

Section 172 statement

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

Purpose, strategy and values

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

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

Duty to promote the success of the Company

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

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

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

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

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

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

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

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

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

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

Having regard to the interests of the Company’s employees

In 2019, the Board established a workforce advisory panel (“WAP”) in order to promote effective engagement with, and encourage participation from, the Group’s workforce. The structure of the WAP deliberately reflects the decentralised nature of the Melrose model and ensures that the voice of the respective workforce is heard where it is most effective in the business unit executive decision-making

process. Clarity and oversight of all actions across the Group are heard at Board level, as well as providing an opportunity for each business to gain insight into best practice from their peers. Further details about the WAP can be found in the ESG report on pages 58 to 69.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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