pursuance of any such contract; and

    f) any Ordinary Shares purchased pursuant to this authority may either be held as Treasury Shares or cancelled by the Company, depending on which course of action is considered by the Directors to be in the best interests of shareholders at the time.

By order of the Board

Garry Barnes
Company Secretary
5 April 2006

Registered office
Precision House
Arden Road
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B49 6HN

Notes
These notes are important and require your immediate attention.

1. The holders of Ordinary Shares and Convertible B Shares in the Company are entitled to attend the Annual General Meeting, but only holders of Ordinary Shares are entitled to vote. A member entitled to attend and vote may appoint a proxy or proxies to attend and on a poll to vote on their behalf. A proxy need not be a member of the Company.

2. A form of proxy is enclosed with this notice. To be effective, a form of proxy must be completed, signed and deposited with the Company's registrars at the address specified on the form of proxy not less than 48 hours before the time for holding the meeting. Depositing a completed form of proxy will not preclude a member from attending the meeting and voting in person.

3. Pursuant to regulation 41 of the Uncertificated Securities Regulations 2001, to be entitled to attend and vote at the Annual General Meeting (and for the purposes of the determination by the Company of the number of votes they may cast), members must be entered on the Company's register of members by 11.30 am on 2 May 2006. Changes to entries on the register of members after this time shall be disregarded in determining the rights of any person to attend or vote at the meeting.

4. Copies of the following documents will be available for inspection at the Company's registered office during normal business hours (Saturdays, Sundays and public holidays excepted) from the date of this notice until the date of the Annual General Meeting and at the place of the Annual General Meeting for 15 minutes prior to and during the meeting:

    a) the register of Directors' interests in shares of the Company;

    b) copies of all service agreements under which Directors of the Company are employed by the Company or any subsidiaries; and

    c) a copy of the terms of appointment of the non-executive Directors of the Company.

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