annual report **2004**

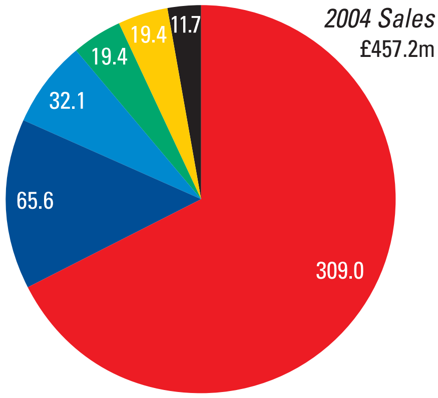
Winner PLC awards 2004 Best Investor Communications

Bodycote

At a glance

Bodycote Heat Treatments…

…providing a vital link in the manufacturing process for the automotive, aerospace, construction, power generation, electronics, consumer products and general engineering industries. Operating 153 plants in 20 countries; an unrivalled strategically located network, experienced in supporting large multi-national customers and their supply chains, as well as local niche specialists. Expanding in Poland and Italy and developing the Bodycote Kolsterising® technology in France and the USA and low pressure carburising in Europe and the USA.

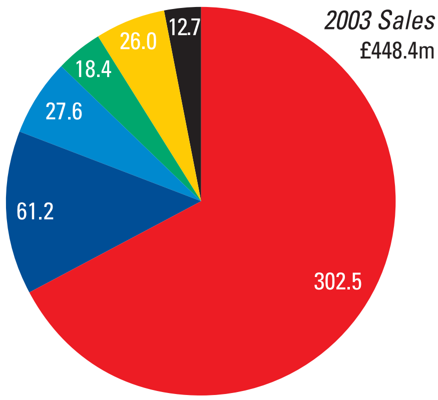


Bodycote Materials Testing…

…assessing and certifying the quality and reliability of materials and products for many clients in the fields of civil engineering, environmental protection, food and household goods, microbiology, pharmaceuticals, pipeline polymers, and transport. Offering a fully accredited group of 53 testing laboratories in 12 countries, serving international customers. Expanding in the Czech Republic and the Middle East, providing a beneficial outsource option for advancing businesses.

Bodycote Hot Isostatic Pressing…

…applying the unique product enhancement and novel material production benefits of this advanced technology to an increasing number of customers in precision foundry, power generation, aerospace, automotive, medical, precision tooling, and electronic engineering. Managing the western world's largest HIP capacity at 11 locations across 6 countries. Developing new materials and manufacturing techniques by collaborative projects with market-leading OEMs.



Bodycote Surface Engineering…

…improving the performance, durability and appearance of components and tools by the application of functional and decorative coatings utilising, sherardizing, mechanical plating, plasma spray, organic, anodising and specialist ceramic coatings processes. Operating 10 environmentally friendly coatings centres in 6 countries and establishing CoatAlloy®, the unique new Bodycote coating service for the petrochemical industry.

Bodycote Electroplating…

…enhancing the corrosion resistance of constructional components and consumer products by the application of electroplating and mechanical plating processes. Operating 4 environmentally friendly coatings centres in 2 countries.

Bodycote PVD Coatings, IonBond strategic alliance…

...expanding the international provision of PVD coatings services by delivering product enhancing PVD coatings for tooling, tribological and decorative applications, from 30 PVD coatings centres in 12 countries.

www.bodycote.com/audiocast

Bodycote continually improves the website offerings for both customers and investors. The most recent is the addition of an audio webcast of Bodycote's 2004 results presentation in the Investor Relation section of the website. We invite you to view and to listen by visiting www.bodycote.com/audiocast

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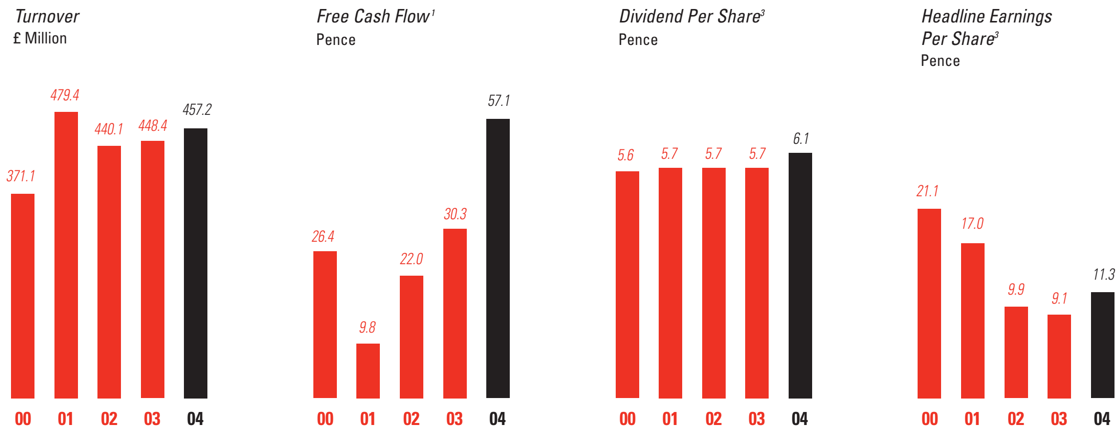
	2004	2003
Turnover	**£457.2m**	£448.4m
Headline Operating Profit[1]	**£52.1m**	£41.7m
Operating Profit	**£43.6m**	£25.1m
Headline Profit Before Taxation[1]	**£44.2m**	£32.0m
Profit/(Loss) Before Taxation	**£24.5m**	(£11.1m)
Headline Earnings Per Share[1,2,3]	**11.3p**	9.1p
Basic Earnings/(Loss) Per Share[3]	**6.1p**	(6.3p)
Dividend Per Share[3]	**6.1p**	5.7p

[1] Headline Operating Profit and Profit Before Taxation are stated before exceptional items (2004: £11.2m; 2003: £34.0m) and amortisation of goodwill (2004: £8.5m; 2003: £9.1m). Free Cash Flow is stated after interest, taxation and capital expenditure.

[2] A reconciliation of headline EPS is given on page 30.

[3] Adjusted for the bonus element of 2004 rights issue.



Chairman's Statement

INTRODUCTION
It has been an encouraging year There has been a good recovery in our overall trading performance with consequent improvement in our profitability. The pressure on pricing and cost increases continued and the extent of the underlying operating improvement has been masked by the impact of currency movements, particularly in respect of the US dollar.

TRADING
Turnover in the year improved by 2.0% to **£457.2m** (2003: £448.4m) and operating profit increased by 73.7% to **£43.6m** (2003: £25.1m). Our profit before taxation, goodwill and exceptional items was **£44.2m** compared to £32.0m in 2003. Goodwill amortisation was **£8.5m** (2003: £9.1m) and exceptional items were **£11.2m** (2003: £34.0m).

All our Strategic Business Units (SBUs) experienced an increase in sales and in the main this translated into improved profitability. Of the £8.8m sales growth, all but £1.8m of our growth in sales has been organic as the acquisitions that we have made occurred late in the year.

The disposal of electroplating has largely been completed and all the loss making plants have either been sold or closed. The increasing profitability of the anodising and organics businesses in Scandinavia and Germany supports the decision to retain them in the Group. Under the current accounting rules we are not able to treat the electroplating activities as discontinued until the process is completed, which we anticipate will be in the current year.

We made four modest acquisitions in the year at a cost of £4.7m. In addition, in November, we transferred our PVD businesses into a strategic alliance with IonBond, creating an operation with strong technical skills and wide geographic scope which will be expanded by acquisition and leveraging its advanced coating technologies.

Our ongoing tight control of capital expenditure brought about a further reduction in the year to £34.0m (2003: £38.3m).

The £62.0m net proceeds from the rights issue in March greatly improved the strength of our balance sheet and gave us the financial flexibility to further develop the business. We have also generated free cash flow of £57.1m from trading and this has been complemented by £20.8m from our disposal programme. Consequently there has been a significant reduction in our net borrowings which have fallen from £210.3m to £88.5m.

OPERATING EXCEPTIONALS AND EXCEPTIONAL CHARGES
Exceptional costs of £7.4m were incurred in 2004 in connection with the electroplating disposals. There was also an £3.8m exceptional charge in respect of transferring our PVD business into the IonBond strategic alliance.

DIVIDEND
A final dividend of 3.85p per share is being recommended by the Directors, which together with the interim dividend, will make a total payment of 6.1p per share which is an increase of 7% (2003: 5.7p after adjustment for bonus element of the rights issue). The dividend will be paid on 6 July 2005 to all shareholders on the register at the close of business on 10 June 2005.

GOVERNANCE
Apart from some minor areas which are explained in the Directors' Report, Bodycote is in compliance with the 2003 FRC Combined Code. This mirrors the high level of compliance achieved by Bodycote in relation to the 1998 Code in the period 1999 to 2003. Plans are in place for reporting future results under International Financial Reporting Standards starting with our Interim Report in August 2005.

EMPLOYEES
We have in the past emphasised the dedication and professionalism of our staff and it is pleasing that this year we can show very positive financial benefits from their efforts which complement the additional investment that was made by our shareholders.

CURRENT TRADING AND PROSPECTS
We are pleased with the current trading at the start of 2005, which is in line with our expectations. We look forward to the rest of 2005 with a degree of confidence that we can further improve our trading performance. As well as continuing to gain new outsourcing contracts we also expect to expand the Group with carefully chosen bolt-on acquisitions which will strengthen our existing businesses and extend their geographic spread.

We have the essential ingredients of a strong balance sheet, capable people, productive facilities and systems to ensure the delivery of exceptional quality and service which should enable us to give a good account of ourselves in the changing market place. The strategy of the Group remains directed towards consistently delivering a pre-tax return on capital employed in the mid teens.

James AS Wallace

James Wallace
1 March 2005

Chief Executive's Review

I am pleased to report a welcome improvement in performance during 2004. We have divested the loss making electroplating operations and poor performing facilities have been sold, transferred or closed. Our PVD businesses have been consolidated into a strategic alliance to provide critical mass in this growing market. We have sharpened our Key Performance Indicator (KPI) metrics, standardised our reporting and improved benchmarking across the Group. All of these actions are helping to rebuild ROCE. Meanwhile, our successful rights issue strengthened the balance sheet. We have closed or sold 42 facilities in the past 3 years (13 in 2004) and acquired 10 new businesses (4 in 2004). We now have 261 facilities operating in 26 countries.

Sales at £457.2m were 2.0% ahead of 2003. Excluding the disposed electroplating and PVD sales and using constant currency exchange rates, sales grew 8.5% compared to 2003, of which 8.0% points were an organic increase. With stable automotive markets, improved demand from general manufacturers, a strong rebound from the Industrial Gas Turbines (IGT) sector, new outsourcing business and increased market share, we were more able to offset cost pressures which resulted from normal wage and benefit increases and volatile energy costs. Operating profit (before goodwill amortisation and exceptional items) grew 25.0% to £52.1m compared with £41.7m a year ago. Without our self help programme and improved sales effort we would not have been able to post such an improvement in performance. I thank all the people in Bodycote who have helped deliver these improving results.

STRATEGY

Our strategy is based on disciplined investments in technologies with a good future, along with continued support of outsourced business from strong manufacturers focusing on their core competencies. Rapidly growing manufacturing demand in Eastern Europe and Asia will support the continued geographic expansion of the Group over the medium term. In addition, our Materials Testing Group is positioned to accelerate its growth by technology transfer, new outsourced programmes and acquisitions.

OPERATIONAL REVIEW

Securing major outsourcing opportunities remains a strategic focus to support our top line growth and margin enhancement. Bodycote's outsourcing initiative offers manufacturers lower total cost, equal or better quality and quick turnaround. The key is our technical expertise in niche technologies which are not core to most manufacturers and our highly productive model where we operate at optimum efficiency. As predicted, the trend to outsourcing and closure of in-house facilities, which is well established in Europe, is accelerating in North America, particularly in automotive. Outsourced work from Strategic Partnerships (SP) and Long Term Agreements (LTA) accounted for 17% of Group turnover as compared to 13% in 2003.

Technology transfer initiatives continue to be successful, with niche capabilities being transferred geographically to existing facilities. These high value added services enhance customer satisfaction and lead to additional revenue.

The cross selling and bundling of multiple services creates a unique offering which appeals to those manufacturers that wish to optimise their performance by focusing on core competencies. Our geographic and market spread reduces the risk associated with any one account. Our top ten customers accounted for approximately 10% of total turnover, compared to 9% in 2003.

Heat Treatment

At constant currency rates, Group wide sales grew 6.7% and operating profit improved 12.0%.

North America

At constant currency rates, sales increased 7.0% and operating profit was up 13.0%.

Aerospace, IGT, and oil and gas all saw improved demand from a combination of market pickup and new outsourcing. The locations which are heavily automotive related saw a decline in the second half which, based on industry forecasts, will continue into 2005. The combination of price pressure and increases in energy and employee benefit costs continues to squeeze margins. We are now able to offer several high value added services (Low Pressure Carburising, Electron Beam Welding and Kolsterising of stainless steel) to complement existing heat treating and brazing services thus helping to improve margins in the oversupplied North American market.

Central European Group (CEG)

At constant currency rates, sales grew 8.1% and operating profit was ahead 17.2%.

Although a difficult environment for the manufacturing sector of the economies served by this SBU our strategies of pursuing outsourcing work, transferring technology and optimising operational efficiencies paid off. The targeted capital investment in equipment and people has allowed us to gain market share while improving the mix of work processed.

All automotive focused facilities are now certified to the stringent TS 16959 while most facilities will achieve ISO 14001 environmental certification by the end of 2005. This positions us in line with quality and responsibility expectations of world class manufacturers.

Our network of East European facilities was expanded at the start of 2005 by the commissioning of a facility in Poland which targets the high end aerospace and tooling markets. We today announced the acquisition of four well-resourced plants in Poland. We anticipate continued growth in our Eastern European operations during 2005 both organically and by acquisition.

France, Belgium, Italy (FBI)

At constant currency rates, sales improved by 1.2% but operating profit was flat.

The challenges we face in France in particular are market migration, price pressures, mix change and cost creep. All facilities in France are now ISO 9000-2000 certified. In addition we now have several plants qualified to the aerospace mandated quality program ACMA-PRO which will be incorporated into the North American originated equivalent Nadcap in 2005. Belgium delivered modest sales growth and moved into profit after rationalisation of 3 facilities into 2.

Nordic, UK (NUK)

At constant currency rates, NUK sales increased 11.7% and operating profit grew 36.0%. The sales growth was driven by recovery of the IGT market and an increase in outsourced work. All UK facilities are now registered to the ISO 14001 environmental standard. We now have 9 facilities Nadcap UK accredited to meet mandates from several key customers such as Rolls-Royce and Boeing.

Chief Executive's Review

Materials Testing

At constant currency rates, sales grew 11.2% and operating profit grew 13.3%.

By concentrating on the high value added services, cross border selling and an industry specific approach we have been able to gain market share at most of our laboratories. Sales increased in all geographies and margins were maintained or improved, with progress in Canada being notable.

The USA saw an improvement in demand for aerospace, high end automotive and oil & gas testing but the gains were eroded by increased people costs and price pressures. We have won several significant outsourcing contracts.

In the Middle East we successfully integrated the laboratories acquired from Carillion plc in 2003 resulting in a 45.0% sales growth year on year. Operating margin in the region was somewhat reduced from last year as 2004 had the tail end benefits of a major construction project that had run beyond the contractors completion date. All facilities are now ISO 17025 accredited; such standards are unique in the Gulf region and give us a competitive advantage as blue chip clients are increasingly insisting on these high standards to protect their major investments in construction projects such as the Dubai airport expansion.

The Canadian Group won significant outsourced contracts from major aerospace, automotive prime and first tier suppliers while managing their costs well. In support of stringent new emission controls stipulated by the Environmental Protection Agency regulations due to come in force in 2007, we have invested in two advanced Heavy Duty Transient Cells for testing emission compliance in the heavy diesel engine market. This investment will start to generate revenue near the end of 2005.

UK and Europe had good sales growth based on IGT, oil and gas, Health Sciences, and Environmental markets.

HIP

At constant currency rates, sales increased 23.9% and operating profit was up 113.4%.

The sales growth was driven by an unexpectedly large increase in IGT demand for new and replacement parts. Aerospace demand picked up slightly in the second half of the year and is expected to maintain this trend throughout 2005. The very high operational gearing, evident in HIP during the downturn in 2002 and 2003, rebounded in our favour. Although margins recovered from 13.0% to 22.5% we still have work to do because the high investment in a HIP facility require yet higher margins in order to achieve an acceptable return on capital employed. We continue to work on innovative new applications in the powder consolidation sector. The ALON ceramic project saw sales increase 100% in 2004 but well behind original expectations. Demand for Densal® treatment of aluminium castings showed excellent progress in the European automotive sector. Two large HIP units which were out of service for a large part of the year will return to service in the first half of 2005. A used HIP unit, previously acquired at low cost, will be brought into service by the first part of 2006 in anticipation of continued increasing demand for IGT and recovering aerospace.

Surface Engineering

At constant currency rates and excluding PVD and discontinued electroplating, sales grew 7.5% and operating profit improved 49.6%.

Anodising and Organics

We are focused on developing this business by transferring know-how and processes between facilities and approaching customers in a more organised manner to gain market share based on technical capability.

Diffusion Bonding

Our K-Tech coatings continue to find more applications in the oil and gas, textile and steel rolling sectors. Being an engineered solutions business, we invest heavily in developing and proving application benefits.

The CoatAlloy® process, which dramatically improves the performance and life of furnace tubes in ethylene production plants, started up in the second half of 2004. We experienced the usual teething problems associated with new processes. Technical issues are now resolved with deliveries expected to commence in the first half of 2005.

Our two Sherardizing facilities were consolidated into Wolverhampton, UK and is now fully functional. This will improve capacity utilisation, technical support and profitability. We have several opportunities under development with customers in other geographies of our network which could see us install our first Sherardizing process capabilities outside the UK. To enhance our market coverage we are installing for start up in the first half of 2005 the Distek process, a modification to Sherardizing, which allows a thicker yet ductile layer to be diffused onto the substrate. This process will offer customers an environmentally friendly alternative to galvanising.

We invested in expanded plasma spray capacity in France to satisfy contracts with suppliers to Airbus for plasma spray of titanium honeycomb parts and expect sales to start next year. We are planning to transfer this technology to our UK facilities in 2005.

ACQUISITIONS, STRATEGIC ALLIANCES AND DIVESTITURES

Several modest acquisitions were made during the year, at a cost of £4.7m, with the emphasis being to expand our Materials Testing operations. Two oil and gas laboratories were acquired in Canada with Hoogensen Metallurgical Engineering Limited and an environmental laboratory was added with Clyde Analytical Limited of Greenock, Scotland. After the year end, four UK environmental and occupational hygiene sites were acquired with Ensecon Laboratories Limited, expanding our health science operations. A controlling interest was also taken in a civil engineering test laboratory in Qatar.

Haustrup Haerderi A/S heat treating in Denmark strengthened our existing market position and enabled us to rationalise our facilities and provide access into the Northern German market.

Bird Electron Beam Corporation in Connecticut, USA adds expanded know-how to our North American Group in a technology that has proven to be of value to key customers in Europe.

In addition, a significant strategic event was the formation of the second largest global Physical Vapour Deposition (PVD) Group resulting from the sale of our 10 PVD operations to IonBond for £25.1m net of costs, with Bodycote taking an initial 15% equity position in the enlarged Group, which was increased to 20% in early 2005 at a total cost of £7.3m. This move is in line with our strategy of growing high value niche businesses whilst managing the risk.

The combined Group will trade under the IonBond name (capital 'B' in IonBond being the red centred Bodycote 'B' trademark) and has pro forma sales in 2004 of £53.2m and operates from 30 locations in 12 countries with more than 600 employees. A long-term cross selling agreement has been put in place under which Bodycote will continue to offer IonBond's PVD services to our extensive multinational client base and IonBond will market Bodycote's heat treatment, materials testing and hot isostatic pressing services. The strategic alliance establishes the technical skills and geographic scope to provide global blue-chip manufacturers with critical solutions. PVD is used in manufacturing to improve mechanical, tribological and decorative properties of components beyond those achievable by traditional methods and in an environmentally safe manner. Market and customer synergies between PVD and heat treating will be enhanced through the additional coverage offered by this focused strategic alliance, which has made an encouraging start.

The divestiture of electroplating has almost been completed with the major loss making facilities divested in the first half and the remainder sold in the second half. Sales and losses before goodwill amortisation and exceptional items were £19.4m and £3.0m respectively compared to £26.0m and £6.8m in 2003. A total £37.4m exceptional write down has been taken of which £7.4m has been charged in the 2004 accounts, the balance of £30.0m having been provided in 2003. During 2004 disposal proceeds net of costs were £1.9m. We have retained the 5 highly successful anodising and organic coating businesses located in Sweden, Finland and Germany and will continue to develop this small specialised coatings group. We believe anodising has significant growth potential due to the highly fragmented market and increased use of aluminium in manufacturing.

SAFETY, HEALTH AND ENVIRONMENTAL (SHE)

SHE has always been of major importance in our business and in 2004 we initiated an enhanced Group wide measurement and benchmarking system to help us better understand the reasons and root cause of accidents occurring within the Group, improve awareness among the employees, change behaviour and drive our accident rate towards our ultimate goal: zero. The unfortunate loss of life by two of our key team members at the Hereford HIP operation underlines the necessity of constant vigilance on the part of all of us. Just as in every other area of our business, we work on continuously improving our understanding and consistent application of safety procedures throughout the Group. We are funding a research project with the University of Southern California to advance safety procedures.

CURRENT TRADING AND PROSPECTS

The New Year has started as expected. With IGT markets having recovered strongly in 2004 we anticipate this sector will show more modest growth in 2005. Aerospace showed a slight increase in 2004 and we anticipate the pace of growth will remain steady throughout 2005. Automotive, which has been forecast to turn down for some time, saw a slowdown in North America, in particular in the second half of 2004, and we anticipate demand in 2005 will remain soft for that market. The Tooling market has continued to decline due to manufacturing of tools and dies being transferred to areas of lower cost where Bodycote does not currently have a significant presence.

People are our number one resource. We will continue to focus our management efforts on improving the productivity and effectiveness of our human resources. Energy, our number two cost, is anticipated to remain relatively high but we expect to continue to pass most of these costs on to our customers.

Overall we expect to continue our performance recovery through our continuous self help programmes, improving market demand and disciplined investments in capital and value enhancing acquisitions.

John D. Hubbard

John D. Hubbard
1 March 2005

Finance Director's Report

SALES AND OPERATING PROFIT

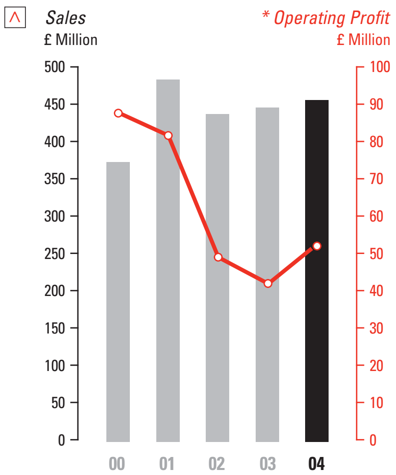
The Group recorded sales of £457.2m, compared to £448.4m in 2003. Trading conditions improved in most of the Group's markets and although the headline turnover increased by only 2%, the improvement was 6.3%, at constant exchange rates. Excluding the discontinuing electroplating and transferred PVD businesses, local currency sales were ahead 8.6%. Existing operations accounted for £455.4m, whilst acquisitions added £1.8m.

Following an approach from SSCP Coating S.à.r.l, Bodycote transferred its PVD business and assets to IonBond, realising £25.1m net of costs. An exceptional charge in 2004 of £3.8m, including the transaction costs, was required in connection with the transaction. As part of the agreement, the Group has also reinvested £5.2m for a 15% stake in the combined business and a further 5% was acquired in early 2005 at a cost of £2.1m.

	Sales		Operating Profit*		Margin	
	2004	2003	**2004**	2003	**2004**	2003
	£m	£m	**£m**	£m	**%**	%
Heat Treatment	**309.0**	302.5	**34.2**	31.5	**11.1**	10.4
Materials Testing	**65.6**	61.2	**12.4**	11.4	**18.9**	18.6
Hot Isostatic Pressing	**32.1**	27.6	**7.0**	3.6	**21.8**	13.0
Surface Engineering	**19.4**	18.4	**3.3**	2.3	**17.0**	12.5
Electroplating (discontinuing)	**19.4**	26.0	**(3.0)**	(6.8)	**(15.5)**	(26.2)
Head Office	**–**	–	**(2.7)**	(1.6)		
Continuing operations	**445.5**	435.7	**51.2**	40.4	**11.5**	9.3
PVD (discontinued)	**11.7**	12.7	**0.9**	1.3	**7.7**	10.2
	457.2	448.4	**52.1**	41.7	**11.4**	9.3

* before amortisation of goodwill of £8.5m (2003: £9.1m) and exceptional items of £11.2m (2003: £34.0m)

As the year progressed, demand for the Group's services increased, following more than two years of difficult conditions. The improvement has been gradual and although less difficult than in recent years, the pricing environment remained challenging. Labour rates have been contained at a rate below inflation and the impact has been mitigated by improved productivity. Energy costs have been stable in continental Europe, but have increased during the autumn in the US and the UK by up to 20%. A majority of the additional cost has been recovered in selling prices. The benefits of our restructuring plans are being seen across the Group, but particularly with the exit from the electroplating businesses, which is essentially complete. Operating losses* in electroplating of £6.8m in 2003 were reduced to £3.0m in 2004, of which only £0.3m was incurred in the second half. £7.4m was charged as an exceptional item in respect of closure and divestment costs bringing the total to £37.4m in 2003 and 2004. Overall Group operating profit* increased from £41.7m to £52.1m.



Heat Treatment

The UK heat treatment business saw sales increase 9.7% with operating profits up 18.4%, as demand improved in both the power generation and construction sectors. The Nordic region produced a significant improvement, with local currency organic sales up 8.5% and the Haustrups acquisition adding a further 5.3%. New outsourced work has been gained in automotive and general engineering and, with improved cost control and the benefit of the new plant in Denmark, operating profit was ahead by 81.9%.
The Central European Group delivered another excellent set of results as outsourcing gains, particularly in automotive, more than made up for any underlying macro economic weakness. Sales and operating profit (at constant exchange rates) advanced 8.1% and 17.2% respectively.
The France/Belgium/Italy business unit suffered the weakest level of demand in the Group with the twelve-month moving average of sales only beginning to pick up in quarter four. Consequently sales were ahead marginally and operating profits (expressed in local currency) were flat year on year.
North America saw sales improve by 7.0%, as demand across most sectors and regions moved up. However, pricing pressure remains stronger than in Europe due to continuing over capacity in the market place and, coupled with higher energy costs, margin improvement was modest.

Materials Testing

The Materials Testing business continues to meet our growth expectations and, at constant exchange rates, sales increased by 11.2% and net margins were maintained at 19.0%. Sales were ahead in all regions and with the exception of a flat performance in the Middle East so was operating profit. In the UK, our well established metallurgical laboratories saw a relatively weak performance against a background of soft general engineering demand. However, this was more than offset by strong IGT demand for radiography and growth in health sciences. The European laboratories again performed strongly as a result of increased activity in oil and gas exploration. The business moved ahead in the Middle East following the acquisition in 2003 of the laboratories from Carillion plc and the continuing strength in both the construction and oil and gas sectors and consequently sales were up 44.9%.

Canada made a major step forward based on notable outsourcing contracts in aerospace and automotive engines testing. The USA also had a good performance helped by a much stronger level of activity in oil and gas and some improvement in aerospace demand.

Hot Isostatic Pressing

Overall, HIP sales in local currency were up 23.9% and profits a pleasing 113.4% higher. Consequently margins improved to 22.5%. The UK and particularly the US saw a notable increase in demand from precision casting customers who serve the IGT market. The USA had its best ever HIP sales. The European plants were more mixed as IGT constitutes a small part of their business which is more focused on powder consolidation and production of near net shapes but all showed improvement compared to 2003. Densal® sales continue to increase, particularly for automotive and it is likely that additional capacity will be needed in 2005.

Surface Engineering

Following the decision to exit the electroplating business, the Group is now focused on nurturing a portfolio of niche coatings businesses which offer proprietary technology or specialist know-how and which complement our core heat treatment business. Sales in local currencies increased by 7.5% and operating profit by 49.6% driven by the specialist anodising plants in Sweden, which offer services principally to automotive and telecoms customers. We also continued to expand the use of K-Tech® ceramic coatings and established the first production location for CoatAlloy® metallic coatings.

PVD

In the ten months prior to transferring the PVD business into IonBond sales were up 13.8% at constant exchange rates, as demand from automotive customers for tribological coatings continued to increase. However, profits were flat due to increased marketing and development costs. Since the transfer, given the Group's significant influence on IonBond, profits will be included in the Group's results on an equity accounting basis. With a 15% shareholding, the Group's share of operating profits in November and December were immaterial.

Electroplating

The major loss making facilities were sold or closed in the first half of 2004, which enabled us to operate at close to breakeven (loss £0.3m) in the second half. We expect the divestiture programme to be completed in early 2005.

PROFIT BEFORE TAX, GOODWILL AMORTISATION AND EXCEPTIONAL ITEMS

Profit before tax, goodwill amortisation and exceptional items was £44.2m compared to £32.0m last year. In 2004, the Group recorded exceptional charges of £11.2m relating to the costs of the disposal of the electroplating business (£7.4m) and the merger of PVD assets with IonBond (£3.8m). Operating profit before goodwill amortisation and exceptional items increased from 2003 to 2004 by £10.4m. Foreign exchange movements during the year resulted in a net reduction to operating profit of £2.5m. The effect of applying current exchange rates to the 2004 results would be an adverse impact on operating profit of approximately £0.2m, although this would be entirely offset by interest savings on dollar borrowings. The Group's interest charge was reduced from £9.7m to £7.9m reflecting lower borrowings and the benefit of a weaker US dollar. Goodwill amortisation reduced by £0.6m to £8.5m as a result of the electroplating and PVD disposals.

TAXATION

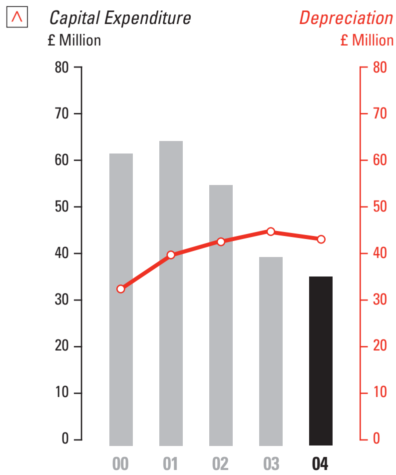
The effective tax rate in 2004, before the amortisation of goodwill (which is not generally allowable for tax) was 17% (2003: 69%). The figure is distorted by the exceptional charges related to the disposal of wet coatings and the merger of the PVD business with IonBond. Before exceptional charges and goodwill amortisation, the effective tax rate is 21.4% (2003: 22.3%), reflecting the mix of taxable profits and losses and the jurisdictions in which the Group operates.

EARNINGS PER SHARE

Headline earnings per share were 11.3p (2003: 9.1p as restated), with basic diluted earnings per share being 6.1p (2003: loss per share 6.3p restated). The Board is recommending a final dividend of 3.85p (2003: 3.6p after adjusting for the Rights Issue) per share. The dividend is covered 1.9 (2003: 1.6) times by headline earnings. Interest was covered 6.6 (2003: 4.3) times by operating profit before goodwill and exceptional items.

CAPITAL EXPENDITURE

Net capital expenditure for the year was £34.0m compared to £38.3m in 2003. The multiple of depreciation (net capital expenditure divided by depreciation) has remained at 0.8 times as the Group continues to maximise the benefit from previous investments. Major projects undertaken during the year included an additional fully automated sealed quench furnace line in Vasteras, Sweden, re-location and expansion of our Materials Testing laboratories in Houston, USA (to be completed in 2005), completion of a new facility specialising in low pressure carburising in Livonia, USA and the start-up of an installation of a Kolsterising line in London, USA.



CASH FLOW AND BORROWINGS

After allowing for capital expenditure, interest and tax the Group generated free cash flow of £57.1m compared to £30.3m in 2003 and cash flow from operations increased to £104.3m from £83.9m in 2003. There has been continued focus on cash collection, which has seen debtor days maintained at 65. Acquisitions, along with the investment in IonBond, resulted in net cash payments of £9.9m. In March 2004 the Group successfully completed a 1 for 4 Rights Issue which raised £62.0m net of expenses. Net borrowings ended the year at £88.5m, a reduction in the year of £121.8m; gearing was reduced from 56.7% to 20.3%.

Finance Director's Report

TREASURY

Treasury is managed centrally covering borrowings and its components. The objective is to minimise risk through a balanced approach. Funds are obtained via privately placed bonds and from banks. The Group aims to have a range of maturities, both committed and uncommitted, currently ranging from 364 day facilities to the five years remaining on the private placement senior notes. The Group also aims to have a mix of fixed and floating rate debt to achieve the desired profile and to manage interest rate volatility. During 2004 the balance has been weighted towards floating allowing the Group to benefit from continued low rates. Funding of overseas activities is generally via local currency borrowings so as to provide a partial hedge against the impact of exchange rate volatility on asset values as translated into Sterling on consolidation.

PENSIONS

The Group has elected to adopt the transitional provisions of FRS 17 (Retirement Benefits) and consequently there is no impact on the 2004 figures. If FRS 17 had been fully adopted in 2004, the Group would have recorded an additional liability, net of deferred tax, in its balance sheet of £15.4m (2003: £10.0m) relating to defined benefit schemes in the UK, France and USA of which the UK plan accounted for £14.5m (2003: £8.7m).

The US plans were inherited with the acquisition of Lindberg. Three of these plans have been closed and no further benefits are accruing. A further two remain open under the terms of union agreement. The actuaries to the UK scheme have advised that contributions to that plan be increased by £0.4m in 2005.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

Following the EU's adoption of Regulation No. 1606/2002 on the use of International Financial Reporting Standards (IFRS) by EU-listed companies, the Group is implementing IFRS from 1 January 2005.

The first financial information to be reported by the Group in accordance with IFRS will be for the six months ending 30 June 2005 but the requirement to present comparative information means that a balance sheet as at 31 December 2003 and primary statements for 2004 prepared in accordance with IFRS will also be required. The Group has continued to report its consolidated accounts in accordance with UK GAAP for 2004.

The Group plans to provide a separate reconciliation of the UK GAAP 2004 results and the balance sheet at 31 December 2003 to IFRS during the second quarter of 2005. At that time a full explanation of the known impacts of IFRS will be given as well as details of the accounting policies that are expected to be adopted under IFRS as from 1 January 2005.

This analysis of the impact of IFRS is being prepared by the Directors using their best knowledge of the expected standards and interpretations expected to be effective, and the accounting policies expected to be adopted, when the Directors prepare the company's first complete set of IFRS financial statements as at 31 December 2005. Therefore, as these interpretations develop, there is a possibility that the analysis may evolve further before constituting the final IFRS balance sheet as at 31 December 2005 when the Company prepares its first complete set of IFRS financial statements.

Our work to date has identified that the following areas will impact the Group's accounts:

Retirement Benefits

Under UK GAAP, the Group currently accounts for defined benefit pension schemes in accordance with SSAP 24 Accounting for Pension Costs (SSAP 24). The Group also reports the transitional disclosures required in accordance with FRS 17 Retirement Benefits (FRS 17), including the adjustment from the figures reported under SSAP 24 which would be required if FRS 17 was adopted in the financial statements.

The methodology and assumptions used to calculate the value of pension assets and liabilities under FRS 17 are substantially consistent with the requirements of IAS 19 Employee Benefits (IAS 19).

Proposed Dividends

Under SSAP 17 Post Balance Sheet Events, proposed dividends are accrued for as an adjusting post balance sheet event in the accounting period to which they relate. Under IAS 10 Events after the Balance Sheet Date, dividends are recognised in the accounting period in which they are declared. Accordingly, the Group will reverse the accrual for its final dividend and report it in the consolidated IFRS accounts for the following period.

Intangible Assets - goodwill

Under UK GAAP, the Group's policy is to capitalise goodwill in respect of businesses acquired and amortise it on a straight line basis over its estimated useful economic life, which has been assessed as 20 years for all acquisitions to date.

On transition to IFRS, IFRS 1 requires the Group to review the carrying value of capitalised goodwill at 31 December 2003 for potential impairments.

In accordance with IFRS 3 Business Combinations, no amortisation of goodwill will be charged in the Group's consolidated IFRS accounts from 1 January 2004. Instead, annual reviews of the goodwill will be performed to test for potential impairments.

Share-based Payments

Under UK GAAP, the cost of share options is based on the intrinsic value in the option at the date of grant, meaning that options granted to employees at market price or allowable discount do not generate an expense. Under IFRS 2 Share-based Payments, the Group is required to measure the cost of all share options granted since November 2002 using fair value models. As a result, additional expense will be recognised in the IFRS profit and loss account in respect of options issued in September 2003.

Deferred Tax

Under IAS 12 Income Taxes, deferred tax liabilities may not be discounted to present value, whereas FRS19 allows this. The Group currently uses the discounting method and accordingly the Group will restate its deferred tax liability under IFRS.

David Landless
1 March 2005

Directors' Report

The Directors are pleased to submit their report and the audited financial statements for the year ended 31 December 2004.

PRINCIPAL ACTIVITIES

The Company is a holding company with subsidiaries carrying on business in the fields of materials technology and metal processing. The activities and locations of the principal subsidiary undertakings are set out on pages 48 to 50. The Chief Executive's Review contains a survey of the Group's activities during the year together with an outline of future developments.

TRADING RESULTS

The profit of the Group before taxation was £24.5m (2003: £11.1m loss), after exceptional charges of £11.2m (2003: £34.0m). Profit attributable to shareholders amounted to £18.7m (2003: £17.4m loss) and, after providing for dividends of £19.6m (2003: £15.6m) the sum of £0.9m (2003: £33.0m) has been set off against reserves.

DIVIDENDS

The Board is recommending a final dividend of 3.85p per share making a total for the year of 6.1p per share (2003: 5.7p as adjusted). The final dividend, if approved, will be paid on 6 July 2005 to shareholders on the register at the close of business on 10 June 2005. The 2003 dividend has been adjusted to take into account the bonus element of the 1 for 4 rights issue completed on 31 March 2004.

SHARE CAPITAL

The Company's issued share capital as at 31 December 2004 was £32.1m and during the year was increased by the issue of

(a) 64,157,581 shares of 10p each issued for a total consideration of £64.2m pursuant to the 1 for 4 rights issue completed on 31 March 2004, and

(b) 180,859 shares of 10p each between 8 November and 2 December 2004 for a total consideration of £179,654 pursuant to options granted under the Company's executive share option schemes.

The shareholders have authorised the Company to purchase up to 32,078,790 of its own shares, although no purchases have been made. This authority expires at the conclusion of the forthcoming Annual General Meeting to be held on 25 May 2005, at which time a further authority will be sought from shareholders.

ACQUISITIONS and DISPOSALS

During 2004 the Group made four acquisitions at a net cost of £4.7m:

On 31 May 2004 Bodycote Värmebehandling A/S acquired the entire issued share capital of Haustrups Haerderiet A/S based at Ejby in Denmark. This acquisition enabled Bodycote to strengthen and broaden its provision of heat treatment services in Western Denmark and Northern Germany.

On 1 August 2004 Bodycote Materials Testing Canada, Inc acquired the entire issued share capital of Hoogensen Metallurgical Engineering Limited. Hoogensen provides engineering, metallurgical and chemical testing and consulting services to the oil and gas sector in Calgary and Edmonton, Alberta.

On 1 December 2004 Bodycote Thermal Processing Inc. acquired the entire issued share capital of Bird Electron Beam Corporation of Suffield Connecticut. Bird operates a NADCAP approved electron beam welding facility for aerospace, medical and industrial gas turbine customers in the Eastern United States.

On 2 December 2004 Bodycote Materials Testing Group Limited purchased the entire issued share capital of Clyde Analytical Limited of Greenock, Scotland. Clyde offers environmental testing services to industry.

The Group also made the following disposals:

On March 9, 2004 the Group announced a programme to dispose of its wet coatings businesses. As a result the Group disposed of or closed its wet coatings facilities at Anderstorp, Solna, Gothenburg, Linkoping (Sweden), Vaasa and Alajarvi (Finland), St Dizier, Auterive, Pau, (France), and Rochdale, Darlington, Poole, and Liverpool in the United Kingdom.

As from 1 November 2004 the Group disposed of its physical vapour deposition facilities in the United Kingdom, Netherlands, France, Italy, Mexico and the United States to SSCP Coating S.à.r.l., the private equity owners of IonBond S.à.r.l. of Luxembourg. At the same time Bodycote International plc secured a 15% shareholding in SSCP Coating S.à.r.l.

Note 23 on page 39 provides the necessary financial disclosures.

DIRECTORS

The current Directors are listed on page 18 and all served throughout the year. Messrs J.D. Hubbard and J. Vogelsang are retiring by rotation and, in accordance with the articles of association and each being eligible, offer themselves for re-election at the forthcoming Annual General Meeting. The service agreements for Mr Hubbard are terminable by one year's notice. Mr Vogelsang does not have a service contract with the Company and his appointment is terminable by six months' notice.

DIRECTORS' INTERESTS

The interests of the Directors in the shares of the Company at 31 December 2004 and 31 December 2003 are set out below:

Beneficial	**2004**	2003
J.A.S. Wallace	**57,287**	45,830
J.D. Hubbard	**949,103**	900,000
D.R. Sleight	**87,500**	70,000
R.T. Scholes	**18,750**	15,000
D.F. Landless	**6,875**	5,500
J. Vogelsang	**–**	–
L.P. Bermejo	**–**	–

Each Executive Director was also technically interested as a potential beneficiary, pursuant to the terms of the Bodycote International Employee Benefit Trust, in 421,823 shares (2003: 400,000) held as trustee by Hill Samuel Offshore Trust Company Limited. No Director has had any dealings in any shares or options in the Company since 31 December 2004. An analysis of Directors' share options is given in the Board Report on Remuneration on page 16. None of the Directors had a material interest in any contract of significance in relation to the Company and its subsidiaries at any time during the financial year.

Directors' Report

CORPORATE GOVERNANCE

The Group's mission is:

- *To provide world class companies with metallurgical and testing services that make a positive contribution to the success of their businesses.*
- *To earn sustainable profits which attract shareholder interest.*
- *To engage, develop and retain competent people, harness their enthusiasm and inspire them to excel.*
- *To act as a good corporate citizen.*

The Group's aim in terms of corporate governance is, therefore, to sustain and support these objectives over the longer term.

Compliance with 2003 FRC Combined Code

The Bodycote Board has overseen substantial changes in its board and committee membership in the last four years. All these changes are appropriate to the Company, in accordance with the principles of good corporate governance, and comply with the provisions of The Combined Code on Corporate Governance published by the UK Financial Reporting Council in July 2003 ('the 2003 Code'), save in three areas where the reasons for the variance are:

(i) Performance evaluation (code provision A.6)

The Board believes a rolling programme of assessments is the most practical and effective method of evaluating Bodycote's control structures. Informal evaluation of Bodycote's actions, control structures and personnel also takes place regularly as part of a continuous momentum for improvement. During 2004 all Executive Directors, the Board, the Audit, Remuneration and Nomination Committees and Messrs Vogelsang and Bermejo all underwent formal internal assessment with the assistance, in the case of the Audit Committee, of the auditors. In 2005 there will be an evaluation of the Board and the Audit Committee as well as the annual appraisal of the Executive Directors. Bodycote aims to carry out and report on assessments of all relevant personnel, committees and the Board itself within a three-year cycle notwithstanding that the 2003 Code lays down a greater frequency.

(ii) Investor Relations (code provision D.1.1)

Bodycote believes that generally it is the responsibility of the Chief Executive and the Finance Director to manage relationships with institutional investors. The Chairman is available to meet and has met institutional investors to discuss overall strategy, governance and any concerns that shareholders may have. Only where these more usual channels of communication have failed would the Company expect the Senior Independent or other Non-Executive Directors to become involved notwithstanding that the 2003 Code specifies attendance of the Senior Independent Non-Executive Director at meetings with major shareholders. Regular feedback by the Company's advisers on investor meetings and results presentations are circulated to all Directors. Non-Executive Directors are also encouraged to attend one of the results presentations each year. On specific issues the Chairman will seek the views of Bodycote's leading investors.

(iii) Committee Membership (code provision B.2.1/C.3.1)

On 22 November 2004 following a recommendation of the Nomination Committee the company announced changes in the membership of the Audit and Remuneration Committees. Until that date the position of the Company Chairman on those committees was at variance with the 2003 Code.

Apart from these distinct areas, Bodycote was in compliance with the provisions of the 2003 Code throughout 2004.

Operation of the 2003 Code

Taken together with the Audit Committee Report and the Board Report on Remuneration presented on pages 13 to 17, this statement explains how Bodycote has applied the principles of good corporate governance set out in the 2003 Code.

Leadership

The Board of Directors comprises seven members, of whom three are independent Non-Executive Directors and three are Executive Directors led by the Company's part-time Non-Executive Chairman, Mr J.A.S. Wallace, who also chairs the Nomination Committee. The Chief Executive is Mr J.D. Hubbard and the Senior Independent Non-Executive Director is Mr R.T. Scholes, who also chairs the Audit Committee. The Remuneration Committee is chaired by Mr J. Vogelsang. Brief biographical details of all Directors are given on page 18. The Board meets at least nine times a year and visits are made to UK and overseas facilities. Certain defined issues are reserved for the Board to decide, inter alia:

- *Approval of financial statements & circulars*
- *Capital projects, acquisitions and disposals*
- *Annual budgets*
- *Strategy*
- *Directors' appointments, service agreements & remuneration*
- *Policies for financial statements, treasury, safety, health and environment, donations*
- *Committees' terms of reference*
- *Board and committee membership*
- *Investments*
- *Equity & bank financing*
- *Internal control & risk management*
- *Corporate governance*
- *Key external & internal appointments*
- *Pensions & employee incentives*

In advance of board meetings Directors are supplied with up-to-date information about the trading performance of each operating location, the Group's overall financial position and its achievement against prior year budgets and forecasts. They are also supplied with the latest available information on safety, health and risk management issues. Where required, a Director may seek independent professional advice at the expense of the Company, all Directors have access to the Company Secretary and they may also address specific issues to the Senior Independent Non-Executive Director.

In accordance with the articles of association all newly appointed Directors and any who have not stood for re-election at the two previous Annual General Meetings, if eligible, must submit themselves for re-election. Non-Executive Directors, including the Chairman, are appointed for fixed terms not exceeding three years, after which the appointment may be extended by mutual agreement. A statement of the Directors' responsibilities is set out on page 19. The Board also operates three committees. These are the Nomination Committee, the Remuneration Committee and the Audit Committee.

Independence of Non-Executive Directors
The Board considers that Messrs R.T. Scholes, J. Vogelsang and L.P. Bermejo are all independent for the purposes of the 2003 Code.

Commitment
Save for one meeting absence recorded by Mr L.P. Bermejo all Directors recorded 100% attendance at the ten Board meetings held in the year, including visits to facilities in The Czech Republic and the UK. 100% attendance was recorded for all meetings of the Audit, Remuneration and Nomination Committees.

Performance Evaluation
Performance evaluation of the Chairman and the Senior Independent Non-Executive Director was carried out internally during 2003. All Executive Directors were appraised internally during 2004 and a performance evaluation of the Chief Executive took place in February 2005. In February 2004 the Board carried out its own evaluation of the Board as a whole. The Remuneration and Nomination Committees reviewed their own performance in November 2004. The Audit Committee assessed its own performance in December 2004 with input from the external auditors, the Chief Executive and the Finance Director. The Chairman assessed the performance of Messrs J. Vogelsang and L.P. Bermejo in December 2004.

Nomination Committee
Mr J.A.S. Wallace chairs the Nomination Committee which also comprises Messrs R.T. Scholes, J. Vogelsang, L.P. Bermejo and J.D.Hubbard. All members attended both 2004 committee meetings, when it determined the policy on external appointments, proposed the nominations for re-election at the 2004 and 2005 Annual General Meetings, agreed the reappointment of the Chairman, discussed general succession planning and carried out a self-assessment.

Proposals for Re-election
Following the performance evaluation carried out by the Chairman in December 2004 in respect of Mr Vogelsang's service as Independent Non-Executive Director, the Board proposes his re-election as Director. His performance was determined to be effective and he has devoted the necessary time and commitment (achieving 100% Board and Committee meeting attendance since appointment in 2003). Following a performance appraisal by the Chairman in February 2005, the Board also proposes the re-election of Mr J.D. Hubbard as a Director.

Internal Control
The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss. The Board has applied Principle C.2 of the 2003 Code by establishing a continuous process for identifying, evaluating and managing the Group's significant risks, including risks arising out of Bodycote's corporate and social engagement.

The Board continuously and regularly reviews the process, which has been in place from the start of 2000 to the date of approval of this report and which is in accordance with Internal Control: Guidance for Directors on the Combined Code published in September 1999.

The Board's monitoring covers all controls, including financial, operational and compliance controls and risk management. It is based principally on reviewing reports from management and from internal audit to consider whether any significant weaknesses are promptly remedied and indicate a need for more extensive monitoring. The Audit Committee assists the Board in discharging these review responsibilities. During 2004, in compliance with provision C.2.1, the Board also performed a specific assessment for the purpose of this annual report.

The assessment considered all significant aspects of internal control arising during the period covered by the report including the work of Internal Audit. In addition, the Managing Director of each of the Group's Strategic Business Units reported on the existing internal control procedure and any failings or weaknesses. They identified and made an assessment of the risks affecting the businesses they control, in each case with the assistance of input from those reporting directly to them. Such risks were measured against their own stated objectives. Following the risk management review by each participant at Strategic Business Unit level, a Group level review was prepared for the Directors to assess. No significant previously unidentified risks were uncovered as part of this process.

Prospects
The Board's view on the Group's position and prospects is given by the Chairman, Chief Executive and Finance Director in their respective statements on pages 2 to 8 of this report. Following a review of the Group's results for 2004 and its budgets for 2005, the Directors consider that the Company and the Group have adequate resources to finance their activities for the foreseeable future, and therefore it is appropriate to adopt the going concern basis in preparing the financial statements.

Investor relations
The Chief Executive and Finance Director regularly talk with and meet institutional investors, both individually and collectively, and this has enabled institutional investors to increase their understanding of the Group's strategy. The business of the Annual General Meeting now comprises a review of the Group's operations for the benefit of shareholders attending. In addition, since 1998, internet users have been able to view up-to-date news on the Group and its share price via the Bodycote website at www.bodycote.com. Users of the website can also enrol free for a service that automatically notifies them of results announcements and recent significant Group events.

Significant enhancements for the benefit of shareholders took place during 2004. Bodycote's financial advisers, corporate brokers and financial public relations consultants provide Directors with opinion surveys from analysts and investing institutions following visits and meetings with the Chief Executive and Finance Director. Non-Executive Directors are themselves invited to attend analysts' presentations at the time of the regular results announcements. As stated on page 10 the Chairman and Senior Independent Non-Executive Director are available to discuss any issues not resolved by the Chief Executive and Finance Director. On specific issues, as with the introduction in 2003 of the share option scheme and in 2005 with the proposed stock bonus plan, the Company will seek the views of leading investors.

Directors' Report

CORPORATE SOCIAL RESPONSIBILITY

As part of the general programme of risk management and review of internal controls, Bodycote regularly keeps under review the risks associated with its corporate and social engagement. Bodycote has already developed appropriate policies and procedures for each Strategic Business Unit. In areas where Bodycote does not perceive either shareholder value and or business risk, the aim is to develop and implement appropriate policies over time. The areas of significance are safety, health and the environment and the Group's employees.

SAFETY, HEALTH AND THE ENVIRONMENT

The Group has a positive approach to safety, health and environmental matters and is committed to the achievement of the highest practicable standards of safety and health at work for all employees and to the minimisation of adverse effects on the environment. Appropriate safety and health policies and procedures are in force at all strategic business units, each of which has a dedicated safety and health team tasked to reduce accidents at work. During 2003 the Group began collating further data in order better to benchmark performance in subsequent years. From 1 January 2004 the Group commenced reporting its performance in terms of lost time, frequency and severity of accidents in a uniform manner. As a result each Strategic Business Unit is now able to benchmark its health and safety performance and formulate criteria for improvements. The Group's target of a 10% reduction in lost time accidents, frequency and severity, compared to 2003, was met in 2004 and a further 10% reduction has been targeted for 2005. Bonus payments to Directors and senior executives are in part dependent on achievement of these targets. Notwithstanding these very positive steps two employees died in an accident at the Group's Hereford HIP facility in June 2004. The cause is still under investigation by the UK Health & Safety Executive.

Where appropriate the Group will develop and implement environmental management systems consistent with international standards. In 2001 the Group began an assessment of the steps required to improve its environmental performance and started seeking environmental accreditation. In 2004 all Strategic Business Units were mandated to obtain ISO14001 or equivalent accreditation by the end of 2006 for all appropriate sites. By the end of 2004 one site in North America, four sites in Sweden, three sites in Central Europe and a further sixteen sites in the UK had been accredited to ISO14001. Two UK sites are in the course of seeking approval. All 53 of the Group's materials testing sites, which have a low environmental profile, operate to the ISO17025 standard which incorporates environmental management requirements.

EMPLOYMENT

The Group recognises the value that can be added to its future profitability and strength by the efforts of employees. The involvement of employees at all levels is key to the Group's continued success. Through their attendance at, or participation in, production, safety and health meetings at site level, employees are kept up to date with the performance and progress of the Group, the contribution to the Group made by their site and are advised of safety and health issues.

During 2004 the Group published, via the Group extranet, two ten-language editions of 'EveryBody Extra' an electronic magazine for all staff detailing the Group's activities, performance and some of its personalities. Approximately 1,320 Bodycote employees are connected to the Bodycote extranet, which will improve knowledge of Group activities, and assist greatly with technology exchange and co-ordination. The latest edition of 'EveryBody Extra' featured the Group's open door policy under which employee concerns can be voiced on a confidential basis.

It is the Group's policy to give full and fair consideration to applications for employment from disabled persons, having regard to their particular aptitudes and abilities, and to encourage the training and career development of all personnel employed by the Group, including disabled persons. Should an employee become disabled the Group, where practicable, will seek to continue the employment and arrange appropriate training. An equal opportunities policy is in operation in the Group.

RESEARCH AND DEVELOPMENT

Product development and quality improvement at all Group companies is a continuous process. The Group has a policy of deploying the best technology available and actively seeking improvements. It also conducts research programmes with its customers. Costs of research and development are written off in the year in which they are incurred.

DONATIONS

Charitable donations during the year net of income tax amounted to £12,000 (2003: £12,000). There were no political contributions.

CREDITORS POLICY

Group operating companies are responsible for agreeing the terms and conditions under which business transactions are conducted. It is Group policy that payments to suppliers are made in accordance with the terms agreed, provided that these suppliers have also complied with applicable terms and conditions. Creditor days at the year end for the Company were 45 days (2003: 45 days).

SHAREHOLDERS

An analysis of the Company's shareholders and the shares in issue at 20 February 2005 and details of major shareholders' interests appearing in the register maintained pursuant to Section 211 of the Companies Act 1985 are given on page 53.

AUDITORS

In accordance with the provisions of section 384 of the Companies Act 1985, a resolution for the reappointment of Deloitte & Touche LLP as auditors is to be proposed at the forthcoming Annual General Meeting.

ANNUAL GENERAL MEETING

The 2005 Annual General Meeting will be held on 25 May 2005 in accordance with the notice set out on pages 51 and 52.

By order of the Board

J.R. Grime
Secretary
1 March 2005

Hulley Road
Hurdsfield
Macclesfield
Cheshire
SK10 2SG

Report of the Audit Committee

Bodycote

The members of the Audit Committee during 2004 were Messrs R.T. Scholes (appointed 1998; Chairman from 2002), J.A.S. Wallace (Committee Chairman 1994 to 2001 and a member from 2002 until retirement from the committee in November 2004), J. Vogelsang (2003) and L.P. Bermejo (2003). Appointments to the Committee are made by the Board at the same time as appointment to the main Board of Bodycote. In the cases of Messrs Vogelsang and Bermejo, appointments were made following a recommendation of the Nomination Committee. All current members of the Committee are independent for the purposes of the 2003 Code.

Mr Scholes is considered to have recent and relevant financial experience having been an investment banker, and also as a chartered accountant. Greater detail on the qualifications and experience of all Directors is given on page 18 and their remuneration on pages 16 and 17. The Committee Chairman's additional responsibilities are reflected by fees of £5,000 per annum for that role.

The Committee met four times during 2004 and has the assistance of the Company Secretary, who serves as committee secretary.100% attendance at committee meetings was achieved by all committee members who served in the year. The Committee held meetings with both the external and internal auditors without management in attendance on 2 occasions. The Head of Internal Audit has a direct reporting line to the Chairman of the Audit Committee. Those attending meetings typically include the Finance Director and Head of Internal Audit.

In reporting financial results to shareholders, the Committee depends on the skill, objectivity and independence of the auditors. In the year ended 31 December 2004 the Committee obtained confirmation of the auditor's independence. It is the policy of the Company not to use the auditor for non-audit services, save for tax compliance, matters where the fee is unlikely to exceed £5,000, or with the prior approval of the Audit Committee. Details of amounts paid to the external auditors, and other firms of auditors, for audit and non-audit services in 2004 are analysed in note 2 on page 27.

The Committee's areas of activity during 2004 included.

- Assessment of independence of auditors
- Approval of auditor's re-appointment and fees
- Approval of scope of internal and external audits
- Approval of accounting policies and resources and plan for (and review of impact of) implementation in 2005 of International Financial Reporting Standards
- Approval of management representations and internal representations
- Review of financial statements and results announcements
- Recommendation on policy on use of auditors for non-audit work
- Review of management improvement letters and audit process
- Review of arrangements for reporting and investigation of employee concerns
- Review of internal audit findings & monitoring of effectiveness of internal audit
- Review of effectiveness of Board's internal controls and risk management process
- Assessment of internal and external audit effectiveness
- Assessment of Committee's own effectiveness
- Recommendation of new terms of reference for committee and internal audit function

Having reviewed and expressed satisfaction with the level of fees, objectivity, independence, expertise, resources and general effectiveness of Deloitte & Touche LLP, the Committee recommends (and the Board agrees to propose) their re-appointment as auditors of the Company in accordance with resolution 6 of the notice of meeting given on page 51.

Approved by the Board.

R.T. Scholes
Audit Committee Chairman
1 March 2005

Board Report on Remuneration

The members of the Remuneration Committee during 2004 were J. Vogelsang (Chairman from November 2004), J.A.S. Wallace (Chairman until November 2004 when he stepped down from the committee), R.T. Scholes, and L.P Bermejo. All current members are independent Non-Executive Directors of the Company and have no personal financial interest, other than as shareholders, in the matters to be decided, no potential conflicts of interest arising from cross directorships and no day to day involvement in running the business.

The Committee met five times during 2004. 100% attendance was recorded at meetings. The Committee operates under terms of reference approved by the Board. These terms, which are available to view on the Group website, were revised in November 2004 following an evaluation of the Committee's performance. This Board Report on Remuneration for the year ended 31 December 2004 and the recommendations of the Remuneration Committee have been approved in full by the Board for submission to shareholders. In accordance with the requirements of the Companies Act, an ordinary resolution seeking shareholders' approval for the report will be proposed at the Annual General Meeting. The tables attached to this report disclosing Directors' emoluments, pensions and share options on pages 16 and 17 have been audited, together with the performance criteria and share price information.

POLICY FOR EXECUTIVE DIRECTORS

The Committee makes recommendations to the Board concerning the policy on remuneration for senior executives and the remuneration package for each Executive Director. In determining the remuneration policy the Committee has given full consideration to the provisions on the design of remuneration policies contained in the 2003 Code and received input from the Chief Executive. New Bridge Street Consultants provided independent market information and remuneration advice during 2002 and 2003. In 2005, the Committee appointed Inbucon Consulting to give advice and prepare documentation for the operation of the group's new stock bonus plan. In addition, during 2004 the Company received actuarial and other pensions advice from JLT Benefit Consultants Limited (who were appointed by the Company in 1995) in relation to the pension scheme, of which currently two Executive Directors are members. None of these organisations provides any other services to, or has any other connection with, the Company.

The Committee aims to provide a remuneration policy consistent with the Group's overall objectives and thereby attract and retain high calibre senior executives, align executive rewards with the creation of shareholder value and motivate executives to achieve and maintain challenging levels of Company and individual performance.

The Committee has used the remuneration practices of UK engineering businesses and other FTSE 250 companies, as well as North American and European companies in similar trades, as comparables. In order to ensure that a substantial proportion of the overall remuneration package can be linked to performance, there are annual bonus schemes and an executive share option scheme. Only basic salaries are pensionable.

SALARY AND BENEFITS

The basic salary of each Executive Director and senior executive is reviewed annually and is determined by taking into account the responsibilities and performance of the individual, having regard to current market practice. Since 2002 the committee has decided to place more emphasis on the variable elements of Directors' and senior executives' pay although market and inflationary adjustments have been made to basic salaries after benchmarking.

This resulted in increases in basic salary for Directors both in 2004 and 2005. The basic salaries of the Executive Directors were increased on 1 January 2005 to the following amounts:

	£
Mr J.D. Hubbard	325,000
Mr D.F. Landless	215,000
Mr D.R. Sleight	161,000

Benefits in kind, which comprise the provision of a company car, private medical insurance for the Executive Director and family and long-term disability insurance, are consistent with industry standards. An analysis of Directors' emoluments is given on page 17.

ANNUAL BONUSES

A performance related annual cash bonus is payable to all Executive Directors and senior executives, based on the Group's earnings before interest and tax (EBIT), the Group's return on capital employed (ROCE) and other qualitative measurements, including health and safety. For those senior executives with Strategic Business Unit responsibilities, part of the performance-related bonus is based on their relevant sphere of responsibility. Targets for 2004 maximum bonus required increases in EBIT, ROCE, organic sales growth and quantitative improvements in health and safety. The bonuses paid to Executive Directors are shown on page 17.

In 2003 the Committee recommended an increase in the total potential bonus to 60% of basic salary if all targets are met and assuming that one-third of the bonus (i.e. up to 20% of salary) is paid in the form of shares in the Company. The shares will be held in trust for three years and will normally be forfeited if executives leave for another employer or are dismissed. Executives could request that their entire annual bonus is paid in cash, in which case the maximum bonus would be 50% of salary. This scheme applied to 2003 and 2004 only.

In 2005 the Committee, with the benefit of advice from Inbucon Consulting, decided to alter the annual bonus arrangements affecting Executive Directors and senior executives from and including 2005 so that: -

(1) Total maximum bonus would increase to 100% of basic salary comprising two elements:-

(a) A maximum cash bonus of 50% of basic salary earned by references to challenging increases in EBIT, ROCE, organic sales growth and quantitative improvements in health and safety.

(b) An additional bonus of up to 50% of basic salary, received as restricted shares in the Company, if the Group's total shareholder return (TSR) for the year is in the upper quartile of TSR achieved by companies within the FTSE 350 Engineering & Machinery Index and certain international comparator companies. The comparator group consists of 17 companies, including Bodycote. Median TSR performance would attract a stock bonus of 12.5% of basic salary. The Remuneration Committee reserves the right to take into account the underlying financial performance of the Company before stock bonuses can be paid.

(2) The stock bonus element will be serviced using shares bought in the market. The shares will be held by the trustees of the Company's employee share ownership trust for three years after which they would vest, but each participant would be expected to retain the stock awarded (save for amounts necessary to pay tax) until the total value of shares held equalled the executive's basic salary. At the end of the holding period, the awards will be enhanced by an amount reflecting dividends paid on the award shares over the three-year period.

The committee has recommended this plan because it encourages challenging performance, increases the variable element of pay and aligns executives' interests with those of shareholders. Performance will be measured over one year in order to maintain a balance between annual bonus arrangements and long-term incentives.

This further illustrates the increasing importance attached by the committee to the variable elements of remuneration and encouraging long-term shareholding by executives.

The committee also recommended payment of a special bonus of £35,000 to the Corporate Development Director to recognise his success in the disposal of the wet coatings businesses and the transfer of Bodycote's PVD interests to IonBond.

No bonuses were paid to Executive Directors in respect of 2002 and 2003 as targets were not met.

SHARE INCENTIVES

The Group believes that participation in share incentive schemes by Executive Directors and other executives of the Group strengthens the link between executives' personal interests and shareholders' interests. Bodycote's Board will encourage Directors and Executives to build up a reasonable shareholding in the Company over a period of time, but it will not be prescriptive since the Directors' ability to do so will depend on a number of factors, not least being their own personal commitments.

SHARE OPTION SCHEMES

The Remuneration Committee governs the granting of share incentives to Directors and senior executives. An analysis of all Directors' share options is given on page 16.

Following a review and advice in 2003 from New Bridge Street Consultants, shareholders approved the establishment of the 2003 Executive share option scheme to replace the 1994 and 1996 schemes, under which no further options will be granted. Under the 2003 Scheme, the value of shares over which options may be granted to an executive in any year may not normally exceed 1.5 times basic salary. The extent to which options may be exercised will depend on the Company's growth in pre-tax earnings per share (EPS) exceeding the growth in the retail price index (RPI) over the three or five year period following grant. (The committee have decided that for any options granted after September 2003 performance would be measured only over a single three-year period.) Options over shares worth up to 0.5 times basic salary may be exercised if the growth in EPS exceeds the growth in RPI by 3% per year, options over shares worth up to 1.5 times basic salary may be exercised if the growth in EPS exceeds the growth in RPI by 10% per year, with intermediate levels of vesting between these two points.

The Committee believes that the use of growth in pre-tax earnings per share is the most appropriate measure of the Company's financial performance, is transparent (because the performance test relies on publicly available data) and is consistent with market practice. The chairman of the Remuneration Committee will verify that the tests have been met.

Share options granted under the 1994 and 1996 share option schemes are only exercisable if, over any rolling period of three years from the date of the award, the growth in the Group's earnings per share exceeds United Kingdom retail inflation by 6% (10% in respect of those options granted in September 2002). Operation of the 1994 and 1996 schemes was extended by using the employee share ownership trust.

Directors made no gains on the exercise of share options during 2003 or 2004. The market price of Bodycote's ordinary shares at 31 December 2004 was 163.5p, the range during 2004 was 125.88p to 165.5p and the average was 144.68p. The performance conditions for options granted since 1998 have yet to be achieved. The performance conditions attached to the options granted before 1999 and still outstanding at 31 December 2004 have been achieved. No options have been granted since September 2003.

Following the implementation of International Financial Reporting Standards from 1 January 2005, the Committee will be reviewing its policy on long-term incentives generally.

SERVICE CONTRACTS

It is the Company's policy that Executive Directors have service contracts with a one-year notice period. All the Executive Directors have service agreements which are terminable by one year's notice by either party at any time, and by one year's remuneration in lieu of notice by the employer, and by one year's remuneration in the event of a change in control of the Company. Legally appropriate factors would be taken into account to mitigate any compensation payment, covering basic salary, annual and long term incentives and benefits, which may arise on the termination of employment of any Executive Director, other than payments made on a change in control or for payments in lieu of notice. Mr Hubbard's contracts are dated 5 February 2002 and those for Messrs Landless and Sleight are each dated 26 September 2001.

PENSIONS

Pensions for current UK domiciled Executive Directors are, as far as practicable, provided for under the Group's UK contributory final salary pension scheme which has a normal retirement age of 65 and is closed to new members.

The main features, in respect of Executive Directors, are:

(a) Pensions from age 65 of 1/60th highest average salary of any consecutive three years out of last ten years prior to retirement (restricted to the earnings cap where it applies) for each year of pensionable service, and with increases in pensionable salary after 31 December 2003 restricted to 4.5% per annum ('the Salary Limit');

(b) A cash death-in-service benefit of four times basic salary at date of death;

(c) Spouse or dependent's pension on member's death equal to half member's prospective retirement pension (restricted as before) at 65 or death in service, or half member's pension entitlement on death in retirement;

(d) Members' contributions are 6% (7% from April 2005) of basic salary.

(e) For Executive Directors with basic salaries above the Salary Limit or the earnings cap the Group will contribute 14% of the excess over the Salary Limit to a defined contribution arrangement.

Arrangements for Mr Hubbard are for a contribution to a defined benefit arrangement of 14% of his basic salary (including any payments being made by the Group into the Group's US 401k retirement plan) from January 2004 onwards.

An analysis of accrued pension entitlements for the two Directors with accruing benefits under the scheme during 2004 is given on page 17. Mr Hubbard, the Chief Executive, is a member of the Group's US 401K retirement plan to which the Group contributed £14,163 (2003: £3,660). Pension contributions for Mr Landless' salary above the earnings cap amounted to £22,606 (2003: £6,684).

Board Report on Remuneration

EXTERNAL APPOINTMENTS

The Company believes that there are benefits to the individual and the Company for Executive Directors to hold one appropriate non-executive directorship in other organisations, as long as it does not conflict with the Company's interests and that the individual may retain the fees earned in connection with such appointment.

NON-EXECUTIVE DIRECTORS

The remuneration of Non-Executive Directors is determined by the Chairman and the Executive Directors. Remuneration for the Chairman is determined by the whole Board (excluding the Chairman). Remuneration for the Chairman and Non-Executive Directors takes into account the time commitments and duties and responsibilities involved. The Chairman and each Non-Executive Director hold letters of appointment for terms of three years. Each is terminable under the Company's articles of association or the Companies Act 1985, by the director's resignation or otherwise on six months' notice (twelve months in the case of the Chairman) if termination occurs before expiry of the term. The Chairman and Non-Executive Directors are not entitled to any pension or other employment benefits or to participate in any incentive scheme. Payment in respect of Mr Vogelsang's service is made to a company owned by him.

TSR PERFORMANCE

The graph on page 17 illustrates the Company's Total Shareholder Return (TSR) performance since 1999 in accordance with paragraph 4 of the Directors' Remuneration Report Regulations 2002, relative to the FTSE Engineering & Machinery Index, of which the Company is a component part. Accordingly this sector is considered to be the most appropriate comparator group for this purpose.

Approved by the Board

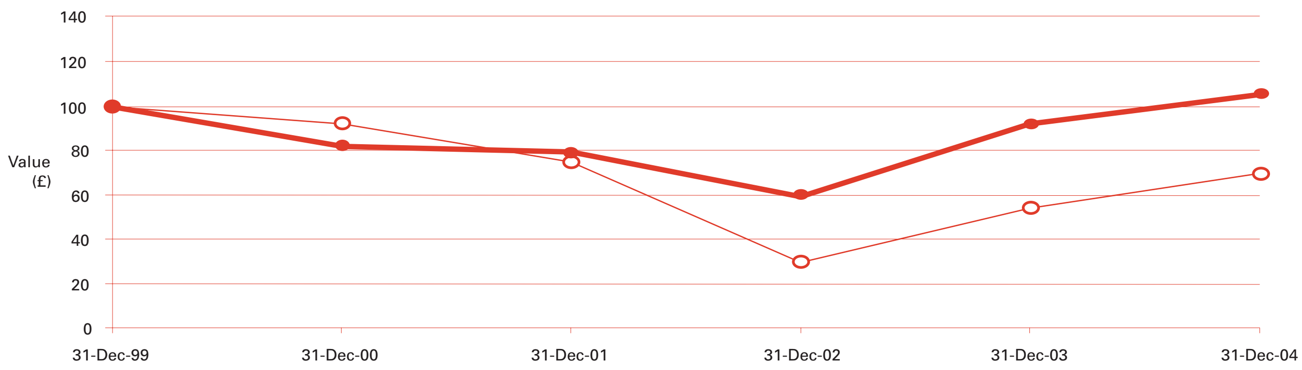
J. Vogelsang
Chairman of the Remuneration Committee
1 March 2005

Directors' share options

Director	1 January 2004	Option lapses	31 December 2004*	Option price* (pence)	Dates from which exercisable	Expiry (lapse) dates
J. D. Hubbard	41,307	–	44,178	315.43	03/12/2000	03/12/2007
	37,500	–	40,107	370.26	26/04/2002	26/04/2009
	25,000	–	26,738	292.19	14/12/2002	14/12/2002
	12,000	–	12,834	231.42	02/05/2003	02/05/2010
	15,000	–	16,042	203.37	24/04/2004	24/04/2011
	60,000	–	64,170	125.76	16/09/2005	16/09/2012
	79,365	–	84,882	147.26	15/09/2006	15/09/2013
D. R. Sleight	55,075	(58,903)	–	241.92	20/05/2000	(20/05/2004)
	37,500	–	40,106	370.26	26/04/2002	26/04/2002
	30,000	–	32,085	292.19	14/12/2002	14/12/2006
	15,000	–	16,042	231.42	02/05/2003	02/05/2007
	20,000	–	21,390	203.37	24/04/2004	24/04/2008
	40,000	–	42,780	125.76	16/09/2005	16/09/2009
	47,619	–	50,929	147.27	15/09/2006	15/09/2013
D. F. Landless	50,000	–	53,475	370.26	26/04/2002	26/04/2009
	50,000	–	53,476	292.19	14/12/2002	14/12/2006
	15,000	–	16,042	231.42	02/05/2003	02/05/2007
	20,000	–	21,390	203.47	24/04/2004	24/04/2008
	40,000	–	42,780	125.76	16/09/2005	16/09/2009
	53,968	–	57,719	147.27	15/09/2006	15/09/2013

* The number of option and the exercise cost per option has been adjusted to reflect the bonus element of the 1 for 4 rights issue completed in March 2004.

TSR Performance Graph



This graph looks at the value, by 31/12/04, of £100 invested in Bodycote International plc on 31/12/99 compared with that of £100 invested in the FTSE Engineering & Machinery Index. The other points plotted are the values at financial year-ends.

Source: Datastream

Directors' emoluments

	Salary and fees £000	Benefits £000	Annual Bonus* £000	**2004** Total £000	2003 Total £000
Executive					
J. D. Hubbard	300	18	150	**468**	265
D. F. Landless	200	14	100	**314**	184
D. R. Sleight	155	11	112	**278**	163
	655	43	362	**1,060**	612
Non-Executive					
J. A. S. Wallace	100	–	–	**100**	80
R. T. Scholes	33	–	–	**33**	28
J. Vogelsang	28	–	–	**28**	25
L. P. Bermejo	28	–	–	**28**	25
	844	43	362	**1,249**	770

* Executive Directors can elect to receive up to a fifth of their cash bonus in restricted stock in which case the Company would match the number of shares received (see page 14, under Annual Bonuses).

Directors' pensions

Director	Accrued annual pension at 01/01/04 £000	Transfer value at 1 January 01/01/04 £000	Real increase in accrued annual pension £000	Inflation £000	Increase in accrued annual pension £000	Transfer value of real increase in accrued annual pension (less members' contributions) £000	Real increase in transfer value less members' contributions £000	Members' contributions £000	Accrued annual pension at 31/12/04 £000	Transfer value at 31/12/04 £000
D.F. Landless	8	42	2	–	2	9	3	6	10	55
D.R. Sleight	48	403	3	1	4	29	20	9	52	515

Board of Directors

EXECUTIVE DIRECTORS

J. D. Hubbard Chief Executive (57) United States
Appointed Chief Executive in January 2002; joined the Board in 2001. Previously served as President of Bodycote's North American Heat Treatment operations from 1996 to 2001. A licensed professional Metallurgical Engineer.

D. F. Landless Finance Director (45)
Appointed Finance Director and joined the Group in 1999. From 1989 to 1997 served as Finance Director in UK and US divisions of Courtaulds Plc. Finance Director of Courtaulds Coatings (Holdings) Limited from 1997 to 1999. A Chartered Management Accountant.

D. R. Sleight Corporate Development Director (55)
Appointed Corporate Development Director in 2002 having joined the Board in 1996, and served previously as Finance Director (1990 to 1995) and Joint Managing Director (1995 to 2001) of Bodycote's Materials Testing operations. A Chartered Accountant.

NON-EXECUTIVE DIRECTORS

J. A. S. Wallace Chairman (61)
Appointed a Director in 1994. Non-Executive Chairman of The Lowry Centre Limited (2002) and Non-Executive Director of Holidaybreak Plc (2002) and NCC Group PLC (2004). Deputy Chairman of Pifco Holdings plc from 1994 to 2001. Chairman of the Nomination Committee. A Chartered Accountant.

R. T. Scholes Senior Independent Non-Executive Director (59)
Appointed in 1998. Non-Executive Director of Keller Group PLC (2002) Chaucer Holdings PLC, Crest Nicholson Plc and Marshalls PLC (2003) and of British Vita plc (1993 to 2003). Investment banker with Dresdner Kleinwort Wasserstein (1986 to 2001). Chairman of the Audit Committee and member of the Remuneration and Nomination Committees. A Chartered Accountant.

J. Vogelsang (62) Netherlands
Appointed in 2003. President of Technology at Basell Polyolefins (2001 to 2002), President of Montell Polyolefins Europe (1999 to 2001), Vice-President Shell Chemical Europe and Africa (1994 to 1999) and Chief Executive of the Shell Companies in Sweden (1992 to 1994). Chairman of the Remuneration Committee and member of the Audit and Nomination Committees. A Chemical Engineer.

L.P. Bermejo (45) France
Appointed in 2003. Director for Northern Europe at Dalkia International from 1 January 2005, Chief Executive Dalkia Plc (UK and Ireland subsidiary of Veolia Environment) 1999 to 2004, Chief Executive of Dalkia in the Czech and Slovak Republics (1995 to 1999) and DEKRA-Veritas Automobile (1993 to 1995), Member of the Audit, Remuneration and Nomination Committees. A Structural Engineer.

SECRETARY AND REGISTERED OFFICE

J. R. Grime
Hulley Road, Hurdsfield, Macclesfield, Cheshire SK10 2SG. Tel: 01625 505300 Fax: 01625 505313. Registered Number 519057 England and Wales.

Advisers

AUDITORS	Deloitte & Touche LLP
PRINCIPAL BANKERS	HSBC Bank plc, Barclays Bank PLC, The Royal Bank of Scotland plc, Svenska Handelsbanken AB, Bank of Scotland and Lloyds TSB Bank plc
FINANCIAL ADVISERS	Dresdner Kleinwort Wasserstein Limited
SOLICITORS	Eversheds LLP
BROKERS	Dresdner Kleinwort Wasserstein Securities Limited
REGISTRARS	Capita Registrars Limited, Huddersfield

Directors' Responsibilities

The Directors are required by company law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that year. In preparing the financial statements the Directors are required to:

- *select suitable accounting policies and then apply them consistently;*
- *make judgements and estimates that are reasonable and prudent;*
- *state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and*
- *prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.*

The Directors are responsible for keeping proper accounting records which disclose, with reasonable accuracy at any time, the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and Group and to prevent and detect fraud and other irregularities.

Independent Auditors' Report

to the Members of Bodycote International Plc

We have audited the financial statements of Bodycote International plc for the year ended 31 December 2004, which comprise the consolidated profit and loss account, the balance sheets, the consolidated cash flow statement, the consolidated statement of total recognised gains and losses and the related notes 1 to 26 together with the reconciliation of net cash flow to movement in net debt, the reconciliation of movements in Group shareholders' funds and the accounting policies. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the Board Report on Remuneration that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose.To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

As described in the statement of Directors' responsibilities, the Company's Directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the Board Report on Remuneration. Our responsibility is to audit the financial statements and the part of the Board Report on Remuneration described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Board Report on Remuneration described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

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

We read the Directors' Report and the other information contained in the annual report for the above year as described in the contents section, including the unaudited part of the Board Report on Remuneration, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Board Report on Remuneration described as having been audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

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

OPINION

In our opinion:

- the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2004 and of the profit of the Group for the year then ended; and
- the financial statements and part of the Board Report on Remuneration described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and
Registered Auditors

Manchester
1 March 2005

Consolidated Profit and Loss Account

for the year ended 31 December 2004

	2004 £m	2003 £m	Note
Turnover			1
Existing operations	**443.7**	435.7	
Acquisitions	**1.8**	–	
Continuing operations	**445.5**	435.7	
Discontinued operations	**11.7**	12.7	
	457.2	448.4	
Operating profit			2
Existing operations	**42.5**	23.8	
Acquisitions	**0.2**	–	
Continuing operations	**42.7**	23.8	
Discontinued operations	**0.9**	1.3	
Total operations:			
Trading	**52.1**	41.7	
Operating exceptional item arising from restructuring and asset write downs	**–**	(7.5)	2
Goodwill amortisation	**(8.5)**	(9.1)	
Operating profit	**43.6**	25.1	
Exceptional items			3
(Loss)/profit on disposal of discontinued operations	**(3.8)**	3.5	
Loss on termination of operations	**(7.4)**	(30.0)	
Profit/(loss) on ordinary activities before interest and taxation	**32.4**	(1.4)	
Net interest payable	**(7.9)**	(9.7)	4
Profit/(loss) on ordinary activities before taxation	**24.5**	(11.1)	1
Tax on profit/(loss) on ordinary activities	**(5.6)**	(6.2)	6
Profit/(loss) on ordinary activities after taxation	**18.9**	(17.3)	
Minority interests - equity	**(0.2)**	(0.1)	18
Profit/(loss) for the financial year	**18.7**	(17.4)	
Dividends - paid and proposed	**(19.6)**	(15.6)	8
Retained loss for the financial year	**(0.9)**	(33.0)	17
Earnings/(loss) per share		Restated	9
Headline	**11.3p**	9.1p	
Headline - diluted	**11.3p**	9.1p	
Basic	**6.1p**	(6.3p)	
Basic - diluted	**6.1p**	(6.3p)	

The accompanying notes and statement of accounting policies are an integral part of these financial statements.

Balance Sheets
as at 31 December 2004

Bodycote

	Group		Company		Note
	2004 £m	2003 £m	**2004 £m**	2003 £m	
Fixed assets					
Intangible assets - goodwill	**131.4**	137.5	**–**	–	10
Tangible assets	**428.7**	478.7	**2.7**	0.2	11
Investments	**6.2**	0.9	**853.6**	831.6	12
	566.3	617.1	**856.3**	831.8	
Current assets					
Stocks	**13.4**	18.2	**–**	–	13
Debtors	**108.4**	102.7	**11.9**	11.4	14
Cash at bank and in hand	**142.1**	35.2	**74.9**	3.2	
	263.9	156.1	**86.8**	14.6	
Creditors					
Amounts falling due within one year	**(117.2)**	(119.1)	**(60.0)**	(32.4)	15
Net current assets/(liabilities)	**146.7**	37.0	**26.8**	(17.8)	
Total assets less current liabilities	**713.0**	654.1	**883.1**	814.0	
Creditors					
Amounts falling due after more than one year	**(234.2)**	(239.5)	**(518.0)**	(493.2)	15
Provisions for liabilities and charges	**(42.9)**	(42.8)	**(0.1)**	–	16
Net assets	**435.9**	371.8	**365.0**	320.8	1
Capital and reserves					17
Called-up share capital	**32.1**	25.7	**32.1**	25.7	
Share premium account	**300.0**	244.4	**300.0**	244.4	
Currency and other reserves	**17.1**	14.2	**0.6**	0.7	
Profit and loss account	**85.7**	86.6	**32.3**	50.0	
Shareholders' funds - equity	**434.9**	370.9	**365.0**	320.8	
Minority interests - equity	**1.0**	0.9	**–**	–	18
	435.9	371.8	**365.0**	320.8	

Approved by the Board of Directors on 1 March 2005 and signed on its behalf by:

J. D. Hubbard } Directors
D. F. Landless

The accompanying notes and statement of accounting policies are an integral part of these financial statements.

Consolidated Cash Flow Statement
for the year ended 31 December 2004

	2004 £m	2003 £m	Note
Net cash inflow from operating activities	**104.3**	83.9	20
Returns on investments and servicing of finance	**(7.8)**	(10.3)	21
Taxation	**(5.4)**	(4.9)	
Capital expenditure and financial investment	**(34.0)**	(38.3)	21
Acquisitions and disposals	**10.5**	1.3	21
Equity dividends paid	**(15.6)**	(15.6)	
Cash inflow before management of liquid resources and financing	**52.0**	16.1	
Management of liquid resources	**(70.9)**	5.9	21
Financing	**56.3**	(23.5)	21
Increase/(decrease) in cash in the year	**37.4**	(1.5)	

	2004 £m	2003 £m	Note
Reconciliation of net cash flow to movement in net debt			
Increase/(decrease) in cash in the year	**37.4**	(1.5)	
Cash outflow from decrease in debt and lease financing	**5.7**	23.7	
Cash outflow/(inflow) from movement in liquid resources	**70.9**	(5.9)	
Change in net debt resulting from cash flows	**114.0**	16.3	
Debt acquired with subsidiaries	**(1.7)**	–	
Debt disposed of with subsidiaries	**1.0**	–	
Currency adjustments	**8.5**	7.6	
Movement in net debt in the year	**121.8**	23.9	
Net debt at 1 January	**(210.3)**	(234.2)	
Net debt at 31 December	**(88.5)**	(210.3)	22

The accompanying notes and statement of accounting policies are an integral part of these financial statements.

Consolidated Statement of Total Recognised Gains and Losses
for the year ended 31 December 2004

Bodycote

	2004 £m	2003 £m
Profit/(loss) for the financial year	**18.7**	(17.4)
Currency adjustments	**2.9**	14.4
Total recognised gains and losses relating to the year	**21.6**	(3.0)

Reconciliation of Movements in Group Shareholders' Funds
for the year ended 31 December 2004

	2004 £m	2003 £m
Profit/(loss) for the financial year	**18.7**	(17.4)
Dividends paid and proposed	**(19.6)**	(15.6)
Retained loss for the financial year	**(0.9)**	(33.0)
Currency adjustments	**2.9**	14.4
New shares issued	**62.0**	0.3
Net movement in shareholders' funds	**64.0**	(18.3)
Shareholders' funds at 1 January	**370.9**	389.2
Shareholders' funds at 31 December	**434.9**	370.9

The accompanying notes and statement of accounting policies are an integral part of these financial statements.

Accounting Policies

ACCOUNTING CONVENTION

The financial statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards.

The accounting policies have been applied consistently throughout the year and the preceding year in dealing with items that are considered material in relation to the Group's financial statements.

BASIS OF CONSOLIDATION

The Group financial statements consolidate the accounts of the Company and its subsidiary undertakings, all of which are drawn up to 31 December each year. The acquisition method of accounting has been adopted. The results of subsidiaries acquired or sold during the year are consolidated from or to the date on which control passed.

In accordance with Section 230 of the Companies Act 1985 a separate profit and loss account dealing with the results of the Company has not been presented.

GOODWILL

Purchased goodwill arising on the acquisitions of subsidiary undertakings before 1 January 1998, when FRS 10 Goodwill and Intangible Assets was adopted, was written off to reserves in the year of acquisition and, as allowed by this Standard, has not been reinstated in the balance sheet. On disposal or closure of a previously acquired business, the attributable amount of goodwill previously written off to reserves is included in determining the profit or loss on disposal.

Purchased goodwill arising on acquisitions since 31 December 1997 has been capitalised and is being amortised in equal instalments over its estimated useful life of twenty years. Provision is made for any impairment.

TURNOVER

Turnover represents amounts receivable for goods and services sold to outside customers, excluding value added tax.

INVESTMENTS

Investments are held at cost less provision for impairment.

ASSOCIATES

In the Group financial statements investments in associates are accounted for using the equity method. Where material the consolidated profit and loss account includes the Group's share of associates' profits less losses while the Group's share of the net assets of the associates is shown in the consolidated balance sheet. Goodwill arising on the acquisition of associates is accounted for in accordance with the policy set out above. Any unamortised balance of goodwill is included in the carrying value of the investment in associates. There were no material associates in 2004.

STOCK

Stock is valued at the lower of cost and net realisable value. In the case of manufactured products, cost includes the attributable proportion of manufacturing overhead costs. Net realisable value comprises the estimated selling price less all further costs to completion and all costs to be incurred in selling and distribution.

PENSION COSTS

For defined benefit schemes the amount charged to the profit and loss account in respect of pension costs is the estimated regular cost of providing the benefits accrued in the year, adjusted to reflect variations from that cost. For defined contribution schemes the amounts charged are the contributions payable in the year.

LEASES

Assets held under finance leases and other similar contracts, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the lease to produce a constant rate of charge on the balance of capital repayments outstanding. Hire purchase transactions are dealt with similarly, except that assets are depreciated over their useful lives.

Rental costs under operating leases are charged to the profit and loss account over the period of the lease.

TANGIBLE FIXED ASSETS

Tangible fixed assets are stated at cost or valuation. Depreciation is provided on a straight line basis, to reduce the carrying value to the estimated residual value at the point of sale, at the following annual rates:

Land	nil
Fixtures and fittings	10% to 20%
Plant and machinery	5% to 20%
Leasehold property	over the period of the lease
Buildings	2%
Motor vehicles	20% to 33%

Residual value is calculated on prices prevailing at the date of acquisition.

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TAXATION

Current UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Group's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into by the subsidiary.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a discounted basis to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained on government bonds with similar maturity dates and currencies to those of the deferred tax assets or liabilities.

FOREIGN CURRENCIES

The results of overseas subsidiaries are translated into Sterling using average rates of exchange during the year. Assets and liabilities of overseas subsidiaries are translated at the rates of exchange ruling at the balance sheet date. Exchange differences arising from the translation of investments in subsidiary undertakings at closing rates are taken to reserves, together with exchange differences on foreign currency borrowings which finance a proportion of foreign currency investments.

GOVERNMENT GRANTS

Capital based government grants are included within accruals and deferred income in the balance sheet and credited to the profit and loss account over the estimated useful economic lives of the assets to which they relate. Revenue based government grants are credited to the profit and loss account in the period in which they are receivable.

DEBT

Debt is initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount is increased by the finance cost in respect of the accounting period and reduced by payments made in the period. Finance costs of debt are recognised in the profit and loss account over the term of such instruments at a constant rate on the carrying amount.

DERIVATIVES AND FINANCIAL INSTRUMENTS

The Group uses derivatives and financial instruments to reduce exposure to foreign exchange risk. The Group does not hold or issue derivatives or financial instruments for speculative purposes.

For a forward foreign exchange contract to be treated as a hedge, the instrument must be related to actual foreign currency assets or liabilities or to a probable commitment. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the Group's operations. Gains and losses arising on these contracts are deferred and recognised in the profit and loss account, or as adjustments to the carrying amount of fixed assets, only when the hedged transaction has itself been reflected in the Group's accounts.

Notes to the Financial Statements
31 December 2004

1. Segmental analysis

By activity	Turnover		Profit before goodwill amortisation		Profit after goodwill amortisation		Net assets*	
	2004	2003 Restated	**2004**	2003 Restated	**2004**	2003 Restated	**2004**	2003 Restated
	£m	£m	**£m**	£m	**£m**	£m	**£m**	£m
Heat treatment	**309.0**	302.5	**34.2**	31.5	**26.7**	24.1	**297.7**	200.2
Materials testing	**65.6**	61.2	**12.4**	11.4	**11.7**	10.7	**42.4**	37.2
Hot isostatic pressing	**32.1**	27.6	**7.0**	3.6	**7.0**	3.6	**56.6**	64.6
Surface engineering	**19.4**	18.4	**3.3**	2.3	**3.0**	1.9	**18.8**	16.4
Electroplating - discontinuing	**19.4**	26.0	**(3.0)**	(6.8)	**(3.0)**	(7.4)	**7.7**	24.1
	445.5	435.7	**53.9**	42.0	**45.4**	32.9	**423.2**	342.5
PVD - discontinued	**11.7**	12.7	**0.9**	1.3	**0.9**	1.3	**12.7**	29.3
	457.2	448.4	**54.8**	43.3	**46.3**	34.2	**435.9**	371.8
Head office expenses			**(2.7)**	(1.6)	**(2.7)**	(1.6)		
Operating profit before exceptional items			**52.1**	41.7	**43.6**	32.6		
Net interest payable			**(7.9)**	(9.7)	**(7.9)**	(9.7)		
Profit on ordinary activities before amortisation of goodwill and exceptional items			**44.2**	32.0				
Amortisation of goodwill			**(8.5)**	(9.1)				
Profit on ordinary activities before exceptional items			**35.7**	22.9	**35.7**	22.9		
Operating exceptional item arising from restructuring and asset write downs					**–**	(7.5)		
Exceptional items (note 3)					**(11.2)**	(26.5)		
Profit/(loss) on ordinary activities before taxation					**24.5**	(11.1)		

By geographical origin	Turnover		Profit before tax		Net assets*	
	2004	2003	**2004**	2003	**2004**	2003
	£m	£m	**£m**	£m	**£m**	£m
United Kingdom	**62.5**	60.6	**2.0**	(0.9)	**57.8**	2.7
Mainland Europe	**234.2**	229.0	**17.8**	(5.5)	**343.9**	340.1
North America	**155.4**	154.9	**11.2**	4.2	**27.9**	23.7
Rest of World	**5.1**	3.9	**1.4**	0.8	**6.3**	5.3
	457.2	448.4	**32.4**	(1.4)	**435.9**	371.8
Net interest payable			**(7.9)**	(9.7)		
Profit/(loss) on ordinary activities before taxation			**24.5**	(11.1)		

By geographical destination	Turnover	
	2004	2003
	£m	£m
United Kingdom	**60.8**	58.8
Mainland Europe	**233.7**	224.9
North America	**155.2**	154.9
Rest of World	**7.5**	9.8
	457.2	448.4

*Net assets for Heat treatment and the United Kingdom include Head office net assets.

1. **Segmental analysis** continued

The segmental disclosure by activity for 2003 has been restated to reflect the transfer of certain businesses from Heat treatment to the PVD division and from Electroplating (formerly Wet Coatings) to Surface engineering (formerly Specialty coatings). The former Specialty coatings division has been divided into Surface engineering and PVD.

2. **Operating profit**

	2004 Existing Operations £m	2004 Acquisitions £m	2004 Discontinued Operations £m	2004 Total £m	2003 Continuing Operations £m	2003 Discontinued Operations £m	2003 Total £m
Turnover	**443.7**	**1.8**	**11.7**	**457.2**	435.7	12.7	448.4
Cost of sales	**(302.1)**	**(1.1)**	**(7.8)**	**(311.0)**	(307.0)	(8.4)	(315.4)
Gross profit	**141.6**	**0.7**	**3.9**	**146.2**	128.7	4.3	133.0
Distribution costs	**(14.2)**	**(0.1)**	**(0.8)**	**(15.1)**	(15.5)	(0.8)	(16.3)
Administrative expenses							
- Other	**(76.5)**	**(0.3)**	**(2.2)**	**(79.0)**	(72.8)	(2.2)	(75.0)
- Goodwill amortisation	**(8.4)**	**(0.1)**	**–**	**(8.5)**	(9.1)	–	(9.1)
- Operating exceptional items arising from restructuring and asset write downs	**–**	**–**	**–**	**–**	(7.5)	–	(7.5)
Operating profit	**42.5**	**0.2**	**0.9**	**43.6**	23.8	1.3	25.1

	2004 £m	2003 £m
Operating profit is stated after charging/(crediting):		
Depreciation	**43.7**	45.7
Amortisation of goodwill	**8.5**	9.1
Operating lease rentals, plant and machinery	**2.8**	3.2
Operating lease rentals, other	**5.4**	5.7
Auditors' remuneration for audit services	**0.4**	0.4
Government grants receivable	**(0.2)**	(0.2)
Rents receivable	**(0.7)**	(0.7)
Operating exceptional item (see page 28)	**–**	7.5

Amounts payable to Deloitte & Touche LLP and their associates by the Group in respect of non-audit services were £0.5m (2003: £0.4m). Amounts paid to other audit firms in respect of non-audit services totalled £0.6m (2003: £0.2m). Projects by other audit firms included due diligence, sales consultancy, tax and secondment of temporary staff.

A more detailed analysis of the auditors' remuneration on a worldwide basis is provided below:

	2004 £m	2004 %	2003 £m	2003 %
Audit services				
Statutory audit	**0.4**	**45**	0.4	50
Tax services				
Compliance services	**0.2**	**22**	0.1	13
Advisory services	**0.2**	**22**	0.2	25
	0.4	**44**	0.3	38
Other services				
Other services not covered above	**0.1**	**11**	0.1	12
	0.9	**100**	0.8	100

Notes to the Financial Statements

2. Operating profit continued

In addition to the amounts shown on the previous page, the auditors received fees of £7,000 (2003: £7,000) for the audit of the Group's UK pension schemes. A description of the work of the Audit Committee is set out in the Report of the Audit Committee on page 13 and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditors.

Operating exceptional item:
In the year ended 31 December 2003 a restructuring charge of £7.5m was recognised to cover the costs of plant closures, asset write offs and reorganisation of continuing operations. £1.5m (2003: £2.1m) remains as a provision at 31 December 2004 (see note 16).

	2003 Total £m
Heat treatment	5.4
Hot isostatic pressing	0.1
Materials testing	0.5
Electroplating	0.9
PVD	0.6
Total	7.5

3. Exceptional items reported after operating profit

	2004 £m	2003 £m
Loss on disposal of PVD operations	**(3.8)**	–
Loss on termination of discontinuing operations (see below)	**(7.4)**	(30.0)
Receipt of fully provided deferred consideration relating to prior years' disposal	**–**	3.5
	(11.2)	(26.5)

	2004 £m	2003 £m
The loss on termination of discontinuing operations comprises		
Closure costs	**7.4**	–
Goodwill impairment losses	**–**	11.1
Tangible fixed assets impairment losses	**–**	18.9
	7.4	30.0

4. Net interest payable

	2004 £m	2003 £m
Interest payable and similar charges - bank loans and overdrafts	**(12.3)**	(12.9)
Finance lease and hire purchase contract charges	**(0.3)**	(0.3)
Bank interest receivable	**4.7**	3.5
	(7.9)	(9.7)

5. Employees

	Year end 2004 Number	**Average monthly 2004 Number**	Year end 2003 Number	Average monthly 2003 Number
The number of persons employed by the Group (including Executive Directors) was:				
Heat treatment	**4,905**	**4,703**	4,629	4,787
Materials testing	**1,439**	**1,413**	1,334	1,281
Hot isostatic pressing	**293**	**282**	269	265
Surface engineering	**352**	**352**	365	365
Electroplating	**165**	**468**	586	583
PVD	**–**	**234**	226	217
	7,154	**7,452**	7,409	7,498

5. Employees continued

	2004 £m	2003 £m
Total employee costs (including Executive Directors) were:		
Wages and salaries	**166.6**	166.9
Social security costs	**27.1**	30.4
Other pension costs (see note 24)	**7.5**	4.9
	201.2	202.2

Details of Directors' emoluments are given on page 17.

6. Tax on profit/(loss) on ordinary activities

	2004 £m	2003 £m
The charge for tax comprises:		
Current tax:		
UK corporation tax	**0.5**	1.4
Overseas tax	**6.4**	5.0
Adjustments in respect of prior years:		
- UK corporation tax	**(0.8)**	0.4
- Overseas tax	**(1.9)**	(1.0)
Total current tax	**4.2**	5.8
Deferred tax:		
Origination and reversal of timing differences	**0.1**	2.1
Decrease/(increase) in discount	**1.3**	(1.7)
Total deferred tax (see note 16)	**1.4**	0.4
Total tax on profit/(loss) on ordinary activities	**5.6**	6.2
The tax effect of exceptional items comprises:		
Profit on disposal of discontinued operations - overseas	**(3.9)**	1.8
Operating exceptional restructuring charges	**–**	(2.7)
	(3.9)	(0.9)

The loss on termination of operations in 2003 (note 3) has no tax effect.

The difference between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	2004 £m	2003 £m
Group profit/(loss) on ordinary activities before tax	**24.5**	(11.1)
Tax on Group profit/(loss) on ordinary activities at standard UK corporation tax rate of 30% (2003 - 30%)	**7.4**	(3.3)
Effects of:		
Goodwill amortisation not deductible for tax purposes	**2.5**	2.7
Other expenses not deductible for tax purposes	**0.1**	0.1
Recognition of tax losses previously not recognised	**(2.4)**	–
Overseas earnings taxed at different rates	**(0.6)**	–
Exceptional provision for asset write downs not considered recoverable	**–**	9.0
Adjustments to tax charge in respect of previous periods	**(2.7)**	(0.6)
Origination and reversal of timing differences	**(0.1)**	(2.1)
Group current tax charge for the year	**4.2**	5.8

A deferred tax asset amounting to £11.8m (2003: £14.2m) for trading losses has not been recognised because in the opinion of the directors there will be no suitable taxable income available in the forseeable future.

Notes to the Financial Statements

7. Profit/(loss) for the financial year

The profit for the financial year dealt with in the financial statements of the parent company amounted to £1.9m (2003: £4.2m loss).

8. Dividends - paid and proposed

	2004 **£m**	2003 £m
Interim - 2.25p per share (2003: 2.25p) on 320,968,766 (2003: 256,630,326) shares paid 7 January 2005 (2003: 6 January 2004)	**7.3**	5.8
Final - 3.85p per share (2003: 3.85p) proposed on 320,968,766 (2003: 256,630,326) shares	**12.3**	9.8
	19.6	15.6

A total dividend of 6.1p per share for the year ended 31 December 2003 has been restated in the Directors' Report as 5.7p per share to reflect the bonus element of the rights issue completed in March 2004.

9. Earnings/(loss) per share

	2004 **£m**	2003 £m
Profit/(loss) for the financial year	**18.7**	(17.4)
Goodwill amortisation charge	**8.5**	9.1
Exceptional items after tax	**7.3**	33.1
Headline earnings	**34.5**	24.8

	Number	Number Restated
Weighted average number of ordinary shares in issue - basic	**304,605,680**	273,921,081
Adjustment in respect of share options	**124,007**	–
Weighted average number of ordinary shares in issue - diluted	**304,729,687**	273,921,081

		Restated
Headline	**11.3p**	9.1p
Headline - diluted	**11.3p**	9.1p
Basic	**6.1p**	(6.3p)
Basic - diluted	**6.1p**	(6.3p)

The Directors consider that the headline earnings per share figures more accurately reflect the underlying performance of the Group. The figures for basic and diluted weighted average share capital exclude 421,823 shares (2003: 400,000) in respect of which dividend entitlement has been waived on behalf of the Bodycote International Employee Benefit Trust.

The comparative figures for earnings per share and share capital above have been restated to take into account the bonus element of the 1 for 4 rights issue completed on 31 March 2004.

10. Intangible fixed assets - Goodwill

Group	
Cost	£m
1 January 2004	182.8
Additions (note 23)	3.1
Disposals (note 23)	(5.9)
31 December 2004	**180.0**
Amortisation	
1 January 2004	45.3
Charge for the year	8.5
Disposals (note 23)	(5.2)
31 December 2004	**48.6**
Net book value	
31 December 2004	**131.4**
31 December 2003	137.5

11. Tangible fixed assets

	Land and buildings			Plant	Fixtures	
		Long	Short	and	and	
	Freehold	leasehold	leasehold	machinery	fittings	Total
	£m	£m	£m	£m	£m	£m
Group						
Cost						
1 January 2004	167.6	13.4	6.4	555.0	42.3	784.7
Currency adjustments	(1.7)	–	(0.1)	(5.8)	(0.1)	(7.7)
Businesses acquired	1.7	–	–	3.0	0.1	4.8
Businesses sold	(11.9)	(1.5)	(0.2)	(61.8)	(3.2)	(78.6)
Additions	2.7	0.2	0.2	32.1	2.6	37.8
Disposals	(1.7)	(0.1)	–	(23.9)	(2.8)	(28.5)
31 December 2004	**156.7**	**12.0**	**6.3**	**498.6**	**38.9**	**712.5**
Depreciation						
1 January 2004	27.1	7.0	1.8	237.5	32.6	306.0
Currency adjustments	(0.1)	0.1	0.1	(0.6)	–	(0.5)
Businesses acquired	0.2	–	–	0.9	0.1	1.2
Businesses sold	(5.2)	(0.2)	(0.1)	(33.7)	(3.0)	(42.2)
Charge for the year	4.0	0.3	0.3	35.5	3.6	43.7
Disposals	(0.2)	(0.1)	–	(21.4)	(2.7)	(24.4)
31 December 2004	**25.8**	**7.1**	**2.1**	**218.2**	**30.6**	**283.8**
Net book value						
31 December 2004	**130.9**	**4.9**	**4.2**	**280.4**	**8.3**	**428.7**
31 December 2003	140.5	6.4	4.6	317.5	9.7	478.7

Included in the net book value of fixed assets of £428.7m (2003: £478.7m) is £10.3m (2003: £13.1m) which relates to freehold land not depreciated.

In the Directors' opinion the net book value of leased assets is not material.

11. Tangible fixed assets continued

	Fixtures and fittings £m
Company	
Cost	
1 January 2004	0.3
Additions	2.8
31 December 2004	**3.1**
Depreciation	
1 January 2004	0.1
Charge for the year	0.3
31 December 2004	**0.4**
Net book value	
31 December 2004	**2.7**
31 December 2003	0.2

12. Investments

	Group			Company			
	Shares in associates £m	Other investments £m	Total £m	Shares £m	Shares in associates £m	Loans £m	Total £m
Cost							
1 January 2004	0.6	0.6	1.2	397.5	–	436.1	833.6
Acquisitions and advances	5.2	–	5.2	–	5.2	30.1	35.3
Disposals and repayments	–	–	–	–	–	(5.3)	(5.3)
Currency adjustments	0.3	(0.2)	0.1	–	–	(8.0)	(8.0)
31 December 2004	**6.1**	**0.4**	**6.5**	**397.5**	**5.2**	**452.9**	**855.6**
Provision							
1 January 2004 and **31 December 2004**	**0.3**	**–**	**0.3**	**2.0**	**–**	**–**	**2.0**
Net book value							
31 December 2004	**5.8**	**0.4**	**6.2**	**395.5**	**5.2**	**452.9**	**853.6**
31 December 2003	0.3	0.6	0.9	395.5	–	436.1	831.6

Shares in associates comprise:

Name of company	Nature of business	Country of incorporation	% Holding of ordinary shares
Traitement Compression Services SA	Hot Isostatic Pressing	France	49
International Heat Treatment Limited	Heat Treatment	Hong Kong	40
SSCP Coating S.à.r.l.*	PVD Coatings	Luxembourg	15

*The Group increased its holding in SSCP Coating S.à.r.l. (owners of IonBond) from 15% to 20% on 20 February 2005. Equity accounting has not been applied in respect of these entities as the impact would be immaterial.

Details of principal subsidiary undertakings are given on pages 48 to 50.

13. Stocks

	Group	
	2004	2003
	£m	£m
Raw materials and consumables	**9.3**	12.0
Work in progress	**3.8**	5.3
Finished goods and goods for resale	**0.3**	0.9
	13.4	18.2

There is no material difference between the balance sheet value of stocks and their replacement cost.

14. Debtors

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Amounts falling due within one year:				
Trade debtors	**88.3**	86.1	**–**	–
Amounts owed by subsidiary undertakings	**–**	–	**4.8**	6.9
Corporation tax recoverable	**1.6**	–	**1.5**	–
Other debtors	**6.3**	6.0	**3.3**	3.5
Prepayments and accrued income	**6.1**	6.9	**0.1**	1.0
	102.3	99.0	**9.7**	11.4
Amounts falling due after more than one year:				
Other debtors	**6.1**	3.7	**2.2**	–
	108.4	102.7	**11.9**	11.4

15. Creditors

	Group		Company	
	2004	2003	**2004**	2003
	£m	£m	**£m**	£m
Amounts falling due within one year:				
Bank loans	**3.7**	9.3	**–**	2.9
Obligations under finance leases	**1.2**	1.6	**–**	–
Bank overdrafts	**3.3**	5.4	**4.1**	1.9
Trade creditors	**33.3**	36.1	**0.4**	0.3
Amounts owed to subsidiary undertakings	**–**	–	**32.7**	10.0
Corporation tax	**2.5**	3.2	**–**	–
Proposed dividends	**19.6**	15.6	**19.6**	15.6
Other taxes and social security	**14.7**	14.5	**0.1**	–
Other creditors	**5.4**	8.6	**0.3**	0.3
Accruals and deferred income	**33.5**	24.8	**2.8**	1.4
	117.2	119.1	**60.0**	32.4
Amounts falling due after more than one year:				
Bank loans	**219.5**	224.9	**212.2**	216.0
Obligations under finance leases	**2.9**	4.3	**–**	–
Amounts owed to subsidiary undertakings	**–**	–	**305.8**	277.2
Other creditors	**11.8**	10.3	**–**	–
	234.2	239.5	**518.0**	493.2

Notes to the Financial Statements

15. Creditors continued

	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
Bank loans are repayable:				
After 5 years	**1.9**	47.6	**–**	44.7
Between 2 and 5 years	**44.8**	165.8	**41.8**	161.3
Between 1 and 2 years	**172.8**	11.5	**170.4**	10.0
	219.5	224.9	**212.2**	216.0
On demand or within 12 months	**3.7**	9.3	**–**	2.9
	223.2	234.2	**212.2**	218.9

	Group 2004 £m	Group 2003 £m
Finance leases are repayable:		
After 5 years	**0.4**	0.6
Between 2 and 5 years	**1.1**	2.5
Between 1 and 2 years	**1.4**	1.2
	2.9	4.3
On demand or within 12 months	**1.2**	1.6
	4.1	5.9

Bank loans are secured by interlocking intra Group guarantees with principal subsidiaries. Finance leases are secured on the assets to which they relate.

16. Provisions for liabilities and charges

	Group Deferred tax £m	Group Restructuring provision £m	Group Total £m	Company Deferred tax £m
1 January 2004	40.7	2.1	42.8	–
Utilisation	–	(0.6)	(0.6)	–
Profit and loss account charge	1.4	–	1.4	0.1
Currency adjustments	(0.6)	–	(0.6)	–
Businesses acquired	0.3	–	0.3	–
Businesses sold	(0.4)	–	(0.4)	–
31 December 2004	**41.4**	**1.5**	**42.9**	**0.1**

Deferred tax	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
Deferred tax is provided as follows:				
Accelerated capital allowances	**61.2**	64.9	**0.1**	–
Other timing differences	**(2.5)**	(5.6)	**–**	–
Undiscounted provision for deferred tax	**58.7**	59.3	**0.1**	–
Discount	**(17.3)**	(18.6)	**–**	–
Discounted provision for deferred tax	**41.4**	40.7	**0.1**	–

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17. Capital and reserves

Share capital:

	2004 £m	2003 £m
Authorised 430,000,000 (2003: 347,060,000) ordinary shares of 10p each	**43.0**	34.7
Allotted, called-up and fully paid 320,968,766 (2003: 256,630,326) ordinary shares of 10p each	**32.1**	25.7

An analysis of the shares that were issued during the year is given in the Directors' Report on page 9.

Share options:

Options covering 180,859 ordinary shares were exercised and 1,662,841 options lapsed. 2004 option prices and numbers have been adjusted for the 2004 rights issue.

At 31 December 2004 options under the Bodycote International Share Option Schemes 1994, 1996 and 2003 were outstanding in respect of 7,457,381 ordinary shares granted to 384 employees at prices ranging from 106.34p to 475.92p per share and which expire at dates between 4 May 2005 and 15 September 2013.

Outstanding options

Date of grant		Option price pence	Exercise period	Number of options 2004	2003
November	1994	98.67	1997-2004	**–**	154,467
May	1995	106.34	1998-2005	**33,981**	46,411
October	1995	133.17	1998-2005	**20,349**	19,027
June	1996	178.19	1999-2006	**78,291**	73,202
December	1996	253.46	1999-2006	**334,256**	366,238
May	1997	241.92	2000-2007	**737,738**	2,399,805
December	1997	315.43	2000-2007	**540,401**	571,372
January	1998	353.06	2001-2008	**235,241**	240,000
May	1998	475.92	2001-2008	**41,441**	38,750
October	1998	285.18	2001-2008	**286,070**	285,000
April	1999	370.26	2002-2009	**478,465**	459,875
May	1999	329.12	2002-2009	**16,042**	15,000
December	1999	292.19	2002-2009	**197,859**	185,000
May	2000	231.42	2003-2010	**1,031,856**	1,034,000
April	2001	203.37	2004-2011	**1,170,513**	1,184,558
April*	2001	203.37	2004-2008	**45,926**	42,942
September	2002	125.76	2005-2012	**867,031**	870,700
September*	2002	125.76	2005-2009	**90,158**	84,300
September	2003	147.27	2006-2013	**1,251,763**	1,230,434
				7,457,381	9,301,081

Shares under option marked * have been purchased in the market from previously issued share capital and are held by the trustees of the Bodycote International Employee Benefit Trust.

17. Capital and reserves continued

Reserves:

	Share premium account £m	Currency and other reserve £m	Profit and loss account £m	Total £m
Group				
1 January 2004	244.4	14.2	86.6	345.2
Currency adjustments on foreign currency net investments	–	(5.6)	–	(5.6)
Currency adjustments on related borrowings	–	8.5	–	8.5
Retained loss for the year	–	–	(0.9)	(0.9)
Premium on shares issued	55.6	–	–	55.6
31 December 2004	**300.0**	**17.1**	**85.7**	**402.8**
Company				
1 January 2004	244.4	0.7	50.0	295.1
Currency adjustments on foreign currency net investments	–	(7.9)	–	(7.9)
Currency adjustments on related borrowings	–	7.8	–	7.8
Retained loss for the year	–	–	(17.7)	(17.7)
Premium on shares issued	55.6	–	–	55.6
31 December 2004	**300.0**	**0.6**	**32.3**	**332.9**

Cumulative goodwill written off to reserves at 31 December 2004 and 2003 amounted to £122.1m.

The currency and other reserve for both the Group and the Company is stated after deducting £0.8m (2003: £0.8m) relating to the shares held in the Bodycote International Employee Benefit Trust. The trust holds Bodycote shares and satisfies awards made under various employee incentive schemes when issuance of new shares is not appropriate. As at 31 December 2004 421,823 (2003: 400,000) shares were held by the trust and following recommendations by the employer are provisionally allocated to satisfy awards under employee incentives schemes. The market value of these shares was £0.7m (2003: £0.6m).

18. Minority interests - equity

	Group	
	2004 £m	2003 £m
Equity interest at 1 January	**0.9**	0.2
Currency adjustments	**(0.1)**	–
Share of profits for the period	**0.2**	0.1
Acquisition of subsidiary undertaking	**–**	0.7
Dividend payable	**–**	(0.1)
Equity interest at 31 December	**1.0**	0.9

19. Capital and leasing commitments

	Group 2004 £m	Group 2003 £m
Contracted capital expenditure not provided for in the financial statements:	**6.7**	12.1

The annual commitment for payments in respect of operating leases is:

	Land and buildings 2004 £m	Land and buildings 2003 £m	Other 2004 £m	Other 2003 £m
Expiring:				
Within 12 months	**0.5**	0.6	**0.7**	1.9
Between 1 and 5 years	**2.1**	1.1	**1.8**	2.2
After 5 years	**1.8**	2.2	**0.1**	0.2
	4.4	3.9	**2.6**	4.3

20. Reconciliation of operating profit to operating cash flows

	2004 £m	2003 £m
Operating profit	**43.6**	25.1
Depreciation charges	**43.7**	45.7
Amortisation of goodwill	**8.5**	9.1
Loss on sale of tangible fixed assets	**0.3**	0.1
Fixed assets written off on restructuring	**–**	3.5
Decrease in stocks	**3.8**	–
(Increase)/decrease in debtors	**(2.1)**	12.1
Increase/(decrease) in creditors and provisions	**6.5**	(11.7)
Net cash inflow from operating activities	**104.3**	83.9

21. Analysis of cash flows

	2004 £m	2003 £m
Returns on investments and servicing of finance:		
Interest received	**4.2**	3.6
Interest paid	**(12.0)**	(13.8)
Dividend paid to minority shareholder	**–**	(0.1)
Net cash outflow from returns on investments and servicing of finance	**(7.8)**	(10.3)
Capital expenditure and financial investment:		
Purchase of tangible fixed assets	**(37.8)**	(39.9)
Sale of tangible fixed assets	**3.8**	1.5
Sale of investments	**–**	0.1
Net cash outflow from capital expenditure and financial investment	**(34.0)**	(38.3)

Notes to the Financial Statements

21. Analysis of cash flows continued

	2004 £m	2003 £m
Acquisitions and disposals:		
Net cash acquired with subsidiaries	**–**	0.7
Purchase of subsidiary undertakings (note 23)	**(4.7)**	(2.9)
Net cash disposed of upon sale of business	**(0.4)**	–
Sale of business (note 23)	**20.8**	3.5
Investment in associates	**(5.2)**	–
Net cash inflow from acquisitions and disposals	**10.5**	1.3
Management of liquid resources:		
Cash withdrawn from short term deposits	**148.3**	70.8
Cash placed on short term deposits	**(219.2)**	(64.9)
Net cash (outflow)/inflow from management of liquid resources	**(70.9)**	5.9
Financing:		
Issue of ordinary share capital	**62.0**	0.2
Repayment of bank loans	**(9.2)**	(215.6)
Additional bank loans	**5.1**	192.6
Repayment of finance leases	**(1.9)**	(1.5)
Additional finance leases	**0.3**	0.8
Net cash inflow/(outflow) from financing	**56.3**	(23.5)

22. Analysis of changes in net debt

	1 Jan 2004 £m	Cash flow £m	Acquisitions £m	Disposals £m	Non-cash changes £m	Currency adjustments £m	31 Dec 2004 £m
Cash	33.7	34.5	–	–	–	1.5	69.7
Short term deposits	1.5	70.9	–	–	–	–	72.4
Cash at bank and in hand	35.2	105.4	–	–	–	1.5	142.1
Bank overdrafts	(5.4)	2.9	–	–	–	(0.8)	(3.3)
Bank loans due within one year	(9.3)	8.0	(0.1)	–	(2.4)	0.1	(3.7)
Bank loans due after one year	(224.9)	(3.9)	(1.0)	0.2	2.4	7.7	(219.5)
Finance leases due within one year	(1.6)	1.3	–	0.2	(1.0)	(0.1)	(1.2)
Finance leases due after one year	(4.3)	0.3	(0.6)	0.6	1.0	0.1	(2.9)
	(210.3)	114.0	(1.7)	1.0	–	8.5	(88.5)

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23. Acquisitions and disposals

Acquisitions

Acquisitions were made at a cost of £4.7m. The acquisitions in the year are stated on page 9 in the Directors' Report. The following table analyses the acquisitions made in the year. No fair value adjustments were required to be made to the amounts at which the assets and liabilities were recorded in the books of the acquired entities.

	2004 Book and fair value £m
Tangible fixed assets	**3.6**
Debtors	**0.7**
Cash	**0.2**
Creditors	**(0.7)**
Bank overdrafts	**(0.2)**
Bank loans	**(1.1)**
Finance leases	**(0.6)**
Deferred tax	**(0.3)**
Total net assets acquired	**1.6**
Goodwill	**3.1**
Cash paid	**4.7**

Of the goodwill arising on the acquisition of subsidiary undertakings, £3.1m was capitalised in the year in accordance with FRS 10. This then resulted in an amortisation charge of £0.1m. The subsidiary undertakings acquired during the year contributed £0.2m to the Group's net operating cash flow, paid £0.1m in respect of net returns on investments and servicing of finance and utilised £0.5m for capital expenditure.

Disposals

Details of the disposals made in the year are given on page 9 in the Directors' Report. Net assets disposed of and the related sale proceeds were as follows:

	2004 £m
Intangible fixed assets	**0.7**
Tangible fixed assets	**36.4**
Stocks	**0.8**
Debtors	**2.0**
Cash	**0.6**
Creditors	**(1.5)**
Bank loans	**(0.2)**
Finance leases	**(0.8)**
Overdrafts	**(0.2)**
Deferred tax	**(0.4)**
Net assets disposed	**37.4**
Loss on sale	**(11.2)**
Sale proceeds	**26.2**
Satisfied by:	
Cash	**20.8**
Deferred consideration	**5.4**
	26.2
Net cash inflows in respect of the sale comprised:	
Cash consideration	**20.8**
Net cash sold	**(0.4)**
	20.4

The operating loss of these disposals up to the date of disposal was £1.9m and for the last financial year was £5.0m.

24. Pension schemes

The Group operated a number of pension schemes during the year. The cost to the Group of these schemes was £7.5m (2003: £4.9m) of which £5.6m (2003: £3.3m) related to overseas arrangements.

UK Scheme

The Group operates a funded defined benefit arrangement for UK employees in which the assets are held in separate trustee administered funds and which is closed to new entrants. The pension cost relating to the UK arrangement is assessed in accordance with the advice of qualified actuaries using the attained age method. The last actuarial assessment of the scheme was performed on 6 April 2002. The assumptions that have the most significant effect on the results of each of the actuarial assessments are those relating to the rate of return on the investments (6.5%), the rate of increase in salaries (4.25%) and the allowance (3.0%) made for pension payment increases of 5% or retail price inflation if less.

At the last actuarial valuation of the scheme, the market value of the assets totalled £26.8m. The actuarial value of these assets represented 83% of the benefits that had accrued to members after allowing for expected future increases in earnings.

At 6 April 2002, there was a surplus of £0.2m on the basis of the minimum funding requirement of the Pensions Act 1995.

The contributions made by the employer over the financial year have been £1.6m, equivalent to 19% of pensionable pay (after allowing for National Insurance rebates). In addition the employer made a special contribution of £0.2m. The contribution rate for 2005 will be 21% of pensionable pay and will be reviewed following the triennial valuation of the scheme due as at 6 April 2005. As the scheme is closed to new entrants, the current service cost as a percentage of pensionable payroll is likely to increase as the membership ages, although it will be applied to a decreasing pensionable payroll.

The transitional arrangements of the accounting standard FRS 17 require disclosure of assets and liabilities as at 31 December 2004 calculated in accordance with the requirements of FRS 17. They also require disclosure of the items which would appear in the profit and loss account and in the statement of total recognised gains and losses were the full requirements of FRS 17 in place. For the purpose of these financial statements, all of these figures are illustrative only and do not impact on the actual 31 December 2004 balance sheet or on this year's performance statements.

Assumptions

The assets of the scheme have been taken at market value and the liabilities have been calculated using the following principal actuarial assumptions:

	2004 % p.a.	2003 % p.a.	2002 % p.a.
Inflation	**3.00**	2.75	2.50
Salary increases	**4.25**	4.00	3.75
Rate of discount	**5.30**	5.75	5.50
Allowance for pension increases of 5% per annum or RPI if less in payment or if deferred	**3.00**	2.75	2.50

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the expected rate of return at each balance sheet date were:

	2004 %	**2004 £m**	2003 %	2003 £m	2002 %	2002 £m
Equities	**7.6**	**20.2**	7.0	18.2	7.0	14.8
Bonds	**4.5**	**5.2**	4.7	2.9	5.4	2.5
Cash	**4.75**	**–**	4.0	0.5	4.0	0.8
With profits insured policy	**4.5**	**4.6**	4.7	4.5	5.2	4.6
Total fair value of assets		**30.0**		26.1		22.7
Present value of scheme liabilities		**(50.7)**		(38.6)		(36.1)
Deficit in the scheme		**(20.7)**		(12.5)		(13.4)
Related deferred tax asset		**6.2**		3.8		4.0
Net pension liability		**(14.5)**		(8.7)		(9.4)

24. Pension schemes continued

Amounts which would be charged to the profit and loss account over the financial year

	2004 £m	2003 £m
Current service cost (charge to operating profit)	1.1	0.7
Interest on pension scheme liabilities (charge to net finance costs)	2.2	2.0
Expected return on pension scheme assets (credit to net finance costs)	(1.7)	(1.4)
Total charge	1.6	1.3

Amounts which would be included within the statement of total recognised gains and losses

	2004 £m	2004 % of scheme assets/ liabilities	2003 £m	2003 % of scheme assets/ liabilities
Difference between expected and actual return on assets	(0.9)	3.0	(2.4)	9.2
Experience gains and losses arising on the scheme liabilities	(0.1)	0.2	(0.1)	0.3
Effects of changes in the demographic and financial assumptions underlying the present value of the scheme liabilities	9.4	18.5	1.9	4.9
Total charge/(credit)	8.4		(0.6)	

Analysis of movements during the year	2004 £m	2003 £m
Deficit at 1 January	12.5	13.4
Movement in the year:		
Current service cost	1.1	0.7
Net finance charge	0.5	0.6
Contributions	(1.8)	(1.6)
Actuarial loss/(gain)	8.4	(0.6)
Deficit at 31 December	20.7	12.5

Overseas Schemes

The Group operates an unfunded scheme for employees in France. The total liability in respect of benefits is €3.3m (£2.4m) 2003: €3.3m (£2.3m) of which €2.7m (£1.9m) 2003: €2.4m (£1.7m) has been provided.

The company also sponsors five defined benefit pension arrangements in the USA. These are Metallurgical Inc. Pension Plan, Lakeside Heat Treating, and Supplemental Retirement Plan (each of which is closed to new members and with no additional benefits accruing to members) and two small plant specific plans, the Lansing (UAW) and the St Louis Hourly, under which benefits continue to accrue and which are open to new members. The figures calculated for the purposes of US accounting requirement FASB No 32 as at 31 December 2004 have been obtained and adjusted on an approximate basis for the purpose of illustrating the liabilities for the UK accounting standard FRS 17. The disclosures required under the transitional arrangements of FRS 17 in respect of these pension schemes are set out below.

The contributions made by the employer over the financial year have been $239,000 (£131,000) equivalent to 4.4% of pensionable pay. The next actuarial valuations for funding purposes are at dates between 1 September 2004 and 1 January 2005.

Assumptions

The assets of the schemes have been taken at market value and the liabilities have been calculated using a discount rate of 5% per annum (5% at 31 December 2003).

24. Pension schemes continued

The fair value of the assets in the schemes, the present value of the liabilities in the schemes and the expected rate of return at each balance sheet date were:

	2004 %	2004 £m	2004 $m	2003 %	2003 £m	2003 $m	2002 %	2002 £m	2002 $m
Equities	**7.00**	**0.9**	**1.8**	7.00	0.9	1.7	7.00	0.8	1.3
Bonds	**5.00**	**0.4**	**0.8**	5.00	0.5	0.9	5.00	0.6	0.9
Cash	**2.25**	**0.4**	**0.7**	1.25	0.3	0.6	1.25	11.6	18.6
Total fair value of assets		**1.7**	**3.3**		1.7	3.2		13.0	20.8
Present value of scheme liabilities		**(2.5)**	**(4.9)**		(3.0)	(5.4)		(16.0)	(25.8)
Deficit in the scheme		**(0.8)**	**(1.6)**		(1.3)	(2.2)		(3.0)	(5.0)
Related deferred tax asset		**0.3**	**0.6**		0.6	1.0		1.3	2.3
Net pension liability		**(0.5)**	**(1.0)**		(0.7)	(1.2)		(1.7)	(2.7)

Charge to the profit and loss account over the financial year

	2004 £m	2004 $m	2003 £m	2003 $m
Current service cost (charge to operating profit)	**–**	**0.1**	0.1	0.2
Gain on settlements and curtailments	**–**	**–**	(0.6)	(1.0)
Total operating charge/(credit)	**–**	**0.1**	(0.5)	(0.8)
Interest on pension scheme liabilities (charge to net finance costs)	**0.2**	**0.3**	0.4	0.6
Expected return on pension scheme assets (credit to net finance costs)	**(0.1)**	**(0.2)**	(0.1)	(0.2)
Total charge/(credit)	**0.1**	**0.2**	(0.2)	(0.4)

Amounts which would be included within the statement of total recognised gains and losses

	2004 £m	2004 $m	2004 % of scheme assets/ liabilities	2003 £m	2003 $m	2003 % of scheme assets/ liabilities
Difference between expected and actual return on assets	**(0.1)**	**(0.2)**	**6.1**	–	(0.1)	3.9
Experience gains and losses arising on the scheme liabilities	**(0.2)**	**(0.4)**	**8.2**	–	0.1	2.2
Total charge	**(0.3)**	**(0.6)**		–	–	

Analysis of movements during the year	2004 £m	2004 $m	2003 £m	2003 $m
Deficit at 1 January	**1.2**	**2.2**	3.0	5.0
Movement in the year:				
Current service cost	**–**	**0.1**	0.1	0.2
Contributions	**(0.1)**	**(0.2)**	(1.5)	(2.4)
Other finance charges	**0.1**	**0.1**	0.2	0.4
Gain on curtailment	**–**	**–**	(0.5)	(1.0)
Actuarial gain	**(0.3)**	**(0.6)**	–	–
Deficit at 31 December	**0.9**	**1.6**	1.3	2.2

24. Pension schemes continued

The analysis of reserves that would have arisen if FRS 17 had been fully implemented is as follows:	2004 £m	2003 £m
Profit and loss reserve excluding pension liability	**86.9**	86.6
Amount relating to defined benefit pension liability, net of related deferred tax	**(15.4)**	(10.0)
Profit and loss reserve	**71.5**	76.6

25. Contingent liabilities

The Company has guaranteed bank overdrafts and loans of certain subsidiary undertakings amounting to £1.3m (2003: £2.3m).

26. Derivatives and other financial instruments

The Finance Director's Report on page 8 summarises the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the period.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in FRS 13 Derivatives and Other Financial Instruments: Disclosures. Certain financial assets such as investments in subsidiary and associated companies are excluded from the scope of these disclosures.

As permitted by FRS 13, short term debtors and creditors have also been excluded from the disclosures, other than the currency disclosures.

Interest rate profile

Financial assets:

The Group's financial assets are made up of cash deposits which are part of the financing arrangements of the Group. These deposits comprise amounts placed on money market at fixed rates for various durations from call up to one week and are detailed as follows:

	2004 £m	2003 £m
Currency:		
Sterling	**69.8**	3.5
US Dollar	**21.2**	6.7
Swedish Krona	**3.4**	0.2
Norwegian Krone	**0.5**	0.5
Danish Krone	**0.2**	0.1
Euro	**38.9**	19.9
Canadian Dollar	**1.9**	0.3
UAE Dirham	**2.4**	1.2
Swiss Franc	**0.5**	0.5
Czech Koruna	**2.6**	1.6
Chinese Renminbi	**0.6**	–
Omani Rial	**0.1**	0.2
Mexican Peso	**–**	0.5
Total	**142.1**	35.2

Notes to the Financial Statements

26. Derivatives and other financial instruments continued

Financial liabilities:
After taking into account forward foreign currency contracts entered into by the Group, the interest rate profile of the Group's financial liabilities at 31 December 2004 and 31 December 2003 was as follows:

	Total 2004 £m	**Floating rate 2004 £m**	**Fixed rate 2004 £m**	Total 2003 £m	Floating rate 2003 £m	Fixed rate 2003 £m	Interest free 2003 £m
Currency:							
Sterling	**0.5**	**0.5**	**–**	1.2	1.1	0.1	–
US Dollar	**123.5**	**81.7**	**41.8**	135.3	90.6	44.7	–
Swedish Krona	**14.9**	**14.9**	**–**	14.9	14.9	–	–
Danish Krone	**3.4**	**3.4**	**–**	1.5	1.5	–	–
Euro	**72.0**	**67.1**	**4.9**	74.7	64.5	9.9	0.3
Canadian Dollar	**0.4**	**0.1**	**0.3**	1.4	1.2	0.2	–
Swiss Franc	**15.7**	**15.3**	**0.4**	16.1	16.1	–	–
Czech Koruna	**–**	**–**	**–**	0.4	–	0.4	–
Polish Zloty	**0.2**	**0.2**	**–**	–	–	–	–
Total	**230.6**	**183.2**	**47.4**	245.5	189.9	55.3	0.3

Further analysis of the interest rate profile at 31 December 2004 and at 31 December 2003 is as follows:

	2004 Fixed rate Weighted average interest rate %	**2004 Fixed rate Weighted average period for which rate is fixed Years**
Currency:		
US Dollar	**7.79**	**5.0**
Euro	**5.05**	**1.8**
Swiss Franc	**2.00**	**0.2**
Canadian Dollar	**5.21**	**1.1**

	2003 Fixed rate Weighted average interest rate %	2003 Fixed rate Weighted average period for which rate is fixed Years	2003 Interest free Weighted average period to maturity Years
Currency:			
Sterling	12.08	0.4	–
US Dollar	7.79	6.0	–
Czech Koruna	20.00	1.3	–
Euro	4.49	3.1	2.8
Canadian Dollar	7.30	0.3	1.0

The interest on floating rate financial liabilities is based on the relevant national inter-bank rate and is fixed in advance for periods normally between 3 and 12 months.

26. Derivatives and other financial instruments continued

Currency exposures

The Group's objectives in managing the currency exposures arising from its net investment overseas (in other words, its structural currency exposures) are to maintain a low cost of borrowings and to retain some potential for currency-related appreciation while partially hedging against currency depreciation. Gains and losses arising from these structural currency exposures are recognised in the statement of total recognised gains and losses.

The table below shows the Group's currency exposures; in other words, those transactional (or non-structural) exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the Group that are not denominated in the operating (or 'functional') currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas operations.

The exposures as at 31 December 2004 were as follows:

	Net foreign currency monetary assets			
	US $ £m	**Euro £m**	**SEK £m**	**Total £m**
Functional currency of Group operation:				
Sterling	**7.4**	**0.4**	**0.1**	**7.9**
Euro	**2.6**	**–**	**–**	**2.6**
Swiss Franc	**–**	**0.1**	**–**	**0.1**
Swedish Krona	**0.3**	**2.0**	**–**	**2.3**
Canadian Dollar	**1.1**	**–**	**–**	**1.1**
Total	**11.4**	**2.5**	**0.1**	**14.0**

The exposures at 31 December 2003 for comparison purposes were as follows:

	Net foreign currency monetary assets			
	US $ £m	Euro £m	SEK £m	Total £m
Functional currency of Group operation:				
Sterling	1.1	1.4	0.1	2.6
Swiss Franc	–	0.1	–	0.1
Total	1.1	1.5	0.1	2.7

The amounts shown in the tables above take into account the effect of any forward contracts and other derivatives entered into to manage these currency exposures.

Maturity of financial liabilities

The maturity profile of the Group's financial liabilities at 31 December 2004 and 31 December 2003 was as follows:

	2004 £m	2003 £m
In one year or less	**8.2**	16.3
In more than one year but not more than two years	**174.2**	12.7
In more than two years but not more than five years	**45.9**	168.3
In more than five years	**2.3**	48.2
Total	**230.6**	245.5

26. Derivatives and other financial instruments continued

Fair values

Set out below is a comparison by category of book values and fair values of the Group's financial assets and liabilities at 31 December 2004 and 31 December 2003.

	2004 Book value £m	2004 Fair value £m	2003 Book value £m	2003 Fair value £m
Primary financial instruments held or issued to finance the Group's operations				
Financial assets	**142.1**	**142.1**	35.2	35.2
Long-term borrowings	**(222.4)**	**(223.4)**	(229.2)	(231.4)
Short-term financial liabilities and current portion of long-term borrowings	**(8.2)**	**(8.2)**	(16.3)	(16.3)

The fair value of forward foreign currency contracts and US Dollar denominated long-term fixed rate debt with a carrying amount of £41.8m (2003: £44.7m) have been calculated by discounting cash flows at prevailing interest rates. All the other fair values shown above have been determined by reference to prices available from the markets on which the instruments involved are traded.

Gains and losses on hedges

The Group enters into forward foreign currency contracts to eliminate the currency exposures that arise on sales and purchases denominated in foreign currencies when those sales or purchases are transacted. Changes in the fair value of instruments used as hedges are not recognised in the financial statements until the hedged position matures. The unrecognised gains and losses were not material either in 2004 or 2003.

Borrowing facilities

The Group had undrawn committed borrowing facilities at 31 December 2004 and 31 December 2003, in respect of which all conditions precedent had been met, as follows:

	2004 £m	2003 £m
Expiring in one year or less	**17.4**	18.4
Expiring in more than two years	**15.7**	14.5
Total	**33.1**	32.9

Five Year Summary

Bodycote

	2004	2003 As restated	2002 As restated	2001 As restated	2000 As restated
	£m	£m	£m	£m	£m
Turnover					
Continuing operations	**445.5**	435.7	429.5	469.1	359.4
Discontinued operations	**11.7**	12.7	10.6	10.3	11.7
	457.2	448.4	440.1	479.4	371.1
Profits/(Losses)					
Trading profit	**43.6**	32.6	40.7	72.1	82.8
Operating exceptional items	**–**	(7.5)	(18.3)	–	–
Operating profit	**43.6**	25.1	22.4	72.1	82.8
(Loss)/profit on disposal of operations	**(11.2)**	3.5	–	(1.9)	9.5
Restructuring costs	**–**	(30.0)	–	–	–
Loss on disposal of fixed assets	**–**	–	–	(0.8)	–
Net interest payable	**(7.9)**	(9.7)	(11.2)	(13.9)	(6.9)
Profit/(loss) before taxation	**24.5**	(11.1)	11.2	55.5	85.4
Taxation	**(5.6)**	(6.2)	(4.8)	(18.0)	(21.0)
Profit/(loss) after taxation	**18.9**	(17.3)	6.4	37.5	64.4
Minority interests	**(0.2)**	(0.1)	(0.1)	(0.1)	–
Profit/(loss) for the financial year	**18.7**	(17.4)	6.3	37.4	64.4
Headline earnings per share (pence)*	**11.3**	9.1	9.9	17.0	21.1
Dividend per share (pence)*	**6.1**	5.7	5.7	5.7	5.6
Assets employed					
Intangible fixed assets	**131.4**	137.5	155.5	154.4	81.6
Tangible fixed assets	**428.7**	478.7	498.4	496.6	410.5
Other current assets and liabilities	**(35.7)**	(34.1)	(30.3)	(18.5)	(31.1)
	524.4	582.1	623.6	632.5	461.0
Financed by					
Share capital	**32.1**	25.7	25.6	25.6	25.6
Reserves	**402.8**	345.2	363.6	364.2	341.7
Shareholders' funds	**434.9**	370.9	389.2	389.8	367.3
Minority interests	**1.0**	0.9	0.2	0.7	0.2
Net borrowings	**88.5**	210.3	234.2	242.0	93.5
	524.4	582.1	623.6	632.5	461.0
Net assets per share (pence)	**135.5**	144.5	151.8	152.0	143.3
Return on capital employed before exceptional items (%)	**7.9**	5.4	6.5	13.2	19.2
Return on capital employed after exceptional items (%)	**5.9**	(0.2)	3.6	12.8	21.4

Figures marked * have been adjusted to take into account the 1 for 4 rights issue completed in March 2004.

Principal Subsidiary Undertakings

Heat Treatment

		Country of incorporation or registration
*Bodycote Heat Treatments Limited	Aldridge, Broxburn, Cambridge, Chard, Cheltenham, Coventry, Derby, Gillingham, Great Barr, Hazel Grove, Macclesfield, Rotherham, Skelmersdale, Walsall, Willenhall and Woodford	England
Bodycote Wärmebehandlung GmbH	Ebersbach, Eching, Essen, Esslingen, Karben, Köln, Korntal, Landsberg, Langenselbold, Lüdenscheid, Menden, Nürnberg, Remscheid, Sömmerda, Sprockhövel and Wehingen	Germany
Bodycote Hardingscentrum BV	Diemen, Hengelo, Tilburg and Venlo	Netherlands
Bodycote Hardiff BV	Apeldoorn	Netherlands
Bodycote Rheintal Wärmebehandlung AG	Schaan	Liechtenstein
Bodycote Austria Wärmebehandlung GmbH	Kapfenberg, Marchtrenck and Vienna	Austria
Bodycote Switzerland Wärmebehandlung AG	Fallenden and Urdorf	Switzerland
Bodycote Czech Republic Heat Treatment S.r.o.	Modrice, Pilzen and Prague	Czech Republic
Bodycote Pribram S.r.o.	Pribram	Czech Republic
Bodycote HT S.r.o.	Brno and Liberec	Czech Republic
Bodycote Polska Sp z.o.o.	Warsaw	Poland
Nitrex-HTC Sp z.o.o.	Czestochowa, Chelmno, Grodzisk Mazowiecki and Zabrze	Poland
Bodycote Hokezelo KFT	Budapest	Hungary
Vide Express Romania	Brasov	Romania
Bodycote IMT Inc.	London OH and Camas WA	USA
Bodycote Thermal Processing, Inc.	Boaz AL, Fremont, San Diego, Santa Fe Springs, Santa Ana, Gardena, Huntington Park, Los Angeles, Rancho Dominguez, Vernon, Walnut, Westminster and Tarzana CA, Berlin, Waterbury, South Windsor and Suffield CT, Ipswich and Worcester MA, Canton, Lansing, Livonia and Grand Rapids MI, Cincinnati and Cleveland OH, Oklahoma City and Tulsa OK, Dallas, Houston and Fort Worth TX, Laconia NH, Melrose Park IL, Indianapolis IN, Eden Prairie MN, St Louis MO, Rochester NY, Lexington TN, Clintonville, Sturtevant and New Berlin WI	USA
Bodycote Thermal Processing Canada, Inc.	Newmarket and Kitchener ON	Canada
Bodycote HIT	Ambazac, Amiens, Beaugency, Brétigny sur Orge, Billy-Berclau, Cernay, Chanteloup les Vignes, Charleville Mézières, Chassieu, Cluses, Condé sur Noireau, Gemenos, Gennevilliers, Lagny sur Marne, La Monnerie Le Montel, La Talaudière, Le Subdray, Neuilly sur Marne, Neuilly en Thelle, Nogent, Pusignan, Serres Castet, St Aubin les Elbeuf, St Dié, St Nicolas d'Aliermont, St Rémy en Mauges, Thyez and Voreppe	France
Bodycote Italia Srl	Gorgonzola	Italy
Bodycote Trattamenti Termici SPA	Flero, Madone and Rodengo	Italy
Bodycote Belgium	Brussels and Nivelles	Belgium
Bodycote Värmebehandling AB	Anderstorp, Göteborg, Karlskoga, Linköping, Malmö, Mora, Stockholm, Värnamo and Västerås	Sweden
Bodycote Lämpökäsittely Oy	Pieksämäki, Tampere, Vaasa and Vantaa	Finland
Bodycote Värmebehandling A/S	Århus and Herlev	Denmark
Bodycote Haustrup Haerderiet A/S	Ejby	Denmark

Vacuum and sealed quench and induction heat treatment, carburising, carbonitriding, gas and plasma nitriding, nickel, copper, silver and gold brazing, hardening, tempering, kolsterising, low pressure carburising and electron beam welding.

Materials Testing

Bodycote Materials Testing Limited	Bridgwater, Burton-on-Trent, Dalkeith, Daventry, Droitwich, Dudley, Glasgow, Greenford, Greenock, Huddersfield, Lancaster, Manchester, Middlesbrough, Newcastle, Newbridge, Nuneaton, Salford, Sheffield, Shotton, Washington and Windsor	Scotland
Bodycote Materials Testing BV	Emmen and Spijkenisse	Netherlands
Bodycote Materials Testing A/S	Sandnes	Norway
Bodycote Materials Testing Srl	Milan	Italy
Bodycote CTR Srl	Padua	Italy
Bodycote Materials Testing Services Limited	Abu Dhabi and Al Ain	Guernsey
Al Futtaim Bodycote Materials Testing Services LLC (49% owned)‡	Dubai	Dubai
Bodycote Materials Testing Services Limited Company & LLC (70% owned)‡	Muscat and Sohar	Oman
Bodycote Materials Testing Services LLC (24.5% owned)‡	Doha	Qatar
Bodycote Materials Testing Inc.	Chicago and Melrose Park IL, Houston TX, Los Angeles CA, Detroit MI and Portland OR	USA
Bodycote Materials Testing Canada Inc.	Burlington, Cambridge, Mississauga and Niagara Falls ON, Montreal and Quebec City QC, Calgary and Edmonton AL	Canada
Bodycote Polymer AB	Nyköping	Sweden
Bodycote CMK AB	Karlskoga	Sweden
Bodycote Materials Testing s.r.o.	Pilzen	Czech Republic

Testing services for producers and users. Mechanical, corrosion, physical, radiographic and chemical testing of ferrous and non-ferrous alloys, building products, ceramics, composites and plastics and lifetime assessment of polymers. Healthcare testing, microbiological assessment, water analysis, fire, drug, pharmaceutical, asbestos and food product testing. Automotive engine structural and environmental exposure testing.

Hot Isostatic Pressing

*Bodycote H.I.P. Limited	Chesterfield and Hereford	England
Bodycote IMT Inc.	Andover MA, London OH, Princeton KT and Camas WA	USA
Bodycote Heiss-Isostatisches Pressen GmbH	Haag	German
Bodycote IMT NV	Sint-Niklaas	Belgium
Bodycote Hot Isostatic Pressing AB	Surahammar	Sweden

Application of the hot isostatic process and the manufacture of specialist steels and products using hot isostatic pressing technology.

Principal Subsidiary Undertakings

Surface Engineering

		Country of incorporation or registration
*Bodycote Metallurgical Coatings Limited	Knowsley, Macclesfield, Uxbridge and Wolverhampton	England
Bodycote K-Tech, Inc	Hot Springs AR	USA
Bodycote Ytbehandling AB	Gnosjö, Katrineholm, Karlstad, Mullsjö, Vansbro and Västra Frölunda	Sweden
Bodycote Pintakäsittely Oy	Espoo	Finland
Bodycote Nussbaum GmbH & Co KG.	Kaufbeuren	Germany

Surface engineering for product improvement including sherardizing, mechanical plating, organic, plasma spray, anodising and ceramic coating.

Property and General

*Thomas Cook & Son Insurance Brokers Limited (75% owned)	Burnley	England

Insurance broking, industrial and commercial risk management, independent financial advisers.

Bodycote Property Holdings Inc.	Mississauga ON	Canada

Managers of the Group's property interests.

SSCP Coating S.à.r.l. - Physical Vapour Deposition

Through its investment in SSCP Coating S.à.r.l. in which the Company has a 20% shareholding, Bodycote has sales representation at the following IonBond locations:

Consett and Mansfield (England), Cernay, Chassieu, Neuilly-en-Thelle, Serres Castet, and Auterive (France), Gorgonzola and Vimercate (Italy), Nurnberg and Hohenstein-Ernstthal (Germany), Venlo (Netherlands), Linkoping (Sweden), Madison Heights and Troy MI, West Chicago IL, Beachwood OH, Indianapolis IN, Greensboro NC, Rockaway NJ, Duncan SC, West St Paul MN (USA), Stoney Creek and Cambridge ON (Canada), Sta Caterina and Tecate (Mexico), Bangplee (Thailand) and Singapore.

Except where stated, these companies are wholly owned subsidiaries and have only one class of issued shares. Subsidiaries marked with an asterisk* are held directly by Bodycote International plc. Entities marked ‡ have been treated as subsidiary undertakings in the financial statements because the Group exercises a dominant influence over these entities.

Notice of Annual General Meeting

NOTICE IS HEREBY GIVEN that the 52nd Annual General Meeting of BODYCOTE INTERNATIONAL PLC will be held at The Stanneylands Hotel, Stanneylands Road, Wilmslow SK9 4EY on Wednesday 25 May 2005, at 1500 hours for the following purposes:

As ordinary business

1. To receive the annual report and statement of accounts for the year ended 31 December 2004.
2. To approve the Board Report on Remuneration.
3. To declare a final dividend.
4. To re-elect Mr J D Hubbard as a Director of the Company.
5. To re-elect Mr J Vogelsang as a Director of the Company.
6. To re-appoint Deloitte & Touche LLP as auditors of the Company and authorise the Directors to fix their remuneration.

As special business

To consider and, if thought fit, to pass the following resolutions which will be proposed as to resolution 7 as an ordinary resolution and as to resolutions 8 and 9 as special resolutions:

7. That the Directors be and they are hereby generally and unconditionally authorised pursuant to Section 80 of the Companies Act 1985 to exercise any power of the Company to allot and grant rights to subscribe for or to convert securities into shares of the Company up to a maximum aggregate nominal amount of £10,899,953 PROVIDED THAT the authority hereby given shall expire on the date which is fifteen calendar months after the passing of this resolution unless previously renewed, varied or revoked by the Company in general meeting save that the Directors may, notwithstanding such expiry, allot any shares or grant any such rights under this authority in pursuance of an offer or an agreement so to do made by the Company before the expiry of this authority.

8. That, subject to the passing of the resolution numbered 7, the Directors be and they are hereby empowered pursuant to Section 95 of the Companies Act 1985 to allot equity securities (within the meaning of Section 94 of the Companies Act 1985) for cash pursuant to the authority conferred by the said resolution as if Section 89(1) of the Companies Act 1985 did not apply to any such allotment provided that this power shall be limited:

   (a) to the allotment of equity securities (within the meaning of Section 94 of the Companies Act 1985) in connection with rights issues in favour of ordinary shareholders where the equity securities respectively attributable to the interests of all ordinary shareholders are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them subject to such exclusions or other arrangements as the Directors consider appropriate, necessary or expedient to deal with any fractional entitlements or with any requirements of any regulatory body or recognised investment exchange or otherwise;

   (b) to the allotment of equity securities pursuant to the terms of the Bodycote International executive share option schemes

   (c) to the allotment (otherwise than pursuant to sub-paragraphs (a) and (b) above) of equity securities up to an aggregate nominal value of £1,605,002 being 5% of the issued share capital of the Company; and

   (d) the authority hereby given shall expire at the close of the next annual general meeting of the Company to be held after the date hereof unless such authority is renewed prior to such time; but a contract of purchase may be made before such expiry which will or may be executed wholly or partly thereafter, and a purchase of shares may be made in pursuance of any such contract.

9. That the Company be and it is hereby generally and unconditionally authorised to make market purchases (within the meaning of Section 163(3) of the Companies Act 1985) of ordinary shares of 10 pence each in the Company provided that:

   (a) the maximum number of shares hereby authorised to be acquired is 32,096,876;

   (b) the maximum price which may be paid for any such share is an amount equal to 105% of the average of the middle market quotations for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the share is contracted to be purchased;

   (c) the minimum price which may be paid for any such share is 10 pence; and

   (d) the authority hereby given shall expire at the close of the next annual general meeting of the Company to be held after the date hereof unless such authority is renewed prior to such time; but a contract of purchase may be made before such expiry which will or may be executed wholly or partly thereafter, and a purchase of shares may be made in pursuance of any such contract.

By order of the Board
J. R. GRIME,
Secretary.

Hulley Road, Hurdsfield,
Macclesfield, Cheshire SK10 2SG
1 March 2005

Notes

1. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the Company specifies that only those shareholders registered in the Register of Members of the Company as at 1700 hours on 23 May 2005 shall be entitled to attend or vote at the Meeting in respect of the number of shares registered in their names at that time. Changes to entries on the Register of Members after 1700 hours on 23 May 2005 shall be disregarded in determining the rights of any person to attend or vote at the Meeting.
2. Every member who is entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and on a poll vote in his/her stead. A proxy need not be a member.
3. Brief biographical details of Directors standing for re-election at the Meeting are set out on page 18.

Recommendation and explanatory notes

Renewal of authority to allot shares (Resolutions 7 and 8)

Under the provisions of Section 80 of the Companies Act 1985 the Directors are not able to allot shares except with the general or specific approval of shareholders. A general authority was granted on 26 May 2004 in respect of the shares then unissued and it is now proposed in resolution number 7 in the notice convening the annual general meeting that this authority be renewed for a period of fifteen months from the date of passing the resolution in respect of £10,899,953 (being the unissued share capital as at 20 February 2005) which represents 33.9% of the issued share capital. No shares are held in treasury.

The Board has no present intention of issuing any further shares nor will any such issue be made which would effectively alter the control of the Company without the prior approval of shareholders in general meeting.

Sections 89 and 95 of the Companies Act 1985 provide that any ordinary shares issued for cash must first be offered to existing shareholders unless their approval is obtained that this stipulation should not be applied. The Directors consider it desirable that they should have the authority to make allotments of ordinary shares for cash, other than by way of rights issues to existing shareholders, up to a maximum nominal value of £1,605,002 being 5% of the issued ordinary share capital as at 20 February 2005.

Purchase of own Shares (Resolution 9)

Under Article 9 the Company is empowered to purchase its own shares. The Directors consider that the power to make purchases in the market of the Company's own shares should be maintained, and accordingly recommend the approval of the special resolution set out as resolution number 9. The Directors intend to exercise this authority only where, in the light of market conditions prevailing at that time, they believe that the effect of such purchases would be to increase earnings per share, or to deliver shares to participants in the Bodycote International executive share option schemes. Any shares purchased in this way will either be cancelled, in which case the number of shares in issue will be reduced accordingly, or held as treasury shares.

The resolution specifies the maximum and minimum prices at which shares may be bought, and the maximum number of shares which may be bought, this being 10% of the Company's issued ordinary share capital. As at 31 December 2004 outstanding share options over unissued shares totalled 7,321,297 and this represented 2.3% of the Company's issued share capital. If the Company utilised the authority proposed by resolution 9 in full, outstanding share options would then represent 2.5% of the consequently reduced share capital.

The Directors consider that the proposals described in this notice are in the best interests of the shareholders as a whole and unanimously recommend shareholders to vote in favour of all the resolutions proposed, as they intend to do in respect of their own beneficial holdings.

A form of proxy is enclosed for those entitled to vote. Instructions are given for electronic proxy voting and voting by CREST.

Financial Calendar

Annual general meeting	25 May 2005
Final dividend for 2004	6 July 2005
Interim results for 2005	August 2005
Interim dividend for 2005	January 2006
Results for 2005	March 2006

Shareholder Enquiries

Enquiries on the following administrative matters can be addressed to the Company's registrars, Capita Registrars, Northern House, Woodsome Park, Fenay Bridge, Huddersfield HD8 0LA. Telephone: 0870 1623131 or +44(0)208 639 2157; Fax: +44(0)1484 600911; and email: shareholder.services@capitaregistrars.com

- Change of address
- Lost share certificates or dividend cheques
- Dividend mandates
- Amalgamation of holdings

Forms for these matters can be downloaded from the registrars' website at www.capitaregistrars.com, where shareholders can also check their holdings and details.

Shareholder Analysis

Analysis of share register as at 20 February 2005

Holding range:	Number of shareholders	%	Number of Shares	%
1 to 1,000	945	29.10	478,291	0.15
1,001 to 10,000	1,619	49.86	5,917,432	1.84
10,001 to 100,000	594	18.29	43,218,802	13.46
100,001 to 500,000	36	1.11	25,877,366	8.06
500,001 and over	53	1.64	245,508,571	76.49
	3,247	100.00	321,000,462	100.00

Types of shareholders:	% of shareholders	% of total shares
Directors' interests	0.1	0.5
Major institutional and corporate holdings	7.1	92.0
Other shareholdings	92.8	7.5
	100.0	100.0

As at 1 March 2005 the following interests of 3% or more in the issued share capital of the Company appeared in the register maintained under the provisions of Section 211 of the Companies Act 1985:

	Number of shares	%
Sprucegrove Investment Management Limited	24,005,166	7.5
Franklin Resources Inc.	20,433,059	6.4
Aegon Asset Management UK plc	17,840,270	5.6
LD Pensions	14,917,556	4.6
Legal & General Investment Management Limited	13,120,030	4.1

outsourcing for industry

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Printed by County Print on Munken Lynx, produced by the Arctic Paper mills in an environmentally friendly process which is constantly developed to give the least impact on the environment. The mills are all certified according to ISO 14001 and report their work according to EMAS.

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Hot Isostatic Pressing
Metallurgical Coatings