7 March 2019

MELROSE INDUSTRIES PLC

AUDITED RESULTS
FOR THE YEAR ENDED 31 DECEMBER 2018

Melrose Industries PLC today announces its audited results for the year ended 31 December 2018. This includes 8 months of contribution from GKN since acquisition. An additional measure to guide ongoing performance, the 2018 unaudited, annualised adjusted[1] numbers, is also shown below.

Highlights

- The results for 2018 are ahead of the Board's previous expectations
- This outperformance has been achieved before including a £63 million positive impact from the required IFRS accounting treatment for loss-making contracts. Resolution of these loss-making positions offers significant potential for further performance improvement
- Adjusted[1] diluted earnings per share were up 36% on last year, with a proposed final dividend of 3.05 pence per share which is 9% up on last year, giving a full year dividend of 4.6 pence per share, up 10%
- Total free cash flow from trading was £196 million. This was after all costs including restructuring, special pension contributions and tax
- The net debt to EBITDA[1] leverage ratio has reduced to 2.3x, ahead of the previous guidance of 2.5x
- North America Aerostructures is approaching operational break-even, on a run rate basis, and relationships with key aerospace customers have been much improved
- In Automotive, present indications are consistent with a slowdown, but this is not currently expected to cause a major impact on 2019 profitability. Improvement actions are underway to ensure the successful long-term development of the business
- Nortek Group adjusted[1] operating margins have increased from 8.7% at acquisition to 14.7% in 2018 with the potential for further improvement
- The GKN UK defined benefit pension accounting deficit has reduced from £691 million to £588 million since December 2017, and an independent Chairman of the trustees has been appointed
- An investor event for Aerospace and Automotive will be held on 3 April 2019 in London

Justin Dowley, Chairman of Melrose Industries PLC, today said:

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

The audited results

	Results	
	Statutory £m	**Adjusted[1] £m**
Revenue	8,605	9,102
Operating (loss)/profit	(392)	847
(Loss)/profit before tax	(550)	703
Diluted earnings per share	(12.0)p	13.3p

- The statutory and adjusted[1] results include GKN for the eight months since acquisition on 19 April 2018
- The 2018 adjusted[1] operating profit was £847 million; excluding the positive impact from the required IFRS accounting for loss-making contracts in GKN it would have been £784 million
- The statutory loss before tax of £550 million arose primarily due to significant acquisition related items, most of which arise from GKN

The unaudited annualised adjusted[1] results – including 12 months of GKN

	Annualised adjusted[1] results including 12 months of GKN £m
Revenue	12,247
Operating profit	1,095
Profit before tax	886
Diluted earnings per share	13.8p

- The annualised adjusted[1] results include a full 12 months of GKN assuming it was acquired on 1 January 2018, and give a meaningful measure of annualised performance to guide ongoing results
- The annualised adjusted[1] operating profit was £1,095 million; excluding the positive impact from the required IFRS accounting for loss-making contracts in GKN it would have been £1,002 million
- The annualised adjusted[1] diluted earnings per share were 13.8 pence, up 41% on Melrose adjusted[1] diluted earnings per share last year

1. Described in the glossary to the 2018 Preliminary Announcement, released on 7 March 2019

ENDS

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CHAIRMAN'S STATEMENT

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

CALENDAR YEAR 2018

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

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

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

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

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

DIVIDEND

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

SHAREHOLDERS

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

BOARD MATTERS

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

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[1] Considered by the Board to be a key measure of performance. Adjusted measures are defined in the glossary to the Preliminary Announcement

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

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

ANNUAL REPORT & ACCOUNTS

The Annual Report & Accounts will be posted on 5 April 2019.

STRATEGY

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

OUTLOOK

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

Justin Dowley
Chairman
7 March 2019

CHIEF EXECUTIVE'S REPORT

2018 has obviously been a significant year in Melrose's history. We were pleased to be given the opportunity by shareholders to unlock the undoubted potential that exists within the GKN businesses and we look forward to delivering value to all of our shareholders. Upon taking control of GKN, we immediately set about removing the duplicated central functions and decentralising the GKN businesses, simultaneously reorganising the Melrose Group into the five divisions we have today: Aerospace; Automotive; Powder Metallurgy; Nortek Air & Security; and Other Industrial.

For the GKN businesses, decentralisation was the first step in bringing about the change in culture we believe is vital to securing long-term improvement. For GKN Aerospace and GKN Powder Metallurgy, we worked with incumbent management teams to agree their management plans. For GKN Automotive, we were pleased to fill the CEO vacancy with a high calibre candidate with a strong track record in the sector. With an ambitious new executive team around him, the GKN Automotive business will be transformed. In all cases these businesses present the exciting opportunity to improve their performance, as expected.

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

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

Part of these improving relationships has been the focus coming from the opening balance sheet review that identified a significant number of poorly performing contracts which are further detailed in the Finance Director's Review. While we have adopted the appropriate accounting treatment for these, we have also been clear that addressing these is a key priority for each of the GKN businesses and progress is already being made which has been welcomed by customers. Some of our investments to date have also been supporting this. We look forward to further updating shareholders on progress with these over the months to come. It is apparent that at acquisition these contracts constituted approximately 10% of GKN net sales, requiring a provision of £629 million as discussed in the Finance Director's Review. We think these contracts offer a large potential for performance improvement in the future.

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

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

Whilst FKI has been a very successful acquisition for shareholders, Brush has in recent years suffered from very difficult markets. A largescale restructuring was initiated in 2018 as a result, and it has been successfully implemented by Brush's management. This will be completed in 2019.

Unfortunately, the well publicised further difficult market conditions mean that your Board considers it should again reduce the holding value of this company and this has been done in these accounts.

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

OUTLOOK

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

Simon Peckham
Chief Executive
7 March 2019

AEROSPACE DIVISION

GKN Aerospace is a world-leading multi-technology manufacturer of aircraft and engine structures and electrical interconnection systems for the global aerospace industry, supplying both civil and military platforms. Its technology is used throughout the aerospace industry: from high-use single aisle aircraft and the world's largest passenger planes, through to business jets, helicopters and the world's most advanced fighter jets.

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

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

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

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

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

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

OUTLOOK

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

AUTOMOTIVE DIVISION

GKN Automotive supports over 90% of the world's car manufacturers as a leading developer, manufacturer and supplier of market leading driveline products and systems throughout the global automotive industry. The recent appointment of a new Chief Executive has led to the creation of a focused new central executive team and a reorganisation of the management structure of the business. Internally the business is principally organised around its two core competencies: (i) Driveline, which is the world's preeminent driveshaft manufacturer; and (ii) ePowertrain, the industry leader in electric powertrains ("eDrive") and intelligent all-wheel drive ("AWD") systems.

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

With an unrivalled global production footprint across 21 countries, GKN Automotive is closely aligned with its key customers. Its unparalleled experience in the traditional driveshaft business provides platform opportunities to be the premier technology partner for OEMs, as well as having the in-depth knowledge and unique perspective from which to grow its market leading eDrive business. Accordingly, this year GKN Automotive invested a further £50 million in e-Powertrain research and development which was instrumental in delivering its first fully electric drive programme with a leading global OEM. This is an important step forward for the eDrive business and increases GKN Automotive's ability to further differentiate its business from competitors.

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

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

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

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

OUTLOOK

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

POWDER METALLURGY DIVISION

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

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

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

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

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

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

OUTLOOK

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

NORTEK AIR & SECURITY DIVISION

The Nortek Air & Security Division comprises three businesses: (i) Nortek Global HVAC, (ii) Air Quality & Home Solutions, and (iii) Security & Smart Technology.

NORTEK GLOBAL HVAC

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

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

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

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

OUTLOOK

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

AIR QUALITY & HOME SOLUTIONS

AQH is a leading manufacturer of ventilation products for the professional remodelling and replacement market, new residential construction market and DIY market. It supplies to distributors and dealers of electrical and lighting products, kitchen and bathroom dealers, retail home centres and private label customers from its four manufacturing locations around the world.

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

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

OUTLOOK

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

SECURITY & SMART TECHNOLOGY

The Security & Smart Technology ("SST") business is a leading developer and manufacturer of security, home automation and access control technologies for the residential and commercial markets, principally in North America. The business continues to build on its expertise in the design and manufacture of wireless connectivity devices, its strong brand presence in professional security, integrator and custom installer channels and its relationships with top resellers.

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

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

OUTLOOK

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

OTHER INDUSTRIAL DIVISION

The Other Industrial Division comprises four businesses: (i) Brush, (ii) Ergotron, (iii) Walterscheid Powertrain Group (previously GKN Off-Highway Powertrain), and (iv) GKN Wheels & Structures.

BRUSH

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

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

OUTLOOK

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

ERGOTRON

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

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

OUTLOOK

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

WALTERSCHEID POWERTRAIN GROUP

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

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

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

OUTLOOK

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

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

GKN WHEELS & STRUCTURES

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

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

OUTLOOK

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

FINANCE DIRECTOR'S REVIEW

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

ACQUISITION OF GKN

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

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

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

MELROSE GROUP RESULTS

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

Statutory results:

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

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

Adjusted results:

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

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

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

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

Annualised adjusted results:

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

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

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

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

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

STATUTORY, ADJUSTED AND ANNUALISED ADJUSTED RESULTS BY REPORTING SEGMENT

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

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

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

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

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

RECONCILIATION OF STATUTORY RESULTS TO ADJUSTED RESULTS

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

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

Adjusting items:

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

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

- A charge of £156 million in respect of the GKN businesses. Within this, £56 million related to the Aerospace division, predominantly in North America, with key focus on improving quality and delivery for customers. Within the Automotive business £46 million of costs have been incurred restructuring and enhancing the future performance of the business under new leadership. In addition, £54 million of restructuring costs were incurred in respect of early actions within other GKN businesses, including the ceasing of GKN head office functions.

- A charge of £59 million (2017: £6 million) in respect of the closure of the Dutch turbogenerator facility in Brush and the restructuring of its turbogenerator production in the UK following the announcement on 1 February 2018.

- A charge of £22 million (2017: £27 million) within Nortek Air & Security, which mostly related to footprint rationalisation within the HVAC business.

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

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

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

Finished goods and work in progress inventory which are present in a business when acquired, in accordance with IFRS 3, are required to be uplifted in value to closer to their selling price. As a result, in the early months of an acquisition, reduced profits are generated as this inventory is sold. The one-off effect in the year, relating to GKN acquired inventory, was a charge of £121 million (2017: £nil) and is excluded from adjusted results due to its size and non-recurring nature.

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

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

Income Statement. This cost is excluded from adjusted results due to its non-trading and non-recurring nature.

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

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

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

RECONCILIATION OF ADJUSTED RESULTS TO ANNUALISED RESULTS

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

FINANCE COSTS AND INCOME

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

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

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

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

TAX

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

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

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

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

IFRS 3 "BUSINESS COMBINATIONS"

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

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

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

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

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

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

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

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

ADOPTION OF IFRS 15 "REVENUE FROM CONTRACTS WITH CUSTOMERS" AND THE FUTURE IMPACT OF IFRS 16 "LEASES"

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

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

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

CASH GENERATION AND MANAGEMENT

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

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

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

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

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

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

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

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

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

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

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

ASSETS AND LIABILITIES

The summarised Melrose Group assets and liabilities are shown below:

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

These assets and liabilities are funded by:

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

GOODWILL, INTANGIBLE ASSETS AND IMPAIRMENT REVIEW

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

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

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

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

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

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

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

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

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

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

PROVISIONS

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

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

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

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

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

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

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

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

PENSIONS AND POST-EMPLOYMENT OBLIGATIONS

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

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

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

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

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

The values of the Group plans were updated at 31 December 2018 by independent actuaries to reflect the latest key assumptions. A summary of the assumptions used are shown in note 12 of the Preliminary Announcement.

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

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

FINANCIAL RISK MANAGEMENT

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

These are discussed in turn below.

Liquidity risk management

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Finance cost risk management

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

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

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

Exchange rate risk management

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

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

The translation rate risk is the effect on the Group results in the period due to the movement of exchange rates used to translate foreign results into Sterling from one period to the next. No specific exchange instruments are used to protect against the translation risk because it is a non-cash risk to the Group, unless foreign currency is converted to Sterling. However, the Group has debt drawn in Euros and US Dollars, and the hedge of having debt drawn in these currencies funding the trading units with US Dollars or Euro functional currencies protects against some of the Balance Sheet and banking covenant translation risk.

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

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

US Dollar	**Twelve month average rate**	**8 month average (GKN businesses)**	**Closing rate**
2018	1.33	1.31	1.27
2017	1.29	N/A	1.35
Euro			
2018	1.13	1.13	1.11
2017	1.14	N/A	1.13

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

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

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

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

£m	**USD**	**EUR**
Increase in debt	176	59

Contract and warranty risk management

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

Commodity Risk Management

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

BREXIT

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

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

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

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

POST BALANCE SHEET EVENT

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

GOING CONCERN

The Melrose Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Chief Executive's Report. In addition, the

Consolidated Financial Statements include details of the Melrose Group's borrowing facilities and hedging activities along with the processes for managing its exposures to liquidity risk, finance cost risk, exchange rate risk, contract and warranty risk and commodity cost risk.

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

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

Geoffrey Martin
Group Finance Director
7 March 2019

CAUTIONARY STATEMENT

This announcement contains forward-looking statements. These statements are made in good faith based on the information available up to the time of the approval of this announcement, and should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information. Accordingly, readers are cautioned not to place undue reliance on any such forward-looking statements. Subject to compliance with applicable laws and regulations, the Company does not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this announcement.

This announcement has been prepared solely to provide information to shareholders to assess the Company's strategies and the potential for those strategies to succeed, and neither the Company nor its directors accept any liability to any other person save as would arise under English law.

Melrose Industries PLC
Consolidated Income Statement

Continuing operations	Notes	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Revenue	3	**8,605**	2,092
Cost of sales		**(6,920)**	(1,439)
Gross profit		**1,685**	653
Share of results of equity accounted investments	10	**34**	-
Net operating expenses		**(2,111)**	(660)
Operating loss	3, 4	**(392)**	(7)
Finance costs		**(163)**	(22)
Finance income		**5**	1
Loss before tax		**(550)**	(28)
Tax	5	**75**	4
Loss after tax for the year		**(475)**	(24)
Attributable to:			
Owners of the parent		**(475)**	(24)
Non-controlling interests		**-**	-
		(475)	(24)
Earnings per share			
- Basic	7	**(12.0)p**	(1.2)p
- Diluted	7	**(12.0)p**	(1.2)p

Adjusted Results

Adjusted revenue	3	**9,102**	2,095
Adjusted operating profit	3, 4	**847**	279
Adjusted profit before tax	4	**703**	258
Adjusted profit after tax	4	**539**	191
Adjusted basic earnings per share	7	**13.3p**	9.9p
Adjusted diluted earnings per share	7	**13.3p**	9.8p

Melrose Industries PLC
Consolidated Statement of Comprehensive Income

	Notes	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Loss for the year		**(475)**	(24)
Items that will not be reclassified subsequently to the Income Statement:			
Net remeasurement (loss)/gain on retirement benefit obligations		**(36)**	12
Income tax credit/(charge) relating to items that will not be reclassified	5	**9**	(1)
		(27)	11
Items that may be reclassified subsequently to the Income Statement:			
Currency translation on net investments		**625**	(133)
Share of other comprehensive income from equity accounted investments		**9**	-
Transfer to Income Statement from equity of cumulative translation differences on disposal of foreign operations		**-**	(1)
(Losses)/gains on hedge relationships		**(97)**	9
Transfer to Income Statement on hedge relationships		**(2)**	(4)
Income tax credit/(charge) relating to items that may be reclassified	5	**29**	(1)
		564	(130)
Other comprehensive income/(expense) for the year		**537**	(119)
Total comprehensive income/(expense) for the year		**62**	(143)
Attributable to:			
Owners of the parent		**44**	(143)
Non-controlling interests		**18**	-
		62	(143)

Melrose Industries PLC
Consolidated Statement of Cash Flows

Continuing operations	Notes	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Net cash from operating activities	14	**373**	32
Investing activities			
Disposal of businesses, net of cash disposed		**(4)**	10
Purchase of property, plant and equipment		**(344)**	(48)
Proceeds from disposal of property, plant and equipment		**20**	2
Purchase of computer software and capitalised development costs		**(35)**	(3)
Dividends received from equity accounted investments		**66**	-
Equity accounted investment additions		**(3)**	-
Acquisition of subsidiaries, net of cash acquired(1)		**(1,009)**	(9)
Interest received		**5**	1
Net cash used in investing activities		**(1,304)**	(47)
Financing activities			
Purchase of non-controlling interests		**(224)**	-
Costs of issuing shares		**(1)**	-
Repayment of borrowings		**(820)**	-
New bank loans raised		**2,558**	56
Costs of raising debt finance		**(51)**	-
Repayment of finance leases		**-**	(1)
Dividends paid to non-controlling interests		**(1)**	-
Dividends paid to owners of the parent	6	**(129)**	(63)
Net cash from/(used in) financing activities		**1,332**	(8)
Net increase/(decrease) in cash and cash equivalents		**401**	(23)
Cash and cash equivalents at the beginning of the year	14	**16**	42
Effect of foreign exchange rate changes	14	**(2)**	(3)
Cash and cash equivalents at the end of the year	14	**415**	16

(1) Comprises consideration of £1,316 million, net of cash and cash equivalents acquired of £307 million (note 9).

As at 31 December 2018, the Group had net debt of £3,482 million (31 December 2017: £572 million). A reconciliation of the movement in net debt is shown in note 14.

Melrose Industries PLC
Consolidated Balance Sheet

	Notes	31 December 2018 £m	31 December 2017 £m
Non-current assets			
Goodwill and other intangible assets		**11,071**	2,238
Property, plant and equipment		**3,171**	219
Interests in equity accounted investments		**492**	-
Deferred tax assets		**149**	49
Derivative financial assets		**26**	4
Trade and other receivables		**504**	2
		15,413	2,512
Current assets			
Inventories		**1,489**	276
Trade and other receivables		**2,328**	332
Derivative financial assets		**15**	10
Current tax assets		**74**	-
Cash and cash equivalents		**415**	16
		4,321	634
Total assets	3	**19,734**	3,146
Current liabilities			
Trade and other payables		**2,583**	367
Interest-bearing loans and borrowings		**377**	-
Finance lease obligations		**5**	-
Derivative financial liabilities		**204**	1
Current tax liabilities		**137**	7
Provisions	11	**381**	92
		3,687	467
Net current assets		**634**	167
Non-current liabilities			
Trade and other payables		**778**	2
Interest-bearing loans and borrowings		**3,378**	588
Finance lease obligations		**52**	-
Derivative financial liabilities		**227**	-
Deferred tax liabilities		**874**	69
Retirement benefit obligations	12	**1,413**	18
Provisions	11	**1,064**	117
		7,786	794
Total liabilities	3	**11,473**	1,261
Net assets		**8,261**	1,885
Equity			
Issued share capital	13	**333**	133
Share premium account		**8,138**	1,493
Merger reserve		**109**	109
Other reserves		**(2,330)**	(2,330)
Hedging reserve		**(67)**	8
Translation reserve		**562**	(66)
Retained earnings		**1,492**	2,538
Equity attributable to owners of the parent		**8,237**	1,885
Non-controlling interests		**24**	-
Total equity		**8,261**	1,885

The Financial Statements were approved and authorised for issue by the Board of Directors on 7 March 2019 and were signed on its behalf by:

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Geoffrey Martin
Group Finance Director

Simon Peckham
Chief Executive

Melrose Industries PLC
Consolidated Statement of Changes in Equity

	Issued share capital £m	Share premium account £m	Merger reserve £m	Other reserves £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	**Equity attributable to owners of the parent £m**	Non-controlling interests £m	**Total Equity £m**
At 1 January 2017	129	1,493	112	(2,330)	4	68	2,686	**2,162**	-	**2,162**
Loss for the year	-	-	-	-	-	-	(24)	**(24)**	-	**(24)**
Other comprehensive income/(expense)	-	-	-	-	4	(134)	11	**(119)**	-	**(119)**
Total comprehensive income/(expense)	-	-	-	-	4	(134)	(13)	**(143)**	-	**(143)**
Dividends paid	-	-	-	-	-	-	(63)	**(63)**	-	**(63)**
Equity-settled share-based payments	-	-	-	-	-	-	10	**10**	-	**10**
Deferred tax on share-based payment transactions	-	-	-	-	-	-	34	**34**	-	**34**
Incentive scheme related	4	-	(3)	-	-	-	(116)	**(115)**	-	**(115)**
At 31 December 2017	133	1,493	109	(2,330)	8	(66)	2,538	**1,885**	-	**1,885**
Loss for the year	-	-	-	-	-	-	(475)	**(475)**	-	**(475)**
Other comprehensive (expense)/income	-	-	-	-	(75)	628	(34)	**519**	18	**537**
Total comprehensive (expense)/income	-	-	-	-	(75)	628	(509)	**44**	18	**62**
Acquisition of GKN[(1)]	169	5,631	-	-	-	-	-	**5,800**	857	**6,657**
Purchase of non-controlling interests	31	1,014	-	-	-	-	(419)	**626**	(850)	**(224)**
Implementation of IFRS 9[(2)]	-	-	-	-	-	-	(2)	**(2)**	-	**(2)**
Dividends paid	-	-	-	-	-	-	(129)	**(129)**	(1)	**(130)**
Equity-settled share-based payments	-	-	-	-	-	-	13	**13**	-	**13**
At 31 December 2018	**333**	**8,138**	**109**	**(2,330)**	**(67)**	**562**	**1,492**	**8,237**	**24**	**8,261**

(1) Relates to the purchase of approximately 85% of the issued share capital of GKN plc. The amount recognised within the share premium account for the acquisition of GKN of £5,631 million is net of £1 million for costs associated with issuing shares.
(2) The Group adopted IFRS 9 on 1 January 2018. See note 1 for details.

Notes to the Financial Statements

1. Corporate information

The financial information included within this Preliminary Announcement does not constitute the Company's statutory Financial Statements for the years ended 31 December 2018 or 31 December 2017 within the meaning of s435 of the Companies Act 2006, but is derived from those Financial Statements. Statutory Financial Statements for the year ended 31 December 2017 have been delivered to the Registrar of Companies and those for the year ended 31 December 2018 will be delivered to the Registrar of Companies during April 2019. The auditor has reported on those Financial Statements; their reports were unqualified, did not draw attention to any matters by way of emphasis and did not contain statements under s498(2) or (3) of the Companies Act 2006.

While the financial information included in this Preliminary Announcement has been prepared in accordance with the recognition and measurement criteria of International Financial Reporting Standards ("IFRSs"), this announcement does not itself contain sufficient information to comply with IFRSs. The Company expects to publish full Financial Statements that comply with IFRSs during April 2019.

The Group has adopted a number of Standards and Interpretations which became mandatory during the current financial year. The adoption of these new Standards and Interpretations has not had a significant impact on the comparative amounts reported in this Preliminary Announcement, however, does impact results reported in the current year. The most significant changes relate to IFRS 15: "Revenue from Contracts with Customers" and IFRS 9: "Financial Instruments".

The Group adopted IFRS 15 on 1 January 2018 using the full retrospective approach. Due to the immaterial impact of IFRS 15 on the Group for the year ended 31 December 2017, no further disclosure is provided on the comparative results or balance sheet position. The GKN IFRS 15 impact forms part of the acquired business and therefore is not included in the transitional impact within this Preliminary Announcement. The impact of IFRS 15 on the enlarged Group reduced annual revenue by approximately £80 million, due to the reclassification of certain costs. There was a £15 million increase in operating profit, which principally relates to recognition of variable consideration.

The Group adopted IFRS 9 on 1 January 2018. IFRS 9 replaces IAS 39 and the main impacts relate to; a) classification and measurement of financial assets and liabilities, b) impairment of financial assets, and c) hedge accounting. The Group has elected not to restate the comparatives but instead record any adjustments identified in retained earnings in line with the transition arrangement within the standard. Following management's review, a £2 million reduction in net assets was identified. The GKN IFRS 9 impact forms part of the acquired business and therefore is not included in the transitional impact within this Preliminary Announcement.

The Directors do not expect that the adoption of Standards and Interpretations in issue but not yet effective, with the exception of IFRS 16, will have a material impact on the Financial Statements of the Group in future periods.

IFRS 16 is effective for accounting periods beginning on or after 1 January 2019. IFRS 16 will supersede the current lease guidance including IAS 17: "Leases" and related interpretations. It will require all leases to be recognised on the Balance Sheet. Currently, IAS 17 only requires arrangements categorised as finance leases to be recognised on the Balance Sheet, with other arrangements categorised as operating leases not recognised on the Balance Sheet but expensed through the Income Statement instead.

The impact of IFRS 16 will be to recognise a lease liability and a corresponding asset in the Balance Sheet for leases currently classified as operating leases, except for short-term leases and leases of low value assets. There will also be a specific reclassification from operating costs to finance costs.

IFRS 16 will be adopted for the year ending 31 December 2019 via a modified retrospective approach and it is anticipated that the right-of-use asset recognised on transition will be measured at an amount materially equal to the lease liability. At 31 December 2018, the Group had non-cancellable operating lease commitments of £710 million. A preliminary assessment has been undertaken involving all businesses. This entailed a review of all arrangements to identify those affected by IFRS 16. Future cash flow obligations have been collated for each identified lease and the associated lease liability has been assessed. For arrangements that meet the definition of a lease under IFRS 16, the Group will recognise a right-of-use asset and corresponding liability unless they qualify as low value or short-term leases as defined by IFRS 16. The right-of-use asset and lease liability to be recognised upon transition is expected to be in the range of £550 million to £600 million. The expected annual impact of IFRS 16 on the Income Statement in the year ended 31 December 2019 will be an increase to operating profit, expected to be in the range £10 million to £15 million. This is expected to be more than offset by an increase in finance costs in the range of £15 million to £20 million.

For arrangements previously classified as finance leases, where the Group is a lessee, as the Group has already recognised an asset and a related finance lease liability for the lease arrangement, the Directors do not anticipate that the application of IFRS 16 will have a significant impact on the amounts recognised in the Group's Consolidated Financial Statements, at 31 December 2018.

The accounting policies followed are the same as those detailed within the 2017 Annual Report and Accounts as updated in the 2018 Interim Report, which are available on the Group's website www.melroseplc.net.

The Board of Directors approved the Preliminary Announcement on 7 March 2019.

2. Alternative Performance Measures

The Group presents Alternative Performance Measures ("APMs") in addition to the statutory results of the Group. These are presented in accordance with the Guidelines on APMs issued by the European Securities and Markets Authority ("ESMA").

APMs used by the Group are set out in the glossary to this Preliminary Announcement and the reconciling items between statutory and adjusted results are listed below and described in more detail in note 4.

Adjusted revenue includes the Group's share of revenue from equity accounted investments.

Adjusted profit/(loss) excludes items which are significant in size or volatility or by nature are non-trading or non-recurring, and any item released to the Income Statement that was previously a fair value item booked on an acquisition.

On this basis, the following are the principal items included within adjusting items impacting operating profit:

- Amortisation of intangible assets that are acquired in a business combination, excluding computer software and development costs;
- Significant restructuring costs and other associated costs, including losses incurred following the announcement of closure for identified businesses, arising from significant strategy changes that are not considered by the Group to be part of the normal operating costs of the business;
- Acquisition and disposal costs;
- Impairment charges that are considered to be significant in nature and/or value to the trading performance of the business;
- Movement in derivative financial instruments not designated in hedging relationships, including revaluation of associated financial assets and liabilities;
- Reversal of inventory uplift in value recorded on acquisition;
- Removal of adjusting items, interest and tax on equity accounted investments to reflect operating results;
- The charge for the Melrose equity-settled compensation scheme, including its associated employer's tax charge;
- One-off costs associated with gender equalisation of guaranteed minimum pensions ("GMP") for occupational schemes; and
- The release of fair value items booked on acquisitions.

Further to the adjusting items above, adjusting items impacting profit before tax include:

- Acceleration of unamortised debt issue costs written off as a consequence of Group refinancing; and
- The fair value changes on cross-currency swaps, entered into by GKN prior to acquisition, relating to cost of hedging which are not deferred in equity.

In addition to the items above, adjusting items impacting profit after tax include:

- Net effect of significant new tax legislation changes; and
- The tax effects of adjustments to profit/(loss) before tax.

The Board considers the adjusted results to be an important measure used to monitor how the businesses are performing as this provides a meaningful reflection of how the businesses are managed and measured on a day-to-day basis and achieves consistency and comparability between reporting periods, when all businesses are held for a complete reporting period.

The adjusted measures are used to partly determine the variable element of remuneration of senior management throughout the Group and are also in alignment with performance measures used by certain external stakeholders. The adjusted measures are also taken into account when valuing individual businesses as part of the "Buy, Improve and Sell" Group strategy model.

Adjusted profit is not a defined term under IFRS and may not be comparable with similarly titled profit measures reported by other companies. It is not intended to be a substitute for, or superior to, GAAP measures. All APMs relate to the current year results and comparative periods where provided.

3. Segment information

Segment information is presented in accordance with IFRS 8: "Operating Segments" which requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reported to the Group's Chief Operating Decision Maker ("CODM"), which has been deemed to be the Group's Board, in order to allocate resources to the segments and assess their performance.

The Group's reportable operating segments were reconsidered following the acquisition of GKN in April 2018. The Group now reports under a revised segment structure and comparative results have been restated accordingly. The operating segments are as follows:

Aerospace – comprises GKN's aerospace operations: a multi-technology tier one supplier of air frame and engine structures, including Aerostructures, Engine Systems and Special Technologies.

Automotive – comprises GKN's Driveline, All Wheel Drive and eDrive (together ePowertrain), and Cylinder Liners businesses; a global technology and systems engineer which designs, develops, manufactures and integrates an extensive range of driveline technologies.

Powder Metallurgy – a global leader in the manufacture of precision powder metal parts for the automotive and industrial sectors, as well as the production of powder metal.

Nortek Air & Security – comprises the Group's Air Management and Security & Smart Technology businesses, previously reported as separate segments. The Air Management and Security & Smart Technology segments have been aggregated based on commonality of economic characteristics, including manufacturing footprint. Air Management includes the Air Quality & Home Solutions business ("AQH") and the Global Heating, Ventilation & Air Conditioning business ("HVAC"). AQH is a leading manufacturer of ventilation products for the professional remodelling and replacement markets, residential new construction market and DIY market. Global HVAC manufactures and sells split-system and packaged air conditioners, heat pumps, furnaces, air handlers and parts for the residential replacement and new construction markets along with custom designed and engineered products and systems for non-residential applications. Security & Smart Technology manufactures and distributes products designed to provide convenience and security primarily for residential applications and audio visual equipment for the residential audio video and professional video market.

Other Industrial – comprises the Group's Ergotron and Brush businesses, previously reported separately as the Ergonomics and Energy segments respectively, as well as GKN's Wheels & Structures and Walterscheid Powertrain (formerly Off-Highway Powertrain) businesses. Further details are provided in the Chief Executive's Report.

In addition, there are central cost centres which are also reported to the Board. The central corporate cost centres contain the Melrose Group head office costs, the remaining GKN central costs and charges related to the divisional management long-term incentive plans.

Prior year comparatives have been restated following the change in the Group's segment structure. Reportable segment results include items directly attributable to a segment as well as those which can be allocated on a reasonable basis. Inter-segment pricing is determined on an arm's length basis in a manner similar to transactions with third parties.

The Group's geographical segments are determined by the location of the Group's non-current assets and, for revenue, the location of external customers. Inter-segment sales are not material and have not been disclosed.

The following tables present the results and certain asset and liability information regarding the Group's operating segments and central cost centres for the year ended 31 December 2018.

a) Segment revenues

The Group derives its revenue from the transfer of goods and services over time and at a point in time. The Group has assessed that the disaggregation of revenue recognised from contracts with customers by operating segments is appropriate as this is the information regularly reviewed by the CODM in evaluating financial performance. The Group also believes that presenting this disaggregation of revenue based on the timing of transfer of goods or services provides useful information as to the nature and timing of revenue from contracts with customers.

Year ended 31 December 2018

Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Total £m
Adjusted revenue	**2,521**	**3,382**	**851**	**1,458**	**890**	**9,102**
Equity accounted investments	(42)	(446)	(5)	-	(4)	(497)
Revenue	**2,479**	**2,936**	**846**	**1,458**	**886**	**8,605**
Timing of revenue recognition						
At a point in time	1,483	2,936	846	1,458	879	7,602
Over time	996	-	-	-	7	1,003
Revenue	**2,479**	**2,936**	**846**	**1,458**	**886**	**8,605**

Year ended 31 December 2017 - restated

Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Total £m
Adjusted revenue	**-**	**-**	**-**	**1,600**	**495**	**2,095**
Equity accounted investments	-	-	-	-	(3)	(3)
Revenue	-	-	-	**1,600**	**492**	**2,092**

b) Segment operating profit

Year ended 31 December 2018

Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate[2] £m	Total £m
Adjusted operating profit/(loss)	**250**	**231**	**98**	**198**	**98**	**(28)**	**847**
Items not included in adjusted operating profit[1]:							
Amortisation of intangible assets acquired in business combinations	(176)	(103)	(34)	(54)	(34)	-	(401)
Restructuring costs	(56)	(46)	(11)	(22)	(73)	(32)	(240)
Acquisition and disposal costs	(7)	-	(1)	-	-	(145)	(153)
Impairment of assets	(17)	-	(3)	-	(132)	-	(152)
Movement in derivatives and associated financial assets and liabilities	-	-	-	-	-	(143)	(143)
Reversal of uplift in value of inventory	(50)	(42)	(11)	-	(18)	-	(121)
Equity accounted investments adjustments	(1)	(24)	-	-	-	-	(25)
Melrose equity-settled compensation scheme charges	-	-	-	-	-	(13)	(13)
Impact of GMP equalisation on UK pension schemes	(2)	(1)	-	-	(1)	(7)	(11)
Release of fair value items	15	-	-	4	1	-	20
Operating (loss)/profit	**(44)**	**15**	**38**	**126**	**(159)**	**(368)**	**(392)**
Finance costs							(163)
Finance income							5
Loss before tax							**(550)**
Tax							75
Loss for the year							**(475)**

Year ended 31 December 2017 – restated

Continuing operations	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate[2] £m	Total £m
Adjusted operating profit/(loss)	**-**	**-**	**-**	**215**	**87**	**(23)**	**279**
Items not included in adjusted operating profit[1]:							
Impairment of assets	-	-	-	-	(145)	-	(145)
Amortisation of intangible assets acquired in business combinations	-	-	-	(56)	(26)	-	(82)
Restructuring costs	-	-	-	(27)	(8)	-	(35)
Melrose equity-settled compensation scheme charges	-	-	-	-	-	(24)	(24)
Acquisition and disposal costs	-	-	-	-	-	(6)	(6)
Release of fair value items	-	-	-	5	1	-	6
Operating profit/(loss)	**-**	**-**	**-**	**137**	**(91)**	**(53)**	**(7)**
Finance costs							(22)
Finance income							1
Loss before tax							**(28)**
Tax							4
Loss for the year							**(24)**

[1] Further details on adjusting items are discussed in note 4.
[2] Corporate adjusted operating loss of £28 million (2017: £23 million), includes £6 million in respect of remaining GKN central costs (2017: £nil) and £2 million (2017: £8 million) of costs in respect of divisional long-term incentive plans.

c) Segment total assets and liabilities

At 31 December 2018

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate £m	Total £m
Total assets	7,738	5,675	2,070	2,142	1,494	615	**19,734**
Total liabilities	(3,053)	(2,320)	(521)	(492)	(499)	(4,588)	**(11,473)**

At 31 December 2017 - restated

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate £m	Total £m
Total assets	-	-	-	2,030	1,047	69	**3,146**
Total liabilities	-	-	-	(484)	(173)	(604)	**(1,261)**

d) Segment capital expenditure and depreciation

Year ended 31 December 2018

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate £m	Total £m
Capital expenditure[1]	105	198	53	44	22	-	**422**
Depreciation[1]	88	116	37	24	17	-	**282**

Year ended 31 December 2017 - restated

	Aerospace £m	Automotive £m	Powder Metallurgy £m	Nortek Air & Security £m	Other Industrial £m	Corporate £m	Total £m
Capital expenditure[1]	-	-	-	48	4	-	**52**
Depreciation[1]	-	-	-	23	12	-	**35**

[1] Including computer software and development costs. Capital expenditure excludes finance lease additions.

e) Geographical information

The Group operates in various geographical areas around the world. The parent company's country of domicile is the UK and the Group's revenues and non-current assets in Europe and North America are also considered to be material.

The Group's revenue from external customers and information about its segment assets (non-current assets excluding deferred tax assets; non-current trade and other receivables; and non-current derivative financial assets) by geographical location are detailed below:

	Revenue[(1)] from external customers		Segment assets	
Continuing operations	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m	**31 December 2018 £m**	31 December 2017 £m
UK	**852**	105	**2,432**	130
Rest of Europe	**2,043**	124	**3,609**	109
North America	**4,602**	1,768	**7,241**	2,207
Other	**1,108**	95	**1,452**	11
Total	**8,605**	2,092	**14,734**	2,457

(1) Revenue is presented by destination.

4. Reconciliation of adjusted profit measures

As described in note 1, adjusted profit measures are an alternative performance measure used by the Board to monitor the operating performance of the Group.

a) Operating profit

Continuing operations	Notes	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Operating loss		**(392)**	(7)
Amortisation of intangible assets acquired in business combinations	a	**401**	82
Restructuring costs	b	**240**	35
Acquisition and disposal costs	c	**153**	6
Impairment of assets	d	**152**	145
Movement in derivatives and associated financial assets and liabilities	e	**143**	-
Reversal of uplift in value of inventory	f	**121**	-
Equity accounted investments adjustments	g	**25**	-
Melrose equity-settled compensation scheme charges	h	**13**	24
Impact of GMP equalisation on UK pension schemes	i	**11**	-
Release of fair value items	j	**(20)**	(6)
Total adjustments to operating loss		**1,239**	286
Adjusted operating profit		**847**	279

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

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

- A charge of £156 million in respect of the GKN businesses. Within this, £56 million related to the Aerospace division, predominantly in North America, with key focus on improving quality and delivery for customers. Within the Automotive business £46 million of costs have been incurred restructuring and enhancing the future performance of the business under new leadership. In addition, £54 million of restructuring costs were incurred in respect of early actions within other GKN businesses, including the ceasing of GKN head office functions.

- A charge of £59 million (2017: £6 million) in respect of the closure of the Dutch turbogenerator facility in Brush and the restructuring of its turbogenerator production in the UK following the announcement on 1 February 2018.

- A charge of £22 million (2017: £27 million) within Nortek Air & Security, which mostly related to footprint rationalisation within the HVAC business.

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

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

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

f. Finished goods and work in progress inventory which are present in a business when acquired, in accordance with IFRS 3, are required to be uplifted in value to closer to their selling price. As a result, in the early months of an acquisition, reduced profits are generated as this inventory is sold. The one-off effect in the year, relating to GKN acquired inventory, was a charge of £121 million (2017: £nil) and is excluded from adjusted results due to its size and non-recurring nature.

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

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

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

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

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

b) Profit before tax

Continuing operations	Notes	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Loss before tax		**(550)**	(28)
Adjustments to operating loss per above		**1,239**	286
Write-off previous debt facility unamortised fees	k	**7**	-
Fair value changes on cross-currency swaps	l	**8**	-
Equity accounted investments - interest	m	**(1)**	-
Total adjustments to loss before tax		**1,253**	286
Adjusted profit before tax		**703**	258

k. To enable the acquisition of GKN, a new bank facility was negotiated which replaced the old Group bank facility. As a result, the amortisation of the remaining £7 million of debt fees relating to the old facility was accelerated and written off in the year. This charge is shown as an adjusting item because of its one-off, non-trading nature.

l. The fair value changes on cross-currency swaps relating to cost of hedging which are not deferred in equity, are shown as an adjusting item because of its volatility and non-trading nature.

m. As explained in paragraph g above, the profits and losses of EAIs are shown after interest and tax in the statutory results. They are adjusted to show the profit before tax and the profit after tax, consistent with the subsidiaries of the Group.

c) Profit after tax

Continuing operations	Notes	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Loss after tax		**(475)**	(24)
Adjustments to loss before tax per above		**1,253**	286
Equity accounted investments - tax	m, 5	**(9)**	-
Net effect of new tax legislation in the US	n	-	(27)
Tax effect of adjustments to loss before tax	5	**(230)**	(44)
Total adjustments to loss after tax		**1,014**	215
Adjusted profit after tax		**539**	191

n. The net tax credit arising from US tax legislation enacted in December 2017, including an estimated repatriation charge and changes to closing deferred tax items due to a reduction in the Federal tax rate from 35% to 21%, was included as an adjusting item because of its size and nature.

5. Tax

Continuing operations	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Analysis of tax credit in year:		
Current tax		
Current year tax charge	**55**	13
Adjustments in respect of prior years	**(21)**	-
Total current tax charge	**34**	13
Deferred tax		
Origination and reversal of temporary differences	**(33)**	6
Adjustments in respect of prior years	**(6)**	-
Tax on the change in value of derivative financial instruments	**(31)**	-
Adjustments to deferred tax attributable to changes in tax rates	**(34)**	(39)
Loss utilisation against US repatriation charge	**-**	16
Recognition of previously unrecognised deferred tax assets	**(5)**	-
Total deferred tax credit	**(109)**	(17)
Total tax credit	**(75)**	(4)

Analysis of credit in year:	£m	£m
Tax charge in respect of adjusted profit before tax	**164**	67
Tax credit in respect of adjusting items	**(239)**	(71)
Total tax credit	**(75)**	(4)

The tax charge of £164 million (2017: £67 million) arising on adjusted profit before tax of £703 million (2017: £258 million), results in an effective tax rate of 23% (2017: 26%).

Tax in respect of adjusting items includes a credit of £230 million (2017: £44 million) arising on adjusting items of £1,253 million (2017: £286 million), £nil (2017: £27 million) arising from the impact of the US tax measures enacted in December 2017 and £9 million (2017: £nil) in respect of tax on equity accounted investments.

The tax credit for the year for continuing operations can be reconciled to the loss before tax per the Income Statement as follows:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Loss before tax	**(550)**	(28)
Tax credit on loss before tax at the weighted average rate of 20% (2017: 14%)	**(110)**	(4)
Tax effect of:		
Disallowable expenses and other permanent differences within adjusted profit	**10**	5
Disallowable items included within adjusting items	**57**	22
Temporary differences not recognised in deferred tax	**14**	11
Recognition of previously unrecognised deferred tax assets	**(5)**	-
Withholding taxes	**10**	-
Adjustments in respect of prior years	**(27)**	(10)
Tax charge/(credit) classified within adjusting items	**10**	(27)
Effect of changes in tax rates	**(34)**	(1)
Total tax credit for the year	**(75)**	(4)

The reconciliation has been performed at a blended Group tax rate of 20% (2017: 14%) which represents the weighted average of the tax rates applying to profits and losses in the jurisdictions in which those results arose.

Tax credits included in Other Comprehensive Income are as follows:

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Deferred tax on retirement benefit obligations	**(9)**	1
Deferred tax on hedge relationship gains and losses	**(24)**	1
Deferred tax on foreign currency gains and losses	**(5)**	-
Total (credit)/charge for the year	**(38)**	2

In addition to the amounts recognised in Other Comprehensive Income in 2017, a deferred tax credit of £34 million in respect of share based payments was recognised directly in retained earnings.

6. Dividends

	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Final dividend for the year ended 31 December 2016 paid of 1.9p	**-**	36
Interim dividend for the year ended 31 December 2017 paid of 1.4p	**-**	27
Final dividend for the year ended 31 December 2017 paid of 2.8p	**54**	-
Interim dividend for the year ended 31 December 2018 paid of 1.55p	**75**	-
	129	63

Proposed final dividend for the year ended 31 December 2018 of 3.05p per share (2017: 2.8p per share) totalling £148 million (2017: £54 million).

The final dividend of 3.05p was proposed by the Board on 7 March 2019 and, in accordance with IAS 10: "Events after the reporting period", has not been included as a liability in this Preliminary Announcement.

7. Earnings per share

Earnings attributable to owners of the parent	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Earnings for basis of earnings per share from continuing operations	**(475)**	(24)

	Year ended 31 December 2018 Number	Year ended 31 December 2017 Number
Weighted average number of ordinary shares for the purposes of basic earnings per share (million)	**3,959**	1,919
Further shares for the purposes of diluted earnings per share (million)	**-**	22
Weighted average number of ordinary shares for the purposes of diluted earnings per share (million)	**3,959**	1,941

On 19 April 2018, 2,469 million ordinary shares were issued as a result of the acquisition of GKN. Further issues of share capital totalling 448 million took place between 19 April 2018 and 30 June 2018 in order to purchase the remaining non-controlling interests of GKN. The total number of ordinary shares in issue therefore increased from 1,941 million at 31 December 2017 to 4,858 million at 31 December 2018.

Earnings per share	Year ended 31 December 2018	Year ended 31 December 2017
Basic earnings per share	**(12.0)p**	(1.2)p
Diluted earnings per share	**(12.0)p**	(1.2)p

Adjusted earnings	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Adjusted earnings for the basis of adjusted earnings per share[(1)]	**526**	191

[(1)] Adjusted earnings for the year ended 31 December 2018 comprises adjusted profit after tax of £539 million (note 4), net of an allocation to non-controlling interest of £13 million.

Adjusted earnings per share

Continuing operations	Year ended 31 December 2018	Year ended 31 December 2017
Adjusted basic earnings per share	**13.3p**	9.9p
Adjusted diluted earnings per share	**13.3p**	9.8p

8. Goodwill and other intangible assets

Goodwill acquired in business combinations, net of impairment, has been allocated to the businesses, each of which comprises several cash-generating units ("CGUs"). Goodwill in respect of GKN businesses remains provisional at 31 December 2018.

Goodwill	**31 December 2018 £m**	31 December 2017 £m
Brush	**-**	122
Nortek businesses:		
AQH	**370**	348
HVAC	**246**	232
Security & Smart Technology	**357**	320
Ergotron	**435**	410
GKN businesses:		
Aerostructures	**576**	-
Aerospace Engine Systems	**347**	-
Aerospace Special Technologies	**51**	-
Automotive Driveline	**704**	-
Automotive ePowertrain	**345**	-
Powder Metallurgy	**529**	-
Walterscheid Powertrain	**92**	-
	4,052	1,432

Impairment Testing

The Group tests goodwill annually or more frequently if there are indications that goodwill might be impaired. In accordance with IAS 36: "Impairment of assets" the Group values goodwill at the recoverable amount, being the higher of the value in use basis and the fair value less costs to sell basis.

Value in use calculations have been used to determine the recoverable amount of goodwill allocated to each group of CGUs. The calculation uses the latest approved forecast extrapolated to perpetuity using growth rates shown below, which do not exceed the long-term growth rate for the relevant market.

Based on impairment testing completed at the year end, no impairment was identified in respect of the Nortek businesses or the GKN businesses. No reasonably possible change in key assumptions would result in an impairment in the AQH and HVAC groups and GKN groups of CGUs. The recoverable amount of the GKN groups of CGUs at 31 December 2018 are higher than the recent acquisition date fair values. As a result, no sensitivity analysis has been disclosed for these businesses.

Both Security & Smart Technology and Ergotron have manufacturing facilities located in China that export to the US and their results in 2018, and the ongoing market environment, have been negatively impacted by the increase in US tariffs placed on Chinese goods. The intention is to pass any increased tariffs through to customers, but the uncertainty around how customers will react and/or a further escalation of US tariffs on Chinese goods and the impact that this could have on the behaviour of competitors means that there is a risk that future forecasts could be negatively impacted. No impairment of goodwill is required within these businesses, but sensitivity analysis has been provided.

An impairment charge of £123 million in respect of goodwill recorded in the Brush group of CGUs has been recorded in the Consolidated Income Statement and is shown as an adjusting item (note 4).

Significant assumptions and estimates

Each group of CGUs has been assessed through a value in use methodology, using the following significant assumptions.

The basis of these impairment tests and the key assumptions are set out in the table below:

	31 December 2018			31 December 2017		
Group of CGUs	**Pre-tax discount rates**	**Long-term growth rates**	**Period of forecast**	Pre-tax discount rates	Long-term growth rates	Period of forecast
Brush	10.8%	1.5%	5	11.9%	2.2%	5
AQH	11.8%	3.3%	3	12.6%	3.0%	4
HVAC	11.8%	3.1%	3	12.6%	3.0%	4
Security & Smart Technology	12.0%	3.3%	3	12.6%	3.0%	4
Ergotron	11.8%	3.3%	3	12.6%	3.0%	4
Aerostructures	10.2%	2.0%	5	-	-	-
Aerospace Engine Systems	10.1%	2.5%	5	-	-	-
Aerospace Special Technologies	9.7%	2.5%	5	-	-	-
Automotive Driveline	11.6%	0.0%	5	-	-	-
Automotive ePowertrain	12.0%	3.0%	5	-	-	-
Powder Metallurgy	12.0%	2.0%	5	-	-	-
Walterscheid Powertrain	14.5%	2.0%	5	-	-	-

Pre-tax risk adjusted discount rates

Cash flows are discounted using a pre-tax discount rate specific to each group of CGUs. Discount rates reflect the current market assessments of the time value of money and the territories in which the CGU operates. In determining the cost of equity, the Capital Asset Pricing Model ("CAPM") has been used. Under CAPM, the cost of equity is determined by adding a risk premium, based on an industry adjustment ("Beta"), to the expected return of the equity market above the risk-free return. The relative risk adjustment reflects the risk inherent in each group of CGUs relative to all other sectors and geographies on average.

The cost of debt is determined using a risk-free rate based on the cost of government bonds, and an interest rate premium equivalent to a corporate bond with a similar credit rating to Melrose.

Assumptions applied in financial forecasts

The Group prepares cash flow forecasts derived from financial budgets and medium-term forecasts. Each forecast has been prepared using a cash flow period deemed most appropriate by management, considering the nature of each group of CGUs. The key assumptions used in forecasting pre-tax cash flows relate to future budgeted revenue and operating margins likely to be achieved and the expected rates of long-term growth by market sector. Underlying factors in determining the values assigned to each key assumption are shown below:

Revenue growth and operating margins:

Revenue growth assumptions in the forecast period are based on financial budgets and medium-term forecasts by management, taking into account industry growth rates and management's historical experience in the context of wider industry and economic conditions. Projected sales are built up with reference to markets and product categories. They incorporate past performance, historical growth rates, projections of developments in key markets, secured orders and orders forecast to be achieved in the short to medium term given trends in the relevant market sector.

Operating margins have been forecast based on historical levels achieved considering the likely impact of changing economic environments and competitive landscapes on volumes and revenues and the impact of management actions on costs. Projected margins reflect the impact of all initiated projects to improve operational efficiency and leverage scale. The projections do not include the impact of future restructuring projects to which the Group is not yet committed. Forecasts for other operating costs are based on inflation forecasts and supply and demand factors.

Aerospace - The key drivers for growth in revenue and operating margins are global demand for commercial and military aircraft. Consumer spending, passenger load factors, raw material input costs, market expectations for aircraft production requirements, technological advancements, and other macroeconomic factors influence demand for these products.

Automotive - The key drivers for growth in revenue and operating margins are global demand for a large range of cars including smaller low-cost to larger premium vehicles. Demand is influenced by technological advancements particularly in electric and full hybrid vehicles, market expectations for global vehicle production requirements, fuel prices, raw material input costs, consumer spending, credit availability, and other macroeconomic factors.

Powder Metallurgy - The key drivers for growth in revenue and operating margins are trends in the automotive and industrial markets. Market expectations for global light vehicle production requirements, raw material input costs, technological advancements, particularly in additive manufacturing, influence demand for these products along with other macroeconomic factors.

Walterscheid Powertrain - The key drivers for growth in revenue and operating margins are the global demand in the agricultural, construction, mining, utility and industrial markets. Demand for these products is impacted by raw material input costs, consumer spending, market expectations on future production requirements, particularly in the agricultural and industrial sectors, and other macroeconomic factors.

HVAC and AQH - The key drivers for growth in revenue and operating margins are the levels of residential remodelling and replacement activity and the levels of residential and non-residential new construction in the markets in which these businesses operate. New residential and non-residential construction activity and, to a lesser extent, residential remodelling and replacement activity are affected by seasonality and cyclical factors such as interest rates, credit availability, inflation, consumer spending, employment levels and other macroeconomic factors.

Security & Smart Technology - The key driver for growth in revenue and operating margins is global demand for security and home automation products. Consumer spending, employment levels, regulation, technological advancements and the evolution of the traditional security market towards home automation and other macroeconomic factors influence demand for these products.

Ergotron - The key driver for growth in revenue and operating margins is demand for technology and wellness products in the markets in which Ergotron operates. Seasonal factors, public authority spending, corporate and consumer spending, employment levels, the public awareness of wellness, regulation, technological advancements and other macroeconomic factors influence demand for these products.

Brush - The key drivers for growth in revenues and operating margins are: i) original equipment investments in the global power market, both new capacity (mainly emerging markets) and replacement capacity (mainly in mature markets); ii) growth in service requirements of the installed base; and iii) new product introduction. Independent forecasts of growth in these power generation markets have been used to derive revenue growth assumptions. Forecasts for other operating costs are based on inflation forecasts and supply and demand factors.

Long-term growth rates:
Long-term growth rates are based on long-term forecasts for growth in the sectors and geography in which the CGU operates. Long-term growth rates are determined using a blend of publicly available data and a long-term growth rate forecast that takes into account the international presence and the markets in which each business operates.

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

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

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

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

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

Sensitivity analysis
Further sensitivity analysis has been carried out on the Brush group of CGUs. For illustration purposes, a further 0.1 percentage point increase in the discount rate or a further five percent reduction in the annual and terminal value of operating profit could result in a reduction in the value in use of £1 million and £5 million respectively. A further 0.1 percentage point decrease in the long-term growth rate could result in a reduction in the value in use of £1 million.

Security & Smart Technology group of CGUs
The goodwill related to the Security & Smart Technology ("SST") group of CGUs is tested for impairment by comparing the carrying amount of the SST group against recoverable amounts of the SST CGUs. Determination of the recoverable amount involved management judgement on highly uncertain matters, particularly with respect to the possible increase in tariffs in the US for goods being imported from China; the level of competition and technological change in the market; the timing and quantity of forecast unit sales; long-term growth rates and discount factors. The value in use model prepared for the SST group was prepared using latest cash flow projections for the period 2019-2021 followed by an assumed long-term growth rate of 3.3%. These cash flow projections were discounted at a pre-tax discount rate of 12.0% and used sale price and cost inflation data from available market sources.

Sensitivity analysis
The forecasts, prepared using a methodology required by IAS 36, show headroom of £88 million above the carrying amount for the SST group of CGUs. In accordance with IAS 36 a sensitivity analysis has been undertaken and a reasonably possible increase in the discount rate from 12.0% to 13.4% would reduce headroom to £nil. A reasonably possible decrease in the long-term growth rate from 3.3% to 1.7% would reduce headroom to £nil. In relation to a possible increase in US tariffs, it is difficult to model the precise impact on business performance at this time but this would likely lead to

reduced sales and margins in the short term. A five percent reduction in the annual and terminal value of operating profit could result in a reduction in the value in use of £34 million.

Ergotron group of CGUs

The goodwill related to the Ergotron group of CGUs is tested for impairment by comparing the carrying amount of the Ergotron group against recoverable amounts of the Ergotron CGUs. Determination of the recoverable amount involved management judgement on highly uncertain matters, particularly with respect to the possible increase in tariffs in the US for goods being imported from China as well as long-term growth rates. The value in use model prepared for the Ergotron group used the latest cash flow projections for the period 2019-2021 followed by an assumed long-term growth rate of 3.3%. These cash flow projections were discounted at a pre-tax discount rate of 11.8% and used sale price and cost inflation data from available market sources.

Sensitivity analysis

The forecasts, prepared using a methodology required by IAS 36, show headroom of £198 million above the carrying amount for the Ergotron group of CGUs. In accordance with IAS 36 a sensitivity analysis has been undertaken and a reasonably possible decrease in the long-term growth rate from 3.3% to 0.2% would reduce headroom to £nil. In relation to a possible increase in US tariffs, it is difficult to model the precise impact on business performance at this time but this would likely lead to reduced sales and margins in the short term. A five percent reduction in the annual and terminal value of operating profit could result in a reduction in the value in use of £42 million.

9. Acquisitions

GKN

On 19 April 2018 the Group acquired approximately 85% of the issued share capital and obtained control of GKN plc for consideration of £7,091 million. The remaining 15% of share capital was acquired subsequently, at a cost of £1,260 million which has been treated as a purchase of a non-controlling interest.

GKN is a global engineering business which designs, manufactures and services systems and components for original equipment manufacturers, specialising in the aerospace and automotive markets.

The Group has reviewed the assets and liabilities acquired. Due to the size of the acquired business, the assessment of the fair value of the assets and liabilities acquired has not yet been finalised. In accordance with IFRS 3: "Business combinations", the acquisition Balance Sheet of GKN at 19 April 2018 remains provisional as of 31 December 2018 as there could be further adjustment to the fair values recognised in the table below, if additional information comes to light.

	GKN £m	**IntelliVision £m**	**Provisional fair value £m**
Property, plant and equipment	2,619	-	2,619
Intangible assets	6,199	9	6,208
Interests in equity accounted investments	512	-	512
Inventories	1,173	-	1,173
Trade and other receivables, excluding contract assets(1)	1,973	1	1,974
Contract assets	524	-	524
Cash and cash equivalents	307	-	307
Trade and other payables	(2,915)	-	(2,915)
Derivative financial instruments	(137)	-	(137)
Provisions and contingent liabilities	(1,180)	-	(1,180)
Deferred tax	(761)	-	(761)
Retirement benefit obligations	(1,369)	-	(1,369)
Current tax liabilities	(89)	-	(89)
Interest-bearing loans and borrowings	(1,430)	-	(1,430)
Non-controlling interests(2)	(857)	-	(857)
Net assets attributable to the parent	**4,569**	**10**	**4,579**
Total consideration	7,091	26	7,117
Provisional goodwill	2,522	16	2,538
Total consideration satisfied by:			
Cash consideration	1,290	26	1,316
Shares issued to GKN shareholders	5,801	-	5,801

(1) The fair value of financial assets include gross trade and other receivables of £1,994 million. The best estimate at the acquisition date of the contractual cash flows not to be collected is £20 million.
(2) Non-controlling interests include an amount of £830 million in respect of approximately 15% of the issued share capital of GKN not acquired on 19 April 2018, but subsequently purchased in the period 19 April 2018 to 30 June 2018.

GKN contributed £7,212 million to adjusted revenue and £607 million to adjusted operating profit for the period between the date of acquisition and the balance sheet date. The amounts recognised in relation to GKN for the period from the 19 April to 31 December 2018 include revenue and profit and the associated impact on working capital, based on an estimate of activity from 19 April to 30 April 2018. If the acquisition of GKN had been completed on the first day of the financial year, Group adjusted revenues would have been £12,247 million and Group adjusted operating profit would have been £1,095 million.

IntelliVision Inc. ("IntelliVision")

On 27 April 2018, the Group's Security & Smart Technology business acquired 100% of the issued share capital and obtained control of IntelliVision, a leader in artificial intelligence, smart cameras and video analytics software, for consideration of £26 million. The amounts recognised in respect of the identifiable assets acquired and liabilities assumed are set out in the table above. Fair values remain provisional as at 31 December 2018 in case additional information comes to light that would require adjustment to the fair values recognised in the table above.

10. Equity accounted investments

Group share of results	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Revenue	**497**	3
Operating costs	**(438)**	(3)
Adjusted operating profit	**59**	-
Adjusting items	**(15)**	-
Net finance costs	**(1)**	-
Profit before tax	**43**	-
Tax	**(9)**	-
Share of results of equity accounted investments	**34**	-

11. Provisions

	Loss-making contracts £m	Property related costs £m	Environmental and litigation £m	Warranty related costs £m	Restructuring £m	Other £m	Total £m
At 1 January 2018	3	14	88	73	20	11	209
Acquisition of businesses	629	62	123	295	24	47	1,180
Utilised[1]	(63)	(5)	(60)	(36)	(111)	(9)	(284)
Net charge to operating profit[2]	(1)	-	43	37	181	(3)	257
Unwind of discount	9	-	-	-	-	1	10
Disposal of businesses	(8)	-	-	-	-	-	(8)
Exchange adjustments	47	3	8	18	2	3	81
At 31 December 2018	**616**	**74**	**202**	**387**	**116**	**50**	**1,445**
Current	65	15	58	130	108	5	381
Non-current	551	59	144	257	8	45	1,064
	616	74	202	387	116	50	1,445

(1) Includes £63 million of non-cash unwind of loss-making contracts provisions, positively impacting operating profit in 2018.
(2) Includes restructuring charges and other adjusting items of £168 million, along with £89 million relating to items charged through adjusted operating profit.

The Group's provision categories have been reconsidered following the acquisition of GKN which has resulted in certain reclassifications between provision categories.

Loss-making contracts

Provisions for loss-making contracts are considered to exist where the Group has a contract under which the unavoidable costs of meeting the obligations exceed the economic benefits expected to be received under it. This obligation has been discounted and will be utilised over the period of the respective contracts, which is up to 15 years.

Calculation of loss-making contract provisions is based on contract documentation and delivery expectations, along with an estimate of directly attributable costs and represents management's best estimate of the unavoidable costs of fulfilling the contract.

Property related costs

The provision for property related costs represents the estimated net payments for surplus property or off-market lease contracts on acquisition, due over the term of the leases and any dilapidation costs for ongoing leases. This is expected to result in cash expenditure over the next eight years. Calculations of surplus leasehold property costs and dilapidations are based on lease agreements with landlords and external quotes, or in the absence of specific documentation, management's best estimate of the costs required to fulfil obligations.

Environmental and litigation

Environmental and litigation provisions relate to the estimated remediation costs of pollution, soil and groundwater contamination at certain sites and estimated future costs and settlements in relation to legal claims and associated insurance obligations. Liabilities for environmental costs are recognised when environmental assessments are probable and the associated costs can be reasonably estimated.

Provisions are recorded for product and general liability claims which are probable and for which the cost can be reliably estimated. These liabilities include an estimate of claims incurred but not yet reported and are based on actuarial valuations using claim data. Due to their nature, it is not possible to predict precisely when these provisions will be utilised.

The Group has on occasion been required to take legal or other actions to defend itself against proceedings brought by other parties. Provisions are made for the expected costs associated with such matters, based on past experience of similar items and other known factors, considering professional advice received. This represents management's best estimate of the likely outcome. The timing of utilisation of these provisions is frequently uncertain, reflecting the complexity of issues and the outcome of various court proceedings and negotiations. Contractual and other provisions represent management's best estimate of the cost of settling future obligations and reflect management's assessment of the likely settlement method, which may change over time. However, no provision is made for proceedings which have been, or might be, brought by other parties against Group companies unless management, considering professional advice received, assess that it is more likely than not that such proceedings may be successful.

Warranty related costs

Provisions for the expected cost of warranty obligations under local sale of goods legislation are recognised at the date of sale of the relevant products and subsequently updated for changes in estimates as necessary. The provision for warranty related costs represents the best estimate of the expenditure required to settle the Group's obligations, based on past experience, recent claims and current estimates of costs relating to specific claims. Warranty terms are, on average, between one and five years.

Restructuring

Restructuring provisions relate to committed costs in respect of restructuring programmes, usually resulting in cash spend within one year. A restructuring provision is recognised when the Group has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by either starting to implement the plan or by announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are necessarily entailed by the restructuring programmes.

Other

Other provisions include long-term incentive plans for divisional senior management and the employer tax on equity-settled incentive schemes which are expected to result in cash expenditure over the next two to five years.

Where appropriate, provisions have been discounted using discount rates between 0% and 9% (31 December 2017: 3%) depending on the territory in which the provision resides and the length of its expected utilisation.

12. Retirement benefit obligations

Defined benefit plans

The Group sponsors defined benefit plans for qualifying employees of certain subsidiaries. The funded defined benefit plans are administered by separate funds that are legally separated from the Group. The Trustees of the funds are required by law to act in the interest of the fund and of all relevant stakeholders in the plans. The Trustees of the pension funds are responsible for the investment policy with regard to the assets of the fund.

Contributions

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

The Group contributed £102 million (2017: £4 million) to defined benefit pension plans and post-employment plans in the year ended 31 December 2018, including £56 million of the Melrose commitment to contribute £150 million to the GKN UK 2012 and 2016 plans within the first twelve months of GKN ownership.

The Group expects to contribute £192 million to defined benefit pension plans and post-employment plans in 2019, consisting of £94 million of one-off special payments, being the balance of the £150 million upfront commitment, and £98 million of ongoing commitments.

Actuarial assumptions

The major assumptions used by the actuaries in calculating the Group's pension liabilities are as set out below:

	Rate of increase of pensions in payment % per annum	**Discount rate % per annum**	**Price inflation % per annum**
31 December 2018			
GKN UK – 2012 plan	3.1	2.9	2.1
GKN UK – 2016 plan	3.1	2.9	2.1
GKN US plans	n/a	4.1	2.5
GKN Europe plans	2.5	1.9	1.8
Brush UK plan	3.2	2.9	2.1
31 December 2017			
Brush UK plan	3.2	2.5	2.1

Balance Sheet disclosures

The amount recognised in the Consolidated Balance Sheet arising from net liabilities in respect of defined benefit plans was as follows:

	31 December 2018 £m	31 December 2017 £m
Present value of funded defined benefit obligations	**(3,937)**	(538)
Fair value of plan assets	**3,273**	524
Funded status	**(664)**	(14)
Present value of unfunded defined benefit obligations	**(749)**	(4)
Net liabilities	**(1,413)**	(18)

The plan liabilities and assets at 31 December 2018 were as follows:

	UK Plans[(1)] £m	US Plans £m	European Plans £m	Other Plans £m	**Total £m**
Plan assets	2,791	412	29	41	**3,273**
Plan liabilities	(3,378)	(565)	(690)	(53)	**(4,686)**
Net liabilities	(587)	(153)	(661)	(12)	**(1,413)**

[(1)] Includes a net deficit in respect of the GKN UK 2012 plan, GKN post-employment medical plans, and the Nortek UK plan and a surplus in respect of the Brush UK plan and the GKN UK 2016 plan.

13. Issued capital and reserves

Share Capital	**31 December 2018 £m**	31 December 2017 £m
Allotted, called-up and fully paid		
4,858,254,963 (31 December 2017: 1,941,200,503) Ordinary Shares of 48/7p each (31 December 2017: 48/7p each)	**333**	133
12,831 (31 December 2017: 12,831) 2017 Melrose Incentive Plan Shares of £1 each	**-**	-
	333	133

The rights of each class of share are described in the Directors' Report.

On 19 April 2018, 2,469 million ordinary shares were issued as a result of the acquisition of GKN. Further issues of share capital totalling 448 million took place between 19 April 2018 and 30 June 2018 in order to purchase the remaining non-controlling interest of GKN. The total number of ordinary shares in issue therefore increased from 1,941 million at 31 December 2017 to 4,858 million at 31 December 2018.

Translation reserve
The Translation reserve contains exchange differences on the translation of subsidiaries with a functional currency other than Sterling and exchange gains or losses on the translation of liabilities that hedge the Company's net investment in foreign subsidiaries.

Hedging reserve
The Hedging reserve represents the cumulative fair value gains and losses on derivative financial instruments for which cash flow hedge and net investment hedge accounting has been applied.

Merger reserve and Other reserves
The Merger reserve represents the excess of fair value over nominal value of shares issued in consideration for the acquisition of subsidiaries. Other reserves comprise accumulated adjustments in respect of Group reconstructions.

14. Cash flow statement

	Note	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Reconciliation of adjusted operating profit to cash generated by continuing operations			
Adjusted operating profit(1)	4	**847**	279
Adjustments for:			
Depreciation of property, plant and equipment		**238**	31
Amortisation of computer software and development costs		**44**	4
Share of adjusted operating profit of equity accounted investments		**(59)**	-
Restructuring costs paid and movements in provisions		**(207)**	(74)
Defined benefit pension contributions paid		**(102)**	(4)
Increase in inventories		**(108)**	(8)
Decrease in receivables		**181**	8
Decrease in payables		**(159)**	(16)
Acquisition costs and associated transaction taxes		**(125)**	(8)
Tax paid		**(66)**	(16)
Interest paid		**(111)**	(16)
Incentive scheme tax related payments		**-**	(148)
Net cash from operating activities		**373**	32

(1) See note 4 for reconciliation of operating loss to adjusted operating profit.

Net debt reconciliation

Net debt consists of interest-bearing loans and borrowings (excluding any acquisition related fair value adjustments), cross-currency swaps and cash and cash equivalents. Currency denominated balances within net debt are translated to Sterling at swapped rates where hedged by cross-currency swaps.

Net debt is considered to be an alternative performance measure as it is not defined in IFRS. The most directly comparable IFRS measure is the aggregate of interest-bearing loans and borrowings (current and non-current) and cash and cash equivalents.

A reconciliation from the most directly comparable IFRS measure to net debt is given below:

	31 December 2018 £m	31 December 2017 £m
Interest-bearing loans and borrowings – due within one year	**(377)**	-
Interest-bearing loans and borrowings – due after one year	**(3,378)**	(588)
External debt	**(3,755)**	(588)
Less:		
Cash and cash equivalents	**415**	16
	(3,340)	(572)
Adjustments:		
Impact of cross-currency swaps	**(199)**	-
Non-cash acquisition fair value adjustments	**57**	-
Net debt	**(3,482)**	(572)

The table below shows the key components of the movement in net debt:

	At 31 December 2017 £m	Cash flow £m	Acquisitions £m	Other non-cash movements £m	Effect of foreign exchange £m	**At 31 December 2018 £m**
External debt	(588)	(1,732)	(1,430)	49	(54)	**(3,755)**
Impact of cross-currency swaps	-	10	(109)	(16)	(84)	**(199)**
Non-cash acquisition fair value adjustments	-	-	73	(16)	-	**57**
	(588)	(1,722)	(1,466)	17	(138)	**(3,897)**
Cash and cash equivalents	16	1,802	(1,401)	-	(2)	**415**
Net debt	(572)	80	(2,867)	17	(140)	**(3,482)**

15. Post Balance Sheet events

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

Glossary

Alternative Performance Measures ("APMs")

In accordance with the Guidelines on APMs issued by the European Securities and Markets Authority ("ESMA"), additional information is provided on the APMs used by the Group below.

In the reporting of financial information, the Group uses certain measures that are not required under IFRS. These additional measures (commonly referred to as APMs) provide additional information on the performance of the business and trends to stakeholders. These measures are consistent with those used internally, and are considered important to understanding the financial performance and financial health of the Group. APMs are considered to be an important measure to monitor how the businesses are performing because this provides a meaningful comparison of how the business is managed and measured on a day-to-day basis and achieves consistency and comparability between reporting periods.

These APMs may not be directly comparable with similarly titled profit measures reported by other companies and they are not intended to be a substitute for, or superior to, IFRS measures.

APM	**Closest equivalent statutory measure**	**Reconciling items to statutory measure**	**Definition and purpose**
Income Statement Measures			
Adjusted revenue and Annualised adjusted revenue	Revenue	Share of revenue of equity accounted investments (note 3) and full period impact of acquisitions	Adjusted revenue includes the Group's share of revenue of equity accounted investments. Annualised adjusted revenue reflects the Group's adjusted revenue as if all acquisitions in the period had occurred on the first day of the financial year. This enables comparability between reporting periods.

Revenue	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Revenue	**8,605**	2,092
Share of revenue of equity accounted investments	**497**	3
Adjusted revenue	**9,102**	2,095
Full year impact of acquisitions	**3,145**	-
Annualised adjusted revenue	**12,247**	2,095

Adjusting items	None	Adjusting items (note 4)	Those items which the Group excludes from its adjusted profit metrics in order to present a further measure of the Group's performance. These include items which are significant in size or volatility or by nature are non-trading or non-recurring, and any item released to the Income Statement that was previously a fair value item booked on an acquisition. This provides a meaningful comparison of how the business is managed and measured on a day-to-day basis and provides consistency and comparability between reporting periods.
Adjusted operating profit and Annualised adjusted operating profit	Operating profit/(loss)(1)	Adjusting items (note 4) and full period impact of acquisitions	The Group uses adjusted profit measures to provide a useful and more comparable measure of the ongoing performance of the Group. Adjusted measures are reconciled to statutory measures by removing adjusting items, the nature of which are disclosed above and further detailed in note 4. Annualised adjusted operating profit reflects the Group adjusted operating profit as if all acquisitions in the period had occurred on the first day of the financial year.

Operating profit	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Operating loss	**(392)**	(7)
Adjusting items (note 4)	**1,239**	286
Adjusted operating profit	**847**	279
Full year impact of acquisitions	**248**	-
Annualised adjusted operating profit	**1,095**	279

APM	Closest equivalent statutory measure	Reconciling items to statutory measure	Definition and purpose
Adjusted operating margin and Annualised adjusted operating margin	Operating margin(2)	Share of revenue of equity accounted investments (note 3), adjusting items (note 4) and full period impact of acquisitions	Adjusted operating margin represents Adjusted operating profit as a percentage of Adjusted revenue. Annualised adjusted operating margin represents Annualised adjusted operating profit as a percentage of Annualised adjusted revenue.
Adjusted EBITDA, Annualised adjusted EBITDA and Annualised adjusted EBITDA for covenant purposes	Operating profit/(loss)(1)	Adjusting items (note 4), depreciation of property, plant and equipment and amortisation of computer software and development costs, share of depreciation of property, plant and equipment and amortisation of computer software and development costs of equity accounted investments, as well as full period impact of acquisitions and adjustments for covenant purposes	Adjusted operating profit before depreciation and impairment of property, plant and equipment and before the amortisation and impairment of computer software and development costs. Adjusted EBITDA and Annualised adjusted EBITDA are measures used to value individual businesses as part of the "Buy, Improve and Sell" Melrose strategy model and by certain external stakeholders to measure performance.

Adjusted EBITDA	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Adjusted operating profit	**847**	279
Depreciation of property, plant and equipment	**238**	31
Amortisation of computer software and development costs	**44**	4
Share of depreciation and amortisation of equity accounted investments	**18**	-
Adjusted EBITDA	**1,147**	314
Full year impact of acquisitions	**378**	-
Annualised adjusted EBITDA	**1,525**	314
Other adjustments required for covenant purposes	**(33)**	-
Annualised adjusted EBITDA for covenant purposes	**1,492**	314

APM	Closest equivalent statutory measure	Reconciling items to statutory measure	Definition and purpose
Adjusted profit before tax and Annualised adjusted profit before tax	Profit/(loss) before tax	Adjusting items (note 4) and full period impact of acquisitions	Profit before the impact of adjusting items and tax. As discussed above, adjusted profit measures are used to provide a useful and more comparable measure of the ongoing performance of the Group. Adjusted measures are reconciled to statutory measures by removing adjusting items, the nature of which are disclosed above and further detailed in note 4. As discussed above, the Group uses adjusted profit measures to provide a useful and comparable measure of the ongoing performance of the Group.

Profit before tax	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Loss before tax	**(550)**	(28)
Adjusting items (note 4)	**1,253**	286
Adjusted profit before tax	**703**	258
Full year impact of acquisitions	**183**	-
Annualised adjusted profit before tax	**886**	258

APM	Closest equivalent statutory measure	Reconciling items to statutory measure	Definition and purpose
Adjusted profit after tax and Annualised adjusted profit after tax	Profit/(loss) after tax	Adjusting items (note 4) and full period impact of acquisitions	Profit after tax but before the impact of the adjusting items. As discussed above, adjusted profit measures are used to provide a useful and more comparable measure of the ongoing performance of the Group. Adjusted measures are reconciled to statutory measures by removing adjusting items, the nature of which are disclosed above and further detailed in note 4. As discussed above, the Group uses adjusted profit measures to provide a useful and comparable measure of the ongoing performance of the Group.

Profit after tax	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Loss after tax	**(475)**	(24)
Adjusting items (note 4)	**1,014**	215
Adjusted profit after tax	**539**	191
Full year impact of acquisitions	**141**	-
Annualised adjusted profit after tax	**680**	191

APM	Closest equivalent statutory measure	Reconciling items to statutory measure	Definition and purpose
Adjusted tax rate	Effective tax rate	Adjusting items, adjusting tax items and the tax impact of adjusting items (note 4 and note 5)	The income tax charge for the Group excluding adjusting tax, the net effect of new tax legislation in the US enacted in December 2017 and the tax impact of adjusting items, divided by adjusted profit before tax. This measure is a useful indicator of the ongoing tax rate for the Group.

Adjusted tax rate	Year ended 31 December 2018 £m	Year ended 31 December 2017 £m
Tax credit per Income Statement	**75**	4
Adjusting tax items	**-**	(27)
Tax impact of adjusting items	**(239)**	(44)
Adjusted tax charge	**(164)**	(67)
Adjusted profit before tax	**703**	258
Adjusted tax rate	**23.3%**	25.9%

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<tr><td>Adjusted basic earnings per share</td><td>Basic earnings per share</td><td>Adjusting items (notes 4 and 7)</td><td>Profit after tax attributable to owners of the Parent and before the impact of adjusting items, divided by the weighted average number of ordinary shares in issue during the financial year.</td></tr>
<tr><td>Adjusted diluted earnings per share</td><td>Diluted earnings per share</td><td>Adjusting items (notes 4 and 7)</td><td>Profit after tax attributable to owners of the Parent and before the impact of adjusting items, divided by the weighted average number of ordinary shares in issue during the financial year adjusted for the effects of any potentially dilutive options.

The Board considers this to be a key measure of performance when all businesses are held for the complete reporting period.</td></tr>
<tr><td>Annualised adjusted diluted earnings per share</td><td>Diluted earnings per share</td><td>Adjusting items (notes 4 and 7) and full period impact of acquisitions</td><td>Annualised profit after tax attributable to owners of the Parent and before the impact of adjusting items, divided by the number of ordinary shares in issue at 31 December 2018 adjusted for the effects of any potentially dilutive options.

The Board considers this to be a key measure of performance when adjusted results include businesses owned for part of a period.

<table>
<thead>
<tr><th>Annualised adjusted diluted earnings per share</th><th>Year ended 31 December 2018 £m</th></tr>
</thead>
<tbody>
<tr><td>Annualised adjusted profit after tax</td><td>680</td></tr>
<tr><td>Attributable to:</td><td></td></tr>
<tr><td>Owners of the parent</td><td>670</td></tr>
<tr><td>Non-controlling interests</td><td>10</td></tr>
<tr><td>Diluted number of shares at 31 December 2018 (million)</td><td>4,858</td></tr>
<tr><td>Annualised adjusted diluted earnings per share</td><td>13.8p</td></tr>
</tbody>
</table>
</td></tr>
<tr><td>Interest cover</td><td>None</td><td>Not applicable</td><td>Adjusted EBITDA as a multiple of net interest payable on bank loans and overdrafts, being 11.6x in year ended 31 December 2018 (2017: 19.6x).

This measure is used for bank covenant testing.</td></tr>
<tr><td colspan="4">Balance Sheet Measures</td></tr>
<tr><td>Working capital</td><td>Inventories, trade and other receivables less trade and other payables</td><td>Not applicable</td><td>Working capital comprises inventories, current and non-current trade and other receivables and current and non-current trade and other payables.</td></tr>
<tr><td>Net debt</td><td>Cash and cash equivalents less interest-bearing loans and borrowings and finance related derivative instruments</td><td>Reconciliation of net debt (note 14)</td><td>Net debt comprises cash and cash equivalents, interest-bearing loans and borrowings and cross-currency swaps but excludes non-cash acquisition fair value adjustments.

Net debt is one measure that could be used to indicate the strength of the Group's Balance Sheet position and is a useful measure of the indebtedness of the Group.</td></tr>
<tr><td>Leverage of net debt to Annualised adjusted EBITDA</td><td>None</td><td>Not applicable</td><td>Bank covenant definition of net debt divided by Annualised adjusted EBITDA for bank covenant purposes.

This measure is used for bank covenant testing.</td></tr>
</tbody>
</table>

APM	Closest equivalent statutory measure	Reconciling items to statutory measure	Definition and purpose
Bank covenant definition of net debt at average rates	Cash and cash equivalents less interest-bearing loans and borrowings and finance related derivative instruments	Impact of foreign exchange and adjustments for bank covenant purposes	Net debt (as above) is presented in the Balance Sheet translated at year end exchange rates. For bank covenant testing purposes net debt is converted using average exchange rates for the year.

Net debt	**31 December 2018 £m**	31 December 2017 £m
Net debt at closing rates (note 14)	**3,482**	572
Impact of foreign exchange	**(86)**	23
Net debt at average rates	**3,396**	595
Other adjustments required for covenant purposes	**11**	-
Bank covenant definition of net debt at average rates	**3,407**	595
Leverage	**2.3x**	1.9x

Cash flow measures			
Adjusted operating cash flow (pre-capex) and Adjusted operating cash flow conversion	Net cash from operating activities	Non-working capital items (note 14)	Adjusted operating cash flow (pre-capex) is calculated as adjusted EBITDA attributable to subsidiaries less movements in working capital. Adjusted operating cash flow (pre-capex) conversion is adjusted operating cash flow (pre-capex) divided by adjusted EBITDA attributable to subsidiaries. This measure provides additional useful information in respect of cash generation and is consistent with how business performance is measured internally.

Adjusted operating cash flow	**Year ended 31 December 2018 £m**	Year ended 31 December 2017 £m
Adjusted EBITDA	**1,147**	314
Share of depreciation and amortisation of equity accounted investments	**(18)**	-
Share of adjusted operating profit of equity accounted investments	**(59)**	-
Adjusted EBITDA attributable to subsidiaries	**1,070**	314
Change in inventories	**(108)**	(8)
Change in receivables	**181**	8
Change in payables	**(159)**	(16)
Positive non-cash impact from loss-making contracts	**(63)**	-
Adjusted operating cash flow (pre-capex)	**921**	298
Adjusted operating cash flow conversion	**86%**	95%

APM	Closest equivalent statutory measure	Reconciling items to statutory measure	Definition and purpose
Free cash flow	Net increase/decrease in cash and cash equivalents	Acquisition related cash flows, dividends paid to owners of the parent, foreign exchange and other non-cash movements	Free cash flow represents cash generated from trading after all costs including restructuring, pension contributions, tax and interest payments.
Capital expenditure (capex)	None	Not applicable	Calculated as the purchase of property, plant and equipment and computer software and expenditure on capitalised development costs during the year, excluding any assets acquired as part of a business combination.
Capital expenditure to depreciation ratio	None	Not applicable	Capital expenditure divided by depreciation of property, plant and equipment and amortisation of computer software and development costs.
Dividend per share	Dividend per share	Not applicable	Amounts payable by way of dividends in terms of pence per share.

(1) Operating profit/(loss) is not defined within IFRS but is a widely accepted profit measure being profit/(loss) before finance costs, finance income and tax.

(2) Operating margin is not defined within IFRS but is a widely accepted profit measure being derived from operating profit/loss[1] divided by revenue.