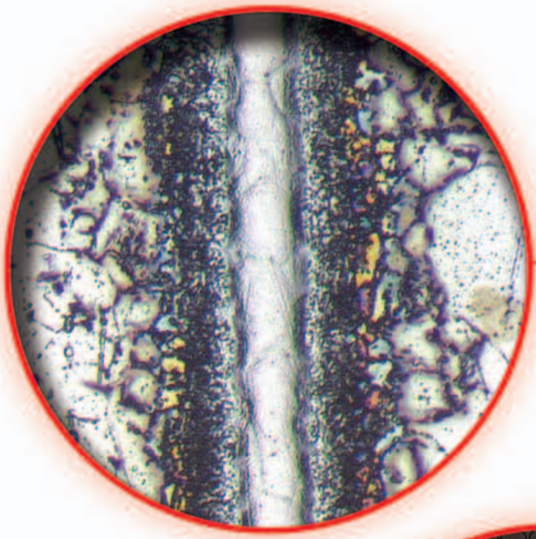
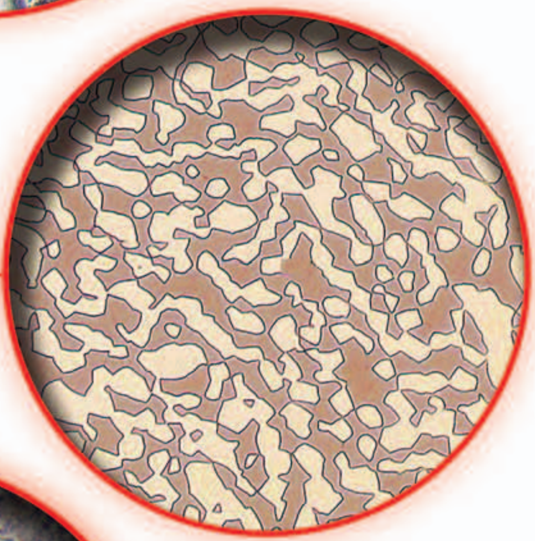
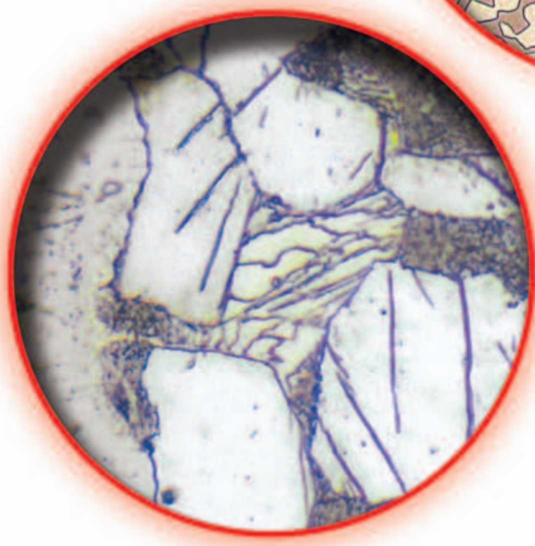


annual report **2005**





Bodycote

At a glance

Bodycote Thermal Processing

Operating 176 plants in 19 countries; an unrivalled strategically located network, experienced in supporting large multi-national customers and their supply chains, as well as local niche specialists and providing a vital link in the manufacturing process for the automotive, aerospace, construction, power generation, electronics, consumer products and general engineering industries.

Heat Treatments and Metal Joining

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. Expanding in Eastern Europe, Asia and other developing economies and developing low pressure carburising technology in Europe and the USA.

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 the Densal® process and other new materials and manufacturing techniques by collaborative projects with market-leading OEMs.

Surface Engineering

Improving the performance, durability and appearance of components and tools by the application of functional and decorative coatings utilising sherardizing, mechanical cladding, plasma spray, organic, anodizing, HVOF and specialist ceramic coatings processes. Establishing CoatAlloy®, the unique new Bodycote coating service for the petrochemical industry.

Bodycote Testing

Offering a fully accredited group of 76 testing laboratories in 12 countries for producers and other users, serving international customers and providing a beneficial outsource option for advanced businesses. Measuring, inspecting and certifying the quality and reliability of materials and products for many clients in the fields of civil engineering, food and household goods, pharmaceuticals, energy and transportation. Bodycote Testing also provides services to protect the environment and workplace.

Materials Testing

Mechanical, metallurgical, physical, radiographic and chemical testing of ferrous and non-ferrous alloys, building products, composites and plastics, oils (wear and high voltage) and the lifetime assessment of polymers. Bodycote Testing provides vital support services for manufacturers and plant operators.

Health Sciences

Testing, evaluation, research and development for food, pharmaceutical and consumer products and asbestos building surveys. Bodycote Health Sciences support a multi-national client base in a highly regulated laboratory environment.

Engineering and Technology

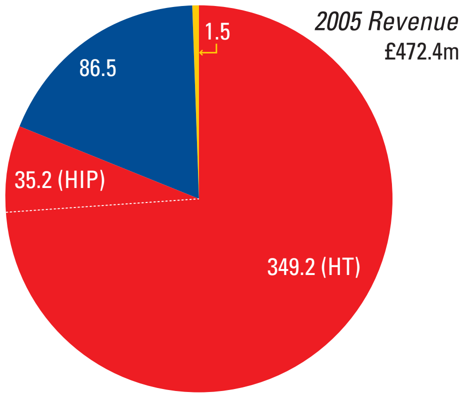
Providing advanced airframe and aero-engine testing for material integrity, oil field, corrosion testing, automotive engine development and production testing. Bodycote Engineering and Technology delivers advanced solutions in a cost effective outsourced environment.

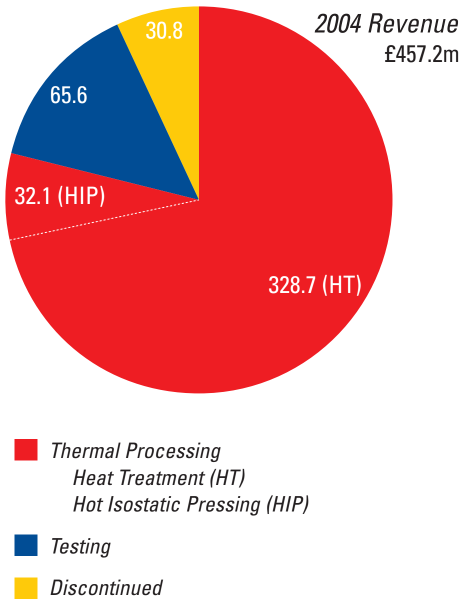
Environmental

Sampling and testing hazardous materials, soils and water, eco-toxicology and stack emission sampling. Bodycote Environmental brings scientific measurement to facilitate environmental studies and management.

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 46 PVD coatings centres in 17 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 2005 results presentation in the Investor Relation section of the website. We invite you to view and to listen by visiting www.bodycote.com/audiocast

Cover images: A nickel brazed joint (top) Duplex stainless steel (middle) Nitrocarburised surface (bottom).

Bodycote

	2005	2004	Change %
Revenue - Continuing Operations	**£470.9m**	£426.4m	10
Headline Operating Profit[1,2]	**£67.8m**	£53.1m	28
Headline Profit Before Taxation[1]	**£58.8m**	£46.7m	26
Headline Earnings Per Share[3]	**14.6p**	11.7p	25
Basic Earnings Per Share	**12.7p**	12.2p	4
Dividend Per Share	**6.4p**	6.1p	5

1 Expressed pre impairment of goodwill (£5.8m, 2004: £nil), amortisation of acquired intangibles (£0.2m, 2004: £nil) and restructuring costs (£nil, 2004: £2.4m).

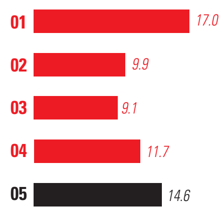
2 Expressed before interest and tax on associates (£0.8m, 2004: £nil).

3 A detailed breakdown can be found in note 10 on page 41.

Revenue - Continuing Operations
£ Million

Dividend Per Share[3]
Pence

Headline Earnings Per Share[3]
Pence



CONTENTS

Chairman's Statement

2005 was another year of solid achievement for Bodycote. Revenue from continuing operations rose in the year by 10% to £470.9m (2004: £426.4m). We achieved strong organic growth of 5% and a further 5% from a series of bolt-on acquisitions.

Profits and cash flow have continued their upward progression in all the regions, both in terms of local currency and after translating into Sterling. Headline operating profit [1, 2] increased by 28% to £67.8m (2004: £53.1m). Our headline profit before taxation [1] showed an increase of 26% to £58.8m (2004: £46.7m). Operating profit improved by 10% to £61.0m (2004: £55.5m), whilst profit before taxation was £52.7m compared to £46.7m in 2004. Our balance sheet is strong.

I am pleased to report that the Board is recommending an increase of 5% for the final dividend to 4.05p per share (2004: 3.85p), to be paid on 5 July 2006 to those shareholders on the register at the close of business on 9 June 2006. The total dividend for the year is therefore up 5% at 6.4p (2004: 6.1p) and is covered 2.3 times by headline earnings.

This year we have improved our return on capital employed (including all goodwill previously written off) from 7.6% to 9.9% at the pre-tax level, whilst at the same time continuing to invest in projects that will bring a longer term benefit to the Group.

IonBond, in which the Group has a 20% shareholding following the transfer of our PVD coatings business, also had a good year having grown sales by 25%, principally by acquisition from £53m to £66m.

We are continuing the expansion of our Testing business both in terms of service offerings and geographical coverage. Further profitable growth is forecast in this Strategic Business Unit (SBU) for 2006. During the year ten testing acquisitions were made by the Testing SBU at a cost of £21.9m. In the current year to date we have made four further acquisitions at a cost of £22.1m.

We are also clearly focussed on growing our Thermal Processing businesses, by expanding into new geographies as well as targeting specific acquisitions in existing territories. We made four acquisitions in 2005 at a cost of £9.9m, established a facility in Poland and are on schedule to open a greenfield plant in China in mid 2006.

As ever we have continued to make progress in the year on improving the safety and health of our employees at work. Further improvement remains a constant focus for all the management team. Similarly there has been significant progress in addressing the Group's environmental profile and our ISO14001 approval programme is moving ahead well.

These are the first year end accounts that have been prepared under IFRS and, as previously reported, whilst adoption of IFRS required significant management resource, except for the fact that goodwill is no longer amortised, the effect is not significant in terms of pre-tax profits and the balance sheet.

Like many companies we do have pension deficits, principally in the UK. However, these liabilities at £29.9m are less than 4% of our market capitalisation and have now been reflected in our balance sheet for the first time in accordance with IFRS.

The Group continues to press for high standards of governance that are appropriate for the needs of the business. Since 1999 we have been performing an annual risk management review and increasing emphasis is placed on risk assessment throughout the Group. The Board and senior operating board assess business risk and prioritise actions and resources to mitigate the impact of identified risks more effectively. The objective is to improve the Group's overall risk management performance and further embed risk management practices at all levels of management. During 2006 it is planned to provide more training for managers in this area.

Our prime objective for delivering value to shareholders is continuing to improve our return on invested capital. We remain focussed on keeping a close control on costs and increasing efficiency.

The Group is in good heart and well positioned for future growth, with its wide customer base, good geographic spread, and a highly committed workforce who are able to offer our customers an ever improving level of service. Going forward we are optimistic that markets are growing, particularly in the area of aerospace, industrial gas turbine (IGT), oil and gas and health sciences. We expect to continue to benefit from our technological innovation and service levels to manufacturers as these customers increasingly seek Bodycote's help to manage their cost base. These strengths and the indications from end markets, mean that we face 2006 with conviction and confidence for further organic growth and the completion of a number of bolt-on acquisitions.

James AS Wallace

James Wallace
28 February 2006

[1] expressed pre impairment of goodwill (£5.8m, 2004: £nil), amortisation of acquired intangibles (£0.2m, 2004: £nil) and restructuring costs (£nil, 2004: £2.4m).

[2] expressed before interest and tax on associates (£0.8m, 2004: £nil).

INTRODUCTION

I am pleased to report that performance continued to improve in 2005. Group revenue (excluding the divested coatings businesses) at £470.9m was 10% ahead of 2004. Using constant currency exchange rates, revenue grew 9% compared to 2004, of which 5% was an organic increase. With growth in the aerospace market, a continuing strong demand from the IGT sector, new outsourcing business, increased market share and the majority of energy cost increases having been recovered, we were able to improve operating margins from 13.0% to 14.4%. Headline operating profit[1] grew 28% to £67.8m compared with £53.1m a year ago. Operating profit increased by 10% to £61.0m from £55.5m in 2004. I thank all the people in Bodycote who have helped deliver these improved results.

OPERATIONAL REVIEW

During the year we made good progress in executing our strategy to rebalance our portfolio by growing the relative size of our Testing SBU whilst continuing to expand our Thermal Processing SBU into developing manufacturing economies. We also increased our investment in our associate undertaking IonBond to 20% by the exercise of an option negotiated at the time of the transfer of our PVD division in 2004.

Securing major outsourcing opportunities remains a key element of our strategy. Outsourcing supports our top line growth, which is typically higher than the official rate of increase in the level of manufacturing activity and enhances margins through increased facility utilisation. Bodycote's outsourcing initiative offers manufacturers lower total cost, equal or better quality and fast, reliable turnaround. The key to our outsourcing success is our technical expertise in niche technologies which are critical but 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) grew 35% and now accounts for 21% of Group revenue compared with 16% in 2004. Several new SPs will start generating revenue in 2006.

Technology transfer initiatives continue to be successful. The extension of these high value added services enhances customer satisfaction and leads 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 their core competencies. The IonBond venture is proving to offer synergistic benefits to our customers and partners. Our geographic and market spread reduces the risk associated with any one account or country. Our top ten customers accounted for approximately 12% of total revenue, compared to 11% in 2004.

During 2005 £31.8m was spent on 14 bolt-on acquisitions. The Health Sciences division of the Testing SBU acquired three laboratories in the food testing sector to spearhead a global expansion in this market. Seven further laboratories were added during the year to enhance our existing footprint in each of the Materials Testing, Engineering & Technology and Environmental divisions. Of particular note was the establishment of a European Engineering & Technical Centre in Sweden through the purchase of CSM Materialteknik AB from SAAB AB.

The Heat Treatment division of our Thermal Processing SBU expanded its geographical presence with four bolt-on acquisitions. In Eastern Europe we acquired four plants in Poland and a 75% interest in the heat treatment activities of Uttis Industries SA in Romania. We also strengthened our position in the aerospace and nuclear market sectors by the purchase of Nadcap-approved Expert Heat Treatments Limited in the UK and ABMT SA in France.

The divestiture of our non-core electroplating activities was completed midyear and generated cash receipts of £5.8m. Other asset sales, including the divestiture of one heat treatment plant in North America, generated a total of £8.6m.

THERMAL PROCESSING

Thermal Processing revenue was £384.4m (7% growth) and operating profit was £54.3m (18% improvement) with an operating margin of 14% compared to 13% in 2004. The Thermal Processing SBU operates as two divisions, Heat Treatment and Hot Isostatic Pressing (HIP) with our remaining Surface Engineering activities now incorporated into the Heat Treatment division. Their performance was as follows:

HEAT TREATMENT

Revenue was £349.2m (6% growth) and operating profit was £44.8m (15% improvement) with operating margin of 13% compared to 12% in 2004. Strong growth in aerospace, oil and gas, continued strength in IGT and overall stable automotive demand provided a reasonable background for our performance.

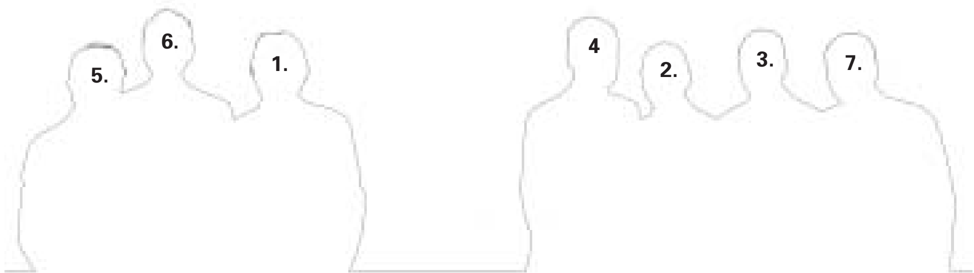
Americas

Revenue of £112.8m (an increase of 9%) and operating profit of £11.2m (up 38%) were generated. Our aerospace, IGT, and oil and gas sectors all saw improved demand from a combination of market pickup and new outsourcing contracts. Several automotive related facilities saw a decline in the second half which, based on industry forecasts, will remain at subdued levels in 2006. The combination of price pressure and increases in energy and employee costs continue to hold back the margin improvement expected from higher volumes. 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 treatment and brazing services thus helping to improve margins in the oversupplied North American market.

The Board of Directors

Members of the Board

1. **James Wallace** Chairman
2. **John Hubbard** Chief Executive
3. **David Landless** Finance Director
4. **Derek Sleight** Corporate Development Director
5. **Richard Scholes** Senior Independent Non-Executive Director
6. **Hans Vogelsang** Non-Executive Director
7. **Laurent Bermejo** Non-Executive Director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Chief Executive's Review

Europe
Revenue of £236.4m (an increase of 5%) and operating profit of £33.7m (up 11%) were generated. Although the manufacturing sector faced a difficult environment, our strategy of pursuing outsourced work, transferring technology and optimising operational efficiencies paid off. Almost all automotive focused facilities are now certified to the stringent TS 16949 automotive quality standard, whilst most facilities will achieve ISO 14001 environmental certification by the end of 2006. This positions us in line with the quality and responsibility expectations of world class manufacturers. Our network of Eastern European facilities was expanded in 2005 by the commissioning of a start-up facility in Poland which was immediately followed by the acquisition of the market leader with four facilities. Our Romanian facility was merged with a competitor to create a market leading position, with Bodycote owning 75% of the new entity. Continued growth in our Eastern European operations during 2006 is anticipated.

Asia
Our previously announced development in Wuxi, China has been boosted by the award of an outsourcing contract from Faurecia SA (affiliated to PSA Peugeot Citroën) for the heat treatment of automotive components. Construction of this 10,000 m^2 plant is expected to be completed in the second half of this year. The size of the plant has been doubled from that originally envisaged due to strong interest from other western companies setting up manufacturing bases in the area. As part of the expansion a Testing laboratory has also been added to the project. The total cost of the new facility is expected to be approximately £5m. Bodycote intends to complete similar new factories in other carefully selected areas of China over the next five years to service predominantly western companies establishing new manufacturing operations in the region. We are actively evaluating opportunities in other Asian markets.

HIP
Divisional revenue was £35.2m (10% growth) and operating profit was £9.5m (34% improvement), with an operating margin of 27% compared with 22% in 2004. The revenue growth was driven by the continuing strong demand from the IGT market for new and replacement parts. Aerospace demand continued to pick up throughout the year and is expected to maintain this growth trend beyond 2006. Although margins improved, we still have work to do because the high investment in HIP facilities requires 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 multi-national nuclear fusion project, ITER, which will be sited in France, opens up the prospect of generating additional revenue as we have successfully demonstrated our ability to HIP manufacture critical components. Demand for Densal® treatment of aluminium castings showed excellent progress in the high performance European automotive sector with adoption in three significant applications. In Europe two large HIP units, out of service for a large part of 2004, returned to service in 2005. In North America a used HIP unit, previously acquired at low cost, will be brought into service in 2006 followed by the addition of new mega-HIP capacity in 2007.

TESTING

Revenue was £86.5m (32% growth), operating profit was £16.3m (31% improvement) and the operating margin was maintained at 19%. This growth in revenue was achieved in generally good trading environments with outsourcing demand driving organic revenue ahead by 9%. Our strategy to grow this division continues, with ten small to medium acquisitions completing in the year.

Business development strategies aligned to customer-facing service provision resulted in a reorganisation of management in 2005 along business streams as opposed to country based organisation. The Testing SBU now operates four divisions: Materials Testing, Engineering & Technology, Health Sciences and Environmental Testing.

Materials Testing
Materials Testing advanced strongly as a result of continued demand from the buoyant oil and gas sector and improving aerospace markets. Automotive outsourcing of testing continues to assist our growth. Our European business saw substantial revenue gains as a number of global projects from the Caspian region and Sakhalin Island produced significant demand for our specialist corrosion services. In aerospace and defence markets, the acquisition of CSM in Sweden strengthened our position in advanced NDT systems, polymer/composite testing, and materials consultancy offerings, enabling deployment of these services across our network.
The Middle East benefited from the acquisition of a start-up in Qatar and the purchase of GHD Cladding in Dubai. Continuing high demand for our services in the Gulf of Mexico region led to investment in a new state of the art facility in Houston, US with relocation completed in February 2006.

Engineering & Technology
In Engineering & Technology we continued to capitalise on our strategy of providing high end technical solutions to a number of industrial sectors. In the UK the acquisition of J W Worsley brings advanced environmental simulation testing into the Group to service our clients in the European transportation market. We invested in several large scale vehicle dynamics test stands at our Technology Centre in Mississauga, Canada to meet demand from North American heavy duty truck manufacturers, with several large outsourcing projects secured.

Health Sciences
The European Health Sciences unit performed extremely well with the addition of a food testing/advisory services business complementing strong revenue growth in our pharmaceutical and occupational hygiene segments. The acquisition of Law Laboratories and Allied Laboratories mid-year positioned Bodycote as the laboratory of choice for a number of large UK food retailers. The network continues to expand, with the acquired expertise and technologies being rolled out to other geographical regions through our technology transfer teams.

Environmental Testing
Our Environmental Testing business posted significant revenue growth, particularly in Canada, where the acquisition of Arthur Gordon, continued operational improvements and investments in fully automated analytical systems allowed greater customer satisfaction on deliveries whilst improving productivity.

SAFETY, HEALTH AND ENVIRONMENTAL (SHE)

SHE has always been of major importance in our business and since initiating an enhanced Group wide measurement and benchmarking system in 2004 we have seen our performance improve but we remain some way from our ultimate goal of zero accidents. Our two safety KPIs for lost time accidents showed improvement: Frequency Rate fell by 2.1% and Severity Rate fell by 12.3%. Our initiative helps us to understand better the reasons and root cause of accidents occurring within the Group, improve awareness among the employees and change behaviour. As in every other area of our business, we work on continuously improving our understanding and application of safety procedures in a consistent manner throughout the Group. We continue to roll out our Zero Tolerance Policy into the various countries. The research project we are funding at a University in California to advance safety in confined space entry procedures is expected to be finalised in 2006, with recommendations which will benefit the whole industry.

CURRENT TRADING AND PROSPECTS

Trading since the start of the New Year has been in line with the Board's expectations. Notably we entered 2006 with annualised revenue for the Testing SBU in excess of £100m.

IGT markets were strong in 2005 and we anticipate this sector will show continued modest growth in 2006. Aerospace showed improvement in 2005 and we anticipate the pace of growth will increase throughout 2006. Automotive is forecast to remain flat in terms of overall build rate for North America and Europe in 2006. The restructuring being undertaken by some manufacturers will offer challenges that we are confident we will manage successfully. The low end tooling market has continued to decline in western markets due to the movement of manufacturing to areas of lower cost, where Bodycote does not currently have a significant presence.

Since the year end we have acquired four laboratories, Norwest Soil Research (seven Canadian locations and three European joint ventures), West Coast Analytical in the USA, Tetra in the UK and ACT Laboratories, Testing and Engineering with two locations in Detroit, as well as one Heat Treatment facility, SGB Solingen, in Germany. The pipeline of potential acquisitions which fit our strategic plan and investment criteria remains well stocked. The rate of acquisitions will continue to be controlled by our commitment to integrate successfully each acquisition into our operations.

People are our number one resource. We will continue to focus our management efforts on training, improving the working environment, increasing the productivity, safety and effectiveness of our human resources. Energy, our number two cost, is anticipated to remain expensive and we will continue our endeavours to pass these costs on to our customers.

Overall we expect to maintain our performance improvement during 2006 through our continuous self-help programmes, improving market demand, disciplined capital investment and value enhancing acquisitions, all with a focus on continuing to improve our return on capital employed.

John D. Hubbard

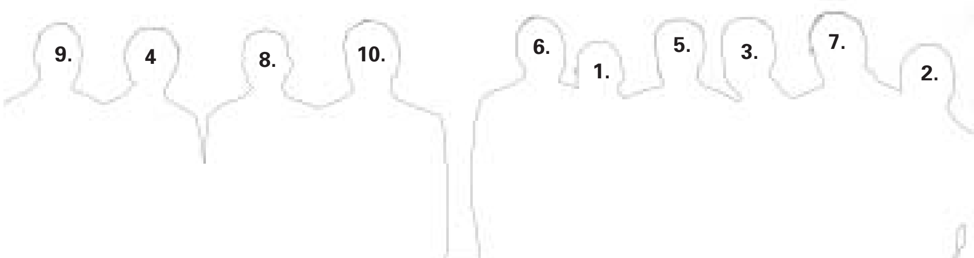
John D. Hubbard
28 February 2006

[1] expressed pre impairment of goodwill (£5.8m, 2004: £nil), amortisation of acquired intangibles (£0.2m, 2004: £nil) and restructuring costs (£nil, 2004: £2.4m).

The Senior Operating Board

Members of the Senior Operating Board

1. **John Hubbard** Chief Executive
2. **David Landless** Finance Director
3. **Derek Sleight** Corporate Development Director
4. **Martyn Wilton** MD North American SBU
5. **Mike Hallas** MD Nordic UK SBU
6. **Gerry Higgins** MD Testing SBU
7. **Jan Elwart** MD Central European SBU
8. **Guy Prunel** MD France and Belgium SBU
9. **Jean-Jacques Jeuch** MD Italian SBU
10. **John Grime** Group Secretary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Finance Director's Report

Revenue and Operating Profit

Group revenue for the continuing business in 2005 was £470.9m compared with £426.4m in 2004. Demand improved in most of the Group's markets, although conditions in automotive were challenging, particularly in the second half, for both North America and continental Europe. Whilst total sales increased by 3%, the improvement excluding the now divested electroplating and PVD businesses was 10%, of which 5% was organic, 4% was from acquisitions and 1% was due to favourable exchange rate movements.

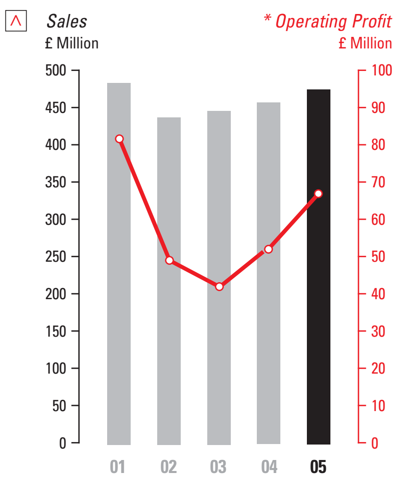
Our exit from the electroplating business was completed in March, except for one facility which was sold in August. The business broke even in 2005 and this compares to a loss, before restructuring costs, of £3.2m in 2004.

As part of our continuous improvement programme, we have reduced the activity at one of our North American heat treatment plants and have decided to write off the associated goodwill in the second half (£4.0m). This is in addition to the charge taken in the first half (£1.8m) associated with the sale of the facility at Grand Rapids, Michigan.

	Revenue		Headline Operating Profit[1]		Margin	
	£m	£m	**£m**	£m	**%**	%
	2005	2004	**2005**	2004	**2005**	2004
Heat Treatment	**349.2**	328.7	**44.8**	38.8	**12.8**	11.8
HIP	**35.2**	32.1	**9.5**	7.1	**27.0**	22.1
Thermal Processing	**384.4**	360.8	**54.3**	45.9	**14.1**	12.7
Testing	**86.5**	65.6	**16.3**	12.4	**18.8**	18.9
Head Office	**–**	–	**(2.8)**	(2.8)	**–**	–
Continuing Business	**470.9**	426.4	**67.8**	55.5	**14.4**	13.0
Electroplating/PVD (discontinued)	**1.5**	30.8	**–**	(2.4)	**–**	–
	472.4	457.2	**67.8**	53.1	**14.4**	11.6

[1] before impairment of goodwill of £5.8m (2004: £nil), amortisation of acquired intangible assets of £0.2m (2004: £nil), tax and interest on the share of results of associates of £0.8m (2004: £nil) and restructuring costs of £nil (2004: £11.2m). A reconciliation of headline operating profit to operating profit can be found on page 34.

Following on from the improved market conditions seen in 2004, the year began well and first half sales showed organic growth of 5.8%. Aerospace, IGT, oil and gas and health science markets all continued to improve. The second half of the year saw a softening in automotive demand and consequently organic growth was somewhat less at 4.7%, resulting in a 5.3% improvement for the year as a whole. The second half was also impacted by a significant escalation in energy prices. Gross energy cost was higher in the first half by approximately £1m compared to a year earlier and in the second half the year on year increase was circa £2m. Of the total annual increase of £3m, approximately £2m was recovered in selling prices during 2005 and we expect to recover the balance in 2006.



The first full year since the establishment of the Group's associate venture, IonBond, has met our expectations of higher attributable operating profit from an investment reduced by three quarters, when compared to the business which was wholly owned. The results are now reported within the heat treatment division of the Thermal Processing Strategic Business Unit, along with those of the continuing surface engineering business.

THERMAL PROCESSING

Heat Treatment

Overall sales at constant currency increased by 5.5% of which 74% was organic. Operational gearing, the ratio of change in organic operating profit to change in organic sales, at 33% was disappointing. This is accounted for by a combination of energy cost increases, soft automotive demand, which kept price increases down and labour costs, due to average people cost increases of c. 2%.

Energy prices in North America were a major issue, with the gross cost increasing by an average of 12% compared to the prior year. More than half of the increase was recovered in selling prices and this accounts for about a quarter of the year on year increase in sales value. Further recovery is expected in 2006. In Europe the largest increases were in the UK followed by Germany but were less of an issue in France and Scandinavia. Cost increases in Europe are being well recovered.

North American sales increased by 8.1%, essentially all organic, driven by growth in aerospace, IGT and oil & gas and despite some softness in automotive demand. Notwithstanding the impact of energy costs, operating margins improved by two percentage points but over-capacity in the Great Lakes region continues to see margins, on average, lower than most other parts of the Group.

In Europe the best performances were in the north. The UK saw organic sales growth of 7.5%, as a result of aerospace demand and the Nordic area was ahead by 3%, due to growth in heavy truck, marine, bearings and general engineering. The UK also benefited from the acquisition of Expert Heat Treatment with sales of £1.7m in 5 months. France and Germany saw modest sales growth in the face of softening automotive demand, particularly in France and Italy in the second half.

The best performing areas of continental Europe were the Czech Republic and Poland, with the latter assisted by the acquisition of four facilities early in the year. However, these countries currently offer a small fraction of the volumes available in the developed economies.

In Asia, the Group's first wholly-owned facility in China is under construction and the first equipment to be installed is being transferred from France.

Several of our speciality businesses had excellent performances in 2005: K-Tech® ceramics, which has much of its sales in oil and gas; plasma spray for aerospace applications and Kolsterising® for hardening stainless steel, whilst our new metallic diffusion product, CoatAlloy® was approved by several prospective customers.

HIP

HIP followed a solid performance in 2004 with further progress in 2005. At constant currencies sales were ahead 10%, driven by aerospace and IGT demand in the UK and USA and by Densal® for automotive in Germany. Operational gearing, at 80%, was good and above our expectations and resulted in a margin improvement to 27% (2004: 22%). We need to improve margins further still to meet our target of mid teens pre tax return on capital.

TESTING

The Testing Strategic Business Unit (SBU) has continued its outstanding record of growth and profit performance. At constant currencies, sales were up 29% of which 9% came from organic growth and the balance from ten bolt-on acquisitions completed during the year at a cost of £21.9m.

All parts of the SBU performed well and margins were maintained at 19% and consequently our return on capital expectations are being met. The Testing division, as with Thermal Processing, is being helped by strength in the aerospace, IGT and oil and gas sectors. Engineering and Technology is similarly benefiting but in addition, and in contrast to other parts of the Group, is seeing increases from automotive in North America as customers seek both to improve their product offerings and hence increase development programmes and lower costs via outsourcing.

Our strengthened Health Science and Environmental businesses have seen good growth, particularly in the UK, the former in the food testing arena and the latter due to asbestos characterisation and management in commercial premises. Our laboratories in the Middle East produced solid results, particularly in civil engineering markets.

PROFIT BEFORE TAX

Headline profit before tax[1] was £58.8m compared to £46.7m last year. Headline operating profit[1, 2] increased from 2004 to 2005 by £14.7 m. Foreign exchange movements during the year resulted in a net increase in operating profit of £0.7m. The Group's net interest charge (excluding net pension financing) was reduced from £8.1m to £7.3m reflecting lower average net borrowings. The net financing charge related to the Group's defined benefit pension schemes was £1.0m compared to £0.7m in 2004.

TAXATION

The effective tax rate in 2005, before impairment of goodwill and amortisation of acquired intangible assets (which are not generally allowable for tax) was 20.2% (2004: 21.4%) reflecting the mix of taxable profits and losses and the jurisdictions in which the Group operates.

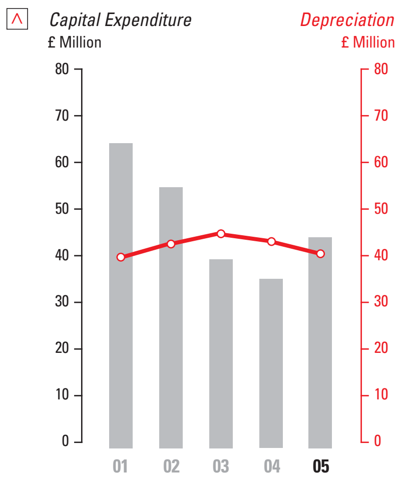
EARNINGS PER SHARE, DIVIDENDS AND INTEREST

Headline earnings per share[3] were 14.6p (2004: 11.7p), with basic diluted earnings per share being 12.7p (2004: 12.2p). The Board is recommending a final dividend of 4.05p (2004: 3.85p). The dividend is covered 2.3 (2004: 1.9) times by headline earnings. Interest, excluding net pension financing, was covered 9.1 (2004: 6.0) times by headline operating profit[1, 2].

CAPITAL EXPENDITURE

Net capital expenditure for the year was £44.0m compared to £34.0m in 2004. The multiple of net capital expenditure to depreciation was 1.1 times, following two years when the ratio was 0.8 times. With buoyant demand in a number of the Group's markets and strong growth expected in Testing, the Group anticipates a similar ratio in the coming year.

Major projects undertaken during the year included new sealed quench furnace lines in Kitchener, Ontario, Indianapolis, Cleveland, Ejby, Denmark and Zabzre, Poland; the establishment of a new heat treatment facility in Brno, Czech Republic and a new laboratory in Houston; additional Heavy Duty emissions and vehicle cooling system test cells at two locations in Canada; additional Low Pressure Carburizing equipment in Detroit and Kapfenberg, Austria; the start of installation of a new large HIP unit in Camas, Washington and a Densal® unit in Munich.



Finance Director’s Report

CASH FLOW AND BORROWINGS

After allowing for capital expenditure, interest and tax the Group generated free cash flow of £42.1m compared to £57.3m in 2004 and cash flow from operations was £95.7m compared to £100.5m in 2004. The reduction in free cash flow was primarily due to increased capital expenditure. There has been continued focus on cash collection, however, debtor days increased from 65 to 68 following a change in the treatment of bills of exchange in France, which increased debtors by £4.7m. Acquisitions, along with the additional 5% investment in IonBond, resulted in net cash outgoings of £33.9m. Net borrowings ended the year at £108.5m, an increase of £18.2m; and gearing was 25% compared to 21% in 2004.

DEFINED BENEFIT PENSION ARRANGEMENTS

The Group has defined pension benefit obligations in the UK, France, Germany and USA, which are all reflected in the Group balance sheet. In the UK the Group has a final salary scheme, which was closed to new members in April 2001 but continues to accrue benefits for current employee members, a total of just over 300 people. The deficit as calculated by the scheme actuary at 31 December 2005 using the principles of IAS 19 is £21.8m. In France we operate a plan which pays a cash lump sum on retirement and also for long service. The plan is open to new employees but by its nature is not mortality dependant. It is unfunded and the IAS 19 liability at 31 December 2005 was €5.9m. The Group’s heat treatment business in Germany has inherited several defined benefit arrangements. They are all unfunded, have no future benefit accrual and are closed to new members. The IAS 19 liability at 31 December 2005 was €4.4m. The company sponsors five defined benefit pension arrangements in the USA, which were inherited with the acquisition of Lindberg and had a total IAS 19 deficit at 31 December 2005 of $1.6m.

TREASURY

Treasury activities have the objective of minimising risk and are centralised in the Group’s head office in Macclesfield. Group Treasury is responsible for management of liquidity and interest and foreign exchange risks, operating within policies and authority limits approved by the Board. The use of financial instruments including derivatives is permitted when approved by the Board, where the effect is to minimise risk to the Group. Speculative trading of derivatives or other financial instruments is not permitted.

Bodycote has operations in 30 countries. Assets are hedged where appropriate, by matching the currency of borrowings to the net assets. The Group principally borrows in US Dollars, Euro and Swedish Krona, consistent with the location of the Groups non-sterling assets. These borrowings are at both fixed and floating interest rates and the Group will use derivatives where appropriate, to generate the desired effective currency and interest rate exposure.

Exposure to interest rate fluctuations on indebtedness is managed by using a combination of fixed and floating rates for borrowings. Consideration is given to entering into interest rate swaps and forward rate agreements. The policy objective is to have a target proportion, currently 25 to 75 per cent of net borrowings, hedged at all times.

At the end of December 2005, 24% of borrowings were at fixed rates for an average period of 4.0 years.

It is Group policy to hedge exposure to cash transactions in foreign currencies when a commitment arises, usually through the use of foreign exchange forward contracts but not to hedge exposure for the translation of reported profits.

Bodycote is financed by a mix of cash flows from operations, short-term borrowings and longer-term loans from banks, capital markets and finance leases. Bodycote’s funding policy is to ensure continuity of finance at reasonable cost, based on committed funding from several sources, arranged for a range of maturities. At 31 December 2005 Bodycote had £72.1m of unutilised committed facilities. The Group’s principal committed facility of £225m (£55m of which was unutilised at 31 December 2005) has a maturity of over 4.5 years. The Group has an $80m US privately placed bond which has just less than 4 years to maturity.

Bodycote also has access to uncommitted and short-term facilities, used principally to manage day-to-day liquidity and working capital requirements. In addition pooling, netting and concentration techniques are used to minimise borrowings.

David Landless
28 February 2006

[1] expressed pre impairment of goodwill (£5.8m, 2004: £nil), amortisation of acquired intangibles (£0.2m, 2004: £nil) and restructuring costs (£nil, 2004: £2.4m).

[2] expressed before interest and tax on associates (£0.8m, 2004: £nil).

[3] a detailed breakdown of EPS can be found in note 10 on page 41.

The Directors are pleased to submit their report and the audited financial statements for the year ended 31 December 2005.

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 85 to 87. The Chief Executive's Review contains a survey of the Group's activities, significant acquisitions and disposals during the year together with an outline of future developments.

TRADING RESULTS

The profit of the Group before taxation was £52.7 million (2004: £46.7 million). Profit attributable to shareholders amounted to £40.7 million (2004: £28.2 million) and, after providing for dividends of £19.8 million (2004: £17.1 million) and other items of recognised income and expense, the balance of £17.4 million (2004: £5.0 million) has been transferred to reserves.

DIVIDENDS

The Board is recommending a final dividend of 4.05p per share making a total for the year of 6.4p per share (2004: 6.1p). The final dividend, if approved, will be paid on 5 July 2006 to shareholders on the register at the close of business on 9 June 2006.

SHARE CAPITAL

The Company's issued share capital as at 31 December 2005 was £32.1m and during the year was increased by the issue of 186,094 shares of 10p each between 31 January and 17 November 2005 for a total consideration of £270,138 pursuant to options granted under the Company's executive share option schemes. The shareholders have authorised the Company to purchase up to 32,096,876 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 23 May 2006, at which time a further authority will be sought from shareholders.

ACQUISITIONS and DISPOSALS

During 2005 the Group made 14 bolt-on acquisitions at a net cost of £31.8m and disposals generated gross proceeds of £5.8m. Notes 31 and 32 on page 58 provide the necessary financial disclosures and the Chief Executive's Review surveys the most significant impacts.

DIRECTORS

The current Directors are listed on page 24 and all served throughout the year. Messrs J.A.S. Wallace, D.R. Sleight and L.P. Bermejo 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 agreement for Mr Sleight is terminable by one year's notice. Messrs Wallace and Bermejo do not have a service contract with the Company and their appointments are terminable by twelve and six months' notice respectively.

DIRECTORS' INTERESTS

The interests of the Directors in the shares of the Company at 31 December 2005 and 31 December 2004 are set out below:

Beneficial	**2005**	2004
J.A.S. Wallace	**57,287**	57,287
J.D. Hubbard	**949,103**	949,103
D.R. Sleight	**87,500**	87,500
R.T. Scholes	**18,750**	18,750
D.F. Landless	**6,875**	6,875
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 1,321,823 shares (2004: 421,823) 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 2005. Details of Directors' share options and deferred restricted bonus shares are given in the Board Report on Remuneration on page 18. 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.

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 years 2001-2004. 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 two areas where the reasons for the variance throughout the year are:

(1) 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 was 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.

(2) 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.

Directors' Report

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.

Apart from these distinct areas, Bodycote was in compliance with the provisions of the 2003 Code throughout 2005.

Operation of the 2003 Code

Taken together with the Audit Committee Report and the Board Report on Remuneration presented on pages 17 to 23, 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 24. 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 and circulars*
- *Capital projects, acquisitions and disposals*
- *Annual budgets*
- *Strategy*
- *Directors' appointments, service agreements and remuneration*
- *Policies for financial statements, treasury, safety, health and environment, donations*
- *Committees' terms of reference*
- *Board and committee membership*
- *Investments*
- *Equity and bank financing*
- *Internal control and risk management*
- *Corporate governance*
- *Key external and internal appointments*
- *Pensions and 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 Environmental and risk management issues and details of the safety and health performance of the Group, and each strategic business unit in terms of severity and frequency rates for accidents at work.

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 16. 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

Apart from one absence on the part of Mr Bermejo, the Directors recorded 100% attendance at the twelve Board meetings held in the year, including visits to facilities in Canada and France. 100% attendance was also recorded for all meetings of the Audit, Remuneration and Nomination Committees.

Performance Evaluation

All Executive Directors were appraised internally during 2005 and a performance evaluation of the Chief Executive took place in February 2005. In December 2005 the Board carried out its own evaluation of the Board as a whole and the Non-Executive Directors evaluated Board performance and the Chairman. The Remuneration and Nomination Committees reviewed their own performance in November 2004 and the Audit Committee assessed its own performance in November 2005. 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 2005 committee meetings, when it determined the policy on external appointments, proposed the nominations for re-election at the 2005 Annual General Meeting, agreed the reappointment of the Chairman and discussed general succession planning.

Proposals for Re-election

Prior to Mr Wallace's re-appointment by the Board as Chairman in 2005 his performance and commitment were assessed and determined to be effective in chairing and attending meetings, achieving 100% board and committee attendance since 2001 and this was confirmed as part of the Board evaluation carried out in December 2005. Accordingly the Board proposes his re-election as a Director.

Following the performance evaluation carried out by the Chairman in December 2004 and a review in January 2006 following Mr Bermejo's appointment at Bureau Veritas, in respect of Mr Bermejo'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 (being absent from only two Board and three Committee meetings since appointment in 2003 despite responsibilities elsewhere as a full-time Chief Executive). Following a performance appraisal by the Chief Executive in January 2006, the Board also proposes the re-election of Mr D.R Sleight 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 2005, 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, and actions for any improvements were scheduled against a timetable for later verification by Internal Audit. 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 12 of this report. Following a review of the Group's results for 2005 and its budgets for 2006, 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 13 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, in 2005 with the proposed stock bonus plan and in 2006 with the proposed introduction of long term incentive and share matching schemes, the Company will seek the views of leading investors.

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 both 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 to better benchmark performance in subsequent years and from 1 January 2004 the Group commenced reporting its performance internally 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 safety and health performance and formulate criteria for improvements. The Group's target of a 10% reduction in lost time accident frequency compared to 2004 was met in 2005, although severity rates only met targeted reductions in Central Europe, Nordic and the UK territories. A further 10% minimum reduction has been targeted for 2006. Bonus payments to Directors and senior executives are in part dependent on achievement of these targets.

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 Thermal Processing facilities were mandated to obtain ISO14001 or equivalent accreditation by the end of 2006 for all appropriate sites. By the end of 2005 one site in North America, 41 sites Europe and a further sixteen sites in the UK had been accredited to ISO14001. The Group's Testing sites, which have a low environmental profile, operate to the ISO17025 standard which incorporates environmental management requirements.

Directors' Report

EMPLOYMENT

The Group recognises the value that can be added to its future profitability and strength by the efforts of employees. The commitment of employees to excel 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 2005 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 1,600 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 winter 2005 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.

DONATIONS

Charitable donations during the year net of income tax amounted to £12,000 (2004: £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 (2004: 45 days).

SHAREHOLDERS

An analysis of the Company's shareholders and the shares in issue at 19 February 2006 and details of major shareholders' interests appearing in the register maintained pursuant to Section 211 of the Companies Act 1985 are given on page 88.

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.

DIRECTORS' RESPONSIBILITIES

The Directors are responsible for preparing the Annual Report and the financial statements. The Directors are required to prepare accounts for the Group in accordance with International Financial Reporting Standards (IFRS) and have chosen to prepare company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (UK GAAP).

In the case of UK GAAP accounts, the Directors are required to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

(1) select suitable accounting policies and then apply them consistently;

(2) make judgments and estimates that are reasonable and prudent; and

(3) state whether applicable accounting standards have been followed.

In the case of IFRS accounts, International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the Preparation and Presentation of Financial Statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards. Directors are also required to:

(1) properly select and apply accounting policies;

(2) present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and

(3) provide additional disclosures when compliance with the specific requirements in International Financial Reporting Standards is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' Report and Board Report on Remuneration which comply with the requirements of the Companies Act 1985.

The Directors are responsible for the maintenance and integrity of the Company website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

ANNUAL GENERAL MEETING

The 2006 Annual General Meeting will be held on 23 May 2006 in accordance with the notice being sent to shareholders with this report.

By order of the Board.

J.R. Grime
Secretary
28 February 2006

Hulley Road
Hurdsfield
Macclesfield
Cheshire
SK10 2SG

Report of the Audit Committee

Bodycote

The members of the Audit Committee during 2005 were Messrs R.T. Scholes (appointed 1998; Chairman from 2002), 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 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 24 and their remuneration on page 23. The Committee Chairman's additional responsibilities are reflected by fees of £5,000 per annum for that role.

The Committee met four times during 2005 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 (and its chairman) held meetings with both the external and internal auditors without management in attendance. 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 2005 the Committee obtained confirmation of the auditor's independence. Further 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 £20,000, or with the prior approval of the Audit Committee. Details of amounts paid to the external auditors for audit and non-audit services in 2005 is analysed in note 3 on page 38.

The Committee's areas of activity during 2005 included:

- Assessment of independence of auditors
- Approval of auditors' re-appointment and fees
- Approval of scope of internal and external audits
- Approval of accounting policies in adopting 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 and 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 the Committee's own effectiveness
- Review of the terms of reference for committee and internal audit function
- Approval of the appointment of a new Head of Internal Audit and plan for enlargement of the Internal Audit department

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 7 of the notice of meeting being sent to shareholders with this report.

Approved by the Board.

R.T. Scholes
Audit Committee Chairman
28 February 2006

Board Report on Remuneration

The members of the Remuneration Committee during 2005 were J. Vogelsang (Chairman), R.T. Scholes, and L.P Bermejo. All members are 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 six times during 2005. 100% attendance was recorded at meetings. The Committee operates under terms of reference (which can be viewed on the Group's website) revised by the Board in November 2004 following an evaluation of the Committee's performance in that year.

This Board Report on Remuneration for the year ended 31 December 2005 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 and incentives on pages 22 and 23 have been audited, together with the performance criteria and share price information.

ADVICE

The Committee has taken advice from Inbucon Consulting in relation to Executive Directors' salary levels, the stock bonus scheme implemented for 2005 and measurement of total shareholder return (TSR) in accordance with the scheme rules, and in relation to the proposal to seek approval for a new long-term share incentive and share matching plan as detailed below.

The Company also received actuarial and other pensions advice from JLT Benefit Consultants Limited (appointed by the Company in 1995) and are currently taking advice from KPMG LLP (appointed by the Company in 2005) in relation to the management of risk arising from the UK final salary pension scheme of which currently two Executive Directors are members, out of an active membership of 314. Although KPMG LLP may provide occasional ad hoc services to the Company as a general consultant in relation to due diligence on selected acquisitions and other projects, neither of the other organisations provides any other services to, or has any other connection with, the Company.

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 Combined Code and received input from the Chief Executive. The Committee aims to provide a remuneration policy consistent with the Group's overall strategic objectives and thereby attract and retain high calibre 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 other North American and European companies in similar trades, as comparables.

The Remuneration Committee believe that once properly benchmarked against the market and in relation to the complexity, scale and size of the responsibilities, increases in basic salary should be modest to reflect inflationary elements with the aim that the proportion of fixed remuneration is reduced and to provide for a growing element of variable pay.

In order to ensure that a substantial proportion of the overall remuneration package can be linked to performance, there is an annual cash bonus scheme, executive share option schemes (up to 2003), the 2005 stock bonus scheme and a proposal for a new long-term share-based incentive and share matching plan for adoption at the 2006 Annual General Meeting. 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 placed more emphasis on the variable elements of Directors' and senior executives' pay although modest market and inflationary adjustments have been made to basic salaries after benchmarking. This resulted in increases in basic salary for Executive Directors both in 2005 and 2006. At his insistence there has been no increase in the Chief Executive's basic salary for 2006. The basic salaries of the other Executive Directors were increased on 1 January 2006 to the following amounts:

Mr D.F. Landless	£226,000
Mr D.R. Sleight	£168,000

Benefits in kind, which comprise the provision of a company car, private medical insurance for the Director and family and long-term disability insurance, are consistent with industry standards. An analysis of Directors' emoluments is given on page 23.

ANNUAL BONUSES

For 2005 an annual bonus is payable to all Executive Directors and senior executives, based on the Group and individual performance. For those senior executives with Strategic Business Unit (SBU) responsibilities, part of the performance-related bonus is based on their relevant sphere of responsibility.

Payment of the maximum cash bonus for 2005 required Executive Directors and senior executives to achieve challenging target increases over 2004 performance in EBIT (93% achieved), ROCE (72% achieved) and organic sales (60% achieved) and quantitative improvements in safety and health (50% achieved). As a result Executive Directors received a cash bonus of 38.5% of basic salary (against a maximum of 50%) and senior executives' cash bonuses ranged from 20% to 42% depending upon individual SBU performances (again compared to maximum of 50%). Details of the cash bonuses paid to Executive Directors are shown on page 23.

An additional bonus of up to 50% of basic salary, received as restricted shares in the Company, to be awarded after the results for the 2005 financial year are announced, will be payable as a result of the Group's 2005 TSR performance in accordance with the rules of the short term stock bonus scheme. The Group's performance was in the upper quartile of TSR achieved by companies within the FTSE 350 Engineering & Machinery Index and certain other comparator companies and, as a consequence, the maximum award will be made. The graph below illustrates the TSR performance of the Group against the peer group which includes companies representing the Group's geographical spread of businesses. The peer group consisted of 17 companies, including Bodycote. The Remuneration Committee have also taken into account the underlying financial performance of the Company before agreeing that these stock bonuses can be granted.

The shares will vest in 2009, but each Executive Director would be required to retain the stock awarded (save for amounts necessary to pay tax) until the total value of shares held equals 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 recommended this plan for 2005 because it encourages challenging performance, increases the variable element of pay and aligns executives' interests with those of shareholders. The 2005 stock bonus scheme will be replaced by the long-term share incentive schemes proposed at the forthcoming Annual General Meeting.

For 2006 the annual cash bonus programme has been increased to a maximum 60% of basic salary earned by achieving further challenging increases in ROCE, Economic Profit and organic sales and quantitative improvements in safety and health, together with achievement of environmental accreditations and implementation of technologies to improve capacity management. If the proposal to adopt the Bodycote Incentive Plan (as detailed below) is approved by shareholders, participants in the 2006 cash bonus programme will be able to defer up to 20% of basic salary into a share matching arrangement.

REVIEW OF LONG-TERM INCENTIVES

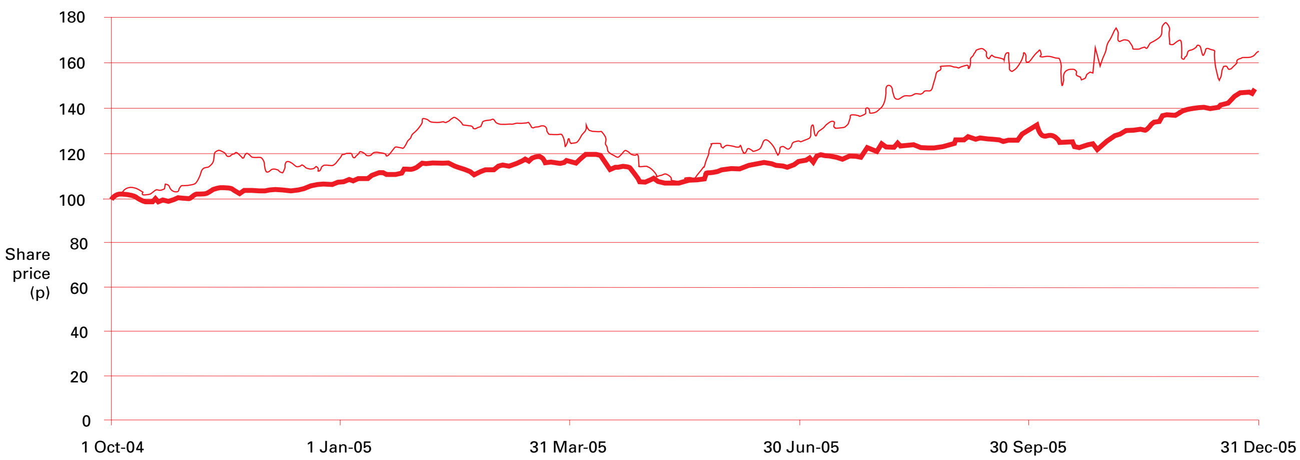
The Group believes that participation in share incentive schemes by Executive Directors and other executives of the Group strengthens the link between executives' personal interests and shareholders' interests.

Following the implementation of International Financial Reporting Standards from 1 January 2005, the Committee decided to review the arrangements for long-term incentives so that there would be an appropriate balance between short and long-term incentives with an increasing proportion devoted to performance-related pay. To promote creation of shareholder value, the Remuneration Committee seeks to encourage and incentivise 'stretch' or exceptional and sustainable financial performances over each three year period, as measured against the strategic plans formulated for the Group. It was decided not to grant any further share options under the 2003 scheme, but to propose adoption by shareholders of a new long-term share incentive scheme ('the Bodycote Incentive Plan'), which will comprise two elements:

(1) A conditional award of shares;

- (a) A conditional award of shares which will vest on the third anniversary of the date of grant.
- (b) Awards can be made annually and the amount awarded will be based upon achievement of targeted Economic Profit performance for the prior year.
- (c) The number of shares forming a conditional award to Executive Directors will not exceed 1.75 times basic salary.
- (d) The number of shares which vest on the third anniversary will depend on the Economic Profit growth of the Group in the three year period commencing with the year of grant.

(2) Award of shares to match bonus payments deferred by executives from their annual cash bonus (if any) in that participants can defer up to 20% of salary or the bonus earned (whichever is the lesser) to be converted into shares which will be held for 3 years and matched at rates between 1 for 2 and 1 for 1 shares depending on growth of the Group's ROCE during the three year period of deferment.



This graph looks at the Share Price Performance (rebased) from 1 October 2004 to 31 December 2005 of Bodycote International plc vs. the Stock Bonus Scheme Peer Group (excluding Bodycote). 1 October 2004 to 31 December 2005 is illustrated because the scheme rules require 3-month share price averaging at start and end of 2005 financial year performance period.

Source: Inbucon/Datastream

Economic Profit for these purposes is defined as earnings before interest and tax (EBIT), less a charge for the cost of the aggregate average of shareholders' funds, net borrowings and goodwill previously written off to reserves, impaired or amortised.

Only Executive Directors and other nominated full-time employees will be eligible to participate.

No awards may be granted more than 10 years after adoption of the plan by shareholders.

No more than 5% of new issue ordinary share capital may be allocated under all of the Company's share schemes over a 10 year period.

Leavers will not normally be entitled to receive conditional awards and or an award of matching shares which in each case will lapse upon a participant leaving group employment.

If approved by shareholders the awards can be made in each of the financial years 2006 to 2015 (although the Committee can decide either to scale back awards or not to make awards in any one year). The final outcome of the first awards proposed to be made in 2006 will depend upon the Group's Economic Profit performance in the period 2006 to 2008.

It is anticipated that adoption of this scheme will suitably emphasise the increasing importance attached by the Committee to the variable elements of remuneration and encourage long-term shareholding and commitment by executives. The Remuneration Committee has decided to propose a long-term incentive scheme based upon growth in Economic Profit because this aligns the scheme with the Group's business objectives, strategy and plan, and the long-term interests of shareholders, in that sustainable and profitable growth should be achieved and because it focuses directly on those elements, which executives have the capacity to influence.

EXECUTIVE DIRECTORS' SHAREHOLDING RETENTION POLICY

The Committee will introduce a shareholding retention policy under which Executive Directors and other senior executives will be required, within five years, to build up a shareholding in the Company. In respect of Executive Directors the requirement will be for their Directors' interests in shares to be worth at least 100% of basic salary.

SHARE INCENTIVES – old arrangements

The Remuneration Committee also reviews and manages share incentive schemes established between 1994 and 2003 and under which awards have yet to vest. Following adoption of the Bodycote Incentive Plan no further share options will be granted to Directors or executives and staff pursuant to the 2003 executive share option scheme, but share options granted before this decision will continue to be capable of exercise. At the time each scheme was approved by shareholders, institutional guidelines were followed and latterly leading investors were consulted.

All outstanding share options have now qualified for exercise. Options granted since 1998 have all qualified on the basis of the increase in headline earnings per share (EPS) since 2002 using the UK GAAP EPS data for 2002 to 2004 and the IFRS headline EPS figure for 2005. Having received and reviewed a reconciliation between the two accounting standards (the calculations for which have been approved by the Audit Committee), the Committee were satisfied that each performance criterion had been met by a wide margin.

Share options granted under the 1994 and 1996 share option schemes were only exercisable if, over any rolling period of three years from the date of the award, the growth in the Group's headline EPS exceeds United Kingdom retail inflation by 6% (10% in respect of those options granted in September 2002).

Under the 2003 scheme the value of shares over which options may be granted to an executive in any one 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 EPS exceeding the growth in the retail price index (RPI) in the three or five year period following grant. Options over shares worth up to 0.5 times salary may be exercised if the growth in EPS exceeds the growth in RPI by 3% per annum.

The Committee believed that the use of growth in pre-tax EPS was at the time the most appropriate measure of the Company's financial performance and was consistent with market practice, when adopted.

Directors made no gains on the exercise of share options during 2004 or 2005. The market price of Bodycote's ordinary shares at 31 December 2005 was 222.0p, the range during 2005 was 146.75p to 239.25p and the average was 190.03p. An analysis of all Directors' share options is given on page 22.

DEFERRED RESTRICTED STOCK BONUS SCHEME 2003 to 2004

In respect of annual cash bonuses payable for 2003 and 2004, Executive Directors and Senior Executives were permitted to defer up to one-third of their cash bonus into shares which were then to be held for three years and which the Company would then match. Details of shares held by Directors pursuant to this scheme are given below. If shareholders approve the share matching scheme forming part of the proposed new Bodycote Incentive Scheme, then Executive Directors and Senior Executives will be able to defer cash bonuses received for 2006 and subsequently convert them into shares and obtain matching shares depending on the Group's ROCE performance during the three-year period of deferment.

	Shares
Mr. J.D. Hubbard	36,697
Mr D.F. Landless	24,464
Mr D.R. Sleight	18,899

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 contract is 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 which 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 4.25% ('the Salary Limit');

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

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

(d) Members' contributions are 7% (6% up until 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 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 2005 is given on page 23.

Mr Hubbard, the Chief Executive, is a member of the Group's US 401K retirement plan to which the Group contributed £24,362 (2004: £14,163). Pension contributions for Mr Landless' salary above the earnings cap amounted to £15,540 (2004: £22,606).

EXTERNAL APPOINTMENTS

The Company believes that there are benefits to the individual and the Company for Executive Directors holding one non-executive directorship in other organisations, provided that they do not conflict with the Company's interests and that, provided the Director's performance is not impaired, he could retain the fees earned in connection with such an 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, the Companies Act 1985, 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 22 illustrates the Company's Total Shareholder Return (TSR) performance since 2000 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. The index was selected in 2002 as the most appropriate comparator group and has been used again this year to be consistent with prior years.

Approved by the Board.

J. Vogelsang
Chairman of the Remuneration Committee
28 February 2006

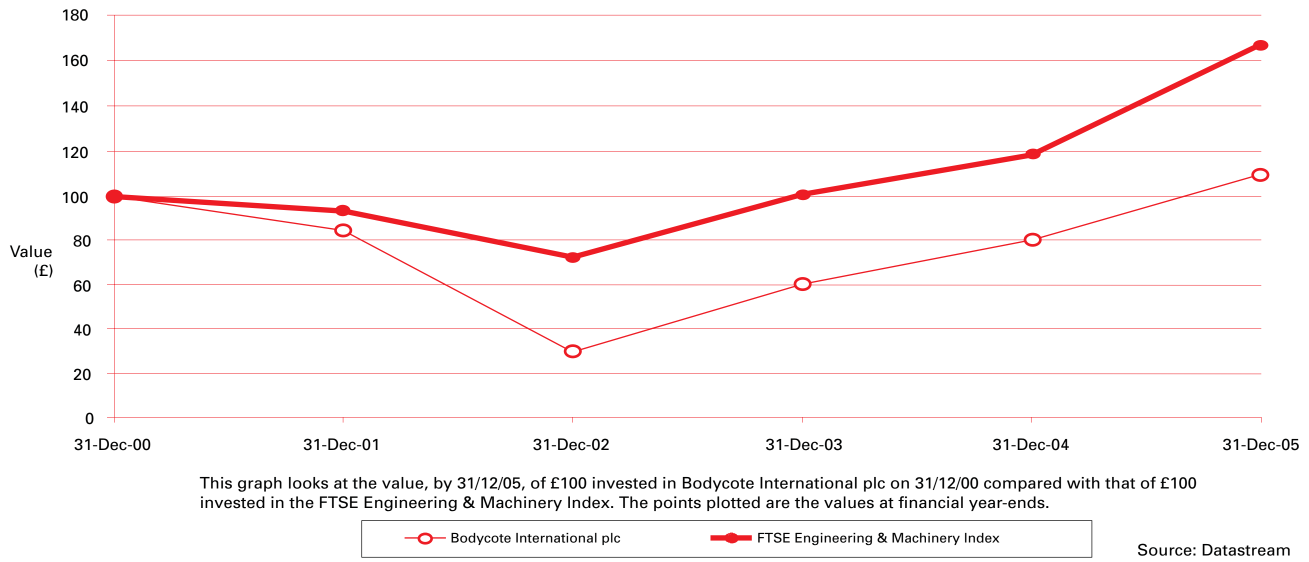
Board Report on Remuneration

Directors' share options – audited

Director	1 January and 31 December 2005	Option price (pence)	Dates from which exercisable	Expiry dates
J. D. Hubbard	44,178	315.43	03/12/2000	03/12/2007
	40,107	370.26	26/04/2002	26/04/2009
	26,738	292.19	14/12/2002	14/12/2009
	12,834	231.42	02/05/2003	02/05/2010
	16,042	203.37	24/04/2004	24/04/2011
	64,170	125.76	16/09/2005	16/09/2012
	84,882	147.27	15/09/2006	15/09/2013
D. F. Landless	53,475	370.26	26/04/2002	26/04/2009
	53,476	292.19	14/12/2002	14/12/2006
	16,042	231.42	02/05/2003	02/05/2007
	21,390	203.37	24/04/2004	24/04/2008
	42,780	125.76	16/09/2005	16/09/2009
	57,719	147.27	15/09/2006	15/09/2013
D. R. Sleight	40,106	370.26	26/04/2002	26/04/2006
	32,085	292.19	14/12/2002	14/12/2006
	16,042	231.42	02/05/2003	02/05/2007
	21,390	203.37	24/04/2004	24/04/2008
	42,780	125.76	16/09/2005	16/09/2009
	50,929	147.27	15/09/2006	15/09/2013

The Performance Criteria are set out in the share incentives section above.

TSR Performance Graph



This graph looks at the value, by 31/12/05, of £100 invested in Bodycote International plc on 31/12/00 compared with that of £100 invested in the FTSE Engineering & Machinery Index. The points plotted are the values at financial year-ends.

Source: Datastream

Directors' emoluments – audited

	Salary and fees £000	Benefits £000	Annual Bonus £000	**2005 Total £000**	2004 Total £000
Executive					
J. D. Hubbard	325	15	125	**465**	468
D. F. Landless	215	16	83	**314**	314
D. R. Sleight	161	11	62	**234**	278
	701	42	270	**1,013**	1,060
Non-Executive					
J. A. S. Wallace	110	–	–	**110**	100
R. T. Scholes	36	–	–	**36**	33
J. Vogelsang	33	–	–	**33**	28
L. P. Bermejo	30	–	–	**30**	28
	910	42	270	**1,222**	1,249

Directors' pensions – audited

Director	Accrued annual pension at 01/01/05 £000	Transfer value at 01/01/05 £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 31/12/05 £000	Transfer value at 31/12/05 £000
D.F. Landless	10	55	1	–	1	4	9	7	11	73
D.R. Sleight	52	515	4	2	6	36	87	11	58	629

Board of Directors

EXECUTIVE DIRECTORS

J. D. Hubbard Chief Executive (58) 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 (46)
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 (56)
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 Testing operations. A Chartered Accountant.

NON-EXECUTIVE DIRECTORS

J. A. S. Wallace Chairman (62)
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 (60)
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 (63) 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 (46) France
Appointed in 2003. Executive Vice-President Industry & Facilities Northern & Eastern Europe at Bureau Veritas from 2006, Director for Northern Europe at Dalkia International from 2004, 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 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

Independent Auditors' Report
To The Members Of Bodycote International Plc

Bodycote

We have audited the Group financial statements of Bodycote International plc for the year ended 31 December 2005, which comprise the consolidated income statement, the consolidated balance sheet, the consolidated cash flow statement, the consolidated statement of recognised income and expense, the statement of accounting policies and the related notes 1 to 40. These Group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Board Report on Remuneration that is described as having been audited.

The corporate governance statement and the Board Report on Remuneration are included in the individual company annual report of Bodycote International plc for the year ended 31 December 2005. We have reported separately on the individual company financial statements of Bodycote International plc for the year ended 31 December 2005 and on the information in the Board Report on Remuneration included in the individual company annual report 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

The Directors' responsibilities for preparing the annual report, the Board Report on Remuneration and the financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRS) as adopted for use in the European Union are set out in the Directors' report.

Our responsibility is to audit the Group 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 International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with the relevant financial reporting framework and whether the Group 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 and Article 4 of the IAS Regulation. We report to you if, in our opinion, the Directors' Report is not consistent with the financial statements. We also report to you 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 other 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 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 statement on internal control covers 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 also report to you if, in our opinion, the Company has not complied with any of the four Directors' remuneration disclosure requirements specified for our review by the Listing Rules of the Financial Services Authority. These comprise the amount of each element in the remuneration package and information on share options, details of long term incentive schemes, and money purchase and defined benefit schemes. We give a statement, to the extent possible, of details of any non-compliance.

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 Group financial statements.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group 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 Group financial statements, and of whether the accounting policies are appropriate to the company's circumstances, 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 Group 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 Group financial statements and the part of the Board Report on Remuneration described as having been audited.

OPINION

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRS as adopted for use in the European Union, of the state of the Group's affairs as at 31 December 2005 and of its profit for the year then ended; and
- the Group 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 and Article 4 of the IAS Regulation.

SEPARATE OPINION IN RELATION TO IFRS

As explained in the statement of accounting policies, the Group in addition to complying with its legal obligation to comply with IFRS as adopted for use in the European Union, has also complied with the IFRS as issued by the International Accounting Standards Board. Accordingly, in our opinion the financial statements give a true and fair view, in accordance with IFRS, of the state of the Group's affairs as at 31 December 2005 and of its profit for the year then ended.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and
Registered Auditors

Manchester
28 February 2006

Consolidated Income Statement
for the year ended 31 December 2005

	2005 £m	2004 £m	Note
Revenue			
Existing operations	**453.7**	424.6	
Acquisitions	**17.2**	1.8	
Revenue - continuing operations	**470.9**	426.4	1
Operating profit			3
Existing operations	**57.0**	54.2	
Acquisitions	**3.3**	1.3	3
Share of results of associates	**0.7**	–	15
Operating profit - continuing operations	**61.0**	55.5	
Operating profit prior to amortisation and impairment	**67.0**	55.5	
Amortisation of acquired intangible fixed assets	**(0.2)**	–	12
Impairment of goodwill	**(5.8)**	–	11
Operating profit - continuing operations	**61.0**	55.5	
Investment income	**5.2**	4.7	5
Finance costs	**(13.5)**	(13.5)	6
Profit before taxation	**52.7**	46.7	
Taxation	**(11.8)**	(9.3)	7
Profit for the year from continuing operations	**40.9**	37.4	
Discontinued operations			
Loss for the year from discontinued operations	**–**	(9.0)	8
Profit for the year	**40.9**	28.4	
Attributable to:			
Equity holders of the parent	**40.7**	28.2	
Minority interest	**0.2**	0.2	
	40.9	28.4	
	Pence	Pence	
Earnings per share			10
From continuing operations:			
Basic	**12.7**	12.2	
Basic-diluted	**12.7**	12.2	
From continuing and discontinued operations:			
Basic	**12.7**	9.3	
Basic-diluted	**12.7**	9.3	

Consolidated Statement of Recognised Income and Expense
for the year ended 31 December 2005

	2005 £m	2004 £m
Exchange differences on translation of foreign operations	**(5.1)**	2.0
Actuarial losses on defined benefit pension schemes	**(3.7)**	(8.2)
Tax on items taken directly to equity	**0.2**	2.1
Net loss recognised directly in equity	**(8.6)**	(4.1)
Profit for the year	**40.9**	28.4
Recognised income and expense for the year	**32.3**	24.3
Attributable to:		
Equity holders of the parent	**32.1**	24.1
Minority interests	**0.2**	0.2
	32.3	24.3

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

Consolidated Balance Sheet
at 31 December 2005

	2005 £m	2004 Restated £m	Note 24
Non-current assets			
Goodwill	**154.2**	139.7	11
Other intangible assets	**3.7**	1.4	12
Property, plant and equipment	**442.9**	425.9	13
Interests in associates	**9.2**	5.8	15
Other investments	**–**	0.4	
Finance lease receivables	**1.9**	–	17
Deferred tax asset	**22.7**	18.9	21
Trade and other receivables	**6.1**	6.1	18
	640.7	598.2	
Current assets			
Inventories	**11.9**	8.9	16
Finance lease receivables	**0.3**	–	17
Trade and other receivables	**114.5**	102.3	18
Cash and cash equivalents	**124.8**	142.1	18
	251.5	253.3	
Non-current assets classified as held for sale	**1.2**	6.9	8
Total assets	**893.4**	858.4	
Current liabilities			
Trade and other payables	**97.2**	86.9	23
Dividends payable	**7.5**	7.2	9
Current tax liabilities	**3.3**	2.5	7
Obligations under finance leases	**1.4**	1.5	22
Bank overdrafts and loans	**6.4**	7.0	19
Short-term provisions	**2.3**	1.5	24
	118.1	106.6	
Net current assets	**133.4**	146.7	
Non-current liabilities			
Bank loans	**221.6**	219.5	19
Retirement benefit obligation	**29.9**	24.2	37
Deferred tax liabilities	**79.9**	72.1	21
Obligations under finance leases	**3.9**	4.4	22
Long-term provisions	**4.7**	6.7	24
Other payables	**1.8**	2.9	23
	341.8	329.8	
Total liabilities	**459.9**	436.4	
Net assets	**433.5**	422.0	
Share capital	**32.1**	32.1	25
Share premium account	**300.3**	300.0	26
Own shares	**(2.5)**	(0.8)	27
Other reserves	**1.7**	1.5	28
Hedging and translation reserves	**11.1**	16.2	29
Retained earnings	**89.4**	72.0	30
Equity attributable to equity holders of the parent	**432.1**	421.0	
Minority interest	**1.4**	1.0	
Total equity	**433.5**	422.0	

Approved by the Board of Directors on 28 February 2006 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 2005

Bodycote

	2005 £m	2004 £m	Note
Net cash from operating activities	**95.7**	100.5	33
Investing activities			
Purchases of property, plant and equipment	**(51.8)**	(37.5)	
Proceeds on disposal of property, plant and equipment and intangible assets	**8.6**	3.6	
Purchases of intangible fixed assets	**(0.9)**	(0.5)	
Acquisition of investment in an associate	**(2.3)**	(5.2)	
Acquisition of subsidiaries	**(31.8)**	(4.7)	
Disposal of subsidiaries	**5.8**	20.4	
Net cash used in investing activities	**(72.4)**	(23.9)	
Financing activities			
Interest received	**5.4**	4.2	
Interest paid	**(14.9)**	(12.9)	
Dividends paid	**(19.5)**	(15.7)	
Dividends paid to a minority shareholder	**(0.1)**	–	
Repayments of bank loans	**(10.1)**	(9.2)	
Repayments of obligations under finance leases	**(1.6)**	(2.2)	
New bank loans raised	**0.1**	5.1	
New obligations under finance leases	**0.1**	0.4	
Proceeds on issue of ordinary share capital	**0.3**	62.0	
Own shares purchased	**(1.7)**	–	
Net cash (used in)/from financing activities	**(42.0)**	31.7	
Net (decrease)/increase in cash and cash equivalents	**(18.7)**	108.3	
Cash and cash equivalents at beginning of year	**138.7**	29.8	
Effect of foreign exchange rate changes	**0.7**	0.6	
Cash and cash equivalents at end of year	**120.7**	138.7	

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

Accounting Policies

BASIS OF ACCOUNTING

The financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted for use in the EU.

Bodycote International plc's consolidated financial statements were prepared in accordance with United Kingdom Generally Accepted Accounting Principles (UK GAAP) until 1 January 2005. UK GAAP differs in some areas from IFRS. In preparing this financial information, management has amended certain accounting and valuation methods applied in the UK GAAP financial statements to comply with the recognition and measurement criteria of IFRS. The comparative figures in respect of 2004 were restated to reflect these adjustments.

The Group has adopted Standards and Interpretations issued by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee of the IASB. Individual standards and interpretations have to be adopted by the European Commission (EC) and the process leads to a delay between the issue and adoption of new standards and in some cases amendment by the EC.

International Financial Reporting Standards are subject to ongoing amendment by the IASB and subsequent endorsement by the EC and are therefore subject to change.

In addition to complying with its legal obligation to comply with IFRS as adopted for use in the European Union, the group has also complied with IFRS as issued by the IASB.

The financial statements have been prepared on the historic cost convention, with the exception of accounting for share-based payments. The principal accounting policies adopted are set out below.

FIRST-TIME ADOPTION OF IFRS

IFRS 1, 'First-time adoption of International Financial Reporting Standards', has been applied in preparing these financial statements. IFRS 1 sets out the procedures that must be followed when adopting IFRS for the first time as the basis for the group financial statements. The Group is required to establish its IFRS accounting policies at 31 December 2005 and apply these retrospectively to determine the IFRS opening balance sheet at the date of transition, 1 January 2004.

IFRS 1 provides a number of optional exemptions to this general rule, the most significant of which are:

- Business combinations - the Group has elected not to restate accounting for business combinations prior to the date of transition;
- Employee benefits - the Group has elected to recognise all cumulative actuarial gains and losses in respect of its defined benefit schemes at the date of transition, with subsequent actuarial gains and losses recognised in full in the period in which they occur in the Statement of Recognised Income and Expense;
- Financial instruments - the Group has elected to adopt IAS 32 and IAS 39 from 1 January 2005 and comparative information is therefore presented in accordance ith UK GAAP; and
- Share-based payments - the group has elected to apply IFRS 2 to all share-based payments granted after 7 November 2002 but not vested at 1 January 2005.

BASIS OF CONSOLIDATION

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

On acquisition, the assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to profit and loss in the period of acquisition. The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets and liabilities recognised. Subsequently, any losses applicable to the minority interest in excess of the minority interest are allocated against the interests of the parent.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

INVESTMENTS IN ASSOCIATES

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee.

The results and assets and liabilities of associates are incorporated in these financial statements using the equity method of accounting. Investments in associates are carried in the balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in the value of individual investments. Losses of the associates in excess of the Group's interest in those associates are not recognised.

Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable net assets of the associate at the date of acquisition is recognised as goodwill. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable net assets of the associate at the date of acquisition (i.e. discount on acquisition) is credited in profit and loss in the period of acquisition.

Where a group company transacts with an associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant associate. Losses may provide evidence of an impairment of the asset transferred, in which case appropriate provision is made for impairment.

NON-CURRENT ASSETS HELD FOR SALE

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell.

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

GOODWILL

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition.

Goodwill is recognised as an asset and reviewed for impairment at least annually. Any impairment is recognised immediately in profit or loss and is not subsequently reversed.

On disposal of a subsidiary, associate or jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts, subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

REVENUE RECOGNITION

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales-related taxes.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Dividend income from investments is recognised when the shareholder's rights to receive payment have been established.

THE GROUP AS LESSEE

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

THE GROUP AS LESSOR

Amounts due from lessees under finance leases are recorded as receivables at the amount of the group's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Group's net investment outstanding in respect of the leases.

FOREIGN CURRENCIES

Transactions in currencies other than pounds sterling are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Gains and losses arising on retranslation are included in net profit or loss for the period.

On consolidation, the assets and liabilities of the Group's overseas operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period unless exchange rates fluctuate significantly. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. The Group has elected to treat goodwill and fair value adjustments arising on acquisitions before the date of transition to IFRS as sterling-denominated assets and liabilities.

BORROWING COSTS

Borrowing costs are recognised in profit or loss in the period in which they are incurred.

GOVERNMENT GRANTS

Government grants relating to property, plant and equipment are treated as deferred income and released to profit and loss over the expected useful lives of the assets concerned.

OPERATING PROFIT

Operating profit is stated after charging restructuring costs, goodwill impairment, amortisation of acquired intangible assets and after the post-tax share of results of associates but before investment income and finance costs.

RETIREMENT BENEFIT COSTS

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due. Payments made to state-managed retirement benefit schemes are dealt with as payments to defined contribution schemes where the Group's obligations under the schemes are equivalent to those arising in a defined contribution retirement benefit scheme.

For defined benefit retirement benefit schemes, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at each balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside profit or loss and presented in the statement of recognised income and expense.

Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation, as reduced by the fair value of scheme assets.

Accounting Policies

TAXATION

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation and any recognised impairment loss.

Depreciation is charged so as to write off the cost of assets, other than land and properties under construction, over their estimated useful lives, using the straight-line method, on the following bases:

Freehold buildings	2%
Leasehold property	over the period of the lease
Fixtures and fittings	10% - 20%
Plant and machinery	5% - 20%
Motor vehicles	20% - 33%

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in income.

IMPAIRMENT OF TANGIBLE AND INTANGIBLE ASSETS EXCLUDING GOODWILL

At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately.

INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Net realisable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Trade Receivables

Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts.

Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand and demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Financial Liabilities and Equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Bodycote

Bank Borrowings

Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accrual basis to the profit and loss account using effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

Trade Payables

Trade payables are not interest-bearing and are stated at their nominal value.

Equity Instruments

Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

HEDGE ACCOUNTING

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates. The Group uses foreign currency debt to hedge its exposure to changes in the underlying net assets of overseas operations arising from exchange rate movements.

Gains and losses arising from the retranslation of foreign currency debt that is designated and effective as a hedge of the Group's investment in overseas operations are recognised directly in equity and the ineffective portion is recognised immediately in the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting.

PROVISIONS

Provisions for restructuring costs are recognised when the group has a detailed formal plan for the restructuring that has been communicated to affected parties.

SHARE-BASED PAYMENTS

The Group has applied the requirements of IFRS 2 Share-based Payments. In accordance with the transitional provisions, IFRS 2 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2005.

The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the group's estimate of shares that will eventually vest. Fair value is measured by use of a Black-Scholes model.

CRITICAL JUDGEMENTS IN APPLYING THE GROUP'S ACCOUNTING POLICIES

In the process of applying the Group's accounting policies, which are described above, management has made the following judgements that have the most significant effect on the amounts recognised in the financial statements (apart from those involving estimations, which are dealt with below).

Provisions for environmental liabilities

The Group provides for the costs of environmental remediation that have been identified, either as part of acquisition due diligence, or in other circumstances where remediation by the Group is required. The provision is reviewed annually.

KEY SOURCES OF ESTIMATION UNCERTAINTY

The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Impairment of Goodwill

Determining whether goodwill is impaired requires an estimation of the value in use of the cash-generating units to which goodwill has been allocated. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the cash-generating unit and a suitable discount rate in order to calculate present value.

GENERAL INFORMATION

Bodycote International plc is a company incorporated in the United Kingdom under the Companies Acts 1948 to 1980. The address of the registered office is given on page 24. The nature of the group's operations and its principal activities are set out on page 13 of the Directors' Report.

These financial statements are presented in pounds sterling because that is the currency of the primary economic environment in which the Group operates. Foreign operations are included in accordance with the policies set out in the Foreign Currencies accounting policy above.

At the date of authorisation of these financial statements, the following Standard, which has not been applied in these financial statements, was in issue but not yet effective:

- IFRS 7 Financial instruments: Disclosures; and the related amendment to IAS 1 on capital disclosures

The Directors anticipate that the adoption of this Standard in future periods will have no material impact on the financial statements of the Group except for additional disclosures on capital and financial instruments when the relevant standard comes into effect for periods commencing on or after 1 January 2007.

Notes to the Consolidated Financial Statements
Year ended 31 December 2005

1. Revenue

	2005 £m	2004 £m
Continuing operations		
Heat treatment, hot isostatic pressing and testing services	**470.9**	426.4
Revenue - continuing operations	**470.9**	426.4
Other operating income	**2.6**	0.3
Investment income (see note 5)	**5.2**	4.7
	478.7	431.4
Discontinued operations		
Revenue (see note 8)	**1.5**	30.8
Total Revenue	**480.2**	462.2

2. Business and geographical segments

	Heat Treatment 2005 £m	Hot Isostatic Pressing 2005 £m	Testing 2005 £m	Discontinued operations: Electro-plating 2005 £m	Discontinued operations: PVD 2005 £m	Discontinued operations 2005 £m	Head Office and Eliminations 2005 £m	Continuing operations 2005 £m
Revenue								
External sales	349.2	35.2	86.5	1.5	–	(1.5)	–	470.9
Inter-segment sales	–	–	0.6	–	–	–	(0.6)	–
Total revenue	349.2	35.2	87.1	1.5	–	(1.5)	(0.6)	470.9
Result								
Segment result prior to amortisation of acquired intangible assets and impairment of goodwill	43.3	9.5	16.3	–	–	–	–	69.1
Share of associate's operating profit	1.5	–	–	–	–	–	–	1.5
Unallocated corporate expenses	–	–	–	–	–	–	(2.8)	(2.8)
	44.8	9.5	16.3	–	–	–	(2.8)	67.8
Amortisation of acquired intangible assets and impairment of goodwill	(5.8)	–	(0.2)	–	–	–	–	(6.0)
Segment result	39.0	9.5	16.1	–	–	–	(2.8)	61.8
Share of associates' interest and tax	(0.8)							(0.8)
Operating profit - continuing operations								61.0
Investment revenues								5.2
Finance costs								(13.5)
Profit before tax								52.7
Tax								(11.8)
Profit for the year								40.9

2. Business and geographical segments continued

	Heat Treatment 2004 £m	Hot Isostatic Pressing 2004 £m	Testing 2004 £m	Discontinued operations: Electro-plating 2004 £m	Discontinued operations: PVD 2004 £m	Discontinued operations 2004 £m	Eliminations 2004 £m	Continuing operations 2004 £m
Revenue								
External sales	328.7	32.1	65.6	19.1	11.7	(30.8)	–	426.4
Inter-segment sales	–	–	0.5	–	–	–	(0.5)	–
Total revenue	328.7	32.1	66.1	19.1	11.7	(30.8)	(0.5)	426.4
Result								
Segment result prior to amortisation of acquired intangible assets and impairment of goodwill	38.8	7.1	12.4	(14.5)	0.9	13.6	–	58.3
Unallocated corporate expenses	–	–	–	–	–	–	(2.8)	(2.8)
Operating profit - continuing operations	38.8	7.1	12.4	(14.5)	0.9	13.6	(2.8)	55.5
Investment revenues								4.7
Finance costs								(13.5)
Profit before tax								46.7
Tax								(9.3)
Loss for the year from discontinued operations								(9.0)
Profit for the year								28.4

Inter-segment sales are charged at prevailing market prices

Other information

	Heat Treatment 2005 £m	**Hot Isostatic Pressing 2005 £m**	**Testing 2005 £m**	**Discontinued operations: Electro-plating 2005 £m**	**Discontinued operations: PVD 2005 £m**	**Head Office and Eliminations 2005 £m**	**Consolidated 2005 £m**
Capital additions	**37.6**	**5.2**	**9.9**	**–**	**–**	**–**	**52.7**
Depreciation and amortisation	**32.2**	**4.3**	**4.9**	**–**	**–**	**–**	**41.4**
Impairment losses recognised in income	**5.8**	**–**	**–**	**–**	**–**	**–**	**5.8**
Balance sheet							
Assets:							
Segment assets	**726.8**	**86.5**	**117.6**	**–**	**–**	**(46.7)**	**884.2**
Interests in associates	**9.2**	**–**	**–**	**–**	**–**	**–**	**9.2**
Consolidated total assets	**736.0**	**86.5**	**117.6**	**–**	**–**	**(46.7)**	**893.4**
Liabilities:							
Segment liabilities	**399.1**	**28.0**	**69.3**	**–**	**–**	**(36.5)**	**459.9**
Segment net assets	**336.9**	**58.5**	**48.3**	**–**	**–**	**(10.2)**	**433.5**

2. Business and geographical segments continued

	Heat Treatment 2004 £m	Hot Isostatic Pressing 2004 £m	Testing 2004 £m	Discontinued operations: Electro-plating 2004 £m	Discontinued operations: PVD 2004 £m	Head Officeand Eliminations 2004 £m	Consolidated 2004 £m
Capital additions	30.6	1.2	5.6	–	0.6	(0.6)	37.4
Depreciation and amortisation	32.6	5.1	4.0	0.6	1.7	(2.3)	41.7
Balance sheet							
Assets:							
Segment assets	700.4	77.1	77.3	–	–	3.6	858.4
Interests in associates	–	–	–	–	–	–	–
Consolidated total assets	700.4	77.1	77.3	–	–	3.6	858.4
Liabilities:							
Segment liabilities	344.1	19.5	41.0	–	–	31.8	436.4
Segment net assest	356.3	57.6	36.3	–	–	(28.2)	422.0

Discontinued operations

During 2004 the Group sold the entire PVD operation to SSCP Coatings Sàrl and the majority of the Electroplating plants. The remaining electroplating plants were sold during 2005. Details can be found in note 8.

By geographical market

	Sales revenue **2005 £m**	Sales revenue 2004 £m
Europe	**297.6**	269.2
North America	**166.7**	152.1
Rest of world	**6.6**	5.1
	470.9	426.4

Revenue from the Group's discontinued operations was derived principally from Europe (2005: £1.5m, 2004: £30.8 million).

	Carrying amount of segment assets **2005 £m**	Carrying amount of segment assets 2004 £m	Additions to property, plant and equipment and intangible assets **2005 £m**	Additions to property, plant and equipment and intangible assets 2004 £m
Europe	**293.0**	275.8	**31.1**	26.2
North America	**126.9**	136.9	**21.0**	10.9
Rest of world	**13.6**	9.3	**0.6**	0.3
	433.5	422.0	**52.7**	37.4

3. Operating profit

	2005 £m Existing operations	2005 £m Acquisitions	2005 £m Continuing operations	2004 £m Existing operations	2004 £m Acquisitions	2004 £m Continuing operations
Revenue	**453.7**	**17.2**	**470.9**	424.6	1.8	426.4
Cost of sales	**(301.4)**	**(10.7)**	**(312.1)**	(283.5)	(1.1)	(284.6)
Gross profit	**152.3**	**6.5**	**158.8**	141.1	0.7	141.8
Other operating income	**2.5**	**0.1**	**2.6**	0.3	–	0.3
Distribution	**(14.3)**	**(0.4)**	**(14.7)**	(13.6)	(0.1)	(13.7)
Administration	**(77.7)**	**(2.9)**	**(80.6)**	(72.2)	0.7	(71.5)
Other operating expenses	**–**	**–**	**–**	(1.4)	–	(1.4)
Impairment of goodwill	**(5.8)**	**–**	**(5.8)**	–	–	–
Operating profit before income from associates	**57.0**	**3.3**	**60.3**	54.2	1.3	55.5
Income from associates after interest and tax			**0.7**			–
Operating profit			**61.0**			55.5

Profit for the year has been arrived at after charging/(crediting):

	Continuing operations 2005 £m	Continuing operations 2004 £m	Discontinued operations 2005 £m	Discontinued operations 2004 £m	Total 2005 £m	Total 2004 £m
Net foreign exchange (gains)/losses	**(0.2)**	0.1	**–**	–	**(0.2)**	0.1
Depreciation of property, plant and equipment	**40.5**	41.1	**–**	2.3	**40.5**	43.4
Restructuring costs	**–**	–	**–**	11.2	**–**	11.2
Amortisation of acquired intangible assets	**0.2**	–	**–**	–	**0.2**	–
Impairment of goodwill	**5.8**	–	**–**	–	**5.8**	–
Loss/(profit) on disposal of property, plant and equipment	**0.6**	(0.5)	**–**	–	**0.6**	(0.5)
Staff costs (see note 4)	**208.5**	201.2	**–**	–	**208.5**	201.2
Auditors' remuneration for audit services (see below)	**0.6**	0.4	**–**	–	**0.6**	0.4

Notes to the Consolidated Financial Statements
Year ended 31 December 2005

3. Operating Profit continued

Amounts payable to Deloitte & Touche LLP and their associates by the company and its UK subsidiary undertakings in respect of non-audit services were £0.2m (2004: £0.1m).

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

	2005 £k	**2005 %**	2004 £k	2004 %
Audit services:				
Statutory audit	**0.6**	**50**	0.4	50
Further assurance services	**0.1**	**8**	0.1	12
Tax services:				
Compliance services	**0.1**	**8**	0.1	13
Advisory services	**0.4**	**34**	0.2	25
	0.5	**42**	0.3	38
	1.2	**100**	0.8	100

In addition to the amounts shown above, the auditors received fees of £8,000 (2004: £7,000) for the audit of the Group pension scheme.

A description of the work of the Audit Committee is set out in the Audit Committee Report and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditors.

4. Staff costs

The average monthly number of employees (including Executive Directors) was:

	2005 Year-end	**2005 Average**	2004 Year-end	2004 Average
Heat treatment	**5,335**	**5,279**	5,257	5,055
Hot isostatic pressing	**314**	**307**	293	282
Materials testing	**2,120**	**1,843**	1,439	1,413
Electroplating	**–**	**–**	165	468
PVD	**–**	**–**	–	234
	7,769	**7,429**	7,154	7,452

Their aggregate remuneration comprised:

	£m	£m
Wages and salaries	**174.9**	166.6
Social security costs	**26.6**	27.1
Other pension costs (see note 37)	**7.0**	7.5
	208.5	201.2

Disclosure of individual Director's remuneration, share options, long term incentive scheme, pension consideration and pension entitlements required by the Companies Act 1985 and those specified for audit by the Financial Services Authority are shown in the tables in the Board Report on Remuneration on pages 22 and 23 and form part of these financial statements. Pension costs have been charged to administration costs.

5. Investment revenue

	Continuing operations and total 2005 £m	2004 £m
Interest on bank deposits	**5.0**	4.5
Other interest receivable	**0.2**	0.2
	5.2	4.7

6. Finance costs

	Continuing operations and total 2005 £m	2004 £m
Interest on bank overdrafts and loans	**11.3**	11.9
Interest on obligations under finance leases	**0.4**	0.5
Interest on pension scheme liabilities	**3.1**	2.5
Return on pension assets	**(2.1)**	(1.8)
Other finance charges	**0.8**	0.4
Total borrowing costs	**13.5**	13.5

7. Tax

	Continuing operations 2005 £m	Continuing operations 2004 £m	Discontinued operations 2005 £m	Discontinued operations 2004 £m	Total 2005 £m	Total 2004 £m
Current tax - charge for the year	**9.5**	11.5	**–**	(4.6)	**9.5**	6.9
Current taxation - adjustment in respect of previous years	**(0.1)**	(2.7)	**–**	–	**(0.1)**	(2.7)
Deferred tax (see note 21)	**2.4**	0.5	**–**	–	**2.4**	0.5
	11.8	9.3	**–**	(4.6)	**11.8**	4.7

UK corporation tax is calculated at 30% (2004: 30%) of the estimated assessable profit for the year. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions. There was no charge to current tax in 2005 relating to Electroplating and PVD divisions, the facilities of which were disposed of during 2004 and 2005. No material tax charge or credit arose on the disposal of the relevant assets. The charge for the year can be reconciled to the profit per the income statement as follows:

	2005 £m	2004 £m
Profit before tax:		
Continuing operations	**52.7**	46.7
Discontinued operations	**–**	(13.6)
	52.7	33.1
Tax at the UK corporation tax rate of 30% (2004: 30%)	**15.8**	9.9
Tax effect of share of results of associates	**(0.2)**	–
Tax effect of expenses that are not deductible in determining taxable profit	**0.9**	0.1
Tax effect of utilisation of tax losses not previously recognised	**(1.5)**	(2.4)
Tax effect of adjustments in respect of previous periods	**(2.3)**	(2.7)
Effect of different tax rates of subsidiaries operating in other jurisdictions	**(0.9)**	(0.2)
Tax expense for the year	**11.8**	4.7

8. Discontinued operations

At the end of 2003 following more than 2 years of very poor performance the Group decided to exit the electroplating business. Activity was conducted at 17 sites in 3 countries. The business was sold piecemeal in 14 transactions with the final transactions being completed in 2005.

With effect from 1 November 2004 the Group's PVD assets were transferred to SSCP Coating Sàrl which operates under the IonBond brand. This followed a strategic review by the Group which concluded that the development of the PVD business could be best achieved within the IonBond network. The Group initially acquired a 15% interest in SSCP Coating Sàrl in November 2004 and increased its holding to 20% in January 2005 at a total cost of £7.2m.

The results of the discontinued operations, which have been included in the consolidated income statement, were as follows:

	2005 £m	2004 £m
Revenue	**1.5**	30.8
Expenses	**(1.5)**	(40.6)
Profit before tax	**–**	(9.8)
Attributable tax expense	**–**	3.2
Loss on disposal of discontinued operations	**–**	(3.8)
Attributable tax expense	**–**	1.4
Net loss attributable to discontinued operations	**–**	(9.0)

The contribution of the discontinued operations on the Group's cash flows were as follows:

Net operating cash flow	**–**	3.7
Investing activities	**–**	0.6
Financing activities	**–**	–

No gain or loss arose on the disposal of the discontinued operations as all assets had been written down to fair value in the prior year.

The effect of discontinued operations on segment results is disclosed in note 2.

As a result of a continued review of the Group's network 5 sites of former heat treatment facilities are held for sale, with a book value of £1.2m. It is expected that all of the sites will be sold within the next 12 months for an amount in excess of book value and hence no impairment losses have been recognised in 2005. Non-current assets held for sale comprise property, plant and equipment.

9. Dividends

	2005 £m	2004 £m
Amounts recognised as distributions to equity holders in the period:		
Final dividend for the year ended 31 December 2004 of 3.85p (2003: 3.85p) per share	**12.3**	9.8
Interim dividend for the year ended 31 December 2005 of 2.35p (2004: 2.25p) per share	**7.5**	7.3
	19.8	17.1
Proposed final dividend for the year ended 31 December 2005 of 4.05p (2004: 3.85p) per share	**13.0**	12.3

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

10. Earnings per share

From continuing and discontinued operations

The calculation of the basic and diluted earnings per share is based on the following data:

	2005 £m	2004 £m
Earnings		
Earnings for the purposes of basic earnings per share being net profit attributable to equity holders of the parent	**40.7**	28.2

	2005 Number	2004 Number
Number of shares		
Weighted average number of ordinary shares for the purposes of basic earnings per share	**319,719,955**	304,605,680
Effect of dilutive potential ordinary shares:		
Share options	**546,590**	124,007
Weighted average number of ordinary shares for the purposes of diluted earnings per share	**320,266,545**	304,729,687

10. Earnings per share continued

From continuing operations

	2005 £m	2004 £m
Earnings		
Net profit attributable to equity holders of the parent	**40.7**	28.2
Adjustments to exclude loss for the year from discontinued operations	**–**	9.0
Earnings from continuing operations for the purpose of basic earnings per share excluding discontinued operations	**40.7**	37.2

The denominators used are the same as those detailed above for both basic and diluted earnings per share from continuing and discontinued operations.

Earnings per share from continuing and discontinued operations

	Pence	Pence
Basic	**12.7**	9.3
Diluted	**12.7**	9.3
Loss per share from discontinued operations:		
Basic	**–**	(2.9)
Diluted	**–**	(2.9)
Earnings per share from continuing operations:		
Basic	**12.7**	12.2
Diluted	**12.7**	12.2

	2005 £m	2004 £m
Headline earnings		
Net profit attributable to equity holders of the parent	**40.7**	28.2
Add back:		
Impairment of goodwill	**5.8**	–
Amortisation of acquired intangible fixed assets	**0.2**	–
Restructuring costs after tax	**–**	7.3
Headline earnings	**46.7**	35.5

	Pence	Pence
Headline:		
Basic	**14.6**	11.7
Diluted	**14.6**	11.7

11. Goodwill

	2005 £m	2004 £m
Cost		
At 1 January	**139.7**	137.5
Exchange differences	**–**	(0.2)
Recognised on acquisition of subsidiaries	**20.3**	3.1
Derecognised on disposal of subsidiaries	**–**	(0.7)
At 31 December	**160.0**	139.7
Accumulated impairment losses		
At 1 January	**–**	–
Impairment losses for the year	**(5.8)**	–
At 31 December	**(5.8)**	–
Carrying amount	**154.2**	139.7

Goodwill acquired in a business combination is allocated, at acquisition, to the business units that are expected to benefit from that business combination. After recognition of impairment losses, the carrying amount of goodwill had been allocated as follows:

	2005 £m	2004 £m
Heat Treatment	**126.2**	127.4
Testing	**28.0**	12.3
	154.2	139.7

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

The recoverable amounts of the Business Units are determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates using rates that reflect current market assessments of the time value of money and the risks specific to the Business Units. The growth rates up to 2010 are based on managment forecasts. Beyond 2010 a growth rate of 2.1% is assumed, being the 50 year average growth in UK GDP. Changes in selling prices and direct costs are based on management forecasts.

The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next five years and extrapolates cash flows thereafter based on an estimated growth rate of 2.1 per cent. This rate does not exceed the average long-term growth rate for the relevant markets.

The rate used to discount the forecast cash flows from all Business Units is 8%.

Goodwill written off in the year relates to a reduction in activity in a North American heat treatment plant (£4.0m) and disposal of another such plant (£1.8m).

12. Other intangible assets

	Software	Other intangibles acquired through business combinations	Total
	£	£	£
Cost			
At 1 January 2004	5.2	–	5.2
Additions	0.5	–	0.5
Disposals	(0.4)	–	(0.4)
At 1 January 2005	5.3	–	5.3
Exchange differences	0.1	–	0.1
Additions	0.9	–	0.9
Acquired on acquisition of subsidiaries	0.2	2.0	2.2
Disposals	(0.2)	–	(0.2)
At 31 December 2005	6.3	2.0	8.3
Amortisation			
At 1 January 2004	3.7	–	3.7
Charge for the year	0.6	–	0.6
Disposals	(0.4)	–	(0.4)
At 1 January 2005	3.9	–	3.9
Charge for the year	0.7	0.2	0.9
Disposals	(0.2)	–	(0.2)
At 31 December 2005	4.4	0.2	4.6
Carrying amount			
At 31 December 2005	1.9	1.8	3.7
At 31 December 2004	1.4	–	1.4

The amortisation period for intangible assets are:

	Years
Software	3 to 5
Customer relationships	10 to 15
Customer lists	15
Non-compete arrangements	2 to 5
Trade names	3

13. Property, plant and equipment

	Land and buildings Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Fixtures and fittings £m	Total £m
Cost or valuation						
At 1 January 2004	163.6	13.2	7.4	560.1	37.2	781.5
Additions	2.7	0.2	0.2	31.9	2.5	37.5
Acquisition of subsidiaries	1.7	–	–	3.0	0.1	4.8
Disposal of subsidiaries	(11.9)	(1.5)	(0.2)	(66.2)	(3.2)	(83.0)
Exchange differences	(1.5)	–	(0.1)	(5.8)	(0.1)	(7.5)
Reclassified as held for sale	(5.9)	–	(0.3)	(4.0)	(0.4)	(10.6)
Disposals	(1.5)	(0.1)	–	(24.3)	(2.3)	(28.2)
At 1 January 2005	147.2	11.8	7.0	494.7	33.8	694.5
Additions	2.3	0.3	0.4	46.7	2.1	51.8
Acquisition of subsidiaries	1.5	1.1	0.1	12.7	1.8	17.2
Exchange differences	0.7	(0.2)	0.3	3.9	(0.1)	4.6
Reclassified as held for sale	(0.3)	–	–	(0.4)	–	(0.7)
Recategorisation	2.2	0.5	–	1.2	(1.7)	2.2
Disposals	(2.4)	–	(0.1)	(15.5)	(3.1)	(21.1)
At 31 December 2005	**151.2**	**13.5**	**7.7**	**543.3**	**32.8**	**748.5**
Accumulated depreciation and impairment						
At 1 January 2004	24.4	7.0	2.3	237.3	29.0	300.0
Charge for the year	3.9	0.2	0.4	35.8	3.1	43.4
Acquisition of subsidiaries	0.2	–	–	0.9	0.1	1.2
Disposal of subsidiaries	(5.2)	(0.2)	(0.1)	(37.2)	(3.7)	(46.4)
Exchange differences	0.1	0.1	–	(0.5)	–	(0.3)
On assets reclassified as held for sale	(1.1)	–	(0.2)	(3.5)	(0.3)	(5.1)
Eliminated on disposals	(0.2)	(0.1)	–	(21.6)	(2.3)	(24.2)
At 1 January 2005	22.1	7.0	2.4	211.2	25.9	268.6
Charge for the year	3.7	0.3	0.3	33.9	2.3	40.5
Acquisition of subsidiaries	0.1	0.1	–	6.3	1.4	7.9
Exchange differences	(0.2)	(0.1)	0.1	0.5	–	0.3
On assets reclassified as held for sale	(0.1)	–	–	–	–	(0.1)
Recategorisation	1.3	–	–	2.5	(1.6)	2.2
Eliminated on disposals	(0.6)	–	–	(10.3)	(2.9)	(13.8)
At 31 December 2005	**26.3**	**7.3**	**2.8**	**244.1**	**25.1**	**305.6**
Carrying amount						
At 31 December 2005	**124.9**	**6.2**	**4.9**	**299.2**	**7.7**	**442.9**
At 31 December 2004	125.1	4.8	4.6	283.5	7.9	425.9

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

The Group has pledged land and buildings having a carrying amount of approximately £10.8 million to secure banking facilities granted to the Group.

At 31 December 2005 the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £16.1 million (2004: 6.7 million).

14. Subsidiaries

A list of the significant investments in subsidiaries, including the name, country of incorporation, proportion of ownership interest is given on pages 85 to 87.

15. Interests in associates

	2005 £m	2004 £m
Aggregated amounts relating to associates		
Total assets	**104.3**	77.7
Total liabilities	**91.3**	73.3
Revenues	**67.1**	54.4
Profit	**4.1**	3.8

A list of the significant investments in associates, including the name, country of incorporation, proportion of ownership interest is given in note 3 to the company's separate financial statements on page 81.

Amounts recognised in the income statement and in the balance sheet are as follows:

	2005 £m	2004 £m
Operating profit	**1.5**	–
Less: Interest	**(0.7)**	–
Less: Tax	**(0.1)**	–
Share of results of associates	**0.7**	–
Interest in associates	**9.2**	5.8

16. Inventories

	2005 £m	2004 £m
Raw materials	**7.0**	4.9
Work-in-progress	**4.7**	3.8
Finished goods and goods for resale	**0.2**	0.2
	11.9	8.9

17. Finance lease receivables

	Minimum lease payments 2005 £m	Minimum lease payments 2004 £m	Present value of minimum lease payments 2005 £m	Present value of minimum lease payments 2004 £m
Amounts receivable under finance leases:				
Within one year	**0.4**	–	**0.3**	–
In the second to fifth years inclusive	**1.7**	–	**1.5**	–
After five years	**0.4**	–	**0.4**	–
	2.5	–	**2.2**	–
Less: unearned finance income	**(0.3)**	–		
Present value of minimum lease payments receivable	**2.2**	–		

	2005 £m	2004 £m
Analysed as:		
Non-current finance lease receivables (recoverable after 12 months)	**1.9**	–
Current finance lease receivables (recoverable within 12 months)	**0.3**	–
	2.2	–
The present value of minimum lease payments were denominated in the following currencies:		
Euro	**1.3**	–
US Dollar	**0.9**	–
	2.2	–

The Group has entered into a finance leasing arrangements with SSCP Coating Sàrl, an associate company, for 3 PVD machines. The average term of finance leases entered into is 7 years. Unguaranteed residual values of assets leased under finance leases at the balance sheet date are estimated at £2.1 million (2004: £nil). The interest rate inherent in the leases is fixed at the contract date for the entire lease term. The average effective interest rate contracted approximates to 4.3%. The fair value of the Group's finance lease receivables at 31 December 2005 is estimated at £2.4 million (2004: £nil).

18. Other financial assets

	2005 £m	2004 £m
Trade and other receivables		
Amounts falling due within one year:		
Amount receivable for the supply of services	**98.3**	88.3
Other debtors and prepayments	**16.2**	14.0
	114.5	102.3
Amounts falling due after more than one year:	**6.1**	6.1

The average credit period given to customers for the supply of services is 69 days. An allowance has been made for estimated irrecoverable amounts from the sale of services of £6.3million (2004: £6.5million). This allowance has been determined by reference to past default experience. The directors consider that the carrying amount of trade and other receivables approximates their fair value.

Credit risk

The Group's principal financial assets are bank balances and cash, trade and other receivables, finance lease receivables and investments. The Group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

Bank and cash balances

Bank and cash balances comprise cash held by the Group and short-term bank deposits with an original maturity of three months or less. The carrying amount of these assets approximates their fair value. A breakdown of significant bank and cash balances by currency is as follows:

	2005 £m	2004 £m
Sterling	**50.9**	69.8
US Dollar	**19.6**	21.2
Euro	**38.5**	38.9
Swedish Krona	**4.8**	3.4
Other	**11.0**	8.8
Total bank and cash balances	**124.8**	142.1

19. Bank overdrafts and loans

	2005 £m	2004 £m
Bank overdrafts	**4.1**	3.4
Bank loans	**223.9**	223.1
	228.0	226.5

	2005 £m	2004 £m
The borrowings are repayable as follows:		
On demand or within one year	**6.4**	7.0
In the second year	**1.9**	172.8
In the third to fifth years	**217.8**	44.8
After five years	**1.9**	1.9
	228.0	226.5
Less: Amount due for settlement within 12 months (shown under current liabilities)	**(6.4)**	(7.0)
Amount due for settlement after 12 months	**221.6**	219.5

Analysis of borrowings by currency:

	Sterling £m	Euro £m	US$ £m	Swedish Krona £m	Other currencies £m	Total £m
At 31 December 2005						
Bank overdrafts	0.8	2.1	0.1	0.1	1.0	4.1
Bank loans	–	64.3	138.0	12.4	9.2	223.9
	0.8	66.4	138.1	12.5	10.2	228.0
At 31 December 2004						
Bank overdrafts	0.5	1.1	–	–	1.8	3.4
Bank loans	–	61.5	123.7	14.5	23.4	223.1
	0.5	62.6	123.7	14.5	25.2	226.5

	2005 %	2004 %
The weighted average interest rates paid were as follows:		
Bank overdrafts	**4.2**	5.9
Bank loans	**4.4**	5.2

Loans and finance leases of £56.5million (2004: £47.4million) were arranged at fixed interest rates and expose the Group to fair value interest rate risk. The remaining borrowings are arranged at floating rates, thus exposing the Group to cash flow interest rate risk.

19. Bank overdrafts and loans continued

The Directors estimate the fair value of the Group's borrowings as follows:

	2005 £m	2004 £m
Bank overdrafts	**4.1**	3.4
Bank loans	**226.5**	223.1

The other principal features of the Group's borrowings are as follows:

(i) Bank overdrafts are repayable on demand. No overdrafts are secured. The average effective interest rate approximates 4.2% (2004: 5.9%).

(ii) The group has two principal loans which are secure by upstream guarantees provided by subsidiaries:

(a) Drawings of £170.0million (2004: £170.4million) under a Revolving Credit Facility of £225million. This unsecured facility commenced on 29th July 2005 for a period of five years. The multi currency drawings under this facility carry an interest rate of between 0.50% and 0.75% above LIBOR (the margin at 31 December 2005 was 0.50%).

(b) A US Dollar denominated fixed rate loan of £46.6million (2004: £41.8million) which matures on 15th December 2009. The loan was advanced on 15th December 1999 at a fixed rate of 7.79%.

At 31 December 2005 the group had available £72.1million (2004: £33.1million) of undrawn committed borrowing facilities.

Disclosures in respect of financial instruments are given under the requirements of IAS 32. The company has taken advantage of the exemption from applying IAS 32 in respect of the comparative period, the year ended 31 December 2004, although disclosures have been given under that standard for information purposes. Accordingly, disclosures in respect of that year are given below under the relevant UK GAAP standard, FRS13.

The Finance Director's Report on page 12 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 as at 31 December 2004 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:

	£m
Currency:	
Sterling	69.8
US Dollar	21.2
Swedish Krona	3.4
Norwegian Krone	0.5
Danish Krone	0.2
Euro	38.9
Canadian Dollar	1.9
UAE Dirham	2.4
Swiss Franc	0.5
Czech Koruna	2.6
Chinese Renminbi	0.6
Omani Rial	0.1
Total	142.1

19. Bank overdrafts and loans 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 was as follows:

	Total £m	Floating rate £m	Fixed rate £m
Currency:			
Sterling	0.5	0.5	–
US Dollar	123.5	81.7	41.8
Swedish Krona	14.9	14.9	–
Danish Krone	3.4	3.4	–
Euro	72.0	67.1	4.9
Canadian Dollar	0.4	0.1	0.3
Swiss Franc	15.7	15.3	0.4
Polish Zloty	0.2	0.2	–
Total	230.6	183.2	47.4

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

	Fixed rate Weighted average interest rate %	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

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.

19. Bank overdrafts and loans 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 amounts shown take into account the effect of any forward contracts and other derivatives entered into to manage these currency exposures.

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

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

	£m
In one year or less	8.2
In more than one year but not more than two years	174.2
In more than two years but not more than five years	45.9
In more than five years	2.3
Total	230.6

19. Bank overdrafts and loans 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.

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

The fair value of forward foreign currency contracts and US Dollar denominated long-term fixed rate debt with a carrying amount of £41.8m 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 in 2004.

Borrowing facilities

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

	£m
Expiring in one year or less	17.4
Expiring in more than two years	15.7
Total	33.1

20. Derivative financial instruments

Currency derivatives

The Group utilises currency derivatives to hedge material future transactions and cash flows. The Group uses foreign currency forward contracts in the management of its exchange rate exposures. The contracts are primarily denominated in the currencies of the Group's principal markets. The unrecognised gains and losses were not material either in 2005 or 2004. At the balance sheet date, the Group had no outstanding forward foreign exchange contracts (2004: £nil). At the balance sheet date, £216.6m of foreign currency denominated debt was designated as a hedging instrument for the purpose of hedging the translation of its foreign operations.

Interest rate swaps

At the balance sheet date the Group had no interest rate derivative contracts.

21. Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period.

	Accelerated tax depreciation £m	Tax losses £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 January 2004	64.7	(9.8)	(4.4)	5.4	55.9
Charge to income	(4.0)	4.6	–	(0.1)	0.5
Charge to equity	–	–	(2.1)	–	(2.1)
Exchange differences	(1.1)	(0.1)	–	0.1	(1.1)
At 1 January 2005	59.6	(5.3)	(6.5)	5.4	53.2
Charge/(credit) to income	5.1	0.8	–	(2.8)	3.1
Charge to equity	2.0	–	(2.2)	–	(0.2)
Acquisition of subsidiaries	0.4	–	–	(0.1)	0.3
Exchange differences	1.3	–	–	0.2	1.5
Effect of change in tax rate:					
Income statement	(0.6)	–	–	(0.1)	(0.7)
At 31 December 2005	**67.8**	**(4.5)**	**(8.7)**	**2.6**	**57.2**

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2005 £m	2004 £m
Deferred tax liabilities	**79.9**	72.1
Deferred tax assets	**(22.7)**	(18.9)
	57.2	53.2

At the balance sheet date, the Group has unused tax losses of £42.8 million (2004: £32.7 million) available for offset against future profits. A deferred tax asset has been recognised in respect of £37.5 million (2004: £20.7 million) of such losses. No deferred tax asset has been recognised in respect of the remaining £5.3 million (2004: £12.0 million) of such losses. Included in unrecognised tax losses are losses of £2.5 million that will expire from 2022 onwards. Other losses may be carried forward indefinitely.

At the balance sheet date, the aggregate amount of undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £269.4 million (2004: £223.4 million). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future. Temporary differences arising in connection with interests in associates and joint ventures are insignificant.

22. Obligations under finance leases

	Minimum lease payments 2005 £m	Minimum lease payments 2004 £m	Present value of minimum lease payments 2005 £m	Present value of minimum lease payments 2004 £m
Amounts payable under finance leases:				
Within one year	**1.7**	1.8	**1.4**	1.5
In the second to fifth years inclusive	**3.4**	3.8	**2.8**	3.0
After five years	**1.2**	1.5	**1.1**	1.4
	6.3	7.1	**5.3**	5.9
Less: future finance charges	**(1.0)**	(1.2)		
Present value of lease obligations	**5.3**	5.9		

	2005 £m	2004 £m
Analysed as:		
Amount due for settlement after 12 months	**3.9**	4.4
Amount due for settlement within 12 months (shown as current liabilities)	**1.4**	1.5
	5.3	5.9

	2005 £m	2004 £m
The present value of minimum lease payments were denominated in the following currencies:		
Euro	**2.4**	2.8
Sterling	**0.9**	0.9
Danish Krone	**0.9**	0.9
US Dollar	**0.9**	1.0
Other	**0.2**	0.3
	5.3	5.9

It is the Group's policy to lease certain of its fixtures and equipment under finance leases. The average lease term is 7 years. For the year ended 31 December 2005, the average effective borrowing rate was 5.4% (2004: 5.8%). Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments. The fair value of the Group's lease obligations approximates to their carrying amount. The Group's obligations under finance leases are secured by the lessors' rights over the leased assets.

23. Other financial liabilities

	2005 £m	2004 Restated* £m
Trade and other payables		
Amounts falling due within one year:		
Trade creditors	**33.4**	33.3
Other taxes and social security	**14.4**	14.7
Other creditors	**12.7**	7.0
Accruals and deferred income	**36.7**	31.9
	97.2	86.9
Amounts falling due after more than one year:		
Other creditors	**1.8**	2.9

* See note 24

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 51 days (2004: 45 days). The Directors consider that the carrying amount of trade payables approximates to their fair value.

24. Provisions

	Restated		
	Restructuring provision £m	Environ-mental £m	Total £m
At 1 January 2005 as previously reported	1.5	–	1.5
Reclassification from long-term payables	1.3	5.4	6.7
At 1 January 2005 as restated	2.8	5.4	8.2
Utilisation of provision	(1.2)	–	(1.2)
At 31 December 2005	**1.6**	**5.4**	**7.0**
Included in current liabilities			2.3
Included in non-current liabilities			4.7
			7.0

The restructuring provision relates to the remaining costs associated with the closure of various heat treatment and electroplating sites in 2002, 2003 and 2004.

The Group provides for the costs of environmental remediation that have been identified, either as part of acquisition due diligence, or in other circumstances where remediation by the Group is required. This provision is reviewed annually.

Cash outflows in respect of these liabilities are expected to occur within five years. The Group has restated the presentation of certain liabilities from long-term payables to provisions and accordingly the comparative information at 1 January 2005 has been restated. This has reduced long-term payables at 31 December 2004 by £6.7 million and increased long-term provisions by the same amount. In the opinion of the Directors, this is a more appropriate presentation of these liabilities.

Bodycote

25. Share capital

	2005 £m	2004 £m
Authorised 430,000,000 (2004: 430,000,000) ordinary shares of 10p each	**43.0**	43.0
Issued and fully paid 321,154,860 (2004: 320,968,766) ordinary shares of 10p each	**32.1**	32.1

The Company has one class of ordinary shares which carry no right to fixed income. Movements in share capital during the year relate to the exercise of share options.

26. Share premium

	2005 £m	2004 £m
Balance at 1 January	**300.0**	244.4
Premium arising on issue of equity shares	**0.3**	55.6
Balance at 31 December	**300.3**	300.0

27. Own shares

	2005 £m	2004 £m
Balance at 1 January	**(0.8)**	(0.8)
Acquired in the year	**(1.7)**	–
Balance at 31 December	**(2.5)**	(0.8)

The own shares reserve represents the cost of shares in Bodycote International plc purchased in the market and held by the Bodycote International Employee Benefit Trust to satisfy share-based payments under the Group's incentive schemes (see note 36).

28. Other reserves

	2005 £m	2004 £m
Balance at 1 January	**1.5**	1.3
Share based payments	**0.2**	0.2
Balance at 31 December 2005	**1.7**	1.5

29. Hedging and translation reserves

	Translation reserve £m
Balance at 1 January 2004	14.2
Exchange differences on translation of overseas operations	2.0
Balance at 31 December 2004	16.2
Exchange differences on translation of overseas operations	(5.1)
Balance at 31 December 2005	**11.1**

30. Retained earnings

	£m
Balance at 1 January 2004	67.0
Dividends paid	(17.1)
Net profit for the year	28.2
Items taken directly to equity	(6.1)
Balance at 31 December 2004	72.0
Dividends paid	(19.8)
Net profit for the year	40.7
Items taken directly to equity	(3.5)
Balance at 31 December 2005	**89.4**

31. Disposal of subsidiaries

As referred to in note 8, the Group disposed of its remaining Electroplating sites during 2005. The final transaction was completed on 22 August 2005.

The net assets of these plants at the date of disposal and at 31 December 2004 were as follows:

	Electroplating plants	
	2005 £m	2004 £m
Property, plant and equipment	**5.6**	5.6
Inventories	**0.2**	0.2
	5.8	5.8
Total consideration - satisfied by cash	**5.8**	
Net cash inflow arising on disposal:		
Cash consideration	**5.8**	

32. Acquisition of subsidiaries

The Group acquired the following subsidiaries during the year:

Interest	Date of acquisition	% of shares acquired	Principal activity
Ensecon Laboratories Ltd	01 Jan 2005	100	Testing
GHD Cladding	01 Jan 2005	100	Testing
Qatar Inspection Services WLL	17 Jan 2005	100	Testing
Nitrex - HTC Sp Z.o.o.	25 Feb 2005	100	Heat Treatment
Cirrus Laboratories Ltd	28 Apr 2005	100	Testing
Law Laboratories Ltd	28 Apr 2005	100	Testing
Application du Brasage des Materiaux et des Traitement SA	08 Jun 2005	100	Heat Treatment
JW Worsley (Coventry) Ltd	05 Jul 2005	100	Testing
Allied Laboratory Services Ltd	08 Jul 2005	100	Testing
CSM Materialteknik AB	05 Aug 2005	100	Testing
Expert Heat Treatments Ltd	19 Aug 2005	100	Heat Treatment
Arthur Gordon Environmental Evaluators Ltd	13 Sep 2005	100	Testing
Food Products Laboratories Inc	13 Sep 2005	100	Testing
UTTIS Industries SA	21 Sep 2005	75	Heat Treatment

All transactions have been accounted for by the purchase method of accounting and are summarised below. These acquistions have been aggregated as they are considered individually immaterial to the Group's results.

	Total Group £m
Book value and fair value of net assets acquired:	
Intangible assets:	
At book value	0.2
Fair value adjustment	2.0
At fair value	2.2
Property, plant and equipment	9.2
Inventories	1.0
Trade receivables	6.0
Cash and cash equivalents	1.1
Trade payables and other payables	(4.4)
Current tax liability	(0.5)
Bank loans	(0.1)
Finance leases	(1.1)
Deferred tax liabilities	(0.3)
Short-term provisions	(0.5)
	12.6
Goodwill	20.3
Total consideration	32.9
Satisfied by:	
Cash	32.4
Directly attributable costs	0.5
	32.9
Net cash outflow arising on acquisition:	
Cash consideration	32.9
Cash and cash equivalents acquired	(1.1)
	31.8

32. Acquisition of subsidiaries continued

The goodwill arising on the acquisitions is attributable to the anticipated profitability of the distribution of the Group's services and the anticipated future operating synergies from the combination. The acquired businesses contributed £17.2million revenue and £3.4million to the Group's profit before tax for the period between the date of acquisition and the balance sheet date. If the acquisition of all the businesses had been completed on the first day of the financial year, Group revenues for continuing operations for the year would have been £484.2 million and Group profit attributable to equity holders of the parent would have been £42.9 million.

33. Notes to the cash flow statement

	2005 £m	2004 £m
Operating profit from continuing operations	**61.0**	55.5
Operating profit from discontinued operations	**–**	(2.4)
Operating profit	**61.0**	53.1
Share of associates' interest and tax	**0.8**	–
Depreciation of property, plant and equipment	**40.5**	43.4
Amortisation of intangible assets	**0.9**	0.6
Impairment of goodwill	**5.8**	–
EBITDA*	**109.0**	97.1
(Gain)/loss on disposal of property, plant and equipment	**(0.6)**	0.5
Income from associates	**(1.6)**	–
Share-based payments	**0.2**	0.2
Operating cash flows before movements in working capital	**107.0**	97.8
(Increase)/decrease in inventories	**(2.1)**	3.6
Increase in receivables	**(8.4)**	(2.1)
Increase in payables	**2.8**	7.1
Increase/(decrease) in provisions	**4.7**	(0.5)
Cash generated by operations	**104.0**	105.9
Income taxes paid	**(8.3)**	(5.4)
Net cash from operating activities	**95.7**	100.5

*Earnings before interest, tax, depreciation and amortisation.

Cash and cash equivalents (which are presented as a single class of assets on the face of the balance sheet) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less.

34. Contingent liabilities

Under the terms of the transfer of the Group's assets into the IonBond associated undertaking, IonBond has a commitment to purchase equipment from a third party supplier in 2006 to the value of €1.7 million (£1.2 million). If IonBond does not meet this commitment, Bodycote International plc is required to reimburse the supplier at a rate of 35% of any shortfall resulting in a maximum contingent liability of €0.6 million (£0.4 million).

Bodycote

35. Operating lease arrangements - the group as lessee

	2005	2004
	£m	£m
Minimum lease payments under operating leases recognised in income for the year	**4.5**	4.4

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2005	2004
	£m	£m
Within one year	**6.2**	5.1
In the second to fifth years inclusive	**13.1**	11.7
After five years	**8.2**	7.0
	27.5	23.8

Operating lease payments represent rentals payable by the Group for certain of its land and buildings, fixtures and fittings and motor vehicles.

36. Share based payments - Equity-settled share option scheme

The company operates 3 share option schemes in relation to Group employees. Options are exercisable at the middle market closing price for the working day prior to the date of grant and are excercisable 3 years from the date of grant if stated performance criteria have been met. Options lapse if not excercised within ten years (7 years for the 1996 scheme) of the date of grant or if the participant leaves Group employment.

Details of the share options outstanding during the year are as follows.

Date of grant	Option price in pence	Exercise period	No of options outstanding **2005**	2004
May-95	106.34	1998-2005	**–**	33,981
Oct-95	133.17	1998-2005	**–**	20,349
Jun-96	178.19	1999-2006	**–**	78,291
Dec-96	253.46	1999-2006	**334,256**	334,256
May-97	241.92	2000-2007	**655,278**	737,738
Dec-97	315.43	2000-2007	**531,567**	540,401
Jan-98	353.06	2001-2008	**227,222**	235,241
May-98	475.92	2001-2008	**33,688**	41,441
Oct-98	285.18	2001-2008	**257,200**	286,070
Apr-99	370.26	2002-2009	**478,465**	478,465
May-99	329.12	2002-2009	**16,042**	16,042
Dec-99	292.19	2002-2009	**197,859**	197,859
May-00	231.42	2003-2010	**952,191**	1,031,856
Apr-01	203.37	2004-2011	**1,090,309**	1,170,513
Apr-01	203.37	2004-2008*	**45,926**	45,926
Sep-02	125.76	2005-2012	**808,210**	867,031
Sep-02	125.76	2005-2009*	**90,158**	90,158
Sep-03	147.27	2006-2013	**1,214,331**	1,251,763
			6,932,702	7,457,381

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 Benefit Trust.

36. Share based payments - Equity-settled share option scheme continued

Movements in share options are summarised as follows:

	2005 Number of share options	**2005 Weighted average exercise price £**	2004 Number of share options	2004 Weighted average exercise price £m
Outstanding at beginning of period	**7,457,381**	**223.86**	9,301,081	240.70
Exercised during the period	**(186,094)**	**145.16**	(180,859)	99.33
Expired during the period	**(338,585)**	**210.46**	(1,662,841)	331.59
Outstanding at the end of the period	**6,932,702**	**226.00**	7,457,381	223.86
Exercisable at the end of the period	**2,053,378**	**285.00**	2,307,768	276.58

The weighted average share price at the date of exercise for share options exercised during the period was 193.03 pence. The options outstanding at 31 December 2005 had a weighted average exercise price of 226.00 pence, and a weighted average remaining contractual life of 4.0 years.

The inputs into the Black-Scholes model are as follows:

		2005	2004
Weighted average share price	pence	**157.5**	157.5
Weighted average exercise price	pence	**157.5**	157.5
Expected volatility		**0.4**	0.4
Expected life	years	**3.0**	3.0
Risk-free rate	%	**4.0**	4.0
Expected dividends	pence	**4.3**	4.3

Expected volatility was determined by calculating the historical volatility of the Group's share price over the previous 3 years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

The Group recognised total expenses of £0.2 million and (2004: £0.2 million) related to equity-settled share-based payment transactions.

37. Pension schemes

The Group operated a number of pension schemes during the year. The defined benefit obligation less fair value of assets at the end of the year and total expense recognised in the income statement are summarised as follows:

Defined benefit obligation less fair value of assets at the end of the year

	Year ended 31 Dec 2005 £m	Year ended 31 Dec 2004 £m
UK Scheme	**21.8**	20.7
USA Schemes	**1.0**	0.8
French Scheme	**4.1**	2.7
German Schemes	**3.0**	–
	29.9	24.2

Total expense recognised in income statement

	Year ended 31 Dec 2005 £m	Year ended 31 Dec 2004 £m
UK Scheme	**2.0**	1.6
USA Schemes	**0.2**	0.2
French Scheme	**0.2**	0.2
German Schemes	**0.1**	–
	2.5	2.0

UK Scheme

The company sponsors the Bodycote International UK Pension Scheme which is a funded defined benefit arrangement for UK employees. The last full actuarial valuation of this scheme was carried out by a qualified independent actuary as at 6 April 2005 and updated on an approximate basis to 31 December 2005.

The contributions made by the employer over the financial year have been £2.0m, equivalent to approximately 21% of pensionable pay plus a special contribution of £0.1m. This level of contribution is currently under review following the triennial valuation of the scheme completed as at 6 April 2005.

It is the policy of the Group to recognise all actuarial gains and losses in the year in which they occur outside the profit and loss account and in the statement of recognised income and expense.

37. Pension schemes continued

Reconciliation of opening and closing balances of the present value of the defined benefit obligation

	Year ended 31 Dec 2005 £m	Year ended 31 Dec 2004 £m
Defined benefit obligation at start of year	**50.7**	38.6
Current service cost	**1.3**	1.1
Interest cost	**2.7**	2.2
Contributions by plan participants	**0.5**	0.5
Actuarial loss	**5.6**	9.3
Benefits paid, death in service insurance premiums and expenses	**(1.3)**	(1.0)
Defined benefit obligation at end of year	**59.5**	50.7

Reconciliation of opening and closing balances of the fair value of plan assets

	Year ended 31 Dec 2005 £m	Year ended 31 Dec 2004 £m
Fair value of assets at start of year	**30.0**	26.1
Expected return on assets	**2.0**	1.7
Actuarial gains	**4.5**	0.9
Contributions by employer	**2.0**	1.8
Contributions by plan participants	**0.5**	0.5
Benefits paid, death in service insurance premiums and expenses	**(1.3)**	(1.0)
Fair value of assets at end of year	**37.7**	30.0

Total expense recognised in the income statement

	Year ended 31 Dec 2005 £m	Year ended 31 Dec 2004 £m
Current service cost	**1.3**	1.1
Interest on pension scheme liabilities	**2.7**	2.2
Expected return on pension scheme assets	**(2.0)**	(1.7)
Total expense	**2.0**	1.6

The cumulative amount of actuarial gains and losses recognised in the statement of recognised income and expenses since adoption of IAS 19 is £1.1m.

37. Pension schemes continued

Assets

	At 31 Dec 2005 £m	At 31 Dec 2004 £m	At 31 Dec 2003 £m
Equities	**25.1**	20.2	18.2
Bonds	**7.0**	5.2	2.9
Cash	**–**	–	0.5
With profits insured policy	**5.6**	4.6	4.5
	37.7	30.0	26.1

None of the fair values of the assets shown above include any of the Company's own financial instruments or any property occupied by, or other assets used by the Company.

Expected long-term rates of return

The expected long-term return on cash is equal to bank base rates at the balance sheet date. The expected return on bonds is determined by reference to UK long dated gilt and bond yields at the balance sheet date. The expected rate of return on equities and property have been determined by setting an appropriate risk premium above gilt/bond yields having regard to market conditions at the balance sheet date.

The expected long-term rates of return are as follows:

	At 31 Dec 2005 % per annum	At 31 Dec 2004 % per annum	At 31 Dec 2003 % per annum
Equities	**7.5**	7.6	7.0
Bonds	**4.3**	4.5	4.7
Insurance Policy	**4.1**	4.5	4.7
Cash	**4.5**	4.75	4.0
Overall for scheme	**6.4**	6.6	6.3

Actual return on plan assets

The actual return on the plan assets over the year ended 31 December 2005 was 21.1%.

Assumptions

	2005 % per annum	2004 % per annum	2003 % per annum
Inflation	**3.0**	3.0	2.75
Salary increases	**4.25**	4.25	4.0
Rate of discount	**4.8**	5.3	5.75
Allowance for pension in payment increases of RPI or 5% p.a. if less	**3.0**	3.0	2.75
Allowance for revaluation of deferred pensions of RPI or 5% p.a. if less	**3.0**	3.0	2.75

37. Pension schemes continued

Present values of defined benefit obligations, fair value of assets and deficit

	At 31 Dec 2005	At 31 Dec 2004	At 31 Dec 2003
	£m	£m	£m
Present value of defined benefit obligation	**59.5**	50.7	38.6
Fair value of plan assets	**(37.7)**	(30.0)	(26.1)
Deficit in the scheme	**21.8**	20.7	12.5

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2005 is that recognised in the balance sheet.

Best estimate of contributions to be paid into the plan for the year ending 31 December 2006

The best estimate of contributions to be paid into the plan for the year ending 31 December 2006 is £2.9m.

Amounts for the current and previous four years

	2005	2004	2003	2002	2001
	£m	£m	£m	£m	£m
Fair value of assets	**37.7**	30.0	26.1	22.7	25.9
Defined benefit obligation	**(59.5)**	(50.7)	(38.6)	(36.1)	(30.9)
Deficit in the plan	**(21.8)**	(20.7)	(12.5)	(13.4)	(5.0)
Experience adjustment on plan liabilities	**0.4**	0.1	0.1	(0.6)	–
Experience adjustment on plan assets	**4.5**	0.9	2.4	(6.4)	–
Effects of changes in the demographic and financial assumptions underlying the present value of the plan liabilities	**(6.0)**	(9.4)	(1.9)	(2.0)	–

USA Schemes

The Group sponsors five defined benefit pension arrangements in the USA. These are Metallurgical Inc Pension Plan, Lakeside Heat Treating, Lansing (UAW), St Louis Hourly and the Supplemental Retirement Plan. The last full actuarial valuation of these schemes was carried out by a qualified independent actuary as at 1 January 2004 (1 September 2004 for the Metallurgical Plan) and updated on an approximate basis to 31 December 2005. The contributions made by the employer over the financial year have been $71,000.

Reconciliation of opening and closing balances of the present value of the defined benefit obligation

	Year ended 31 Dec 2005	Year ended 31 Dec 2004
	$m	$m
Defined benefit obligation at start of year	**4.9**	5.4
Current service cost	**0.1**	0.1
Interest cost	**0.2**	0.3
Actuarial gain	**–**	(0.4)
Benefits paid, death in service insurance premiums and expenses	**(0.3)**	(0.5)
Defined benefit obligation at end of year	**4.9**	4.9

37. Pension schemes continued

Reconciliation of opening and closing balances of the fair value of plan assets

	Year ended 31 Dec 2005 $m	Year ended 31 Dec 2004 $m
Fair value of assets at start of year	**3.3**	3.2
Expected return on assets	**0.2**	0.2
Actuarial gains	**–**	0.2
Contributions by employer	**0.1**	0.2
Benefits paid, death in service insurance premiums and expenses	**(0.3)**	(0.5)
Fair value of assets at end of year	**3.3**	3.3

Total expense recognised in the income statement

	Year ended 31 Dec 2005 $m	Year ended 31 Dec 2004 $m
Current service cost	**0.1**	0.1
Interest on pension scheme liabilities	**0.2**	0.3
Expected return on pension scheme assets	**(0.2)**	(0.2)
Total expense	**0.1**	0.2

The cumulative amount of actuarial gains and losses recognised in the statement of recognised income and expenses since adoption of IAS 19 is nil.

Assets

	At 31 Dec 2005 $m	At 31 Dec 2004 $m	At 31 Dec 2003 $m
Equities	**2.0**	1.8	1.7
Bonds	**0.9**	0.8	0.9
Cash	**0.4**	0.7	0.6
	3.3	3.3	3.2

None of the fair values of the assets shown above include any of the Company’s own financial instruments or any property occupied by, or other assets used by, the Company.

37. Pension schemes continued

Expected long-term rates of return

The expected long-term return on cash is equal to bank base rates at the balance sheet date. The expected return on bonds is determined by reference to UK long dated gilt and bond yields at the balance sheet date. The expected rate of return on equities and property have been determined by setting an appropriate risk premium above gilt/bond yields having regard to market conditions at the balance sheet date.

The expected long-term rates of return are as follows:

	At 31 Dec 2005 % per annum	At 31 Dec 2004 % per annum	At 31 Dec 2003 % per annum
Equities	**7.00**	7.00	7.00
Bonds	**5.00**	5.00	5.00
Cash	**2.25**	2.25	1.25
Overall for scheme	**5.88**	5.51	5.36

Actual return on plan assets

The actual return on the plan assets over the year ending 31 December 2005 was 6%.

Assumptions

The liabilities have been calculated using a discount rate of 5% per annum (5% at 31 December 2004 and 31 December 2003).

Present values of defined benefit obligations, fair value of assets and deficit

	At 31 Dec 2005 $m	At 31 Dec 2004 $m	At 31 Dec 2003 $m
Present value of defined benefit obligation	**(4.9)**	(4.9)	(5.4)
Fair value of plan assets	**3.3**	3.3	3.2
Deficit in scheme	**(1.6)**	(1.6)	(2.2)

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2005 is that recognised in the balance sheet.

Best estimate of contributions to be paid into the plan for the year ending 31 December 2006

The best estimate of contributions to be paid into the plan for the year ending 31 December 2006 is $0.1m.

Amounts for the current and previous four years

	2005 $m	2004 $m	2003 $m	2002 $m	2001 $m
Fair value of assets	**3.3**	3.3	3.2	20.8	21.9
Defined benefit obligation	**4.9**	4.9	5.4	25.8	21.6
(Deficit)/surplus in plan	**(1.6)**	(1.6)	(2.2)	(5.0)	0.3
Experience adjustment on plan liabilities	**–**	0.4	(0.1)	–	–
Experience adjustment on plan assets	**–**	0.2	0.1	(0.5)	–
Effects of changes in the demographic and financial assumptions underlying the present value of the plan liabilities	**–**	–	–	(4.0)	–

37. Pension schemes continued

French Scheme

The Group operates an unfunded scheme for employees in France.

Reconciliation of opening and closing balances of the present value of the defined benefit obligation

	Year ended 31 Dec 2005 €m	Year ended 31 Dec 2004 €m
Defined benefit obligation at start of year	**3.8**	3.6
Current service cost	**0.2**	0.2
Interest cost	**0.2**	0.2
Actuarial loss (gain)	**1.7**	(0.2)
Defined benefit obligation at end of year	**5.9**	3.8

Total expense recognised in the income statement

	Year ended 31 Dec 2005 €m	Year ended 31 Dec 2004 €m
Current service cost	**0.2**	0.2
Interest on pension scheme liabilities	**0.2**	0.2
Total expense	**0.4**	0.4

The cumulative amount of actuarial gains and losses recognised in the statement of recognised income and expenses since adoption of IAS 19 is €0.1m.

Assumptions

The assumptions have been calculated using a discount rate of 4% per annum (2004: 4% per annum).

Present values of defined benefit obligations, fair value of assets and deficit

	At 31 Dec 2005 €m	At 31 Dec 2004 €m	At 31 Dec 2003 €m
Present value of defined benefit obligation	**(5.9)**	(5.7)	(5.3)
Deficit in scheme	**(5.9)**	(5.7)	(5.3)

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2005 is that recognised in the balance sheet.

Best estimate of contributions to be paid into the plan for the year ending 31 December 2006

As the scheme is unfunded the contributions to be paid into the plan for the year ending 31 December 2006 are nil.

37. Pension schemes continued

German schemes

The Group operates unfunded schemes for employees in Germany.

Reconciliation of opening and closing balances of the present value of the defined benefit obligation

	Year ended 31 Dec 2005 €m
Defined benefit obligation at start of year	**3.7**
Interest cost	**0.2**
Actuarial loss	**0.6**
Benefits paid, death in service insurance premiums and expenses	**(0.1)**
Defined benefit obligation at end of year	**4.4**

Total expense recognised in the income statement

	Year ended 31 Dec 2005 €m
Interest on pension scheme liabilities	**0.2**
Total expense	**0.2**

The cumulative amount of actuarial gains and losses recognised in the statement of recognised income and expenses since adoption of IAS 19 is €0.5m.

Assumptions

	At 31 Dec 2005 % per annum	At 31 Dec 2004 % per annum
Salary increases	**2.5**	2.5
Rate of discount	**4.0**	4.75
Pension increases	**1.75**	1.5

37. Pension schemes continued

Present values of defined benefit obligations, fair value of assets and deficit

	At 31 Dec 2005 €m	At 31 Dec 2004 €m
Present value defined benefit obligation	**(4.4)**	(3.7)
Deficit in scheme	**(4.4)**	(3.7)

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2005 is that recognised in the balance sheet.

Best estimate of contributions to be paid to plan for the year ending 31 December 2006
As the scheme is unfunded the contributions to be paid into the plan for the year ending 31 December 2006 is €nil.

38. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its associates are disclosed below. Transactions between the Company and its subsidiaries and associates are disclosed in the Company's separate financial statements.

Trading transactions
During the year, group companies entered into the following transactions with related parties who are not members of the Group:

	Sale of goods and services		Purchase of goods and services		Amounts owed to related parties		Amounts owed by related parties	
	2005 £m	2004 £m	**2005 £m**	2004 £m	**2005 £m**	2004 £m	**2005 £m**	2004 £m
Associates	**3.6**	–	**0.2**	–	**5.7**	–	**0.2**	–

Sales of goods and services include the sale of property, payments received from finance leases (see note 17) and the provision of managment services. All transactions were made at arms length.

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of the amounts owed by related parties.

39. Explanation of the transition to IFRS

This is the first year the Group has presented its financial information under IFRS. The following disclosures are required in the year of transition. The last financial statements under UK GAAP were for the year ended 31 December 2004 and the date of transition to IFRS was therefore 1 January 2004.

Reconciliation of equity at 1 January 2004 (date of transition to IFRS):

	UK GAAP £m	IFRS Adjustments £m	IFRS £m	Note
Non-current assets				
Goodwill	137.5	–	137.5	
Other intangible assets	–	1.5	1.5	a
Property, plant and equipment	478.7	2.8	481.5	b
Interests in associates	0.3	–	0.3	
Other investments	0.6	–	0.6	
Other receivables	3.7	–	3.7	
	620.8	4.3	625.1	
Current assets				
Inventories	18.2	(4.7)	13.5	c
Trade and other receivables	99.0	–	99.0	
Cash and cash equivalents	35.2	–	35.2	
	152.4	(4.7)	147.7	
Non-current assets classified as held for sale	–	1.3	1.3	d
Total assets	773.2	0.9	774.1	
Current liabilities				
Trade and other payables	99.6	(11.3)	88.3	e
Tax liabilities	3.2	–	3.2	
Obligations under finance leases	1.6	0.3	1.9	f
Bank overdrafts and loans	14.7	–	14.7	
Short term provisions	2.1	–	2.1	
	121.2	(11.0)	110.2	
Net current assets	31.2	6.3	37.5	
Non-current liabilities				
Bank loans	224.9	–	224.9	
Retirement benefit obligation	–	15.7	15.7	g
Deferred tax liabilities	40.7	15.2	55.9	h
Obligations under finance leases	4.3	1.8	6.1	f
Other payables	10.3	(1.8)	8.5	i
	280.2	30.9	311.1	
Total liabilities	401.4	19.9	421.3	
Net assets	371.8	(19.0)	352.8	

39. Explanation of transition to IFRS continued

	UK GAAP £m	IFRS Adjustments £m	IFRS £m	Note
Equity				
Share capital	25.7	–	25.7	
Share premium account	244.4	–	244.4	
Currency and other reserves	14.2	0.6	14.8	j
Retained earnings	86.6	(19.6)	67.0	
Equity attributable to equity holders of the parent	370.9	(19.0)	351.9	
Minority interest carried forward	0.9	–	0.9	
Total	371.8	(19.0)	352.8	

Reconciliation of profit or loss for 2004:

	UK GAAP £m	IFRS Adjustments £m	IFRS £m	Note
Revenue	457.2	–	457.2	
Profit from operations	32.4	9.5	41.9	k
Investment income	4.7	–	4.7	
Finance costs	(12.6)	(0.9)	(13.5)	l
Net interest	(7.9)	(0.9)	(8.8)	
Profit before tax	24.5	8.6	33.1	
Tax	(5.6)	0.9	(4.7)	m
Profit for the year	18.9	9.5	28.4	
Attributable to:				
Equity holders of the parent	18.7	9.5	28.2	
Minority interest	0.2	–	0.2	
	18.9	9.5	28.4	
Dividends paid and approved	(19.6)	2.5	(17.1)	

Reconciliation of equity at 31 December 2004:

	UK GAAP £m	IFRS Adjustments £m	IFRS £m	Note
Non-current assets				
Goodwill	131.2	8.5	139.7	n
Other intangible assets	–	1.4	1.4	o
Property, plant and equipment	428.7	(2.8)	425.9	p
Interests in associates	5.8	–	5.8	
Other investments	0.4	–	0.4	
Deferred tax asset	–	18.9	18.9	q
Other receivables	6.1	–	6.1	
	572.2	26.0	598.2	

39. Explanation of transition to IFRS continued

	UK GAAP £m	IFRS Adjustments £m	IFRS £m	Note
Current assets				
Inventories	13.4	(4.5)	8.9	r
Trade and other receivables	102.3	–	102.3	
Cash and cash equivalents	142.1	–	142.1	
	257.8	(4.5)	253.3	
Non-current assets classified as held for sale	–	6.9	6.9	s
Total assets	830.0	28.4	858.4	
Current liabilities				
Trade and other payables	106.5	(12.4)	94.1	t
Tax liabilities	2.5	–	2.5	
Obligations under finance leases	1.2	0.3	1.5	u
Bank overdrafts and loans	7.0	–	7.0	
Short term provisions	1.5	–	1.5	
	118.7	(12.1)	106.6	
Net current assets	139.1	7.6	146.7	
Non-current liabilities				
Bank loans	219.5	–	219.5	
Retirement benefit obligation	–	24.2	24.2	v
Deferred tax liabilities	41.2	30.9	72.1	w
Obligations under finance leases	2.9	1.5	4.4	u
Other payables	11.8	(2.2)	9.6	x
	275.4	54.4	329.8	
Total liabilities	394.1	42.3	436.4	
Net assets	435.9	(13.9)	422.0	
Equity				
Share capital	32.1	–	32.1	
Share premium account	300.0	–	300.0	
Currency and other reserves	17.1	(0.2)	16.9	y
Retained earnings	85.7	(13.7)	72.0	
Equity attributable to equity holders of the parent	434.9	(13.9)	421.0	
Minority interest carried forward	1.0	–	1.0	
Total	435.9	(13.9)	422.0	

39. Explanation of transition to IFRS continued

Explanatory notes:

a) Other intangible assets: IAS 38 (Intangible Assets) requires certain software to be reported as intangible fixed assets. They were previously included in property, plant and equipment.

b) Property, Plant and Equipment: Changes are made up as follows:

	£m
Reclassification of software to Other Intangible Assets (note a above)	(1.5)
Reclassification to Non-current Assets Held for Sale (see note d below)	(1.9)
Reclassification of maintenance spares from inventory (see note c below)	4.7
Reclassification of operating leases	1.5
	2.8

c) Inventories: Under IAS 16 (Property, Plant and Equipment) maintenance spares are treated as non-current assets rather than inventory.

d) Non-Current Assets Held for Sale: Under IFRS 5 (Non-Current Assets held for sale and Discontinued Operations) non-current assets, such as closed plant buildings, are presented separately from other non-current assets. The adjustment represents the transfer from Property, Plant and Equipment after fair value adjustments.

e) Accounts payable: Adjustments are primarily due to dividends which, under IAS 10 (Events after the Balance Sheet Date), may not be recognised until appropriately approved.

f) Obligations under finance leases: Increase is due to reclassification of operating leases to finance leases as required under IAS 17 (Leases).

g) Retirement benefit obligation: The increase is due to the recognition of defined benefit pension deficits, as required under IAS 19 (Employee Benefits).

h) Deferred tax liability: Under IAS 12 (Income Taxes) discounting of deferred tax balances is not permitted. The adjustment reflects the reversal of the disounting, £19.6 million, as was permitted under UK GAAP, less the deferred tax asset of £4.4 million arising from the increase in retirement benefit obligations.

i) Other payables: Reclassification of pension provisions under the requirements of IAS 19 (Employee benefits).

j) Currency and other reserves: Deferred tax adjustments.

k) Profit from operations after exceptional items: Increase of £9.5 million is due to:

	£m
Goodwill amortisation: No longer permitted under IFRS	8.5
Deferred tax charge: Effect of no longer discounting to present value	0.9
Reduction in pension benefit service cost under IAS 19	0.2
Expense for share-based payments recognised under IFRS	(0.1)
	9.5

l) Finance costs: Increase of £0.9 million resulted from the transfer of pension scheme finance charges from operating costs and the reclassification of operating leases to finance leases.

m) Tax expense: Decrease due to the impact on deferred tax of no longer being permitted to discount the expected liability to present value.

n) Goodwill: IFRS 3 (Business Combinations) requires goodwill to be subject to an annual impairment review rather than be amortised over a specified period.

o) Other intangible assets: IAS 38 (Intangible Assets) requires certain software to be reported as intangible fixed assets. They were previously included in property, plant and equipment.

p) Property, Plant and Equipment: Changes are made up as follows:

	£m
Reclassification of software to Other intangible assets (note o above)	(1.4)
Reclassification to Non-current Assets Held for Sale (see note s below)	(7.3)
Reclassification of maintenance spares from inventory (see note r below)	4.4
Reclassification of operating leases	1.5
	(2.8)

q) Deferred tax asset: Under IAS 12 (Income Taxes) restrictions are placed on the netting of deferred tax assets and liabilities.

r) Inventories: Under IAS 16 (Property, Plant and Equipment) maintenance spares are treated as non-current assets rather than inventory.

s) Non-Current Assets Held for Sale: Under IFRS 5 (Non-Current Assets Held for Sale and Discontinued Operations) non-current assets, such closed plant buildings, are presented separately from other non-current assets. The adjustment represents the transfer from Property, Plant and Equipment after fair value adjustments.

t) Accounts payable: Adjustments are primarily due to dividends which, under IAS 10 (Events after the Balance Sheet Date), may not be recognised until appropriately approved.

u) Obligations under finance leases: Increase is due to reclassification of operating leases to finance leases as required under IAS 17 (Leases).

v) Retirement Benefit obligation: The increase is due to the recognition of defined benefit pension deficits, as required under IAS 19 (Employee Benefits).

w) Deferred tax liability: Under IAS 12 (Income Taxes) discounting of deferred tax balances is not permitted. The adjustment reflects the reversal of the disounting, £18.5 million, as was permitted under UK GAAP, plus the £18.9 million reclassification to deferred tax asset (see note q) above), less the deferred tax asset of £6.5 million arising from the recognition of retirement benefit obligations.

x) Other payables: Reclassification of pension provisions under the requirements of IAS 19 (Employee Benefits).

y) Currency and other reserves: Share based payments of £0.2 million less deferred tax adjustments of £0.4 million.

The cash flow differences between UK GAAP and IFRS are either movements within a classification (adjustments netting to zero) or presentational. There is no impact on the final cash position nor the movement during the periods presented.

40. Events after the balance sheet date

Five acquisitions have been completed by the Group since the year end. The total consideration was £22.1m.

Five Year Summary

	IFRS 2005 £m	IFRS 2004 £m	UK GAAP 2003 £m	UK GAAP 2002 £m	UK GAAP 2001 £m
Revenue					
Existing operations	**470.9**	426.4	435.7	429.5	469.1
Discontinued operations	**1.5**	30.8	12.7	10.6	10.3
Revenue - continuing and discontinued operations	**472.4**	457.2	448.4	440.1	479.4
Profit/(losses) for continuing and discontinued operations:					
Headline operating profit	**67.8**	53.1	41.7	49.4	79.4
Share of results of associates: Interest and tax	**(0.8)**	–	–	–	–
(Gain)/loss on disposal of tangible and intangible fixed assets	**(0.6)**	0.5	–	–	0.8
Amortisation and impairment of goodwill and intangibles	**(6.0)**	–	(9.1)	(8.7)	(8.1)
Operating exceptional items	–	–	(7.5)	(18.3)	0.0
Operating profit before restructuring and disposals of operations and fixed assets	**60.4**	53.6	25.1	22.4	72.1
Profit/(loss) on disposal of operations	**–**	(3.8)	3.5	–	(1.9)
Restructuring costs	**–**	(7.4)	(30.0)	–	–
Loss on disposal of fixed assets	**0.6**	(0.5)	–	–	(0.8)
Profit before interest and tax	**61.0**	41.9	(1.4)	22.4	69.4
Net interest payable	**(8.3)**	(8.8)	(9.7)	(11.2)	(13.9)
Profit/(loss) before taxation	**52.7**	33.1	(11.1)	11.2	55.5
Taxation	**(11.8)**	(4.6)	(6.2)	(4.8)	17.0
Profit/(loss) after taxation	**40.9**	28.5	(17.3)	6.4	37.5
Minority interests	**(0.2)**	(0.2)	(0.1)	(0.1)	(0.1)
Profit/(loss) attributable to the equity holders of the parent	**40.7**	28.3	(17.4)	6.3	37.4
Headline earnings per share (pence)	**14.6**	11.7	9.1	9.9	17.0
Share of associate's operating profit	**1.5**	–	–	–	–
	16.1	11.7	9.1	9.9	17.0
Dividends per share (pence)	**6.4**	6.1	5.7	5.7	5.7
	22.5	17.8	14.8	15.6	22.7
Assets employed					
Share of associates' interest and tax	**(0.8)**	(54.6)	(34.1)	(30.3)	(18.5)
	542.1	512.4	582.1	623.6	632.5
Financed by					
Share capital	**32.1**	32.1	25.7	25.6	25.6
Reseves	**400.0**	388.9	345.2	363.6	364.2
Shareholders' funds	**432.1**	421.0	370.9	389.2	389.8
Profit for the year	**1.4**	1.0	0.9	0.2	0.7
Net borrowings	**108.6**	90.3	210.3	234.2	242.0
	542.1	512.4	582.1	623.6	632.5
Net assets per share (pence)	**134.5**	131.2	144.5	151.8	152.0
Return on capital employed:					
Headline operating profit before amortisation of acquired intangibles and impairment of goodwill (%)	**12.9**	9.7	6.9	7.9	14.5
Profit before interest and tax (%)	**11.6**	7.7	(0.2)	3.6	12.7
Return on capital employed (including cumulative goodwill written back to reserves):					
Headline operating profit before amortisation of acquired intangibles and impairment of goodwill (%)	**9.9**	7.6	5.5	6.4	11.6

Company Balance Sheet
as at 31 December 2005

	2005 £m	2004 Restated £m	Note
Fixed assets			
Tangible assets	**0.7**	2.7	2
Investments	**680.3**	853.6	3
	681.0	856.3	
Current assets			
Debtors	**15.9**	10.6	4
Cash at bank and in hand	**47.1**	74.9	
	63.0	85.5	
Creditors			
Amounts falling due within one year	**(20.7)**	(47.5)	5
Net current assets	**42.3**	38.0	
Total assets less current liabilities	**723.3**	894.3	
Creditors			
Amounts falling due after more than one year	**(376.6)**	(518.0)	5
Provisions for liabilities and charges	**–**	(0.1)	6
Net assets	**346.7**	376.2	
Capital and reserves			
Called-up share capital	**32.1**	32.1	7
Share premium account	**300.3**	300.0	7
Currency and other reserves	**–**	0.8	7
Profit and loss account	**14.3**	43.3	7
Equity shareholders' funds	**346.7**	376.2	

Approved by the Board of Directors on 28 February 2006 and signed on its behalf by:

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

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

Independent auditors' report to the members Bodycote International plc

We have audited the individual Company financial statements of Bodycote International plc for the year ended 31 December 2005, which comprise the balance sheet, the statement of accounting policies and the related notes 1 to 10. These individual Company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Group financial statements of Bodycote International plc for the year ended 31 December 2005.

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

The directors' responsibilities for preparing the annual report and the individual Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities.

Our responsibility is to audit the individual Company financial statements in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the individual Company financial statements give a true and fair view in accordance with the relevant financial reporting framework and whether the individual Company financial statements have been properly prepared in accordance with the Companies Act 1985. We report to you if, in our opinion, the directors' report is not consistent with the financial statements. We also report to you 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 other transactions with the Company is not disclosed.

We read the Directors' Report and the other information contained in the annual report for the above year and described in the contents section and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the individual Company financial statements.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the individual Company financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the individual Company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, 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 individual Company financial statements 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 individual Company financial statements.

OPINION

In our opinion:

- the individual Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2005; and
- the individual Company 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.

Deloitte & Touche LLP

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors

Manchester
28 February 2006

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 Company's financial statements.

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.

INVESTMENTS

Investments are held at cost less provision for impairment.

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 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.

THE COMPANY AS LESSOR

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Company's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Company's net investment outstanding in respect of the leases.

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.

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 Company'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.

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 Company uses derivatives and financial instruments to reduce exposure to foreign exchange risk. The Company 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 Company'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 Company's accounts.

Notes to the Company Financial Statements

1. Profit for the year

As permitted by section 230 of the Companies Act 1985 the Company has elected not to present its own profit and loss account for the year. Bodycote International plc reported a loss for the financial year ended 31 December 2005 of £9.2m (2004: profit £1.9m).

The auditors' remuneration for audit services to the Company was £0.2m (2004: £0.1m).

Total employee costs (including Executive Directors) were:

	2005 £m	2004 £m
Wages and salaries	**2.3**	2.1
Social security costs	**0.2**	0.2
Other pension costs	**0.2**	0.2
	2.7	2.5

2. Tangible Fixed Assets

	Fixtures and fittings £m
Cost	
At 1 January 2005	3.1
Additions	0.4
Disposals	(2.5)
At 31 December 2005	1.0
Depreciation	
At 1 January 2005	0.4
Charge for the year	–
Disposals	(0.1)
At 31 December 2005	0.3
Net book value	
At 31 December 2005	0.7
At 31 December 2004	2.7

3. Investments

	Shares £m	Shares in associates £m	Loans £m	Total £m
Cost				
1 January 2005	397.5	5.2	452.9	855.6
Acquisitions and advances	–	2.1	217.3	219.4
Disposals and repayments	–	–	(398.9)	(398.9)
Currency adjustments	–	–	12.4	12.4
At 31 December 2005	397.5	7.3	283.7	688.5
Provision				
1 January 2005	2.0	–	–	2.0
Provision in the year	6.2	–	–	6.2
At 31 December 2005	8.2	–	–	8.2
Net book value				
At 31 December 2005	389.3	7.3	283.7	680.3
At 31 December 2004	395.5	5.2	452.9	853.6

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
SSCP Coating S.à.r.l.	PVD Coatings	Luxembourg	20

4. Debtors

	2005 £m	2004 Restated £m
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	**4.4**	3.5
Corporation tax recoverable	**4.5**	1.5
Deferred taxation	**0.4**	–
Finance lease receivables	**0.3**	–
Other debtors and prepayments	**2.7**	3.4
	12.3	8.4
Amounts falling due after more than one year:		
Finance lease receivables	**1.9**	–
Other debtors	**1.7**	2.2
	15.9	10.6

Notes to the Company Financial Statements

5. Creditors

	2005	2004
		Restated
	£m	£m
Amounts falling due within one year:		
Bank overdrafts	**8.3**	4.1
Trade creditors	**0.5**	0.4
Amounts owed to subsidiary undertakings	**3.1**	32.7
Proposed dividends	**7.5**	7.2
Other taxes and social security	**0.1**	0.1
Other creditors	**0.6**	0.2
Accruals and deferred income	**0.6**	2.8
	20.7	47.5
Amounts falling due after more than one year:		
Bank loans	**216.6**	212.2
Amounts owed to subsidiary undertakings	**160.0**	305.8
	376.6	518.0
Bank loans are repayable:		
After 5 years	**–**	–
Between 2 and 5 years	**216.6**	41.8
Between 1 and 2 years	**–**	170.4
	216.6	212.2
On demand or within 12 months	**–**	–
	216.6	212.2

The Company's principal loans are secured by upstream guarantees from principal subsidiaries.

For prior year adjustment see note 10.

6. Provisions for liabilities and charges

	Deferred tax
	£m
At 1 January 2005	0.1
Profit and loss charge	(0.5)
Reclassification to deferred tax asset	0.4
At 31 December 2005	**–**

Deferred tax

	2005	2004
	£m	£m
Deferred tax is (recognised)/provided as follows:		
Accelerated capital allowances	**(0.4)**	0.1
Undiscounted provision for deferred tax	**(0.4)**	0.1

7. Share Capital and reserves

Share capital:

	2005 **£m**	2004 £m
Authorised 430,000,000 (2004: 430,000,000) Ordinary shares of 10p each)	**43.0**	43.0
Allotted, called-up and fully paid 321,154,860 (2004: 320,968,766) ordinary shares of 10p each	**32.1**	32.1

Details of share options in issue on the Company's share capital and share-based payments are set out in note 36 to the Group Financial Statements.

Reserves:

	Share premium account £m	Currency and other reserves £m	Profit and loss account £m	Total £m
At 1 January 2005 as previously reported	300.0	0.6	32.3	332.9
Prior year adjustment	–	0.2	11.0	11.2
At 1 January 2005 as restated	300.0	0.8	43.3	344.1
Currency adjustments - foreign currency net investments	–	0.8	–	0.8
Retained loss for the year	–	–	(29.0)	(29.0)
Premium on shares issues (net of expenses)	0.3	–	–	0.3
Share based payments and acquisition of own shares	–	(1.6)	–	(1.6)
At 31 December 2005	**300.3**	**–**	**14.3**	**314.6**

The currency and other reserve is stated after deducting £2.5m (2004: £0.8m) relating to shares held in the Bodycote International Employee Benefit Trust. The trust holds Bodycote International plc shares and satisfies awards made under various employee incentive schemes when issuance of new shares is not appropriate.

At 31 December 2005 1,321,823 (2004: 421,823) shares were held by the trust and following recommendations by the employer are provisionally allocated to satisfy awards under employee incentive schemes. The market value of these was £2.9m (2004: £0.7m).

8. Contingent liabilities

The Company has guaranteed bank overdrafts and loans of certain subsidiary undertakings amounting to £3.0m (2004: £1.3m).

Notes to the Company Financial Statements

9. Pension commitments

The Company participates in a group defined benefit scheme, the details of which are disclosed in note 37 to the Group financial statements. However, the Company is unable to identify its share of the underlying assets and liabilities and has therefore accounted for the scheme as if it were a defined contribution scheme. Full disclosures concerning the scheme as required by IAS 19 are set out in note 37 to the Group financial statements.

10. Prior year adjustment

The company's accounting policies for share based payments and dividends were changed during the year in order to implement FRS 20: 'Share based payments' and FRS 21: 'Events after the balance sheet date'. The comparative figures in the primary statements and notes have been restated to reflect the new policies. The effects of the changes in policies are summarised below:

	2005	2004
	£m	£m
Profit and loss account:		
Share based payments	**(0.2)**	(0.1)
Dividends	**(0.6)**	0.1
(Decrease)/Increase in profit for the financial year	**(0.8)**	–
Balance sheet:		
Dividends receivable	**–**	(1.3)
Dividends payable	**(0.6)**	12.4
Other creditors	**–**	0.1
(Decrease)/Increase in net assets	**(0.6)**	11.2
Other reserves	**0.2**	0.2
Profit and loss reserves	**(0.8)**	11.0
(Decrease)/Increase in net assets	**(0.6)**	11.2

In addition, the Company implemented the following accounting standards during the year, the impact of which was £nil:

FRS 17: Retirement Benefits;
FRS 23: The effects of changes in foreign exchange rates;
FRS 24: Financial reporting in hyperinflationary economies;
FRS 25: Financial instruments: disclosure;
FRS 26: Financial instruments: measurement; and
FRS 28: Corresponding amounts.

Principal Subsidiary Undertakings

Thermal Processing - Heat Treatment & Metal Joining

		Country of incorporation or registration
*Bodycote Heat Treatments Limited	Aldridge, Cambridge, Chard, Cheltenham, Coventry, Derby, Gillingham, Gosport, Great Barr, Hazel Grove, Macclesfield, Morden, Rotherham, Skelmersdale, Stillington, Walsall,and Woodford	England
Bodycote Värmebehandling AB	Anderstorp, Göteborg, Karlskoga, Koping, Malmö, Mora, Stockholm, Värnamo and Västerås	Sweden
Bodycote Lämpökäsittely Oy	Hameelina, Pieksämäki, Tampere, Vaasa and Vantaa	Finland
Bodycote Värmebehandling A/S	Herlev	Denmark
Bodycote Haustrup Haerderiet A/S	Ejby	Denmark
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
Bodycote Tratamente Termice SRL (75% owned)‡	Brasov, Bucharest and Cugil	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 and Livonia 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, Sturtevant and New Berlin WI	USA
Bodycote Thermal Processing Canada, Inc.	Newmarket and Kitchener ON	Canada
Bodycote Wuxi Technology Co. Limited	Wuxi	China
Bodycote SAS	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
Applications du Brasage des Materiaux et des Traitements SA	Charvonnex and Villaz	France
Bodycote Italia Srl	Gorgonzola	Italy
Bodycote Trattamenti Termici SPA	Flero, Madone and Rodengo	Italy
Bodycote Belgium	Brussels and Nivelles	Belgium

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.

Principal Subsidiary Undertakings

Thermal Processing - 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.

Thermal Processing - Surface Engineering

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

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

Testing

Bodycote Testing Limited	Birmingham, Bridgwater, Burton-on-Trent, Dalkeith, Daventry, Droitwich, Dudley, Glasgow, Greenford, Greenock, Grimsby, Huddersfield, Lancaster, Manchester, Middlesbrough, Newcastle, Newbridge, Nuneaton, Salford, Sheffield, Shotton, Sittingbourne, 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, Hillsdale, Wixom and Detroit MI and Portland OR	USA
Food Products Laboratories Inc.	Portland OR	USA
West Coast Analytical Service Inc	Santa Fe Springs CA	USA

Testing continued

Norwest Soil Research Limited	Calgary, Edmonton, Lethbridge, Grande Prairie and Fort McMurray AL, Kilbridge ON, Surrey and Fort St John BC, Winnipeg MB	Canada
Bodycote Arthur Gordon Inc	Montreal	Canada
Bodycote Materials Testing Canada Inc.	Burlington, Cambridge, Mississauga and Niagara Falls ON, Montreal and Quebec City QC, Calgary and Edmonton AL and Saltillo (Mexico)	Canada
Bodycote Polymer AB	Nyköping	Sweden
Bodycote CMK AB	Karlskoga	Sweden
Bodycote CSM AB	Stockholm, Karlstad, Tannefors, Linköping, Malmslätt and Järfälla	Sweden
Bodycote Materials Testing s.r.o.	Pilzen	Czech Republic

Testing services for producers and users. Mechanical, metallurgical corrosion, physical, radiographic and chemical testing of ferrous and non-ferrous alloys, building products, ceramics, composites and plastics, oils (wear and high voltage) 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.

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, Paris, Serres Castet, and Auterive (France), Gorgonzola (Italy), Nurnberg and Hohenstein-Ernstthal (Germany), Venlo (Netherlands), Linkoping (Sweden), Kapfenburg (Austria), Dolni Becva (Czech Republic), Grenchen and La Chaux-de-Fonds (Switzerland), Istanbul (Turkey), Madison Heights and Troy MI, West Chicago IL, Beachwood OH, Bend OR, Indianapolis IN, Greensboro NC, Rockaway NJ, Duncan SC, West St Paul MN (USA), Stoney Creek and Cambridge ON (Canada), Sta Caterina and Tecate (Mexico), Suzhou (China), Taegu (Korea), 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.

Financial Calendar

Annual general meeting	23 May 2006
Final dividend for 2005	5 July 2006
Interim results for 2006	July 2006
Interim dividend for 2006	January 2007
Results for 2006	March 2007

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 19 February 2006

Holding range:	Number of shareholders	%	Number of Shares	%
1 to 1,000	882	29.10	437,552	0.14
1,001 to 10,000	1,511	49.85	5,467,755	1.70
10,001 to 100,000	407	13.43	12,223,805	3.81
100,001 to 500,000	121	3.99	27,909,658	8.69
500,001 and over	110	3.63	275,116,090	85.66
	3,031	100.00	321,154,860	100.00

Types of shareholders:	% of shareholders	% of total shares
Directors' interests	0.1	0.8
Major institutional and corporate holdings	8.1	93.0
Other shareholdings	91.8	6.2
	100.0	100.0

As at 28 February 2006 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	22,425,466	7.0
Franklin Resources Inc.	18,251,681	5.7
Legal & General Investment Management Limited	12,690,995	3.9
Atlantic Investment Management Inc.	10,150,821	3.2
LD Pensions	10,073,738	3.1
Standard Life Group	9,961,090	3.1

www.bodycote.com

Testing

Thermal Processing

outsourcing for industry

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