

Business, Energy and Industrial Strategy Committee

Oral evidence: The Future of GKN, HC 844

Tuesday 6 March 2018

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Members present: Rachel Reeves (Chair); Vernon Coaker; Drew Hendry; Stephen Kerr; Peter Kyle; Mr Ian Liddell-Grainger; Albert Owen; Mark Pawsey; Antoinette Sandbach; Anna Turley.

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Witnesses

[I](#): Anne Stevens, Chief Executive, GKN; Jos Sclater, Group Finance Director, GKN.

[II](#): Christopher Miller, Co-founder and Executive Chairman, Melrose Industries; David Roper, Co-founder and Executive Vice-Chairman, Melrose Industries; Simon Peckham, Co-founder and Chief Executive, Melrose Industries.

[III](#): Tony Burke, Assistant General Secretary for Manufacturing, Unite the Union; Steve Turner, Assistant General Secretary for Aerospace, Unite the Union.

Examination of witnesses

Witnesses: Anne Stevens and Jos Sclater.

Chair: Thank you very much for coming to give evidence in our session today. We will be hearing this morning from GKN, Melrose and then Unite the Union on the proposed takeover bid by Melrose for GKN and GKN's response to that. We have a lot of questions to get through, so we are going to start straightaway.

Q1 Mark Pawsey: Good morning. I wonder if you could start by telling us about the performance of the company in the past two or three years and, in particular, the need to issue a profit warning in October of last year.

Anne Stevens: Thank you for the question. First off, thank you for giving us the opportunity to speak with you today and to answer your questions. GKN has been a successful company for many years, with a 250-year history. We are committed to long-term investments in technologies for both the aerospace and auto markets. Many of those technologies have been researched and developed in the UK.

To answer your question specifically, we are a company that has outperformed over many years. I will just give you one statistic: in the past five years, we have outperformed the FTSE 100 Index by 33%. Yes, we encountered problems with large manufacturing companies. Some of the problems we encountered were in launches and transitions from major commercial and military programmes. To the question you asked, some of the problems that we encountered were in US aerospace.

Some of it was because in our contracts we have cost-cutting commitments that we make to the customer. We cut a bit deep. We destabilised the plant a bit and we were producing some product that was not able to be shipped. The product was held in inventory. I could say that we were a bit over-optimistic in evaluating the ability for us to rework the inventory and ship to the customer.

That problem has been corrected, but overall, even with those issues in 2017, we hit a record sales level of over £10 billion for the first time in GKN's history.

Jos Sclater: There was also record profit. You specifically referred to the October trading update. That was also partly because we had a 30 million claim, but that was nothing to do with any product we made. We own a share of the engine programmes of the OEMs. One of those programmes had some launch issues, and that flows through to some of our contracts.

Q2 Mark Pawsey: How old is the origin of the problems you have told us about? Does that go back 10 years or five years? What was the



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management team at that time? Was it aware that this was likely to happen?

Anne Stevens: Are you specifically asking about the problems we spoke of in aerospace?

Q3 **Mark Pawsey:** If that is the only area where there is a problem, yes. Are you saying the remainder of the business was perfectly satisfactory and there were simply problems in aerospace? Were there issues in other parts of the business as well?

Anne Stevens: It was aerospace that I spoke of, and that occurred over the past two years. Some of the product that was produced was defective. It was not all, just some. That has been corrected with teams in place.

Q4 **Mark Pawsey:** Is the management team that was responsible for those problems still in the business?

Anne Stevens: In aerospace, we had a person who was in charge of that operation who is no longer with the company. But let me just address the second thing. In the automotive side of the business we experienced some launch issues with one of our clients. That is a normal process, as you are developing and launching new product. Again, that problem was experienced and the problems have been corrected.

Q5 **Mark Pawsey:** Why is there a bid? Why is there a company looking to acquire GKN?

Anne Stevens: As to why there is a bid, you would have to ask the other company.

Q6 **Mark Pawsey:** But you must have a view. You must know about the state of your organisation and why that has given rise to what has happened.

Anne Stevens: I can talk about our organisation. We have a strategy. Back in 2017, we did a very deep dive at the request of the board of directors to look at the strategy and our plan. We have revised our strategy, which has focused on continuing investment in the world-leading technologies we have in eDrive, composite aerostructures and different types of energy platforms like a new flywheel that adds efficiency.

We have delivered profits over the years at record levels, and we have a revised strategy and a new team to both execute the improvement plans of Project Boost and continue our strategy to develop world-leading products.

Q7 **Mark Pawsey:** Would you be doing the things you are doing in the absence of this bid? Would you be doing them anyway or has this focused your attention? Have you started to attack areas of the business because there is somebody looking over your shoulder?



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Anne Stevens: That is a very good question. The board was looking at the financial performance. There is always an opportunity to improve financial performance, and the work was started in 2017. We saw opportunities to improve cost performance in two particular areas. The first is indirect procurement—for example, things like gloves, glasses and loo paper.

The second thing is this. We have been a world leader in implementation of Industry 4.0. That is about adding automation and other state-of-the-art technology into our manufacturing plants. Early in 2017, we did a study across seven of our plants to accelerate the Industry 4.0 initiative. That started well in advance of the unsolicited offer we got from Melrose.

Q8 **Mark Pawsey:** The criticism of your performance is that you have focused too much on increasing sales at the expense of profit margins. How do you respond to that?

Anne Stevens: There was a strategy to increase sales. We have more stakeholders. Obviously, we have a responsibility to our shareholders, but we have other stakeholders like our employees, pensioners, customers and communities. Part of the sales growth was so that we would have very strong balance sheets to take care of all stakeholders, not just our shareholders.

Q9 **Mark Pawsey:** In terms of profitability, your aerospace margins have never gone above 8%, but you are looking to achieve 11% now. What have you done to the business that will make that achievable?

Anne Stevens: I spoke about our new strategy. When we were looking at objectives in the past, we were averaging and aggregating the businesses within driveline and aerospace. It was difficult to identify exactly where the problems were. We have a world-leading aero engine business. At the same time, we have some very high-tech aerostructures business, but we also had some low-performing structures businesses in North America.

What is different in this strategy is that we have taken aerospace and broken it down into the different product segments, so that we have the appropriate targets in the different segments.

Jos Sclater: Just to be clear, our aerospace business has made more than 8% margin for most of its history, and large parts of it still do. Our aero engines business is a phenomenal and very long-term business; it has a 40-year investment horizon. That makes over 13% margin as it is today. Most of our structures businesses are already making north of 10%.

Q10 **Mark Pawsey:** Is it your strategy to retain all the businesses? Do you have any plans for divesting any parts of the business?

Anne Stevens: We did a deep study of all the different products in the businesses by core and non-core. We broke the core sector into



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businesses where we need to improve the cash and profitability, businesses we want to grow and business like eDrive that we want to develop. Of our businesses, 25% are non-core. There is a programme to find better owners for those businesses.

Jos Sclater: Could I make one extra point on your growth point? I do not want people to think that growth is a bad thing. Growth is fantastically important. Growing an engineering company by £500 million in sales last year—roughly speaking, that is three extra factories—is a fantastic achievement.

I know we have had some growing pains, but we have revenue of £10.5 billion. Now we need to drive the margins up and get more profit out of it. But the hard thing to do is to grow a business that fast, and that is a real achievement.

Q11 **Peter Kyle:** Anne Stevens, you mentioned that there have been changes in your management team. Can you talk us through the changes and what drove those changes?

Anne Stevens: Do you mean the changes I have made to the management team?

Peter Kyle: Indeed, yes.

Anne Stevens: Since I have been in there, I have made some changes. When we identified that we had the issues in aerospace, my predecessor left the company and I took over. Within the aerospace business, we appointed a new head of aerospace. His name is Hans Bruckner. Hans was CEO of Fokker, and he did a fabulous job in that business.

The other thing we did identify, which I have referred to in the past, is the North American structures business. We removed that person from the job, because we had issues that were not taken care of. We replaced him with the previous leader of the aero engines business.

Q12 **Peter Kyle:** There were performance problems in that post.

Anne Stevens: Yes, when we had the build-up of the product that we ultimately had to write off. That person has been replaced as well. I have added infrastructure to help the teams to allocate resources on improvement programmes for things like Industry 4.0.

Q13 **Peter Kyle:** What does “infrastructure” mean in that context? You said that infrastructure has been put in to support teams.

Anne Stevens: Teams have projects. Sometimes, within their own facilities, they have enough resource engineers to support the programmes they have. If we want to have a programme to accelerate automation in a plant, the engineers we currently have in the plant are insufficient to do their day job plus accelerating the manufacturing excellence. In a case like that, we would bring in incremental engineers



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and allocate them to the plant. It is about bringing in people who have access to capability and talent to help the teams achieve their objectives.

Q14 **Peter Kyle:** At board level there have been some changes too. Last month, a non-executive director resigned or stood down. Why was that?

Anne Stevens: Let me just say what happened. Richard Parry-Jones had been both the senior independent director and the head of the remco. He has been the independent director for six years. Good governance is to rotate leaders so you can get fresh perspectives and views. Angus, who has been on the board and who is a sitting CFO, has assumed the role of SID. Richard continues to chair the remco. Both of them are still on the board.

Q15 **Peter Kyle:** Are you saying that the changes in the board have been evolutionary and not impacted at all by any of the other restructures, changes or responses to market conditions that you are talking about?

Anne Stevens: Yes, rotating positions of chair and SID is something most boards do every few years.

Q16 **Peter Kyle:** I understand, but my point is that you have been compelled to restructure parts of your business but not the board. Why is that?

Anne Stevens: In terms of governance, we have a new senior independent director. He has just assumed the role in the last couple of weeks, and I am sure that is something that is on his agenda to look at.

Q17 **Peter Kyle:** Am I misinterpreting you? You are saying the board is evolving as it does in any other period of time. You are restructuring your business in response to the market conditions and adjusting to the fact that you need to drive more profitability. Surely the fact the business has evolved in this way and did not do this at the right time was also linked to board performance. You are saying that the board performance is just carrying on as normal.

Anne Stevens: I am not saying that. I am saying that we did make some changes. I would expect that in the future there will be additional changes, as Angus really looks at skills and competencies. There is also a vacant position on the board. In 2016, I was brought in. I have since taken the executive role. I am sure the board will be looking at the skills and capabilities we have and how to build an even stronger board in the future.

Q18 **Peter Kyle:** The share price jumped upon the announcement from Melrose. Why was that? Is that not the market delivering a verdict on your performance as a management?

Anne Stevens: I will make one comment and then, if I may, I will invite Jos to comment. We had undertaken a review of both our strategy and our plans to improve the profitability of some of the product sectors back in 2017. We had planned to make that announcement at a results presentation on 27 February. Receiving the unsolicited bid pulled forward



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the announcement of a strategy that had been developed before we ever got the bid: the announcement of Project Boost, which was in strong stages of development before we ever got the bid.

The replacement of some of the key members of the team had been done or was planned before we ever got the bid. Having the bid come in accelerated the announcement by a few weeks, but this was already in the plan. We believe, with the announcements we would have made, the share price would have increased as well.

Jos Sclater: The share price is bound to jump because they were offering more money than the share price before it was disturbed. The more important thing is that our new strategy and revealing the quality of things like our engine portfolio, where we have £13 billion of cash flow ahead of us through the investments we have already made, have already put a floor on the share price probably above the Melrose bid. As you see at the moment, our share price is diverging from the Melrose share price. That is probably the market saying that it does not think Melrose will win at this price.

Q19 **Stephen Kerr:** Melrose has accused you of copying its plans. What are the similarities?

Anne Stevens: I can give you documentation—I do not have it with me, but if you would like to see it I am happy to share it with you—that shows our Project Boost was in process well before the bid ever came in. In terms of our strategy, Jos and I met on 6 January¹. We have a picture of the whiteboard that has our product-segment strategy with the categories on 6 January². This is well before they ever came in.

Q20 **Stephen Kerr:** What are the similarities between that plan and Melrose's plan?

Anne Stevens: Mr Kerr, I am sorry. I have not seen the Melrose plan. From what I know of Melrose, I can say it is a buy/sell short-term business model. We have a very long-term business model where we invest in technologies for the long term. I am an engineer. I have worked in auto. I have been on the board of Lockheed Martin. I have run tier 1 companies. I know what it takes in this business to deliver, and I know, for an OEM customer, a short-term programme is seven years, 10 years or more.

Stephen Kerr: Melrose is talking about five.

Anne Stevens: It is five at most—three to five. They buy and sell. We are a long-term business. We are a technical company. It takes technology and long-term relationships with universities, customers and communities to run this business. I do not see how a short-term business model works, but I do not know what their plan is.

¹ Note from the witness: "Saying 6th of January was incorrect, it was in fact the 5th of January".

² As above



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Q21 Stephen Kerr: Is this how you would categorise the main difference in approach, then, in terms of timescale?

Jos Sclater: Yes, it is short-term capitalism versus long-term capitalism. To give you a couple of good examples, take the A350 wing spar in Western Approach, which is a brand new factory we have built. We spent £160 million just on research and development for the carbon fibre wing spar there. We spent £250 million overall on that factory. We will be making carbon fibre wing spars for the A350 for hopefully the next 20 years or more.

Similarly, take the Rolls-Royce Trent engine. We spent £125 million on development and capitalising in order to help launch the Rolls-Royce Trent engine. That will have maybe a 30 or 40-year payback as those engines hang on the wings. Those types of investments are completely incompatible with a five-year timescale. You are investing for your grandchildren. That is what we have been doing; that is what we want to carry on doing.

Q22 Stephen Kerr: Melrose has said that it is planning to improve both main parts of the business.

Jos Sclater: Yes, I notice it is not “grow” but “improve”. They are going to try to drive the margin up, which incidentally we will do. But this is also about growth and long-term investment. Not everything is about driving the margin up. It needs to be a balance between growth—

Q23 Stephen Kerr: They were talking about improving and then splitting them. You are going to split them now. Is that right?

Anne Stevens: Here is what we have done. Part of the growth plan, which you have asked us some questions about already, is to have two very strong investment-grade companies: an aero company and a driveline company. Part of the growth strategy is to grow those companies. In terms of investors, we get a discount in the market because we are a conglomerate. Many investors today prefer to pick what they want to invest in, auto or aero. The plan was to grow and to ultimately demerge into two very strong UK-listed companies.

Q24 Stephen Kerr: Where are you now planning to split these businesses?

Anne Stevens: We had announced that the second quarter of 2019 is when we will demerge the businesses.

Q25 Stephen Kerr: You are also planning to sell the powder metallurgy business. That is in the next 12 to 18 months. Is that right?

Anne Stevens: Yes.

Q26 Stephen Kerr: Why is this not a core business?

Anne Stevens: Let me explain it to you. I was CEO of Carpenter, so I do know the powder metallurgy business. When I came in, I had some assumptions. “Okay, we make some gear parts or engine parts and



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supply internally to aero or driveline". I assumed that was a synergy that was in the company. The synergy is not there. The second thing Jos and I did was to look at what our core competencies were in both aero and driveline. With powder metallurgy, there was no sharing of competencies there.

Thirdly, we were looking at driving cost improvement and technology acceleration like Industry 4.0, and powder metallurgy is a world leader in those types of programmes. When we looked at improvements in profitability, we had already created so much value there.

Q27 Stephen Kerr: Melrose talks about improving the value of this particular business before moving it on. That is the wrong approach in your view.

Anne Stevens: I do not know what their plans are. I have not seen what their assumptions are or how they are going to improve it. I can talk about how we have improved that business. When we look at our competencies and how much improvement is left, there was very little, as we developed Project Boost, in powder metallurgy, as compared to aerospace and driveline.

We felt that this was the right time, and it was very strategic, to build these two strong UK-listed entities, to take that, reinvest it back in the company and return it to the shareholders.

Q28 Stephen Kerr: What other parts of the business do you intend or expect, shall we say, to sell? I mean non-core businesses.

Jos Sclater: There are some parts of the US business. Our focus now is on improving them, but there are bits of it that are getting commoditised quite fast. Five-axis milling is actually quite hard to do in the US and be competitive, because now people do it in low-cost countries. We will try to keep improving the spindle speeds and the throughput, but if we just cannot get those businesses to be competitive against low-cost countries, we may have to sell them on and they may be non-core to us.

Q29 Stephen Kerr: What kind of timescale are you giving yourselves?

Jos Sclater: On those, we have said we are going to work on fixing them for the next two or three years. Then we will look at whether or not they have a long-term future with us. We are really more focused on design and build. We like things like our engine programmes, where we have design authority and are making large, structural parts of the jet engine. There is much more value-add for us when we can design and build. Just cutting metal is not really our core competence. Where we do not have value-add through design, that is probably non-core to us.

Q30 Chair: You plan to make big changes to the business as well. What will that mean for jobs in this country over the next year and perhaps over the next five years?

Anne Stevens: With the programmes we have, we are still a growing company. If you have a growing company and a strong company with



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technology, you have jobs. As you have openings, you hire people. Yes, we have some programmes like Industry 4.0 where we will automate, but we work with our partners in the unions so that we can replace robots with people.

- Q31 Chair:** The problem, Ms Stevens, is that your critique of Melrose is that it has not given detailed plans; you do not know what its plans are for the business. But we as a Committee are not that sure about what your plans for the business are either, because they have evolved quite quickly in the past few weeks since the Melrose bid. What I am asking is this. What is the outlook for jobs in this country if the current management continues to run GKN? Will there be more jobs in the UK in a year's time or in five years' time, or will there be fewer jobs? Can you not make that commitment because you plan to sell off parts of the business?

Anne Stevens: We have a growing company. We have 14 different locations in the UK. We have jobs in those locations today. As the company grows, of course we will have people who will need to fill those positions.

- Q32 Chair:** Today, Moody's has changed the outlook on the ratings for GKN from stable to negative. It says those changes reflect the accelerated and more specific plans to separate GKN into the aerospace and driveline businesses, which would likely result in a weaker credit profile. Do you understand why Moody's has made those changes?

Jos Sclater: It is the uncertainty we are currently facing. It is quite natural for rating agencies to put people on negative watch when it is a bit uncertain what exactly the balance sheets of those two companies will look like. However, we know from our own internal modelling that we can get both of those two entities to the investment grade. I understand it, but I am not concerned about it. We are intentionally creating balance sheets that give both halves investment grade ratings.

- Q33 Drew Hendry:** You talked in previous answers about your long-term vision and your long-term investments. Mr Sclater, you talked about investing for your grandchildren. If that is the case, why did you allow the pension schemes to fall into deficit?

Jos Sclater: We would prefer that they did not fall into deficit, but they went into deficit because interest rates have gone against all pension schemes—not just ours, unfortunately. Because it is a very big liability, as interest rates go down, the return on your investments gets worse. We all implicitly understand this. Money in the bank does not earn any money now. It is the same dynamic on a much larger scale with a pension scheme.

Unfortunately, as investment returns have dropped, the deficit has gone up. Because of that, we have been very keen to grow the company. As the pension scheme has grown, we have wanted to outgrow the pension scheme by continuing to grow the company, which we have done successfully. The good news is that last year we made £680 million of



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profit, which is easily enough to cover the contributions to the pension scheme.

As you probably know, we put £250 million as a bullet payment on top of our normal contributions into the scheme last year, to make sure it is financed to cover pensions for the next 70 years.

Q34 Drew Hendry: You have been looking at filling the gaps that have been created. What recent discussions have you had with the trustees about meeting the £150 million cash injection from Melrose?

Jos Sclater: I do not know exactly what Melrose has agreed, or whether it has agreed anything, with the pension scheme. We have an agreement in principle of what it would look like on a demerger with them. I have talked to them about that. We have always had a constructive relationship with the trustees. They are independent and they take their duties very seriously. Of course, at least in my five years here, and probably for more, we have had proactive engagement with the regulator. We have always tried to work hard to make sure we have a constructive relationship with both the regulator and—

Q35 Drew Hendry: Have you had discussions with them about a further injection of that sort?

Jos Sclater: Yes, it is agreed in principle.

Q36 Drew Hendry: Why do you have reservations about Melrose's records on pensions? What evidence is there that it does not fund them adequately?

Jos Sclater: I do not have anything to say about its previous record. I would frame it more like this. It is basically planning to use my balance sheet to pay our shareholders the cash element of the takeover, which significantly increases the leverage in GKN. If I look at it through my eyes, why do I not just gear up my company, so borrow more, and pay it to the shareholders? My answer would be that it is a really, really bad idea for the pension scheme. I am just increasing my debt to give the money to shareholders, which gives the pension trustees a more indebted company to support the pension scheme.

In terms of what I would expect the pensions trustees to do, if I geared up as much as Melrose is proposing to do, I would de-risk the investment strategy and put more of it into less risky assets like Government bonds. As it moves to a more conservative investment strategy, that increases the size of the trustee deficit. As that increases, you get into this vicious circle. You have borrowed more from your banks and your pension scheme changes to a more conservative strategy, which puts the pension debt up, which means you have to put more money into the pension scheme.

You can get this downward spiral, which is why I have always been extremely keen to keep the company at investment grade. It is the right thing to do for the shareholders, because automotive is quite cyclical. It



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is very cyclical, as we saw in the last credit crisis. But also, if you have a big pension responsibility for the next 70 years, my view is that the prudent thing to do is to keep the balance sheets at investment grade.

Q37 Drew Hendry: Why was the action to address the pension deficit not taken much sooner?

Jos Sclater: We have taken action all the time on the pension scheme. We put money in every single year. We have had a couple of goes at putting in large lump sums. I do not think anyone could have predicted Brexit, but unfortunately that also pushed the interest rate down, which increased the size of the deficit. But that's life. We understand it. That's why we are focused on recovering the situation and why we have a recovery plan with the pension scheme. It is why we have put in £250 million last year. Incidentally, we put £250 million into the pension scheme, and the dividend to the shareholders was £150 million. We have been extremely responsible in the way we have dealt with our pension scheme.

Q38 Chair: Are you aware of any concerns the trustees have with the proposed takeover? Have you spoken to them about this?

Jos Sclater: They are quite good at keeping it confidential. They have not shared anything with me. They did tell me they do not have an agreement with Melrose as part of this deal, which slightly surprised me. I obviously saw the letter from the regulator yesterday. But I do not know exactly what those discussions are and exactly how far apart they are on their agreement.

Q39 Anna Turley: Could I ask about your role in supplying the United States defence industry? How important a supplier are you to the US military?

Anne Stevens: Of our aerospace portfolio, about 25% is military.

Anna Turley: You mean in the US specifically.

Anne Stevens: Yes.

Q40 Anna Turley: Can I ask about conversations you are having with other United States companies? There has been some media coverage about a potential bid with Dana in the US. Are you in discussions with other companies? Would you consider selling, perhaps, to a foreign company over a British company?

Anne Stevens: We cannot discuss a hypothetical situation. We obviously receive approaches. It is our duty to look at anything that comes in and make a recommendation to the shareholders, just like with Melrose's offer. When that came in, it was thoroughly evaluated by the board as well as our financial advisers. Looking at it in depth, it significantly undervalued our company. We are recommending a rejection of the proposal. We seriously look at any offer that comes in.

Q41 Anna Turley: In terms of your relationship with the US military, what



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impact might a takeover have on that? Does it throw it into any sort of jeopardy?

Anne Stevens: I obviously cannot speak for the US military, but what would be required is the approval of CFIUS. As I understand it, Melrose has applied and it would be up to CFIUS whether to agree or not.

Q42 **Anna Turley:** Should the Secretary of State in the UK have any national security concerns about changes in ownership with the takeover?

Anne Stevens: As I have said, I certainly could not speak for the UK Government or the Secretary of State for Defence.

Q43 **Anna Turley:** Is there anything else you would like to say about your importance to the defence industry in this country?

Anne Stevens: We provide products to the defence industry. We provide products for the A400M and the Typhoon. We have a repair-type facility with some aircraft that are still flying. We supply some parts to other military aircraft as well, but we are not a direct supplier to the defence industry. It would be up to the industry to determine whether it is an issue or not.

Q44 **Chair:** Can I ask a couple of other questions about the conversations you are having with the US car supplier Dana? When did those conversations start, Ms Stevens?

Anne Stevens: We cannot comment on a hypothetical. Obviously, any conversations we have are in confidence.

Q45 **Chair:** But they are all over our newspapers, Ms Stevens. Can you confirm that you are having conversations with Dana about some sort of merger or combination of your two businesses?

Anne Stevens: Since this has happened, we have had many approaches and we have had many conversations. But the content of those conversations—I am sorry—is confidential at this point.

Q46 **Chair:** In 2006, Dana went bankrupt in the US. It re-emerged a couple of years later. You have spoken about the importance of investing for the long term and having a long-term perspective in your business. You made that case very powerfully, Ms Stevens. Does Dana have a similar long-term perspective and the capacity or capability to make those long-term plans, given what has happened to it in the past?

Anne Stevens: It is a company I know of in the States, having been an executive at Ford. It was a supplier. It has a long-term business model.

Jos Sclater: Dana is 105 years old. We have been working with it as joint-venture partners for at least the last 40 years. Yes, it did go into chapter 11. It has learnt from its mistake and, as a result, since then it has carried a very prudent level of debt on its balance sheet. If you were to look at its balance sheet as compared to what Melrose is planning to do to GKN, it is completely different. In fact, I have the numbers in front



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of me. Dana is not a highly leveraged company. It understands as well as I do that gearing up or borrowing a lot in an automotive company is a bad idea.

Q47 Chair: One criticism of GKN has been that it has taken the Melrose bid to get you to look more fundamentally at how your business is run and what the core purpose of your business is. Is that a fair criticism? How would you respond to that?

Jos Sclater: I would go back to Anne's previous comment. I can show you on my iPhone a photo of my whiteboard on 6 January, which has the entire strategy that we subsequently launched all written in clear writing—in my writing, in fact. No, none of it is a response to Melrose. It is just unfortunate that it has come over the hill. We always planned to launch the strategy with our results on 27 February. The only thing that changed is we moved it forward two weeks.

Q48 Chair: You have mentioned getting clearance from CFIUS in the United States. How long does that clearance typically take? What is the timescale for your shareholders to make a decision on the Melrose bid?

Anne Stevens: I can only mention the advice that we have been given from attorneys who have looked at the process. The process could be a few months; the process could be six months. It is hard to say. A lot of it depends on how many other applications are in there right now. It could be a couple of months, or it could be five, six or even more months.

Q49 Chair: What is the timetable for shareholders having to vote on the Melrose bid?

Anne Stevens: The first date is 9 March. The final date is 2 April.

Q50 Chair: Shareholders are being asked to make a decision about the future of your business before knowing whether they would be able to be a supplier to the US Government. Is that right?

Anne Stevens: Yes, and I would like to comment on that. In recognising that, we have told Melrose that, if it came to us and asked for an extension for it to get approval, we would happily consider it, because it is not fair to our shareholders to vote on whether or not to accept its proposal without knowing the outcome of the US Government's decision. To protect our shareholders, we proactively said that we would extend the timeline.

Q51 Chair: Anna Turley asked you whether you thought the Secretary of State should call in this takeover bid. Of course, you have said quite rightly that that is a decision for the Secretary of State. But you understand the Enterprise Act 2002 and you understand your business. One of the things Government are considering, I imagine, is whether they have any grounds on which to call in this bid. Given your understanding of your business and the Enterprise Act 2002, do the Government have grounds for calling this in?



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Anne Stevens: I have to apologise. I do not understand the Act.

Jos Sclater: I do not think we have a view on whether or not they should do that.

Q52 **Chair:** But are there grounds to do so? You know the extent to which you are integrated in Government defence contracts both here and in the United States.

Jos Sclater: We are not highly integrated into UK Government defence contracts directly. We just make military parts for other people, like BAE, or parts of engines for Rolls-Royce or Airbus. In the US, our programmes are very much more sensitive. We are on things like the F/A-18. We make large parts of the engine for the F-35. We make the stealth coating for the F-35. We make parts of the black programme. We have been named on the B-21 bomber, which is the stealth bomber for the US. Our US military presence is very important to the US.

That is why we have special security arrangements with our boards in the US, which are quasi-independent of GKN management in the UK. But I cannot take a view on what CFIUS will do through the process. I would say our US military presence is a lot more significant than our UK presence.

Q53 **Chair:** Are there circumstances in which the shareholder vote could be delayed to allow all the information that is material to this decision to be available to your shareholders?

Jos Sclater: We would have quite liked a delay, but we have now given up on that idea.

Q54 **Vernon Coaker:** Can I just ask about CFIUS? You are quite right about the importance both to the UK and the US of the national security implications and the role of CFIUS. According to the information we have from Melrose, though, initially you refused to co-operate with CFIUS and Melrose filed the application unilaterally. It encouraged CFIUS to compel GKN to provide what you have just given to this Committee. Is that right or not? I do not understand. Is that correct or wrong? What would you say?

Anne Stevens: Any time we receive a request from a government authority, we are clearly going to respond to it. There has been no attempt on our part to not respond to questions from CFIUS. We have responded to CFIUS.

Vernon Coaker: You have now responded to CFIUS.

Anne Stevens: Yes.

Vernon Coaker: Okay, that is fine. That was just so that I am clear you put that into CFIUS.

Chair: Thank you very much, Anne Stevens and Jos Sclater, for coming to give evidence to our Committee this morning. We will now hear from

Melrose.

Examination of witnesses

Witnesses: Christopher Miller, David Roper and Simon Peckham.

Chair: Thank you very much for coming to give evidence to us this morning. I think you were here for the previous session with the executives from GKN and you heard what they have to say.

Q55 **Albert Owen:** Good morning. What makes you think you can do a better job of running GKN than the existing management team?

Simon Peckham: I will just say first that we are the three founders of Melrose. We welcome the opportunity to answer your questions today. We hope to deal with any misunderstandings that there are. We accept that GKN is a great British business. However, we would say that it is a business that has lost its way, partly due to the way it has been managed.

Our ambition is to merge GKN and Melrose together to make a bigger British manufacturing powerhouse that can better compete on the world stage. Melrose is a highly successful UK-listed company in its own right. We buy businesses to improve them. We have an outstanding track record on pension schemes, which no doubt we will cover later. We invest in research and development. It may surprise you to find out that we invest more than GKN does. We also invest in skills and capital in our businesses, and we have a model that says we manage and invest in businesses as if we are going to own them for ever.

Our actions, we believe, are in line with the Government's industrial strategy. Essentially, the question here is, which is the best management team to run GKN for the interests of everyone going forward?

To answer your question, collectively here, we have been doing this activity since the 1980s. Admittedly I used to work for these two at that stage and they had more responsibility for that. There was a company that preceded Melrose called Wassall. We engaged in similar activity, which was looking for underperforming companies and rectifying that underperformance.

Companies we bought at that stage include General Cable, which is currently quote on the US stock market—or at least I think it is. We floated that business, having bought it. We also bought a business called TLG, which is a UK lighting business, and a business called DAP, which is a caulks and sealants business. That is ancient history, I accept.



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Moving on to Melrose, since 2003, when we floated the business on the AIM-listed market, Melrose bought companies called McKechnie and Dynacast. McKechnie was an aerospace business. We accept it was not the size of GKN's, but it was still an aerospace business supplying to many of the platforms GKN does. We bought a business called Dynacast, which is a die-casting business. We bought a business called FKI, which is another UK industrial conglomerate. The last two acquisitions we made have been a company called Elster, which is a metering business, and a company called Nortek, which we are in the business of improving at the moment. Both of those last two businesses were US-quoted businesses that we have given UK-based investors the opportunity to benefit from and bring wealth into the UK.

We think we have a different strategy for GKN. We think its strategy is wrong. We can start with its current strategy, which seems to be to sell lots of the businesses we would not sell at this time. If you step back more fundamentally, we think GKN has a concentrated business model of sucking things up to the centre and running everything from the centre. We do not agree with that. What we believe in, and the way we run businesses, is putting the power to run those businesses back into the hands of the operational management.

We tend to find those operational managers know what is wrong and know they are being obstructed by the operations of a central bureaucracy. When you free them up and incentivise them, we find it drives performance and improves a business.

Q56 **Albert Owen:** That is interesting. You mentioned size; you said, "It was not the size of GKN." You have given your recent history. In the past, you have purchased and taken over many other companies, but not of this size and significance. What can you offer differently to the management of this one, given that you have not had the experience of a takeover of a company this large?

Christopher Miller: It is true that this would be the biggest acquisition we have made. But, relative to our pre-existing size, most of our acquisitions have been substantially bigger at the point of acquisition. From our point of view that is not a new departure for us. If I can amplify what Simon was just saying about our management methods, we do not believe in top-down management. We believe boards are there for there to be strategy and for performance monitoring, and obviously for a number of other things, but principally for those two things. They are not there to take decisions for the businesses. That is a key part of what we believe.

Q57 **Albert Owen:** We have heard a lot about the other companies you are willing to acquire, but I just want to hear from you now. We have had the session with GKN. We want to hear what you are going to do differently. I presume you are going to be less central in the way you deal with things. What is your structure going to look like? Given that you have admitted you have not had experience of these large company



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takeovers, what are you going to do differently?

David Roper: Can I contest that?

Albert Owen: I am only repeating what has been said.

David Roper: I just want to address your original point. The business we sold to Honeywell, Elster, we sold for £3.3 billion. That of itself is of a comparable size to the individual constituent parts of GKN. I would admit, as Christopher has said, that this is larger than any other single deal we have done, but in terms of individual businesses it is not on a completely different scale to what we have looked at before.

Chair: This is £7.4 billion, which is more than twice as big. It has constituent parts, but it is an order of magnitude bigger than anything you have undertaken before, Mr Roper.

Q58 **Albert Owen:** I am still waiting for your answer about what you are going to do about the structure. How is your structure going to be that much different? How confident are you that you can run this?

Simon Peckham: We are totally confident. From a structural point of view, we will remove the board. We will restructure the head office, and we have been very open about that. We will put the power from the head office back into the individual businesses. We will talk to and agree a plan with the individual business heads of those three core businesses, and we will put that plan into effect, which is what we have done in every single acquisition we have done.

Q59 **Albert Owen:** Will it be run internally or externally? As a company, will you be recruiting experts in this new merger?

David Roper: No.

Simon Peckham: We are already in the business.

Q60 **Albert Owen:** The existing management team will be running it.

Simon Peckham: Essentially that is our plan, yes.

David Roper: It will not be run by McKinsey, let's us put it that way.

Q61 **Albert Owen:** How will you pay for it? How are you going to fund this purchase?

David Roper: Perhaps I should answer that, as it is about the debt. There have been lots of criticisms thrown at us about being highly leveraged, et cetera. We believe that an appropriate level of debt in companies is good. Obviously, that begs the question: what is appropriate? Nearly 30% of FTSE companies carry the same level of borrowing ratio that we do.

Significantly, when we deal with the commercial banks, our lending banks, we deal with the investment-grade departments there rather than the leveraged finance departments. The bottom line is that we borrow on



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investment-grade terms. As a package, we think we have a prudent structure going into this business. Indeed, with Nortek we started off with a leverage ratio, as they call it, of 2.5 times about 18 months ago. We are down to below two now.

Q62 Albert Owen: Mr Roper, in your letter to us, you said that the company, as it is currently run, represents pension funds, local authorities and insurance companies. Those are the main funders of your company at present. For this acquisition, you are now going to add debt to it to pay it off. Are you going to look to your existing shareholders and ask them for more moneys as well?

David Roper: The essence of this deal is effectively: who is the better management team to improve this great business, GKN?

Christopher Miller: To be clear, 80% of the consideration for the acquisition is in our shares; 20% is in debt.

Q63 Albert Owen: The 20% of it is increased borrowing. You will increase the borrowing.

Christopher Miller: The level of debt we propose to put in—it is called 2.5 times leverage—is the standard level that we use in all our acquisitions. We have managed to get that level of debt down substantially and quickly in all of them.

Q64 Albert Owen: Sure, but can you understand, in the current climate, that people are worried? Many companies feel they are too big to fail, yet all they are doing is increasing their debts. Do you understand the climate that we are in? This is a company of a size that you have never acquired before, and you are going to fund 20% of it with extra debt.

Christopher Miller: It is not extra debt, if I may say so. By the way, the borrowings we will have are not just against GKN; they are against our own balance sheet of £4 billion as well.

Q65 Albert Owen: They are against the new company, as it would stand.

Christopher Miller: They would be against the combined £10 billion-plus company. Our position is that we have done this many times.

Q66 Albert Owen: Mr Roper, you are saying you understand this. What safeguards are you going to put in place?

David Roper: We understand. What we are saying is that we have done this before. We think the level of borrowings we are taking into this transaction is a prudent level of borrowings. This is what we have done for the last 30 years.

Q67 Albert Owen: Have you done it in this kind of company before?

David Roper: Yes.

Albert Owen: You cannot just have a three to five-year plan. You have to have a long-term plan for these types of investments. Have you done



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it before with this kind of company?

David Roper: Yes, we have, although not at this scale.

Albert Owen: That is the concern people have.

David Roper: As Simon said, we manage all our businesses as though we are going to own them for ever. We have a strapline that says "three to five years". There is nothing magical about three to five years. What we aim to do is make businesses better.

Q68 **Albert Owen:** Why do you mention it?

David Roper: When we first started, to get the money from the stock market, it was essentially to try to differentiate ourselves from the conglomerate model that we had been in the 1990s. Therefore, we felt we had to have something, and that is something that has just stuck with us. At the end of the day, we are building businesses for the long term, and we believe that, if they are better businesses, they will be worth more and we will then be able to sell them to a good home.

Simon Peckham: May we just step back a bit? If we combine the two of these businesses together, we end up with probably a business that has a market capitalisation in the region of £10 billion. It would be about a FTSE 50 company. We end up with a profit of about £1 billion. We bring about £300 million. If I am generous to GKN in how we treat the accounting write-off, it has around £700 million, in an overall sense. We believe a company should borrow money. We all borrow money. Basically, it is not a wrong thing to do. The thing to do is to judge how you do it.

Q69 **Albert Owen:** But this borrowing will expose shareholders to additional risk. Do you accept that?

Simon Peckham: I think, in terms of shareholders, it is an appropriate and prudent level.

Q70 **Chair:** How much are you borrowing in total to finance the £7.4 billion takeover bid?

Simon Peckham: The total bank facility is £4.5 billion.

Q71 **Chair:** You are borrowing £4.5 billion.

Simon Peckham: No, the total bank facility is £4.5 billion. It has £1 billion of free capacity in it. The total borrowings would be in the region of £3.5 billion. We have £1 billion of spare facility that we have built into this structure.

Q72 **Chair:** You are borrowing £3.5 billion to acquire this company.

Simon Peckham: It is not just to acquire this company.

Q73 **Chair:** That was my question, Mr Peckham. How much are you borrowing? You keep saying, "That is not what we are borrowing." Just



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answer the question, then. How much are you borrowing to acquire this company?

Simon Peckham: Please, I am trying to answer your question. We are borrowing £3.5 billion, but to buy the company is £1.4 billion of that. We have to cover the borrowings we have and the borrowings it has as well. In terms of the borrowing makeup we have, there is £1.4 billion to fund the cash element, which we accept. The rest is to deal with the working capital in the business.

Christopher Miller: It also covers the existing debt.

Simon Peckham: We have £1 billion headroom.

Q74 **Chair:** You are borrowing £1.4 billion to buy the business and £3.5 billion to cover the borrowings that GKN—

Simon Peckham: The £1.4 billion is included in the £3.5 billion.

Q75 **Chair:** How much of the new business will GKN investors own?

Simon Peckham: At the level of our current offer, 57%.

Q76 **Chair:** When you say “current offer”, does that mean your current offer is not your final offer, or is that your final offer?

Simon Peckham: As you know, I cannot comment on that.

Q77 **Chair:** At the moment, the value of your bid, £7.4 billion, values a GKN share at £4.18. Is that right?

Simon Peckham: It varies on a day-to-day basis. I confess I have not looked today, but that will be in the right region, yes.

Q78 **Chair:** Currently, GKN shares are trading at £4.29. Is that right?

Simon Peckham: Probably, yes.

Christopher Miller: Approximately, yes.

Q79 **Chair:** At the moment, you are offering less than what it is currently trading at. Is that correct?

Simon Peckham: That is correct.

Q80 **Chair:** That was different from when you put in your bid. That suggests the value of GKN is now higher than the £7.4 billion you are bidding for it.

Simon Peckham: As a matter of fact at this moment in time, that is correct

Q81 **Chair:** Usually, when you have bid for and taken over other companies, you have paid a higher premium over the market capitalisation of those businesses. Is that correct?



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Simon Peckham: The premium varies business by business. You cannot draw a comparison one to another, I am afraid.

Q82 **Chair:** You have mentioned already this morning quite a lot of the companies you have previously taken over, such as Nortek and FKI. What premium have you paid over the market capitalisation when you acquired those businesses?

Christopher Miller: The acquisitions you are referring to in our past were cash acquisitions. In the most recent two, the shareholders were taken out entirely for cash. FKI was a little different. In cash offers, it is traditional to offer a much higher premium, because you are paying for the future that that company might have had with its own shareholders. You are paying them off for the things they might have expected to get.

This is substantially an all-share offer. What we are really doing is changing the name on the share certificates and changing the management team. The growth that we expect and hope to be able to get out of GKN will flow through to those shareholders. In those circumstances, premiums offered tend to be lower because they get the future benefit.

Q83 **Chair:** What was the premium on Nortek and FKI, for example?

Christopher Miller: It has been about 30% at the time of launch.

Q84 **Chair:** For GKN at the moment your offer values the company at less than what it is trading at the moment.

Simon Peckham: At the moment, yes. Obviously, the share price has moved around considerably, even on a daily basis.

David Roper: At the outset it was significantly higher than that, and obviously the market has come up to match the value of our offer.

Q85 **Chair:** Yes, as they are looking at the GKN Project Boost compared with the bid that you are making, perhaps. Albert Owen asked about what you were planning to do in terms of management structure. I think what you have said is you are going to sack the board, not bring anybody else in, and allow the people who are running the individual components of the business to make more decisions. You are not bringing in anybody new. It will be you three and your board who are running the business. You are not going to try to put in anybody else to oversee it. In a way, you will be spreading yourself a lot more thinly than you are currently.

Simon Peckham: There is work to do at GKN. That is quite clear from the conversation we have had today. Yes, we are totally happy we can do that. There is a Melrose head office as well. It is not just the three of us. There are lots of people who work very long and hard hours for us. We will absolutely try to work with the management teams and the operational management, and we very much hope they will do that. No, we are not going to bring in a McKinsey consultant to tell us how to run the business.



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Q86 **Chair:** No, I am not suggesting a McKinsey consultant. What I am suggesting is at the moment your board runs a company that has a market capitalisation of, I think, just over £4.2 billion. You are planning to add to that a business with a market capitalisation of £7.5 billion, and you are going to do that without adding any extra capacity. You are going to triple in size, sack a load of people and run the business like that.

Christopher Miller: I see how that can look like a conundrum. The board will go, and that is not because it is some vindictive act. It is because it is duplicative. Two public companies do not need two head offices and those functions. In our view, the businesses should not be run by the board, except in the ways I mentioned earlier: strategy, monitoring and so on. The business is run by the people in the businesses and they will not be in the head office, in our view.

Q87 **Albert Owen:** That will mean job cuts.

Christopher Miller: I am afraid we have already said in terms of head office there will be some duplicative functions that are not required.

Q88 **Chair:** It is just this worry, which I would certainly have, that you already have to deal with challenges in the businesses that you have acquired, like Nortek, for example, and particularly with Brush. You are then going to take on something twice the size of what you are currently running and not add any extra capacity to do that.

Simon Peckham: If I can step back, as the curators of this business, and as the eighth largest shareholders' collective in the entire of Melrose, we think as owners of this business. We would not move on to a next acquisition unless we were happy that Nortek was being run by the management teams on the philosophy we just talked about.

Brush is a problem. We are not walking away from that and we are not walking away from Brush either. Brush was part of an overall larger acquisition of FKI, and we will make sure it gets sorted out. It has a proper well-run management team that is doing that right now.

Q89 **Chair:** But you will not have the same resources to dedicate to Brush if you are also going to now be running a company twice the size of what you currently run.

Simon Peckham: We are happy we can manage that. If we needed to bring in additional resource to help we would, but we think we will be in a position to run the businesses with the divisional management teams and get GKN back to where we think it should be.

Q90 **Mark Pawsey:** I wondered if I might ask how well you know the business that you are hoping to acquire.

Simon Peckham: Reasonably well, I think, as far as we can know from the outside. We do not have the details of the individual numbers for it.



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Q91 **Mark Pawsey:** Do you have any information that is not in the public domain?

Simon Peckham: No.

Q92 **Mark Pawsey:** Have you had any discussions with GKN personnel at any level?

Simon Peckham: It would be inappropriate for us to talk to GKN employees.

Q93 **Mark Pawsey:** How can you be confident about your plans if you do not know the business? You are not a friendly acquirer. You have not had information shared with you. How do you know that you are going to be successful?

Simon Peckham: We have been around this marketplace with GKN in varying different ways since 2003 on our flotation. We have employed people in our business who used to work at GKN.

Q94 **Mark Pawsey:** There is a window into their business through personnel who have moved from one organisation to another.

David Roper: A window into the way they do things, yes.

Simon Peckham: You can now do a considerable amount of analysis from public sources, and we have spent a lot of time doing that. We have talked to people in the industry. We have talked to people, as I said, who have had a past with GKN.

You do a balance of where the risk and reward is from the outside. I am trying to think of a nice way of putting this, but I cannot. The opportunity created by the GKN management is just so big, in the sense that it has underperformed so much that there is enough to go for. When we put this proposal to shareholders, we said in our original presentation, which is available on our website, if we just achieve GKN's expectations at the top end of what it says it can do, that would be enough to justify this acquisition. We believe that is what we can do.

Chair: If you could just achieve the top end of what GKN says it is going to do, that is great, but you do not have the experience or necessarily the capacity.

Q95 **Mark Pawsey:** How do you know you have the right information? How do you know you are working on the right data to be able to make the claims and plans that you have?

Simon Peckham: We are working on the data that GKN provided. It is a public company. There is an awful lot of data in the marketplace, particularly if you look hard for it. We can look at what some of its competitors do. We can look at its competitors on the American automotive side. We can look at its competitors in aerospace. Powder metallurgy is an exception, but in many cases they are also quoted companies, and you can compare and do the analysis.



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What you cannot know is exactly what the solution is, but you know that the business is underperforming. In a way, this is a slightly unusual case, because if you approach companies they generally tend to say, "No, we disagree with you." What GKN did was make our bid public. We did not. The first thing it did was effectively agree with us.

Q96 Mark Pawsey: They talked us through it. They already had those plans in place. You are sceptical about that.

Simon Peckham: To be honest, I was sitting at the back of this room smiling, because, if I heard it correctly, Jos said that he had a whiteboard on 6 January in his office. I may have misheard him. What he did not say was that the first phone call from Melrose to their adviser was on 5 January. I did it. I rang JP Morgan, which is their broker, on 5 January, saying I wanted to arrange a meeting, chairman to chairman, on the Monday, so he would have known. It is quite clear what that means. He would have known that we were coming.

Q97 Mark Pawsey: How could you reassure the Committee that you have the information you need, you are in it for the long term, and we are not going to see you, if you are successful, in a number of years slowly selling off businesses and breaking up what many people would see as a great British company?

Simon Peckham: We have an obligation to set out our intentions under the panel. We have been very clear and we have done that. We are not going to evade your questions. Very simply, we have said that the powder metallurgy business is not core. We will look to sell it in the medium term. We made the CFIUS filing, so that is between year 1 and year 4. We do not think it is the right thing to do to sell it in the next 12 to 18 months, because we think there is further improvement in that. We are looking for more of a long-term view on that, but we will sell it within a five-year period.

We set the agenda for driveline and aerospace as well. We basically said, "We say we have a three to five-year strapline, and we have always said that. We do not put anything whatsoever into our funding structures that requires us to do that." We are quite happy to hold businesses for longer. We are quite happy to go back to our shareholders if necessary and say, "This is the wrong time to do something now. We will keep this business."

Q98 Mark Pawsey: Could we be confident that in five or 10 years' time the structure, leaving aside the powder metallurgy business, would be broadly as it is today?

Simon Peckham: No. We have said, between years 4 and 5, we will sit down and work out what the right thing to do is. I cannot give you a commitment about 10 years' time, but we have set out very clearly in our offer document exactly what we mean.



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Christopher Miller: There was part of your question that I do not think Simon answered, which is about longer-term growth. Because we have the strapline that has slightly been foisted on us of three to five years, it possibly implies that we are short termers. That is a word that can be thrown at us. David also said that we own every business and treat it as if we are going to own it for ever. That means we invest in capital, research and development, people and processes.

We are prepared to be brave. When we bought Elster, which was two acquisitions ago, it was in the middle of deciding how to get into the smart meter market. For a longstanding business, 100 years old, that made mechanical meters, it was a big move. This is into high tech, software and so on. It was unsure as to how to do it. It asked us to get involved in that process. Over a six or nine-month period, we helped it come to a decision. We put extra money in for processes, people and equipment.

This was very early days and not when it was a profit-making product. We helped to position it in the right place so that, when Honeywell came along a year or two later, it paid a fantastic price, frankly, for that business. That is the sort of thing we do. We position businesses for the future.

Q99 **Mark Pawsey:** Say somebody comes along, offering a fantastic price for a part of the business. I get a sense that GKN has a strategy that keeps GKN as it is. Your attitude would be rather different. If somebody comes along for a bit of GKN that you have smartened up, you would be more than happy to dispose of it.

Simon Peckham: In fairness, I do not want to say what the GKN strategy is. It is not my place. The GKN strategy, as I can see it, is to sell powder metallurgy in the next 12 to 18 months. It is pursuing sales talks right now with driveline for Dana. You would not do that if you were not contemplating it. If you had no intention of going through with that process, why on earth would you waste the time talking to Dana? It is looking to do that transaction.

In aerospace, I accept that may be a longer timescale than we are talking about. In terms of how you look at the businesses right now, you may find this ironic, but we have a slightly longer-term strategy than GKN. I would combine that with Chris. By the way, on Elster and Nortek, we spent nearly double as much on R&D as they spent.

We are developers and growers of businesses. We like to make our businesses better. We do not just do that as a charitable gesture. We entirely accept it is part of growing the equity and value of a business. It is what makes it safer for everyone in the long run, including the UK economy.

Q100 **Mark Pawsey:** Mr Peckham, in your earlier remarks, you said that Melrose's acquisition of GKN would be in line with the Government's



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industrial strategy. How so?

Simon Peckham: That is pretty much what I just said. At the end of the day, we want to invest in R&D. We want to develop these businesses. We want to grow them. We want to improve them. We want to take a GKN business that we think is currently underperforming. We have access to the capital markets in a way we do not think it would have.

What we have not mentioned here is that, for Elster, we raised £1.2 billion to buy that from the UK market. For Nortek, we raised £1.6 billion a week after Brexit—credit to the UK capital markets. We have access to that ability to build GKN, if it is the right thing to do, and more flexibility to do that.

I accept we are not saying we are going to hold these assets for ever. We are not sitting in front of you misleading you. While we own them, we will operate and run them as if we are going to own them for ever, including investment. Very kindly, one of our chief executives from the past sent a letter to the Committee, a guy who used to run Bridon. He was very kind about the fact we invested in the R&D programme there. We built a brand new, state of the art factory for these guys up in Newcastle, which you can probably tell from the accent is where I come from.

The other thing he did not mention and we did not look at is a small thing, but illustrative of how we think. Bridon had been trying to get a fibre rope business for years. One came up while we were in the middle of discussions to sell the business to Ontario Teachers' Pension Plan. You could not find a better owner, you would think. We went out of our way to do that deal, even if it was an inconvenience for the transaction, and frankly it was. We still did it, because it was the right thing to do for our businesses.

I am flanked by these two guys, with whom I have worked for a very long time. One of the great things they have always taught me is: "Do the right thing here." One of the things I am proud about with Melrose is that we have a great track record of trying to do the right thing by everyone. We are not a charity. We are a business, but we try to do the right thing.

Q101 **Peter Kyle:** Mr Peckham, have you ever owned a company for ever?

Simon Peckham: No.

Q102 **Peter Kyle:** How do you know what it is like?

Simon Peckham: I would not. I do not know what it is like to own a company for ever.

Q103 **Peter Kyle:** You say that your strapline is three to five years, but you act as if you are going to own it for ever. You do not know what that is like.



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Simon Peckham: Maybe it is a strapline, and maybe it is a soundbite. The bottom line is, when we sit down and make investment decisions, we try to make them so that, for the long run, the business be put in the best place possible.

Q104 **Peter Kyle:** You do not know what it is like to own a company for ever. Your whole business structure is short to occasionally medium term, but you just throw out there that you are owning it and investing in it as if you are going to own it for ever. You cannot have both psychologies at the same time. It is a soundbite that is meaningless.

Christopher Miller: There is a bit of a dichotomy. Maybe we are not explaining ourselves very well. The process of the three to five-year strapline is, admittedly, three to five years and therefore relatively short term. That is maybe our ownership period, but in our ownership period we do the things for those businesses that anybody who owned it and was going to own it for ever would do. They get all the capital investment. We stand on our track record.

Q105 **Peter Kyle:** Except nobody, as a manager, would look you in the eye and think you are going to be here for ever. That is a key thing about an ownership model that lasts for ever. All the staff know that you, as managers, are going to be there for ever, but with you they do not know that.

Christopher Miller: I would contest that.

Simon Peckham: I would disagree with that. The trouble with saying you are going to own a business for ever is the—

Q106 **Peter Kyle:** You said it, not me.

Simon Peckham: Sorry, excuse me. The trouble with saying you are going to own a business for ever is that you can always put off to tomorrow a decision that you could take today. The three to five-year strapline that we use is a metaphorical sand clock in our office.

Q107 **Peter Kyle:** Let us leave the metaphors to one side and crack on with reality. You have said that you want to create a speedy, flat and non-bureaucratic organisation. What will that mean in terms of the granular effect on management structure? What will the impact be? How will you create that speedy, flat and non-bureaucratic organisation?

Simon Peckham: As we have explained, the board will go and we will restructure the head office—not because we are vindictive, but because it is necessary as part of the business. We will put ourselves right next to the people who operate the businesses, so that we will be directly in contact with them as they run the businesses.

Q108 **Peter Kyle:** You can transform a business that employs tens of thousands of people into becoming speedy, flat and non-bureaucratic, simply by getting rid of the 15 or 20 people who are at board level.



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Simon Peckham: I did not say that.

Q109 **Peter Kyle:** What restructures are you planning further down the organisation?

Simon Peckham: We have been very open about it. As we said, we will restructure the head office to remove the central control. We will go to the individual runners of the businesses, come up with a plan for them, tell them the world has changed and explain to them we want to move more quickly and with a better investment philosophy, and we want to try to create a better business and grow the three-year plan with them.

Q110 **Peter Kyle:** This is what you call “declutter”.

Simon Peckham: That is what we call “declutter”, yes.

Q111 **Peter Kyle:** In reply to Mr Pawsey’s questioning, you said that you did not really have a very detailed, granular working knowledge of the company, day to day, deep down into the company. How can you make these quite firm assertions about what needs to change in the heart of the company without having that working experience of it?

Simon Peckham: What I said was that from the outside there was a tremendous amount of public data available. You can do a comparison to its competitors. We know where all its sites are. We know what the products that it does are. Therefore, we can make an assessment from the outside as to where we think are the best places to go to improve it. Unusually perhaps, as we have gone through this process, we have found GKN management has largely agreed with us.

Q112 **Peter Kyle:** Presumably, mostly you are making your judgments from spreadsheets, data and publicly available information. In the past, what difference is there when you finally get your hands on a company? What difference do you find when you get to sit down with managers and long-term employees? Is it often different to what you expected from reading the spreadsheets and the data?

Simon Peckham: We find that the personal touch generally works best. We find that we are popular, actually. You may be surprised, but we find that the people who are running these businesses know better than anyone else what is wrong with them and what is right with them.

It is an anecdote, I accept, but we had one experience where we had bought a business called Eclipse in the United States for our Elster gas business. Literally the first day we walked in, the guy who ran the business went to his bottom drawer, pulled out a plan and said, “This is what I would do if this was my business.” We implemented that plan for him, which was better than our plan. We find that the people who run these businesses really do know.

It is a myth that the boards of companies are all-seeing and all-knowing, and know how to run everything. What is not a myth is that they have an effect on how businesses are run. Therefore, if you can take



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something back to the people who are responsible for it, empower them and give them the incentive to get on with it, we find that that is what makes a difference in businesses. We have a 14-year track record of delivering these returns.

We will no doubt talk about stakeholders in a minute, but purely simply for shareholders, of the 350 companies in the FTSE 350, we are No. 3 in terms of shareholder returns since 2003. If you had invested a pound in Melrose, you would have £18 now. We have made our shareholders a profit of approximately £5 billion over the last 14 years.

Christopher Miller: We have done it by improving the businesses. Otherwise buyers do not buy them for those sorts of prices.

Simon Peckham: Honeywell was prepared to buy Elster from us. We bought Elster for £1.8 billion. We paid 10 times EBITDA for it. We sold it for £3.3 billion, 14 times EBITDA, a profit of £1.5 billion for our shareholders. I am sure we will talk about pensions as well. In that process, by the way, we also used the opportunity to deal with and look after their pensions.

Chair: We are going to come on to some of these, as you say, Mr Peckham.

Q113 **Vernon Coaker:** Good morning. You will know that the national security implications of your proposed takeover have been a matter of considerable concern and discussion. That is not surprising, given that the F-35, the F-18, Chinook, Black Hawk helicopters, Typhoon and the A400M are all parts of the military capabilities that GKN are involved with. You will also know the President of the United States delegates authority to consider national security implications of any bids for companies to CFIUS.

It is really quite important for us to understand what representations you have made to CFIUS, and what discussions you have had with the US Department of Defence and others about your proposed takeover. What assurances and reassurances have you given to them, and what have they said back to you?

Christopher Miller: Taking CFIUS first, Simon and I have been to Washington. We have been to the Pentagon twice. We have been to CFIUS at the Treasury, and CFIUS at the Department of Defence. We have met other senior officials. We have met Vice-Admiral Winter, who runs the F-35 programme. As you can see, we have had a number of discussions.

The first thing to say is that we are a British company buying another British company. As it happens, 57% of us will be the previous company. There has not been a single CFIUS referral that we are aware of or have been advised of from a British company that has failed. I think there have been 15 failures in the last several years, 14 of which were Chinese, and the one that was not was not British, so we start from a good place.



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We filed an application to CFIUS almost immediately. I think it might have been referred to earlier. We did it unilaterally, and we had hoped that the process would then kick off from that point. It did not, because some of the information from GKN lagged. The process is under way. We are in touch with CFIUS. We have advisers in Washington acting on our behalf. From the conversations we have had, we cannot see that there are any issues that cannot be met in the way that they have been met before.

- Q114 **Vernon Coaker:** What assurances have you given CFIUS and so on, given the three to five-year plan that you have, and given that many defence contracts exist on research and development and investments that are sometimes decades into the future? What assurances have you given to CFIUS about long-term contracts? For example, though it may be UK-to-UK company at the moment, presumably you will have to say, "In three or five years' time, we will sell off aspects of the business," as you propose to do. What reassurances have you given CFIUS about who you would sell to? Can you say, "We will not sell to China. We will not sell to Russia. We will not sell to anybody who could in any way conceivably be regarded as somebody we in the West, the UK, the US, would have concerns about"?

Simon Peckham: We can say the third of those, effectively. I cannot pick on individual countries. That would not be right, sitting here in this room.

Christopher Miller: You mentioned the right ones.

- Q115 **Vernon Coaker:** This is what I am saying. Many of the contracts that GKN is involved with are long term. They are not short term. In terms of the longer-term contracts, you have said to and reassured CFIUS that you will not sell to anybody or any country that may be regarded as a threat to the security of our country and our allies.

Simon Peckham: What we have said to CFIUS is that we are British citizens too. I live in this country. My family lives in this country.

- Q116 **Vernon Coaker:** Yes, but the question is whether you would sell.

Simon Peckham: We are not going to sell GKN protected military assets to anyone who is not an appropriate buyer of them. We would never do it.

- Q117 **Vernon Coaker:** Even at a loss.

Simon Peckham: Even if we were free to do it, we would not do it. As you well know, the CFIUS authorities have the power to stop us. They do not need that power because we would never use it, but they have the power to stop us, as indeed do the UK Government.

Christopher Miller: That is the fall-back position.

- Q118 **Vernon Coaker:** Will you wait for the outcome from CFIUS, in terms of



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it looking at your proposal? Will you wait until it has concluded its considerations before you make a deal or try to make a deal?

Simon Peckham: The situation with CFIUS is as follows. We believe that the CFIUS approval process will happen within the term of the bid. That is our advice, based on our lawyers in the United States. If it does not, we believe that you can agree measures with the CFIUS authorities where they are very happy to allow the process to go ahead. We also believe that is the case. If neither of those were true, GKN, in fairness, and we applaud it for doing this, has said that it would suspend the timetable. I think GKN repeated that statement in here.

Q119 **Vernon Coaker:** It did, yes. Sorry to interrupt. I understand the process. It is perfectly possible for you to come to an agreement with CFIUS that has post-deal agreements, where you say, "We will do this," and they are legally binding. I understand that. I am asking for a different sort of answer. Will you wait until you have CFIUS approval before you conclude a deal?

Simon Peckham: The direct answer to that question is no. We think we will get the approval. If we do not get the approval and have agreed measures with them that they are happy for us to close, then that would be enough for us.

Q120 **Vernon Coaker:** The answer is no, you will not wait for full CFIUS approval before you seek to conclude the deal.

Simon Peckham: To be clear—because it is important I phrase this correctly—we absolutely, totally respect the CFIUS authorities and totally respect what they are doing. We would not move against their views, but they have a specified procedure that says that you are able to do this. First, we think we will get the approval. Secondly, if we do not get the approval, basically we are able to contemplate, with their agreement, by the way, going through this process. Thirdly, we will take advice at the time. If that was to be a problem, GKN has very kindly said it wants shareholders to have a vote.

Q121 **Vernon Coaker:** It would be good to have CFIUS approval before a deal is concluded.

Christopher Miller: We are squaring the circle, possibly. With mitigation initiatives, as I think we refer to them, which are assurances from us, it is saying you will get approval but down the road. They therefore allow you to meet the takeover timetable.

Q122 **Vernon Coaker:** Have you met with Congressman Neal Dunn?

Simon Peckham: No.

Q123 **Vernon Coaker:** He is the Florida representative for GKN, including the secret facilities that GKN has there. He wrote to the committee; I think it was that committee. He said that Melrose's strategy to buy, sell, improve within three to five years put the defence programmes I mentioned



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earlier at risk, and that, "Melrose has no track record in defence contracting or relevant high-technology businesses." He added that Melrose's acquisition plan revealed prioritisation of operating cash generation. If the deal is allowed, the Congressman said, "Melrose's strategy will undermine long-term investments in R&D and secure supply chains, which are critical to major defence platforms GKN supplies." If you met Congressman Dunn, what would you be saying to him?

Simon Peckham: I would say the same as we are saying to you. Melrose is a good investor in businesses. We will not be a disruptor of supply chains, which is what we have told the CFIUS authorities. We would be able to convince him that his concerns were misplaced.

Q124 **Vernon Coaker:** So he is wrong.

Simon Peckham: I said I think we will be able to convince him his concerns are misplaced.

Q125 **Vernon Coaker:** What about the British Government? What discussions have you had with the British Government about national security concerns?

Simon Peckham: We have had discussions with BEIS and the Ministry of Defence.

Q126 **Vernon Coaker:** As we understand it—I think I am right in saying this, Chair—they are considering whether they should, in effect, call it in and look at it, are they not?

Simon Peckham: You would have to ask them. I do not know what the position is.

Q127 **Vernon Coaker:** We have. Unless I have got it wrong, I think I am right in saying that the Secretary of State at BEIS is definitely considering whether, on national security grounds, he should call this in and look at the proposed takeover.

Simon Peckham: Under the Enterprise Act 2002, as you know, the Government have the power to look at things from a national security point of view. There have been seven investigations under that. None have involved a UK bidder or a UK buyer of an asset. They have all been overseas companies. Actually, all have been approved, with undertakings being given by the buyer. We would make clear to you that, if the MoD had any concerns about national security in respect of this bid, we would of course do everything we can to alleviate them.

Q128 **Vernon Coaker:** The concern is that, in a nutshell, defence is longer term than three to five years. A balance sheet will not reflect the acquisition of defence capabilities and sometimes investments, in terms of a profit margin, which is what you are seeking to improve. In defence of GKN, that is really difficult with defence, because it is so long term.



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Christopher Miller: Just getting it in proportion, defence sales of GKN are probably less than 10% of the total, and less than half of that is in the UK.

Q129 **Vernon Coaker:** But you understand the concerns.

Christopher Miller: I understand the concerns. In terms of your point about profitability and so on, it is not going to come principally from the defence part of GKN.

Q130 **Vernon Coaker:** Talking about dollars, here is the million-dollar question: would you put profit margin before national security?

Christopher Miller: No.

Q131 **Vernon Coaker:** Even if it meant you losing on profit margin, losing money, selling at a loss, you would always put national security before that.

Christopher Miller: Yes.

David Roper: Yes.

Simon Peckham: Yes. We live here.

Vernon Coaker: We have that on record, so there we go.

Simon Peckham: I promise. We live here.

Chair: We have that undertaking surely.

Q132 **Anna Turley:** I just want to follow up that point that Vernon raised. I am now going to quote from your letter to the shareholders of GKN. You say in it, "We measure our success by the value that we deliver to shareholders". Is that it? You are a company that is looking to take over a company with 6,000 employees in this country, 58,000 employees in the world in over 30 countries, with a major role in British civil aviation, a major role in US defence, and you say, "We measure our success by the value that we deliver to shareholders". Is that it?

Simon Peckham: In fairness, that is one line out of a very long letter that goes through quite a lot of things, including how we deal with pension schemes, R&D and other stakeholders in our businesses. The fortunate thing I can sit here in front of you and say is that Melrose has an outstanding track record in dealing with pension schemes. We have a very good track record in dealing with other stakeholders in the business, and we have a good track record of delivering returns for our shareholders.

Q133 **Anna Turley:** I am going to move on to R&D, which is one of the things that you have mentioned there. I understand you say it is a priority for you. It has been put to us that expense percentages of R&D went down at both Elster and Nortek since you took over. Is that true? What are your plans for improving R&D if you were to take over GKN?



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Simon Peckham: I do not think that is true. No, I do not think that is true.

Q134 **Anna Turley:** I understand there are some concerns about financial engineering, that you have been treating R&D spending as capital and thereby disguising true levels of profitability. Your expense percentages of R&D have actually gone down, since your takeover.

Simon Peckham: Our expensed R&D for Elster and Nortek was 4%. Actually, our expensed R&D in 2017 was 3%. I appreciate 4% is more than 3%, but 3% is more than 2.2%, which is what GKN announced. We do not get Government support or customer support. We write our own cheques for our R&D. In 2017, it was 3% of sales.

Q135 **Anna Turley:** Is that what you would be intending to look at, when you take over GKN?

Simon Peckham: I cannot make a promise. That would be effectively me promising to increase the R&D spend and, as you know, I cannot do that sitting here. I am not allowed.

Christopher Miller: It is easy for us to say, "Look to our track record," all the time, but in the context of a hostile bid, it is awkward to be able to give you more detail, I am afraid, within the panel rules. It is what we have done in every business we have owned. I am sure Brush is going to come up at some point. Even in Brush today, the pension scheme is 100% funded, even though it has gone through the difficulties that have unfortunately been made public and which we have tried to deal with. We have invested £100 million in that business, in 10 years of ownership by the way, not three to five.

Chair: We will come on to pensions, so we will stick to R&D for the moment.

Q136 **Anna Turley:** It comes to the bottom line. At the end of the day, research and development is a long-term priority. You have said that you measure your success by the value that you deliver to shareholders. How can we trust a company that says it has a three to five-year investment plan to prioritise long-term research and development, and investment in that, if you are looking for quick returns for your shareholders?

Simon Peckham: That is how you develop a long-term business that has value attached to it. I think Chris tried to give the example of Elster earlier. When we bought Elster from the US stock market, it was on the beginning of the wave of smart meter development, in Europe particularly. America was less smart: one-way communication. Europe was going to two-way communication. We developed that product because we knew in the long run that was the right thing for the business. We knew one day, when we sat in front of someone we were going to sell it to, they would say it is the right thing for the business.



It is not just about the fact that we believe in doing it. It is also about the fact that it is the economically sensible and rational thing to do. That is why we will do it and why it is economically sensible and rational for GKN. It is not just about spending the money. It is about developing and building a business, and being able to say to customers, "We are doing our bit of this. We are here. We are developing new product for you. We are going to deliver that new product for you." We hope GKN is about to go through the wave of eDrive. We will absolutely support that. Why would you not?

As I say, it is not just because we think it is a good thing to do. It is not just because it would be a good thing to do for the employees and a good thing to do for the country, I hope. It is also because it is a good thing to do for business. The combination of those things is why our model works. That is the answer to your question as to why we will always invest in R&D.

When we maybe get there one day, we would rather walk into a buyer and say, "We have all this money invested. It is all coming down the line. It is all here. We have this growth. We have this profitable growth. We have this growth. We have these new products coming online. This is how well this is going." It is not just a selfless act. It is because that is the right thing for everyone, including the markets. We live in a society that is about producing improvement.

Q137 Drew Hendry: We know from your earlier responses that you are keen to talk about the pension schemes and your plans. What cast iron commitments can you give to looking after the pension schemes of GKN?

David Roper: We have an exemplary track record in terms of dealing with pension schemes. Over the past 15 years, when we have sold a business, every single pension scheme that has come into our ownership has left it in a much more financially secure position than it was before. If I could take the time to give the example of the sale of Elster to Honeywell, when we were approached by Honeywell to sell Elster, we looked at it. It was a bit earlier than ideally we would have wanted to have sold it. However, because Honeywell could see the future, the work that we had done in smart meters, we started talking.

We looked at it and thought to ourselves, "We just cannot sell Elster and the Elster pension liabilities." That would have left behind a group that had materially diminished employer covenants to the remaining pension schemes that were left behind. We went back to Honeywell and said, "I know this is going to be a bit of a tall order, but we cannot contemplate selling this business unless you take some non-Elster related pension liabilities." We ended up negotiating to hand over to Honeywell £1 billion worth of pension liabilities from McKechnie Aerospace and FKI.

Q138 Drew Hendry: That is good, but we are talking about GKN. Why have you offered the sum of £150 million in the first year?



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Simon Peckham: Interestingly enough, I am not sure that information filtered through to the pension scheme for quite some time. From the outside, at the end of the day, we know that when we buy GKN we are buying the opportunity to grow a business and make money for, collectively, our shareholders. You are adding Melrose and GKN together, effectively. You are equally responsible for the liabilities of a business. Pension schemes are part of the liabilities of the business.

It is not a coincidence that Melrose does not have significant pension scheme liabilities. It is because we have dealt with them. It is because we have looked after the pensions in our schemes that we have acquired.

Q139 **Drew Hendry:** Are you saying that you are going to commit to paying extra sums to erase the deficit?

Simon Peckham: We have already said that we will pay £150 million. We have already written to the pension fund trustees and said we will contribute higher contributions. We would actually criticise GKN. He made a lot of the £250 million, but he did not mention the £46 million contributions that have gone down to £36 million, a 25% drop. We have said that we will put more contributions into the scheme.

Q140 **Drew Hendry:** Will you erase the deficit?

Simon Peckham: Over time.

David Roper: We have said we will commit to paying those contributions into the pension scheme not just for a fixed period of time. We will undertake that we will pay those contributions until those schemes are fully funded. In addition, a very important point is that we are bringing £4.2 billion or £4.3 billion, at current valuation, of Melrose assets into the covenant pot. That £4.3 billion, or whatever it is, is basically pension deficit free. You could turn round and say that the GKN pension schemes would have a much better and more secure covenant with us bringing that extra burst.

Q141 **Drew Hendry:** On the covenant, will you seek clearance from the Pensions Regulator in advance, and, if not, why not?

Simon Peckham: We were advised there was no need to. The advisers we spoke to said it is a voluntary application scheme. It is there to protect people if you buy something, or indeed if you sell something. The view from our advisers was that we did not need the protection. All we were doing was looking after the pension schemes. We were not in a position where we had to get clearance. That was the legal advice that we got at the time.

Christopher Miller: We have been talking to the trustees of the scheme on a regular basis since we first appeared. They are responsible for the scheme, so in the first instance we think those are the people to talk to.

Q142 **Drew Hendry:** Many people are concerned that the covenant will be



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weakened by this takeover. How do you answer that?

Simon Peckham: We obviously think it would not. It is an interesting comparison at the moment. You have, rightly or wrongly, a Melrose covenant with an enlarged business: let us say a £10 billion market cap value, roughly £1 billion of profit. You are comparing that now with a GKN covenant with either a split, demerged business—and obviously Moody's had a view on that—or, alternatively, a business where there is an immediate sale to Dana. Obviously, I do not know. GKN is not telling you the facts of that and it is certainly not telling me.

Covenants are comparative. I would say that, on any basis, the Melrose covenant now looks better than the GKN covenant.

Q143 **Chair:** Just following on from the questions that Drew Hendry asked, the Pensions Regulator wrote yesterday to our colleague, Frank Field. In that letter, she says, "We have then met both parties"—you and GKN—"and have strongly encouraged Melrose to make a clearance application to us". She goes on: "We stand ready to deal promptly with (complete) clearance applications and encourage parties in takeover situations where the pension scheme may be materially affected to use this process". You are saying that you are not applying for clearance from the Pensions Regulator.

Simon Peckham: I did not actually say that. What I said was that when we started this process the advice was that there was not a material diminution to the covenant, and therefore there was no requirement to go for a clearance.

Q144 **Chair:** That is entirely true, Mr Peckham. They go on to say, "We cannot compel any company to make an application for clearance, nor do we have power to block a transaction before it happens". However, they say, and I stress this again, that they "have strongly encouraged Melrose to make a clearance application to us". Will you be seeking that clearance from the Pensions Regulator, Mr Peckham?

Simon Peckham: We would like to take away the correspondence that has effectively just happened now and go and speak to our advisers. It is quite a complicated area. We have to deal with a number of issues, take legal advice and work out what the best way forward is.

We are in constructive conversations with the trustees. In fairness, recently they have been a bit distracted. I can totally understand that. They have one or two other things on their plates at the moment. We will re-enter those constructive conversations with the trustees. By the way, we are also talking to the regulator. It is not like we are ignoring it.

Q145 **Chair:** No, they say that they have had those conversations with you, but they also say that they have strongly encouraged you to make a clearance application. I am happy for you to come back to the Committee within the next week with your views and whether you will seek that clearance, which I and the Pensions Regulator believe that you



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should do.

Let me just also quote from the letter from the Pensions Regulator to our colleague, Frank Field. It says that "From the outset we have been concerned that the increased leverage involved in the proposed takeover by Melrose is likely to have a detrimental impact on covenant". That is really the concern that the pension trustees, the Pensions Regulator and, ultimately, the people who have saved the pensions with GKN will have: whether, with the increased leverage that you will have to take on to buy GKN, as you have already spoken about, Mr Peckham and Mr Miller, that saddles you with debt, which makes meeting your obligations to pensioners and future pensions harder.

I am happy for you to comment again, but we would like to have a letter from you within the next week with more detail on the pension scheme, but specifically on this question of whether you will do as the Pensions Regulator has strongly encouraged you to do, to make a clearance application to it, which in the same letter it has committed to deal with that promptly.

Simon Peckham: I hear what you say.

Q146 **Antoinette Sandbach:** You have given a number of assurances to this Committee in your evidence today. Which statements of intent to this Committee, and indeed elsewhere, are you prepared to turn into formal post-offer undertakings that are legally enforceable?

Simon Peckham: As you know, the regime to do that is relatively new. It is the panel rule. The panel is very clear that it has to be agreed with the panel and has to be specific and precise. We have said we are very happy to engage with the panel. We have said to BEIS that we will look at what POUs can be given, at the moment our bid gets to a stage where that could happen. It would have to be either a recommendation from GKN, or indeed our success on day 60. At that moment when we can see what the detail is and are in a position to do that, we have said that we will talk constructively to GKN and BEIS about what might be given.

Q147 **Antoinette Sandbach:** You are saying to this Committee that you are not prepared to give any indication to us, or indeed the public, about what formal post-offer undertakings you will look at.

Simon Peckham: No, I am very happy to say what kind of areas they would cover. We would look at the R&D. Obviously we would be happy to do that. We would be very happy to maintain the names of the GKN Driveline and GKN Aerospace businesses. We do not wish to change the names or the brands. We would be very happy to look at a number of other areas if that is what people wish.

Q148 **Antoinette Sandbach:** Would that include, for example, the pensions issues that have been raised?

Simon Peckham: I would very much hope the pensions issues will be long dealt with by then.



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Q149 **Antoinette Sandbach:** I think it might help the Committee if you would write to us, at the same time you deal with the letter from the Pensions Regulator, about the areas that you would consider making formal post-offer undertakings in. What discussions have you had with trade unions about your plans?

Simon Peckham: Currently we have not met Unite. Unite wrote to us at the beginning of the process and asked for a meeting. We said that we would meet at the appropriate time.

Q150 **Antoinette Sandbach:** Why do you say that now is not the appropriate time, given the approach that you have made to the company?

Simon Peckham: When they originally wrote the letter, which was when I replied to it, it was very early in the bid. There is a long process in this. Remember, we are only about halfway through the bid timetable. We are on day 33 or day 34. This is going to go up to day 60, so there is another whole month. The end of this process is not going to be until around Easter, so there is plenty of time to have those conversations.

Q151 **Antoinette Sandbach:** Yes, but do you not realise that there may be uncertainty or concerns that should legitimately be raised and/or discussed? Why would you seek not to do that at the earliest possible opportunity?

Simon Peckham: We are very happy to have those conversations as soon as they are appropriate. We cannot interfere in the industrial relations of GKN without being careful about it.

Q152 **Antoinette Sandbach:** You are prepared to go ahead without knowing what the industrial relations atmosphere might be, if I can put it that way, or give assurances that may in fact cover these formal post-offer undertakings.

Simon Peckham: We will certainly give those formal post-offer undertakings that we have talked about. We will write back to your Committee when we can, under the panel rules. We are very happy to have a meeting with the unions during that process. By the way, we also have a good track record of dealing with unions. We have a perfectly good industrial relations record on both sides of the Atlantic.

Q153 **Antoinette Sandbach:** How do you argue, given your three to five-year timeline, that your takeover is in the long-term interests of the UK industry and defence interests, rather than the short-term interest of investors?

Simon Peckham: I would argue, as we have done already, that our commitments to invest in R&D, our desire to improve these businesses, and the fact that we are taking them from where they are today to where we hope to take them is in everyone's interest.

Vernon Coaker: Sorry, could you speak up?



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Simon Peckham: Apologies. I would argue that what we have talked about today, our approach to business and R&D, how we look at investment, the fact that basically we invest in businesses as if we are going to own them for ever—I take your point—is totally consistent with what we are saying.

David Roper: This is about trying to make this business a better business all round. We think that, if that happens, its productivity, its arm swing, its trades unions, all the stakeholders involved in the business, will be better off. I know it sounds a bit clichéd and trite to say, but we aim to make it a better business. I hope that what you have heard today gives some sort of evidence that that is what we want to do.

If we are not engaging in discussions right at the moment, it is not because we are saying that we are never going to do it, but there is a right time to do these things and a wrong time. We are in the middle of a takeover bid that is highly constrained by the Takeover Panel and all the rest of it. We want to do the right thing.

Q154 **Antoinette Sandbach:** Do you accept the adage “deeds not words”? Therefore, formal post-offer undertakings that are legally enforceable and those offers being made in the public domain about what you would potentially be prepared to sign up to would give reassurance that you genuinely intend those deeds, rather than just presenting us with words.

Simon Peckham: I would hope that you can look at our track record and see that we do what we say and that we deliver the deeds that we say. We take your point.

Q155 **Chair:** I have been quite surprised today from the three of you at the lack of commitment you have been able or willing to give about your future plans for the business. Most of your answers to the questions from members have been to point to your track record. Even if we accept what you have put to us today in terms of your track record with other businesses, that does not mean that you have made any obligations or we can hold you to account for anything you do in the future. As Antoinette Sandbach has suggested, we would like you to come back with what formal undertakings you would be willing to make if you are successful in your bid. Is that something that you are happy to do, Mr Peckham?

Simon Peckham: Yes.

Q156 **Chair:** I just want to ask you a couple of other questions to follow up from what some of the members have asked you. You said earlier, Mr Peckham, that, in terms of changes you were going to make at the business, you were going to sack the board and then empower the people who work in the business to make decisions, because you think the workers are the people who best understand the business. Is that roughly your plan on how you are going to run the business?



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Simon Peckham: I do not think we exactly characterised it in those terms, but I would not disagree with where you are going.

Q157 **Chair:** I find it a little surprising that you have not yet met with the people who represent those who work in the business, the trade union, Unite. There are 6,000 people who work for GKN in this country, 58,000 globally, but Unite is the recognised trade union. It represents a lot of the people who do the work, who understand the business and who you hope in a few weeks' time are going to be working for you and delivering that shareholder value. When is the appropriate time to meet the representatives of the people you hope will work for you?

Simon Peckham: We are getting much closer to it. If you step back to when I received the original letter on 24 January, it was right at the beginning of the process. We wrote back straightaway, by the way, and said at the appropriate time we would meet. Right at the beginning of that process, we did not know anything that we know today about how the GKN strategy was going to evolve or how this deal would progress. We are very happy to meet Unite and would be very happy to do so in the next few weeks.

Q158 **Chair:** With all respect, Mr Peckham, within the next few weeks this will be done and dusted. It is 6 March today. There are only about three weeks left before we come to a conclusion. The next few weeks might mean before that shareholders' vote or after. Would you commit to meet the trade union this month, in the month of March?

Simon Peckham: Yes.

Q159 **Chair:** You have been to the Pentagon. You have met CFIUS. You have met the pension trustees. You have met the Pensions Regulator. You have spent an amount of time with us this morning, and we appreciate it, but you have not yet met the people you hope will be working for you.

Simon Peckham: We are happy to commit to meet with Unite in this month.

Q160 **Chair:** Can I also ask you how much you, as a board, and the three of you in front of us today, will earn if you are successful in this takeover, on day 1?

Simon Peckham: On day 1, no more than I earn now.

Christopher Miller: Like most British public companies, we have a long-term incentive plan. The current plan expires in May in two years' time. It was voted on by shareholders. If there were to be a successor plan, that would have to be voted on by shareholders too. What that plan produces is unknowable at this point. There have been some numbers bandied about, but I am afraid they are taken out of the air. It is fair to say that we would have to create, in the share price, £1 billion of value before we get a penny out of it. I say "we"; there are 20 people in the pot, in the scheme.



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It is hard to know. If we are very successful with GKN it could be a substantial sum of money, but that is because shareholders will have made 95% of it.

Q161 **Chair:** At the moment, as we have said earlier, you have a market capitalisation of £4.2 billion and your share price is about £2.20. How much did the board take home last year, including through those long-term incentive plans, Mr Peckham?

Simon Peckham: I have a salary of £490,000. I will get a bonus paid on that, I think, of 90% of my salary. Last year we had a five-year period where the LTIP paid out, and I received shares worth £22 million, of which I have kept all.

Q162 **Chair:** What were your total earnings, Mr Peckham, in the last year?

Simon Peckham: We have not finished the tax year to date.

Q163 **Chair:** What about the last financial year?

Simon Peckham: It would probably be about £1 million in the one before that.

Q164 **Chair:** What about in this tax year so far.

Simon Peckham: In this tax year so far, it is considerably more than that, probably about £40 million.

Q165 **Chair:** What about you, Mr Miller and Mr Roper?

Christopher Miller: It is similar.

David Roper: It is similar.

Q166 **Chair:** It is about £40 million.

Christopher Miller: I would point out that the big chunk of that is a five-year scheme, not a one-year scheme.

Chair: If you are successful in taking over GKN, your business will be trebling in size. Would your incentive plan also yield a trebling of earnings for you?

Christopher Miller: No, it does not work like that, unfortunately.

Chair: It may be fortunate for GKN shareholders.

Vernon Coaker: I will take what you have at the moment.

Christopher Miller: It is a bigger company. If we are equally as successful in percentage terms as previous acquisitions, it will be a big cheque.

Q167 **Chair:** You have set out what you plan to achieve for the business. If you are successful in achieving what you have set out to achieve, were you to take over GKN, how much would you earn from that?



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Christopher Miller: I honestly have not done the numbers, and I do not believe you have.

Simon Peckham: We have never set it out in numbers. We could not. We would not be allowed to set out what the proposal would be for GKN going forward.

Q168 **Chair:** You have a current long-term incentive plan, which, as you have said, Mr Peckham, continues for another two years. You also have the plans for GKN that you have set out in your takeover bid. You must be able to tell from that what that would mean for your remuneration.

Simon Peckham: No. We have no way of telling that, because there are no financial numbers going forward in projections in the public domain.

Q169 **Chair:** You had £40 million remuneration in the last year. What is your remuneration based on? What are you incentivised against? Is it shareholder value? Is it jobs created? Is it R&D, innovation or satisfaction among your workforce? What things are you incentivised against?

Simon Peckham: The incentive scheme is in the public domain, so it is perfectly available to everyone. In terms of my pay, I receive a salary. I receive a bonus that I have talked about. We have a three-year incentive scheme that says that, if there is an increase in the value of the market capitalisation of the company, we will get about 3% of that as a management team collectively. That is if there is an increase, by the way; if there is not one we do not get anything. Of that 3%, I get about 17%. As I said before to you, that is a five-year scheme and the money is divided over that period of time.

I do not want to anticipate one of your questions, but if it is one of the questions, it is fully UK taxable. We pay PAYE on our incentive scheme.

Q170 **Chair:** Your long-term incentive plan is entirely based on the share price.

Simon Peckham: It is based on driving shareholder value, correct.

Q171 **Chair:** The three of you have been very honest and open about your remuneration. There are 20 members of the board; is that correct?

Simon Peckham: There are not 20 members of the board; there are about 20 members in the scheme.

Q172 **Chair:** Are they all taking £40 million through this long-term scheme.

Simon Peckham: Sadly not, for them. No, it obviously varies by seniority.

Q173 **Chair:** Overall, through this long-term incentive scheme, what is the total value for the 20 people that are part of it? Between the three of you, it is £120 million.



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Simon Peckham: I think the total payment for everyone was about £200 million in shares, which, by the way, people have kept. I appreciate that this is a difficult subject, but let me put the other side of the equation, which is that, other than to pay those tax levies we have just talked about, in the 15 years that I have worked for Melrose, I have never sold a single share in it. A large proportion of my wealth is tied up in Melrose. Another way of looking at this is that we have an appropriate skin in the game. We are not a hired management team. By the way, I do not think Ms Stevens has any shares in GKN. We have a proper exposure to deliver for our shareholders against what we do.

Q174 **Chair:** Is that the same for all 20 of you who are part of that share scheme? Do you all, for example, pay PAYE?

Christopher Miller: Yes.

Simon Peckham: Well, there are some Americans in that, but in terms of UK-resident people, yes.

Q175 **Chair:** You have all held on to those shares.

Simon Peckham: Yes, we absolutely have with those shares. Chris is in the same position as I am.

David Roper: I have kept hold of those shares. I have sold some shares that I owned earlier, but I am 10 years older than he is.

Q176 **Chair:** I just have a final question. GKN told us in the earlier session that it aims to grow the business in the UK. Is that your intention too?

Simon Peckham: I hope so, yes. We want to grow everywhere. Profitably, yes, but we want to grow everywhere.

Chair: Thank you very much, the three of you, for coming to give evidence to our Committee today.

Examination of witnesses

Witnesses: Tony Burke and Steve Turner.

Chair: Thank you very much for coming to give evidence to our Select Committee, and for sitting through the two earlier sessions this morning. We have a few questions for you, and I suspect that you have some reflections based on the earlier sessions.

Q177 **Stephen Kerr:** Good morning. What is your view of how GKN has been performing and the culture of the company? Do you think that there is any need for restructuring at all?

Tony Burke: We have had a good, long relationship with GKN as a business. Of course, it has some difficulties, but we have some of our shop stewards here today, and I am sure that they would be able to attest that they have managed to work through the problems. GKN has a long-term plan. You heard that from the chief executive today: 15 to 20



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years of investment. Just to recap, it is involved in the Wings of the Future programme now. There is the electric axle, which will be crucial to the production of electronic vehicles in the UK, at Erdington. It has a long-term strategy and a long-term plan.

As far as Melrose is concerned, I thank you very much for the points that you raised there; at least we have a meeting with Melrose coming out of it. At the end of the day, we are about people; this is about workers, people who have been with this company for many, many years and have invested their lives and skills in GKN. You can understand the fact that many of our colleagues at work are very concerned about any potential takeover. If, at the end of the day, GKN beats back the Melrose bid, we will have to sit down and talk with it, and we will have to reach new agreements if needs be, but that is what we do as a trade union, and that is what our stewards do.

Q178 Stephen Kerr: What is your view of how it has been performing as a business? What is your view of the culture of that business?

Tony Burke: As far as we are concerned, we have a good relationship with GKN. The culture is okay, and in terms of our shop stewards, who deal with the company at the coalface all the time, we get occasional industrial relations problems, but in the main—

Q179 Stephen Kerr: So you do not have a view about any restructuring that might be required, or anything about cutting costs or flattening the management structure.

Tony Burke: The situation is that they have Project Boost, which they have been through today. It is an issue for us, and we will have to sit down and negotiate our way through it, making sure that we protect our members' jobs and conditions at the end of the day. We deal with companies like that all of the time.

Q180 Stephen Kerr: Is it your view, regardless of which way this ends up, that job losses are inevitable?

Tony Burke: We will have to see when we get into talks. It may not be inevitable at all. Do not forget that this is a company that is introducing cobots and robots at a fast rate. We have done that through negotiation and discussion.

Q181 Stephen Kerr: In terms of future strategy for the business, offshoring and future location of plants must be something that is on your agenda as well, I assume.

Tony Burke: It always would be with any manufacturing business. We want to keep it here in the UK if we possibly can.

Q182 Albert Owen: Just to follow on from my colleague's questioning there—and I declare an interest as I have sponsorship from Unite, as in the register of interests—you heard Melrose saying that it has a good industrial relationship with trade unions. Are you aware of that? Do you



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have concerns about it as a company dealing with trade unions?

Steve Turner: The only relationship that we have with Melrose is through its ownership of Brush. Brush is a company that, when Melrose assumed control of it, had 1,200 employees. Within a very short period of time, that was reduced to 600 employees, and on the day of its proposal bid being released, it decided to reduce that by another 50% and offshore to eastern Europe. Yes, we do have difficulties with Melrose and its industrial relations model.

To say that we do not have a relationship with the management team at Brush would be wrong, because we do. We have our convenor at Brush who is incredibly concerned about the future for that plant, the future livelihoods for those who are directly employed and the apprentices who would be coming through that programme, and of course the communities that survive around those plants as a consequence of the earnings of the people that continue to work there.

Q183 **Albert Owen:** They have said they are going to get rid of management and that. Do you think they are getting rid of a skills base that is important to you as a union?

Steve Turner: Yes. I found it quite incredible to listen to Melrose this morning, as if you can get rid of the board and miraculously the organisation will transform itself overnight. It will not work like that. I saw that in the financial presentation, and that is part of our concern about the Melrose bid, of course. Melrose has a proven track record. I agree with comments that were made about how you should look at deeds as opposed to your promises, because the reality is, if you look at Melrose's track record, it is exactly that three to five-year transformation. That is what Melrose would call it; we would more rightly define it as asset-stripping. It takes over businesses, breaks those businesses up, compartmentalises them and flogs them off to the highest bidder, in order to maximise shareholder value.

That is the nature of the business. I am not criticising the nature of the business; I just want to be open about it. That is the nature of the business. If all that you are interested in is shareholder value, and all the bid spoke of was maximising shareholder value—there was not a sentence, in terms of its proposed bid, that spoke about employees, growth in the business, the communities that are supported by the business, or any other stakeholders—that is done by compartmentalising and flogging off bits of the business, bit by bit, for maximum value.

Q184 **Anna Turley:** You have talked a bit about Melrose's record. Is there anything else in its record that gives you cause for concern in the way that it has approached businesses? In particular, it would be helpful if you could talk about pension schemes as part of that as well. I know we have spoken a lot about that this morning. Could you give us a broad overview of anything about its history and its record that worries you?



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Tony Burke: If you take a look at some of the businesses that it refers to that it has bought, it owned Dynacast between 2005 and 2011, and began selling it off almost immediately. It acquired McKechnie from Cinven in 2005; from May 2006 it started selling off that business. McKechnie was eventually sold to JLL Partners, a private equity firm in the United States, in 2007, only 23 months after Melrose acquired it. It acquired FKI in 2008 and then started disposing of its divisions a year later. That is its record.

On pensions, which you raised, I found it astounding that the Pension Regulator has now said, "I would advise you to come in and see us," and the answer that you got was, "We were advised we do not have to." Quite frankly, 32,000 pensioners, who have dedicated their lives to this business, are going to be wondering, if they are watching this on the broadcast, about their pensions, and a company that is trying to acquire the business is saying, "We have not yet met the Pensions Regulator, and we will come back to this Committee and tell you what we have done." That is astounding.

Chair: I think they have met the Pensions Regulator, but they have not given the commitment that the Pensions Regulator has asked for. We are looking at the moment, as a Select Committee, at what is happening at Carillion, and there is a very real worry about what happens to pensions when they are not fully funded. That is an issue at GKN, but it is also an issue, as the Pensions Regulator has said, with the highly leveraged ownership model.

Q185 **Peter Kyle:** Both parties have said that they are going to sell off bits of the company to create shareholder value. Do you see that there is a difference in the approaches of the two parties?

Steve Turner: Fundamentally, there is a difference. There are discussions going on with Dana. We understand that, and we understand why the company perhaps did not want to disclose too much information about that today in the Select Committee. That process will take its course and we will deal with that in due course, as the appropriate unions. We are in discussions with the company about a number of changes. It has spoken about the powder metallurgy business, and it has analysed the powder metallurgy business as being non-core. We will continue to have discussions about that. It is going to turn that business around if it can during the course of a two to three-year period. That is what it has discussed with you today, and what it has previously discussed with us. That business is centred in Germany and it will be IG Metall and the German unions that are in discussions, through the works council structure and the rest of it, with GKN on how it deals with the issues from powder metallurgy.

We have a relationship with GKN that allows us to sit down and work through future planning. That is the big difference between GKN and Melrose. Apart from Melrose's short-termism, Melrose has no real positive approach towards dealing with trade unions, and that is



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highlighted in the letter response that we got from Melrose when we made an initial request to sit down and have a constructive, positive discussion very early on in this process. It said it was not appropriate.

Q186 Peter Kyle: The primary difference, really, is the staff and union engagement.

Steve Turner: And on the sale of businesses. It is talking to Dana about setting up a new company. It is not talking about breaking that company up and flogging it off as separate assets in order to maximise shareholder value. It sees the driveline business as a long-term powerhouse, in a core sector of the economy, pump-priming industrial strategy and manufacturing in the UK. It has a vision, and it has a vision, actually, at board level. It has a vision and a strategy, as a board, to take this business forward. That was highlighted as a major failing in Melrose's presentation this morning: that it believes that the board has a different purpose to the board at GKN. GKN is a tier 1 supplier in the automotive and aerospace sector. Melrose has never had any experience of tier 1 supply to either of those sectors. In the aerospace sector, a number of colleagues have raised the question about defence implications, and we are incredibly concerned. I have personally written to CFIUS, and to Jim Mattis, the Secretary of Defence in the United States. We also deal with Gavin Williamson regularly here, and he equally has concerns, through the MoD, and has raised those through with Greg Clark.

Q187 Peter Kyle: GKN plans to break up the company before Melrose. Do you approve of that?

Steve Turner: I do not think it plans to break up the business. If it was to come to fruition, it plans to establish a new company jointly between GKN and its partner organisations. That may or may not come to fruition, but our response to that is that is a direct consequence of a hostile bid; GKN is having to take measures in order to defend itself because of a failure to learn the lessons from previous takeovers, such as the takeover of Cadbury by Kraft, where hostile bids forced companies into very difficult positions. We have hedge funds and others investing at late notice in these businesses. We are currently running on close to 15% short options being taken out now, in the last few weeks, against Melrose. All these businesses will have a vote, and they will be voting to line their pockets, of course, as opposed to voting for the long-term interests of GKN or its workforce.

Tony Burke: I find it astounding that you have heard today that Melrose is a business that wants to own companies for the future, and yet the strapline on its own website is absolutely clear: it wants to dispose of businesses. That is what it is likely to be. The difference is, if there are problems or difficulties with GKN, we will sit down and talk it through. We will sit down and look at its auto business; we will sit down and look at its aerospace business. You did not hear one thing today about this massive investment that GKN is putting into the automotive business, developing the electric axles that are going to be absolutely crucial for



our car industry in the future. We did not hear anything about that. We did not hear anything about the Wings of the Future programme, which is absolutely crucial for the aerospace industry.

Q188 Vernon Coaker: Can I first of all declare an interest as a Unite member, and also refer to the register of Members' interests with respect to Unite and some of the support we receive?

You heard what I was asking about national security, which has been a huge concern that has been raised, and the needs for answers to that concern if this were to go ahead. What is Unite's view about the Secretary of State's powers to intervene, and why would you say that he or the Government should be intervening?

Steve Turner: Our view is that he should intervene; absolutely he should intervene.

Q189 Vernon Coaker: Just for the benefit of the record, can you outline why, please?

Steve Turner: There are very clear national security implications from this. It is not just about what GKN is involved in now; it is also about our future defence capabilities moving forward. We do have a plan for a future fighter. We have a plan for a future trailer. GKN is involved in not just existing products like the Eurofighter Typhoon project here with BAE and with Airbus industries elsewhere across Europe; it is also involved with significant product development and R&D, in terms of 15-year innovative products with the US Government, and also prime contractors in the United States, including Boeing, Lockheed Martin and Northrop Grumman. Those are all involved in product that is not just being produced here in the UK by way of workshare and manufactured in the United States but is being procured by the UK Government.

We have the P-8 Poseidon aircraft, which is being built in the United States but is being procured for use here. We have the Joint Strike Fighter; we are going to buy the F-35 for our aircraft carriers. GKN is an instrumental tier 1 supplier to that. We have the Stealth Bomber; we have the Apache; we have the Chinook helicopters; we have the Black Hawk programme. We have a whole series of programmes that are key not just to the UK's defence strategy moving forward. Unfortunately, we would argue, the MoD prefers to buy off the shelf in the United States than build here; that is a different argument for a different Committee, perhaps, but the reality is that these products are being procured by the MoD for use by our armed services to defend our national security interests.

They are being built now and GKN is a tier 1 supplier, so we have real fears about future ownership structures and about the future of intellectual property and where that may very well end up as Melrose breaks up this business. We genuinely believe that is what it will do. It is its MO; it is its proven track record, whatever it may have said in front of the Committee this morning. I prefer to look at its actions and its past



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records, as opposed to what it believes may happen in the future. There is every reason—not just for what we are involved in now and what the UK Government are purchasing now—to defend our future defence capabilities. We have a tier 1 supplier that is instrumental in the development and long-term—10, 15 or 20-year—development plans for defence products. In the aviation sector, the Wings of the Future project is a 20-year programme with millions of pounds of investment.

There has been more investment in R&D in the last 10 years from GKN than the three that appeared before you this morning have taken in share options and payments. The three people, in the last 10 years, have trousered over £400 million as a consequence of shareholder value improvements in the businesses they have acquired. Over £500 million of investment in that period has been put into UK manufacturing by GKN.

Q190 Vernon Coaker: But it is one UK company taking over another UK company. Is the concern you have, on national security grounds, that you do not believe or do not trust what Melrose is saying?

Steve Turner: We do not believe it. National security works over a 10, 15 or 20-year development period, let alone the manufacturing process, which will go on for 30 or 40 years in service. There is a whole series of maintenance and upgrade review programmes taken into account during the service period, which GKN is directly involved in as well. That gives you a 50-year lifespan. It is developing product now, and it will take 10 years, in R&D and engineering development, to get a product to market. It will take 10 to 15 years to do that. It is developing product now that we will not see in our skies for 15 years. There will not be a sale of that product to Government for 15 years. That is all pump-primed investment. It is pump-primed investment by GKN as a supplier; it is supported by the prime contractors, whether that be Airbus, Boeing or whoever it may be—BAE is in the UK—and indeed there is government investment. The UK Government have invested in these programmes as well.

Q191 Vernon Coaker: If I understood rightly what GKN said this morning, it is not highly integrated in the UK defence industry. If it is not highly integrated in the UK defence industry, what are the concerns?

Steve Turner: Well, it is. Companies are very sensitive sometimes. We argue with them about why they do not do more political lobbying, and they say, "It is our main client. It is difficult for us."

Vernon Coaker: They did say that, unless I misunderstood this morning.

Steve Turner: They said it, and it is difficult. It is true to say that their exposure to defence interests is greater in the United States than it is in the UK. It is not true to say that the products that they are developing and manufacturing in the United States with primes in the US are not then being purchased by the MoD, using British taxpayers' money, to service our national security interests here. We have been through those already.



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It is also about the future fighter programme, which is a development programme that the MoD is supporting. We will have a European alliance at some point to develop the Future Fighter, and when we do we need that core alliance of manufacturers that are key to the development and innovation of that product.

Q192 **Vernon Coaker:** In a sense, those are the national security concerns you are raising about Melrose's offer for GKN, notwithstanding the point that was made this morning about GKN not being highly integrated within the UK defence industry.

Steve Turner: It is about short-termism. It is not just for today but for tomorrow, training apprentices to keep those skills and those jobs in those industries, so that we are in a position to be able to defend ourselves and not simply rely on purchasing off the shelf when the decision is finally taken by Government that that is the right thing to do.

Q193 **Vernon Coaker:** What have you said to GKN about the reports that we read about it talking to a US company, Dana?

Tony Burke: Dana is in the automotive industry. We have members in Dana in the UK. We have a relatively good relationship with them. We were a bit surprised that it came out on Friday, but we have had some discussions with them and they are going to progress that. They have said to us, "We will keep you posted. We will talk to you and let you know what is happening."

Q194 **Vernon Coaker:** Would you rather it stayed in British ownership?

Tony Burke: Obviously, but let us be clear: this is not a sell-off; it is a new business and a new merger. In some respects, GKN undersold itself on the national security and defence question. Steve is right: they downplay it, but it is absolutely crucial. You heard what the chief executive said. The amount of time, effort and money that has gone into development of the Trent engine at Rolls-Royce in Derby is absolutely fantastic.

Can I say something else? The customers in the industry do not necessarily shout from the rooftops that they do not like it, but they tell us; they do not want this deal. The Society of Motor Manufacturers and Traders has a similar view. The aerospace employers' trade association, ADS, again has made the case that it does not believe, at the end of the day, that this is in the interests of manufacturing in the UK. In terms of national security, Steve has answered that.

Q195 **Vernon Coaker:** To sum it up, your message to the Secretary of State for BEIS is, "Call it in". You believe that is supported by the MoD and other parts of Government, and you have made those things clear to CFIUS, the American Secretary of Defence and others. I am interested in what you have had back from those people, whether you have you talked to the American trade unions, and what you have had back from CFIUS and all those.



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Steve Turner: We have had acknowledgement that it is in process. We would not necessarily expect anything more at this point. We have spoken to our US counterparts at the UAW—the United Automobile Workers—in the automotive industry and the machinists union in terms of the aerospace industry. They are very well aware of the difficulties that they have, and they are in discussions with their GKN counterparts in the United States about how they deal with some of the issues that GKN was very open about this morning. It has been very open with us about the difficulties, where they have emanated from, and what it has had to do in order to stem the tide of losses, particularly in the United States, where the CEO was appointed and dismissed before he took up his post as CEO; that is the reality of it. He was the responsible party in the United States for the culture that led to the write-off. The write-off led to a profit warning and the profit warning was seen by Melrose as an opportunistic avenue in, to put in a bid.

It is a hostile bid. We do not support the bid and we do not see the bid being supportive of either our industrial strategy here in the UK or our manufacturing industry. We see it as being about shareholder value issues. It is about maximising shareholder value and trousering lots of money; that is the reality of it. If you can get away with it, it is all very well, but it is no good for UK plc and we will oppose it every step of the way.

Q196 **Antoinette Sandbach:** Having just said that last sentence, are there formal post-offer undertakings that would help reassure you? If so, what would you be looking at as a union in terms of those undertakings?

Tony Burke: First of all, you have managed to drag out of them that they will meet us. We will obviously wait for them to contact us and we will get into some discussions. Clearly, we have to talk to our shop stewards and our union members. Six thousand people are very, very concerned about their futures, so we will have to listen to their views as well. We would then have to look at what we want in terms of assurances. At the end of the day, the position is that GKN is opposing this bid, and so is everybody else, so we would have to take that into account if and when we meet them.

Q197 **Antoinette Sandbach:** Are you saying that because you have not been offered a meeting yet you have not taken those kinds of soundings?

Tony Burke: We would not do at the moment because we would not want to confuse the situation.

Steve Turner: We want safeguards. We have an idea about how we see the future of this business, and we would want to enter into a positive, constructive discussion with Melrose, if it was serious about wanting to discuss issues with us, about what its intent was. I am not sure we are clear about its intent.

Q198 **Antoinette Sandbach:** For example, you heard a commitment of 3% to



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R&D, with the current investment rate on R&D of 2.2%. Is that the type of thing that would reassure you?

Steve Turner: It would, but it is a long-term investment that is absolutely critical to both the automotive and the aerospace sectors of this business. It is a long-term commitment, and those long-term commitments are not just about cash. They are about relationships, joint ventures, partnerships, and trust and understanding that you have a long-term future relationship between suppliers. The supply chain is an integrated supply chain; it is not just here in the UK, for instance, but across Europe and indeed across the globe. Particularly the European operation is really integrated, in terms of GKN's European supply chain.

I do not want to make things personal, but these are funders of the Leave campaign, and you have to question the future commitment they have to European supply chains and to customs unions. These are things that are really, really important to the future of this business and this business surviving in the UK, in a very difficult, sensitive market right now, particularly as we run into Brexit. We weigh all that up, we have those discussions with our members, we understand what is going on and we understand the politics of some of this, but there are genuine concerns of our members that we would welcome the opportunity to discuss with anybody.

Tony Burke: We revolve around, as Steve says, job protection, investment and the issue on pensions.

Chair: Thank you very much. I hope your meeting and discussions with Melrose go well when you meet. We are grateful to you and previous witnesses for coming today to give evidence. I hope we have also given some more information to the workforce, to shareholders and to other stakeholders, including people who get their pensions from GKN, about the respective cases of Melrose and of GKN. We look forward to hearing in writing from Melrose about its commitments to pensioners as well as its other undertakings if it was successful in its bid. We will continue to seek clarity from the Government in terms of what they plan to do with regard to calling in this takeover bid. Thank you very much.