



Rt Hon Greg Clark MP
Secretary of State for Business, Energy and Industrial Strategy
Department for Business, Energy and Industrial Strategy
1 Victoria Street
London
SW1H 0ET

27 March 2018

Dear Secretary of State,

Further to our meeting on 22 March and your letter dated 26 March, I write to draw together in one letter to you our strong commitment to create a £10 billion UK engineering and manufacturing powerhouse and returning GKN to its rightful place, competing on the world stage.

We buy good but underperforming manufacturing and engineering businesses and improve them to the benefit of all stakeholders. This letter follows helpful discussions with your Department, Ministry of Defence, Parliament, GKN's pensions trustees, Unite and the various regulatory bodies involved.

We have been working hard to ensure we are able to be as clear as possible about our ambition and intentions for GKN, and to make sure that we act in the best interests of all stakeholders should we acquire the business. Unfortunately, as a result of the nature of the transaction, we have not had access to the information we would expect in order to make detailed commitments.

Nonetheless, our commitment throughout has been clear.

Although we set out a number of undertakings and intention statements in our letter to the Business, Energy and Industrial Strategy Select Committee, we recognise the concerns you have raised with us and have sought to provide further commitments to address these.

Industry

We are a British listed company that is focused on improving the good but underperforming businesses we acquire. We invest in R&D. We invest in our people, in skills and training. We boost productivity. It is partly through this investment that we make the operational improvements and productivity gains that are central to our strong track record.

Takeover Panel enforceable undertakings

We have been able to agree with the Takeover Panel the form of the following legally enforceable undertakings:

- For a period of five years, Melrose will:
 - maintain its UK listing;
 - maintain its UK headquarters;

- ensure a majority of its directors are resident in the UK; and
- ensure that the Aerospace and Driveline divisions retain the rights to the GKN name;
- Melrose will at least maintain GKN's current level of expensed research and development investment equal 2.2% of sales over the financial years 2019, 2020, 2021, 2022 and 2023.

These undertakings are enforceable by, and have been agreed with, the Takeover Panel pursuant to the Takeover Code.

However, our ambitions for GKN's businesses go beyond the commitments we have been able to agree with the Panel. Therefore, we have set out further commitments below outside the regime of the Takeover Code.

A long-term commitment

We are a great British success story and are totally transparent about our ambitions and intentions. We are here because under the management of its current board, GKN has underperformed its potential and its peers and the business needs help. We believe we are the right team to return this ailing business to once again become a British engineering and manufacturing powerhouse, competing on the world stage, for the benefit of all stakeholders.

With our understanding of the challenges facing GKN, we anticipate that their improvement period under our ownership will extend for a number of years. Throughout, we would invest as if we were going to own these businesses forever to make them as successful as possible. We do this because it is the right thing to do, but also because it is in the best interests of our investors and other stakeholders. It is fundamental to our core business philosophy and is the best way to maximise value. We have no set sale deadline and can hold a business for as long as we consider appropriate for the improvement profile of the particular business. Once we have improved GKN's businesses, we will review all strategic options as to what would be best for the next stage of development for each business.

To demonstrate the strength of our commitment and ensure that its improvement and investment programme is not unduly interrupted, we are willing to make a legally binding commitment to you (or in the form of a post offer undertaking, if permissible under the Takeover Code) that, subject to below, Melrose will not sell the Aerospace Division before 1 April 2023.

This undertaking would not apply to any of the non-material or non-core businesses as already identified by GKN or where required by any competent overseas regulatory authority or under a pre-existing obligation, nor would it prohibit the flotation of Aerospace on the UK stock market. In addition, should we be approached by a suitable strategic purchaser offering a long-term ownership and investment proposal for Aerospace prior to 1 April 2023, we would ask that you consider in good faith, with the advice of your Department, the approval of such a proposal.

Although flexibility is an important part of the Melrose business model that is well understood and supported by our shareholders, we hope that this will demonstrate our commitment to the UK industrial base and is in direct contrast to the fire-sale being undertaken by the current GKN board.

Creation of a Skills, Innovation and Productivity Fund

Our commitment to skills, innovation and productivity is clear. Based on 2017 sales of approximately £10 billion, the Takeover Code undertaking above would have equated to an investment in R&D of £220 million in 2017, or £1.1 billion across five years. However, we consider this 2.2% commitment to be a floor, not a ceiling on our ambitions.

Because we believe in building Britain's industrial base, and because we invest for the long-term regardless of how long we own our businesses for, we will also create a new Melrose skills, innovation and productivity fund.

Going beyond our Takeover Code undertaking to invest 2.2% of sales in R&D, we will make a further £10 million available over five years to support the creation of between 100 to 150 new apprenticeships in engineering, technology and science.

The investment will be directed by a new Melrose Skills Board made up of UK representatives from the enlarged Melrose Group, including GKN Driveline and GKN Aerospace. We will appoint an independent chair with experience in high-end skills to ensure the funding is directed as effectively as possible. The funding will be available to support our businesses, but will also be available to higher education colleges around both businesses in the South West, Midlands and Oxford to create new opportunities for young people in those regions and help foster the next generation of great British engineers.

In addition, while much has been rightly made of the importance of eDrive technology, in reality we understand that little of the development or manufacturing of this technology by GKN is currently located in the UK. Although GKN opened an innovation centre in Abingdon, Oxfordshire last year, this remains in its infancy. It is our intention to enhance and grow the current R&D facilities in Abingdon wherever possible, not only in relation to its focus on composites and additive manufacturing, but also building towards becoming a global centre of excellence for the development of the exciting eDrive technology. This is in contrast to GKN's proposal with Dana for Driveline, which so far as we are aware involves no similar UK commitments and clearly aligns the future development towards the US.

Supporting Britain's industrial base

Under our ownership, the Aerospace and Driveline businesses will continue to operate under the venerable British GKN brand. We enjoy strong support on the UK equity markets, which provides access to significant funding for strategic acquisitions to grow and transform these businesses. Not only does a growing business provide the platform to support increased employment for all, but with the potential strategic options for these businesses following their improvement including a relisting, if they achieve the necessary scale, either of these businesses could return to the UK stock exchange.

Across all our businesses we understand the need for a strong and skilled workforce to power the Industrial Strategy. All the existing contractual and statutory employment rights, including in relation to existing pensions contributions, of GKN's management and employees will be fully safeguarded in accordance with applicable law.

We have outlined above our commitment to investing in R&D and to establishing a new skills, innovation and productivity fund to support the creation of 100 to 150 new apprenticeships in engineering, technology and science. Furthermore, we understand the importance of good industrial relations and have always had good working relationships with our unions. We have met

with Unite as a part of this acquisition and will continue to work with them following our acquisition. As a recognition of their importance to the success of our businesses, we would be keen for them to take a seat on the Melrose Skills Board to help direct the available funds most effectively.

In respect of GKN Driveline, we intend to continue to support the automotive sector deal between government and industry, within which GKN plays an important role. This will include continued efforts to ensure the UK remains at the forefront of low-carbon and electric vehicle technology.

We are equally committed to GKN Aerospace. As well as intending to continue to support the sector deal known as the Aerospace Growth Partnership, we also intend to continue to support the Wing of the Future programme and to partner with the Aerospace Technology Institute.

We have also publicly stated the intention to work with Government to explore opportunities to promote GKN, its customers and suppliers around the world. GKN has a first-class customer and supplier base. Having already engaged with some of its key public and private sector customers during the bid period to make clear our ambitions for an improved GKN, we intend to continue to work closely with OEMs, such as Airbus, Northrop Grumman and Rolls-Royce in the aerospace sector, and with businesses including Jaguar Land Rover, Toyota, Honda and Nissan in the automotive sector, to seek further development of the UK's industrial base. We believe this will help to generate inward investment and to boost the UK economy.

The deal is also not just about GKN but its supply chain too. We intend to work with the many UK companies large and small in GKN's supply chain to drive productivity and deepen relationships. We intend to keep GKN listed as a signatory of the Prompt Payment Code.

UK tax residency

Melrose is a UK listed company and has been tax resident here since its establishment. We are wholly committed to continuing our tax residency in UK, for the period of our ownership of GKN and beyond.

Pensions

We have always been good stewards and improved the strength of every pension scheme that has come into our ownership. Our only material UK pension scheme is currently in surplus and the other smaller schemes we recently acquired with the Nortek business are well on their way. The other schemes we have held were effectively fully funded by the time we found them new, responsible and financially secure homes with Honeywell and Ontario Teachers' Pension Plan.

As you will have seen from the announcement of our agreement with the GKN Pension Scheme Trustees, our plan for GKN pensions schemes is no different.

We have agreed to pay into the GKN Pension Schemes approximately £1 billion during our ownership of the business that will take them to fully funded on the basis of a discount rate of Gilts + 0.75%.

This includes a £150 million payment in the first year, split between the schemes so that the 2016 scheme is immediately fully funded to self-sufficiency. In respect of the 2012 scheme, in addition to its proportion of the initial £150 million payment, we have committed to doubling the level of annual contributions from £30 million to £60 million a year. We are also reorganising the 2012 scheme amongst the GKN businesses, so that the liabilities better match their income profiles, plus setting a new and improved funding target on the basis of a discount rate of Gilts + 0.75%. This is

twice as good as the current basis of Gilts + 1.6% and far better than the Gilts + 1.2% proposed in connection with the Dana deal.

Recognising the potentially significant sale proceeds available as we exit some of our existing businesses, we have agreed to contribute 5% of the proceeds from any existing Melrose non-GKN business and 10% of the proceeds from the sale of any GKN non-core business until the schemes are fully funded. This will mean the pension schemes are well progressed towards fully funded to their new and improved funding level prior to reviewing strategic options for the Aerospace and Driveline businesses. In any event, we have committed to ensuring the schemes are fully funded before they exit the Melrose Group.

Our £1 billion contribution to the GKN pension schemes is far more than currently promised by GKN and almost double the £525 million of deficit reduction contributions outlined in the GKN-Dana Heads of Terms agreement. Under our proposal, the deficits are likely to be recovered within five years.

Both we and the GKN pension trustees kept open lines of communication with the Pension Regulator throughout our offer process. We understand the Pensions Regulator was kept fully informed by the GKN pension scheme trustees, including being provided with copies of all documents and advice, and had a number of conversations with them throughout. We have also met with the Pensions Regulator since reaching the agreement with trustees last week to answer their further questions.

Without us, GKN pensioners would face an uncertain future under current GKN management. With the announcement of the potential sale to Dana, the approximately 3,000 members that 'win' the lottery, will be transferred to a business that has sent a UK pension scheme to the PPF in the last ten years. Those that remain behind, find themselves supported by an Aerospace business with a profit to pension liability ratio three times the FTSE 100 average. This is a very uncomfortable balance of gross pension liabilities relative to the company size and will damage the covenant of the company even if they are funded to an accounting deficit level.

National Security

We are British and work in the national interest. We understand you have the power under the Enterprise Act 2002 to intervene in transactions on the basis of national security, but we have been very clear with you and the Ministry of Defence that is not necessary in this case. We are wholly committed to securing the UK's national security.

To alleviate any concerns, we will execute a deed of undertaking in favour of the Ministry of Defence that addresses all aspects of national security.

Recognising the importance that our actions match the strength of our words, I am also committed to the continued engagement with you and your Department during the course of our ownership of GKN to demonstrate our full delivery of all these commitments.

Whatever the outcome of our bid, GKN will be a different business over the coming months. Its Board have agreed a deal which, if allowed to go through, will leave GKN Driveline as a foreign owned business, listed abroad, led and managed by a team based outside the UK. In its announcement, both GKN and Dana have been clear that they expect this new business to deliver significant savings through a range of cost cutting measures including consolidation of its sites.

We do not believe the proposed sale of GKN Driveline to Dana is in the best interests of GKN's employees, pensioners, customers, suppliers, shareholders or the wider UK economy. In fact, it would go further – it places them at risk.

We will keep working hard to ensure we secure the best possible deal for all GKN's stakeholders and the wider UK economy.

Yours sincerely,



Simon Peckham
Chief Executive
Melrose Industries plc