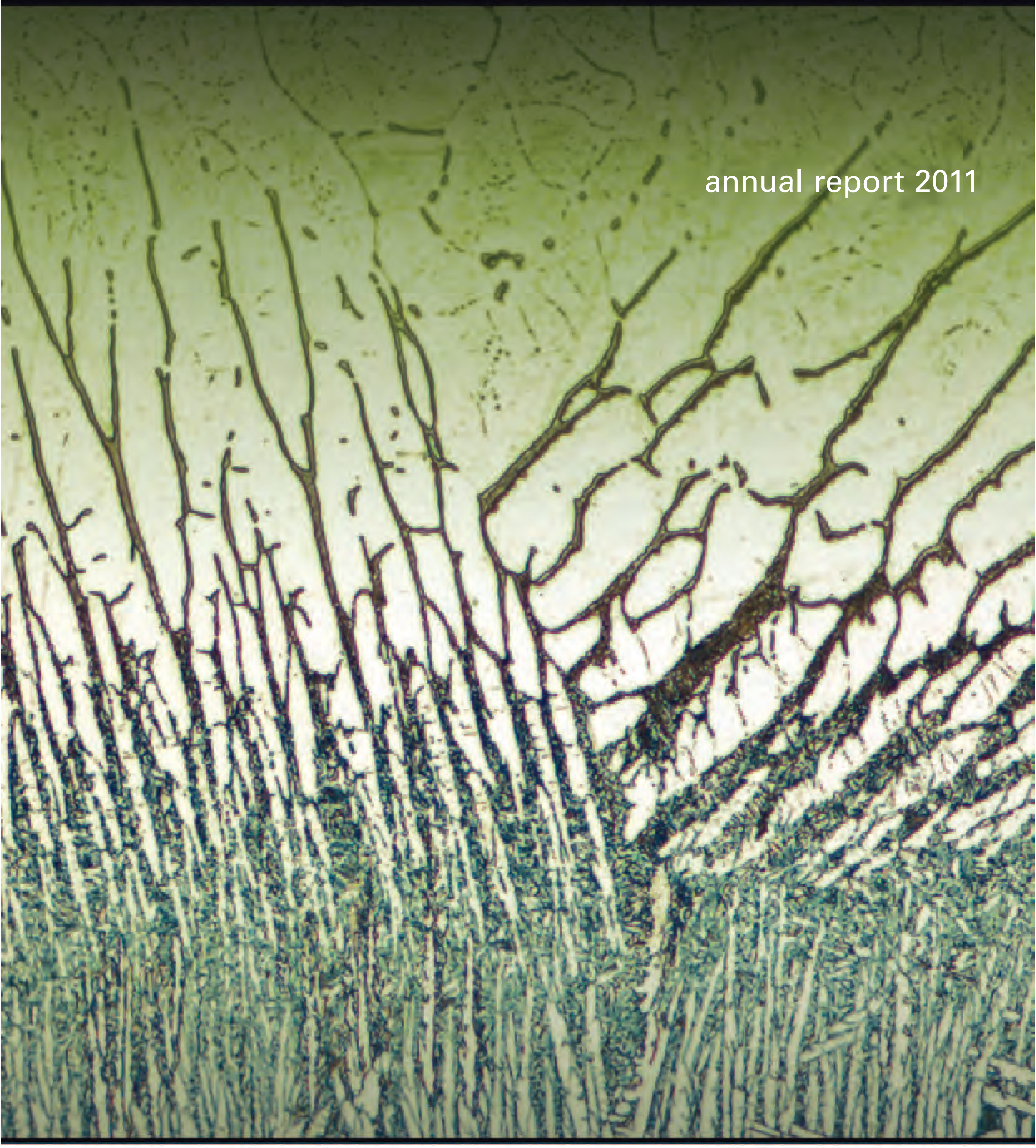

annual report 2011

Bodycote

At a glance

Operating an international network of facilities, Bodycote is the world's leading provider of thermal processing services.

Experienced in supporting large multi-national customers and their supply chains, as well as local niche specialists, Bodycote provides a vital link in the manufacturing process for virtually every market sector including aerospace and defence, automotive, power generation, oil & gas, construction, medical and transportation.

Our structure

The Group operates in two major areas:

Aerospace, Defence & Energy (ADE)

Automotive & General Industrial (AGI)

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Cover image
This photograph shows a microstructure of brazed titanium alloy and pure titanium. Brazing is a versatile metal joining method which is suitable for a range of alloys and can be carried out by various methods in order to create simple or complex components. Owing to titanium's high strength-to-weight ratio and corrosion-resistance, it is used to make strong, lightweight alloys, usually by alloying with aluminium and vanadium, for use in aerospace and other critical applications.

Financial highlights

	2011	2010
Revenue – continuing operations	**£570.7m**	£499.8m
Headline operating profit[1] – continuing operations	**£85.5m**	£52.1m
Operating profit – continuing operations	**£80.4m**	£51.2m
Headline profit before taxation[1] – continuing operations	**£80.9m**	£46.1m
Profit before taxation – continuing operations	**£75.8m**	£45.2m
Headline operating cash flow[2]	**£96.0m**	£77.3m
Operating cash flow[3]	**£90.3m**	£68.1m
Net cash / (debt)	**£0.1m**	£(51.3)m
Basic headline earnings per share[4] – continuing operations	**32.7p**	18.3p
Basic earnings per share	**30.0p**	14.9p
Dividend per share[5]	**10.9p**	8.7p
Return on capital employed[6] – continuing operations	**16.9%**	10.1%

1 Headline operating profit and headline profit before taxation exclude impairment charges of £4.2m (2010: £nil) and the amortisation of acquired intangibles of £0.9m (2010: £0.9m).

2 Headline operating cash flow is defined as operating cash flows stated before cash flow relating to restructuring of £5.7m (2010: £9.2m).

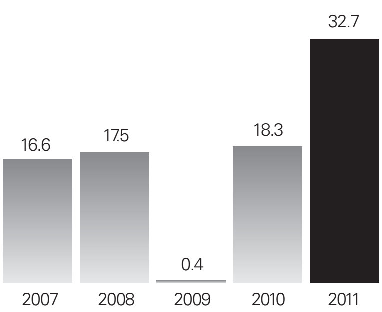
3 Operating cash flow is defined as cash generated by operations of £134.8m (2010: £103.9m) less net capital expenditure of £44.5m (2010: £35.8m).

4 A detailed reconciliation is provided in note 10 on page 70.

5 See note 9 on page 69.

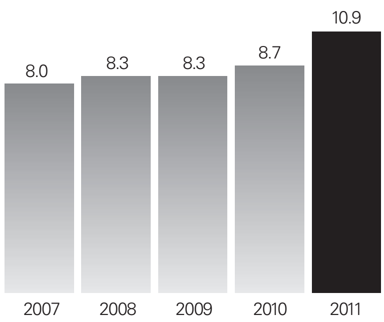
6 Return on capital employed is defined as headline operating profit of £85.5m (2010: £52.1m) divided by the monthly average capital employed of £505.2m (2010: £517.9m). Capital employed is defined as net assets minus / plus net cash / (debt).

Headline earnings per share
Pence



32.7p +78.7%
(2010: 18.3p)

Dividend per share
Pence



10.9p +25.3%
(2010: 8.7p)

Business model

Provider of essential services to engineering manufacturers

Heat Treatment and Metal Joining

- Heat treatments are controlled processes used to alter the microstructure of materials such as metals and alloys to impart properties which benefit the working life of a component.
- Metal joining includes specialised processes used to join and assemble parts, sometimes dissimilar in material.

Hot Isostatic Pressing (HIP)

- HIP combines very high temperature with inert gas under very high pressure. HIP can be used to eliminate porosity in castings and manufacture specialist components with unique properties.

Surface Technology

- Surface technologies are used extensively to prolong the working life of components and protect them from environmental factors such as corrosion and abrasion.

The global leader

Value of the network

- Bodycote's global network of over 170 facilities in 27 countries brings economies of scale – particularly for energy consumption and equipment utilisation. This makes Bodycote's processing inherently more efficient than customers' in-house operations and limits the ability of smaller thermal processing companies to compete. The capital intensive nature of Bodycote's business also provides significant barriers to entry.
- The scope of Bodycote's network enables Bodycote to specialise more effectively than competitors at individual locations and provides comprehensive service back-up for our customers.

Transferable know-how

- The global Bodycote network provides unique opportunities for the transfer of knowledge and skills, and the transfer of technology.
- With some of the best metallurgists, engineers and technicians in the industry, Bodycote is ideally placed to provide solutions for customers, whatever their market or wherever in the world they may be.

Long-term agreements

- In many cases customer relationships lead to component and service-specific agreements which embody protection and freedom from risk for the customer and Bodycote. These are often exclusive in character and provide the basis for mutual business development, with both companies freed to concentrate capital and other resources on core competencies.

Strategic partnerships

- Strategic partnering is Bodycote's win-win approach to improving the traditional subcontract processing method, achieved by ensuring processing is close to the customer, including where appropriate at greenfield facilities adjacent to their premises.

The partner of choice

Service

- Bodycote has become the partner of choice for the world's most respected and innovative engineering companies by providing highly efficient, cost-effective services to the highest quality standards through strategic investment in people and the latest technology, equipment and quality systems.

Quality

- Bodycote's quality management systems, validated by major engineering OEMs, have been developed to meet the requirements of international and national accrediting bodies. All Bodycote facilities hold industry and customer approvals appropriate to the services they offer and the markets they serve.

Expertise

- Bodycote's extensive facilities and expertise mean that projects can extend beyond customers' in-house capabilities, developing specific processes and equipment for a customer, where required, and finding solutions to meet needs.
- Our own development and improvement of standard processes has led to Bodycote offering a range of proprietary processes which far outperform their standard counterparts.

Tangible benefits

To customers

- Value-adding services
- Global supplier which can meet multiple processing needs
- Access to entire Bodycote knowledge base, and expertise
- Cost and environmental benefits versus in-house operations

To Bodycote

- Mutually beneficial customer partnerships
- Wide customer base means Bodycote is not reliant on key customers
- Ideally positioned to promote growth in emerging markets and proprietary technologies
- Clearly focused strategy

To investors

- Financially stable and sustainable business
- Good growth drivers
- Superior return on investment
- Strong margins and cash flow

Core technologies

Thermal processing

Bodycote provides thermal processing services which improve material properties such as strength, durability and corrosion resistance, enabling manufacturers' components to work more efficiently with significantly extended operational lifetimes. Bodycote's services consist of a number of core technologies: heat treatment and metal joining, hot isostatic pressing (HIP) and surface technology.

Heat treatment and metal joining

Heat treatments are controlled processes used to alter the microstructure of materials, such as metals and alloys, to impart properties which benefit the working life of a component, for example: increased surface hardness, temperature resistance, ductility and strength. Metal joining includes specialised processes such as electron beam welding, vacuum and honeycomb brazing – complex operations requiring a fusion of expertise and technology.

Bodycote offers an extensive range of heat treatment services and specialist metal joining techniques from facilities around the world. With unmatched capacity and computerised systems, Bodycote facilities can process a wide range of component sizes to exacting standards with reliable, repeatable results.

Hot isostatic pressing (HIP)

HIP combines very high temperature (up to 2,000°C) with inert gas under very high pressure (up to 30,000 psi – equivalent to that found at an ocean depth of 11,000m such as at the bottom of the Mariana Trench in the Pacific Ocean). HIP can be used to eliminate porosity in castings and consolidate encapsulated powders to dense materials. Dissimilar materials can be bonded together to manufacture unique cost-effective components. Every week a typical Bodycote HIP plant will process many tons of titanium, aluminium, steel and super-alloy castings, removing porosity and improving the performance of parts such as turbine blades and oilfield components.

With the largest operational capacity in the world and a wide variety of sizes of equipment, Bodycote HIP is able to accommodate large volumes of small product as economically as large individual components.

Surface technology

Surface technologies are used extensively to prolong the working life of components and protect them from environmental factors such as corrosion and abrasion. The range of surface treatments available from Bodycote covers a wide variety of applications, providing manufacturers with solutions to meet requirements such as durability, wear resistance, improved hardness and electrical conductivity.

Bodycote is a provider of specialised plasma spray, high velocity oxy fuel (HVOF) and thermally formed ceramic treatments and is able to surface engineer components (including complex geometric shapes and internal bores) that are designed to operate in the most demanding of industrial applications.

The partner of choice

Bodycote has become the partner of choice for the world's most respected and innovative engineering companies by providing highly efficient, cost-effective services to the highest quality standards through strategic investment in people and the latest technology, equipment and quality systems.

By outsourcing non-core but vitally important thermal processing requirements to Bodycote, customers are able to concentrate their business resources where they are needed most. Bodycote's services offer tangible benefits to customers such as reduced equipment maintenance, capital expenditure, energy costs, people costs and a major reduction in CO_2 emissions.

Bodycote has a long history of successful outsourcing partnerships, from global to local manufacturers. In many cases, subcontracting relationships lead to component and service-specific long-term agreements, or strategic partnering arrangements, which embody protection and freedom from risk for the customer and Bodycote. These are normally exclusive in character and provide the basis for mutual business development, with both companies freed to concentrate capital and other resources on core competencies.

Making innovations possible

Bodycote's extensive facilities and expertise mean development projects can expand far beyond customers' in-house capabilities, helping to realise goals more quickly and more cost-effectively.

Around the globe, Bodycote has dedicated teams working on a variety of projects. When required, this may include the development of specific processes and equipment for a customer or verification of materials or designs, prior to their application.[W]

Strategy and objectives

Bodycote's objective is to create superior shareholder returns through the provision of selected thermal processing services that are highly valued by our customers.

Our strategy is based on the following fundamentals:

– Serving the aerospace, defence and energy markets, with a focused network of globally coordinated facilities, attuned to these customers' specific needs and requirements.

– Serving the automotive and chosen general industrial markets through a regionally organised business, catering for these customers' specific local needs and proximity requirements.

– Capitalising on our proprietary technologies to provide our customers with the ability to create innovative, differentiated products.

– Achieving the highest levels of customer service in terms of quality, delivery, reliability and technical problem solving.

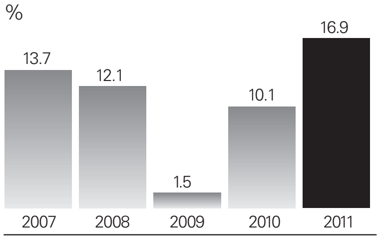
– Migrating technology, over time, from the developed markets to our target emerging markets with an emphasis on Eastern Europe, Brazil and China.

Bodycote aims to achieve this in a safe working environment and with minimal environmental impact.

Measuring our progress

Return on Capital Employed (ROCE)

%



Performance

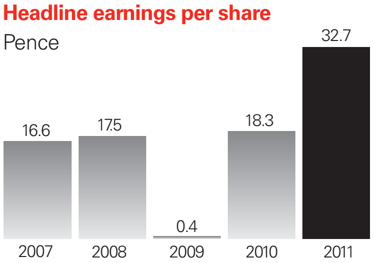
Return on capital employed increased by 6.8 percentage points during the year, from 10.1% to 16.9%. Headline operating profit increased by 64.1% from £52.1m to £85.5m, while average capital employed reduced by 2.5% to £505.2m.

Definition

Headline operating profit as a percentage of average capital employed from continuing operations. Capital employed is defined as net assets minus / plus net cash / (debt).

Headline earnings per share

Pence



Performance

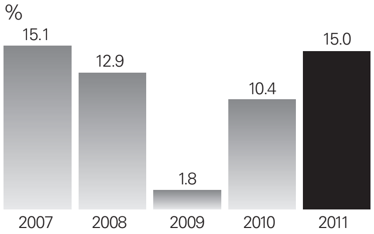
Headline earnings per share increased by 14.4 pence during the year, from 18.3 pence to 32.7 pence. Headline earnings increased by 78.8% from £34.0m to £60.8m, while the average number of shares in issue remained static.

Definition

Headline earnings per share is defined in note 10 to the Group financial statements.

Return on Sales (ROS)

%



Performance

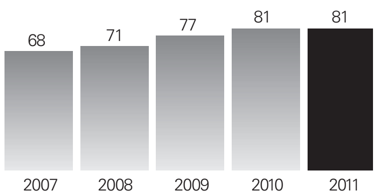
Return on sales increased by 4.6 percentage points during the year, from 10.4% to 15.0%. Headline operating profit increased by 64.1% from £52.1m to £85.5m, while revenue from continuing operations increased by 14.2% from £499.8m to £570.7m.

Definition

Headline operating profit as a percentage of revenue from continuing operations.

ISO 14001 accredited facilities

%



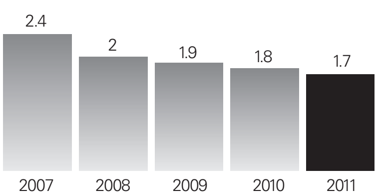
Performance

Reducing the environmental impact of the Group's activities is taken very seriously. Compliance with the requirements of ISO 14001 helps minimise the risk of adverse environmental effects at Bodycote locations. At the end of 2011, 81% of our plants had ISO 14001 accreditation – 139 plants out of a total of 171 (2010: 140 out of 173).

Definition

The number of ISO 14001 accredited facilities divided by the total number of operating facilities x 100.

Accident frequency



Performance

Bodycote works tirelessly to reduce workplace accidents and is committed to providing a safe environment for everyone who works at or visits our locations. The accident frequency rate was reduced to 1.7 (2010: 1.8).

Definition

Accident frequency – the number of lost time accidents x 200,000 hours (approximately 100 man years), divided by the total hours worked.

Global network

Bodycote is experienced in all major market sectors and is able to combine the capability and expertise of a network of over 170 worldwide locations to deliver global, or local, services for customers.

Overview

As the only truly global provider of subcontract thermal processing services, Bodycote is able to offer significant advantages to its customers. Through an international network of plants, Bodycote can effectively utilise a wealth of knowledge, experience and specialist expertise to deliver quality service when and where it is needed.

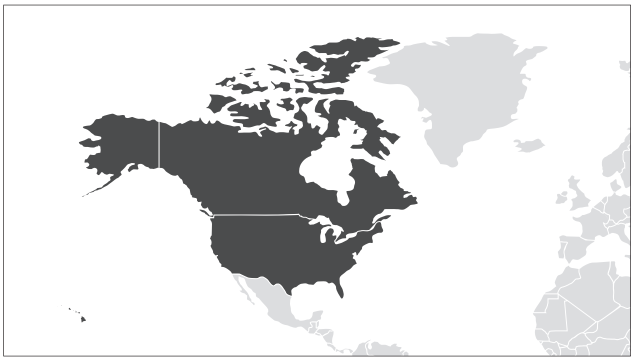
The network operates from over 170 worldwide locations, with customers able to benefit from Bodycote's comprehensive range of services from multiple locations. Customers know that if their business expands, Bodycote will have the capability to meet their needs. They know that if they were to broaden their manufacturing footprint, Bodycote would be able to assist them. They know that they can obtain the same process to the same quality standards from multiple locations.

Such a large network brings economies of scale, with technology developed at one location being available globally if the market requires it.

The Bodycote network has a wealth of technical accreditations, some industry or customer specific, others more general. Individual operations concentrate on the accreditations suited to their market.

Although Bodycote is headquartered in the UK, 89% of the Group's revenue is derived outside the UK. With facilities in 27 countries, Bodycote is truly global.

North America



Bodycote is the largest provider of thermal processing services in North America by a significant margin, with a comprehensive network coverage. This network offers convenient locations to customers in all areas where manufacturing and technical industries are concentrated.

Our facilities offer the widest and deepest range of processes for aerospace and energy applications and all the leading technologies for automotive applications.

Group revenue by market sector

General industrial	£237.6
Automotive	£147.4
Aerospace and Defence	£113.6
Energy	£72.0

Revenue by market sector – North America

General industrial	£43.7
Automotive	£23.9
Aerospace and Defence	£65.3
Energy	£30.5

Although Bodycote is headquartered in the UK, 89% of the Group's revenue is derived outside the UK. With facilities in 27 countries, Bodycote is truly global.

Western Europe

Bodycote is the number one provider of thermal processing services in Western Europe with the largest network by far and a comprehensive service offering.

The depth of process offerings vary somewhat by country and region, reflecting which types of industry are prominent in those locations, thus enabling the Group to best meet the needs of customers.

Emerging markets

Bodycote has 29 facilities in emerging geographies covering Eastern Europe, China, Brazil, India, Singapore and Dubai.

Bodycote is the number one thermal processing provider in both Brazil and Eastern Europe and is the leading western provider in China. These markets have a special emphasis in the Group's growth strategy for the future.

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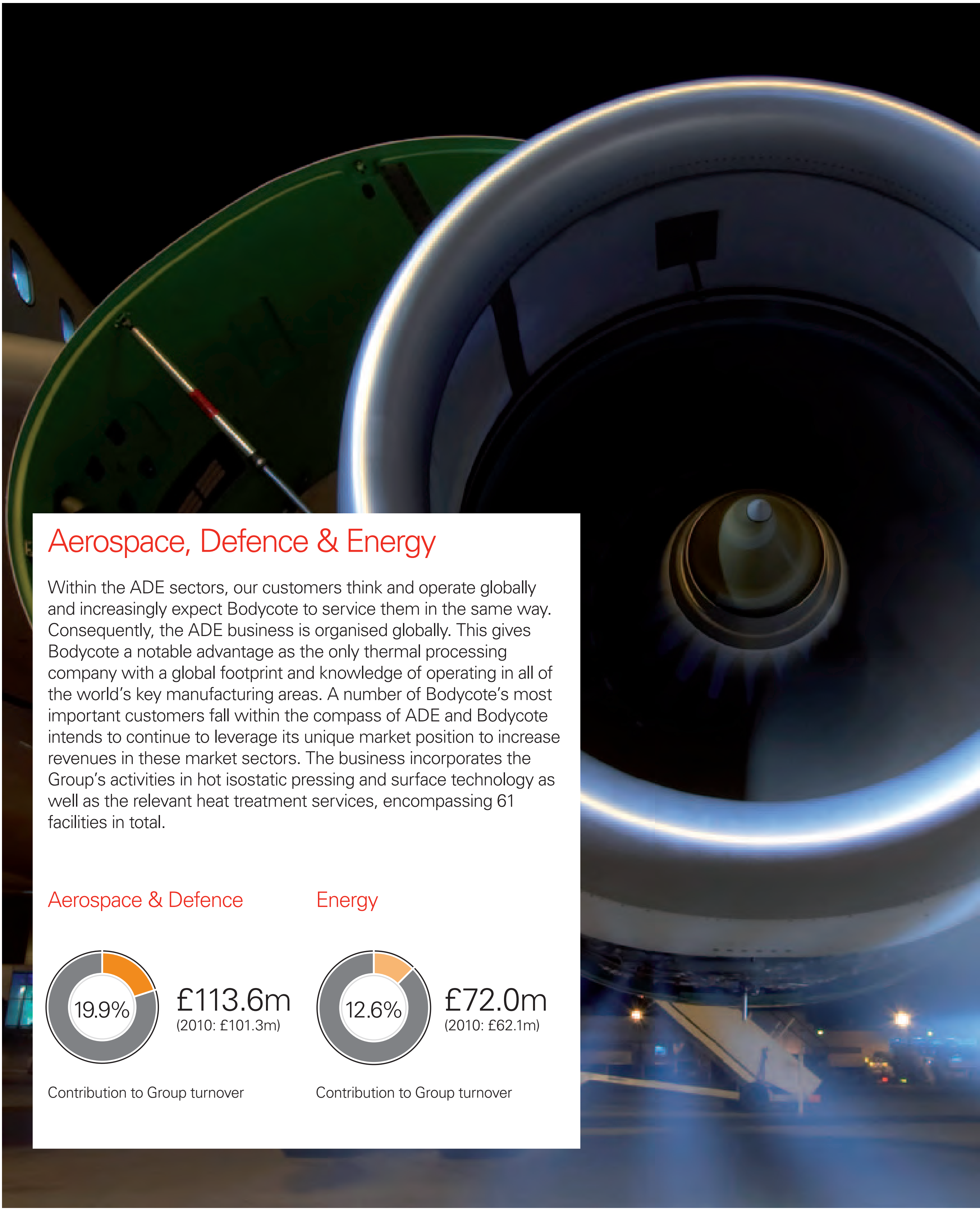
Markets we serve –
Aerospace, Defence & Energy



Aerospace, Defence & Energy

Within the ADE sectors, our customers think and operate globally and increasingly expect Bodycote to service them in the same way. Consequently, the ADE business is organised globally. This gives Bodycote a notable advantage as the only thermal processing company with a global footprint and knowledge of operating in all of the world's key manufacturing areas. A number of Bodycote's most important customers fall within the compass of ADE and Bodycote intends to continue to leverage its unique market position to increase revenues in these market sectors. The business incorporates the Group's activities in hot isostatic pressing and surface technology as well as the relevant heat treatment services, encompassing 61 facilities in total.

Aerospace & Defence

19.9%

£113.6m
(2010: £101.3m)

Contribution to Group turnover

Energy

12.6%

£72.0m
(2010: £62.1m)

Contribution to Group turnover

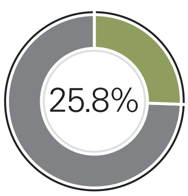
Markets we serve –
Automotive & General Industrial

Automotive & General Industrial

Whilst the AGI marketplace has many multinational customers which tend to operate on a regionally-focussed basis, it also has very many medium-sized and smaller businesses. Generally, there are more competitors to Bodycote in AGI and much of the business is locally-oriented, meaning that proximity to the customer is very important.

Bodycote's uniquely large network of 110 AGI facilities enables the business to offer the widest range of technical capability and security of supply, continuing to increase the proportion of technically differentiated services that it offers. Bodycote has a long and successful history of serving this wide-ranging customer base.

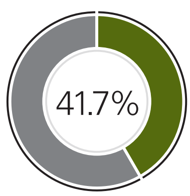
Automotive



£147.4m
(2010: £134.3m)

Contribution to Group turnover

General Industrial



£237.6m
(2010: £202.2m)

Contribution to Group turnover

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Board

The composition of the Board remained unchanged throughout 2011. It is an effective Board which brings together a group of individuals with an appropriate combination of business skills, management experience and industry knowledge. The Bodycote Board is small by design and its members interact well, with each member contributing fully at our meetings. Every year I evaluate the effectiveness of the Board and its members following interviews with each of my colleagues and also with external advisers. At our November 2011 Nominations Committee meeting we identified that, while the Board was effective, there was a need to broaden the Board membership, particularly with respect to gender, ethnicity and age. We have engaged an international search firm to identify suitable candidates with relevant hands-on experience. I hope to be able to report on the successful outcome of this search in the coming months.

Summary

The successful restructuring of Bodycote over the last few years has resulted in encouraging levels of sales growth and an excellent profit and margin improvement. At the same time, strong cash flow focus and tight balance sheet controls have resulted in a positive net cash position. We have, therefore, increased the dividend by 25.3% in 2011.

These results have been attained through the efforts of Stephen Harris our CEO and his 5,500 colleagues across the globe who have worked tirelessly to achieve this improvement in the Company's fortunes. On your behalf I would like to thank all of them, for their ongoing contribution to the success of your Company.

I said last year that Bodycote is a first class business with good prospects for the future. I remain firmly of that view.

A.M. Thomson
Chairman
23 February 2012

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Chief Executive's review

Bodycote's strategy is aimed at growing the business above and beyond the background growth rate of the global economy while delivering consistently superior value. The pace of execution of this strategy is gaining momentum and we enter 2012 in good shape.

Stephen Harris
Chief Executive

Trading overview

Bodycote delivered a strong financial result in 2011, moving the Group closer to achieving the kind of performance to which we aspire. Sales increased 14% to £570.7m, headline operating profit[1] was £85.5m, an increase of 64%[2] and headline margins improved to 15%. Basic headline EPS grew to 32.7 pence, a major step forward from the EPS performance the Bodycote group has previously achieved.

In the early part of the year much of the growth in market demand was driven by the tail end of recovery in the early cycle markets such as automotive and a strengthening in a number of the general industrial segments. As the year progressed the expected ramp up in the later cycle markets of aerospace and energy started to feature more strongly. These 'secular growth' markets are now starting to move from slow recovery mode into an increasing rate of longer term underlying growth. While we have benefited from the cyclical recovery in many of our markets it is particularly pleasing to see that we continue to expand our market share and, as a consequence, are driving growth above the underlying rate of those markets.

Improved margins are being achieved in nearly every area of the Group. The improvement stems in part from higher volumes, but a significant amount comes from an improvement in mix as we focus on higher added-value opportunities. Improving efficiency continues to be a key focus for the Group; it is notable that while average headcount reduced by 1%, sales grew by 14%.

Net capital expenditure increased to £44.5m which was 0.9 times depreciation (0.8 times in 2010). Maintenance capital remained relatively unchanged at approximately 0.4 times depreciation. The increase in capital expenditure primarily reflects a higher level of expansion capital in the aerospace and energy markets, the emerging economies and specific chosen technologies.

Return on Capital Employed was 16.9% compared to 10.1% in 2010. This is an important metric for the long term performance of the Group. The Headline operating cash flow, measured after capital spending, was £96.0m representing profit-to-cash conversion of 112%. Our free cash flow[1] of £70.5m enabled the elimination of net debt by year end.

Strategic progress

Bodycote has continued to develop in line with the strategic direction that we outlined at the start of 2010. Our differentiated focus on each of Automotive & General Industrial and Aerospace & Energy is delivering results. Some of the evidence of this is the increased rate of securing larger long term contracts that has been a notable feature of the business in 2011. The new agreements with Rolls-Royce and Precision Castparts Corp reflect our strategic focus on the secular growth markets of aerospace and energy.

The agreement with automotive supplier, ZF Lenksysteme, in China is a good example of our 'hub and spoke' expansion strategy for the emerging markets, where we develop new work at a hub location and move out to a new greenfield facility once volumes justify. The business with this customer has been developed at our 'hub' site in Wuxi, China, and will now be transferred to a new greenfield site being built in Jinan, China. This will make way for further business development at Wuxi while at the same time helping the expansion of our services to other customers near the new plant in Jinan.

1 Headline operating profit and free cash flow are reconciled on page 15.

2 Operating profit from continuing operations increased 57% to £80.4m.

In general, the expansion strategy in our emerging markets has been going extremely well. Our business in China, Poland, the Czech Republic and Turkey has grown strongly as capacity has been added. The business in Romania is, as yet, still small but is doing well and has attractive prospects for the future. We converted our majority shareholding in this territory into a wholly owned venture in 2011. Revenues in the emerging markets, excluding Brazil, grew by 23%. The financial results in Brazil were the only disappointment in the year, with the losses virtually unchanged from 2010. This was largely driven by the restructuring induced dip in sales (down 27% on 2010). This programme has now been completed and operationally the Brazilian business is in good shape to deliver a high level of service to customers. We are cautiously optimistic that we can achieve substantial progress in the medium term, but experience has shown that this is likely to take longer in this territory than we have typically achieved in other parts of the Group.

Significant progress has been made on the development of the Group's proprietary products business units.

- Speciality Stainless Steel Products (S^{3}P) continues to exceed our expectations, with demand for these specialist processes continuing to outstrip supply. Sales grew by 21%, we added 25% more capacity during the year and a further 50% capacity increase is under construction to meet the increasing opportunities we have.
- The Hot Isostatic Pressing Product Fabrication (HIP PF) business unit revenues grew by over 60%, with expansion of activity in all territories. The constraint to expansion of this business has, so far, largely been an issue of recruiting and training sales and operational resources at a sufficient rate. Much progress has been made during the year and the business now has significant strength and depth of expertise. HIP PF specific capital equipment requirements are relatively modest and expansion of this capacity is proceeding well. General HIP capacity is used both for HIP PF and HIP Services. Demand for HIP services from the aerospace and industrial gas turbine markets is buoyant and we expect further growth in this area for some considerable time. As a result of the HIP PF growth and the HIP Services growth trends, we are starting to see capacity constraints ahead. Our initial capacity pinch-point is in North America. In response to this we have agreed to invest over $20m of expansion capital in this area which will be deployed over the next eighteen months.

Opportunities to expand the business continue to surface at a high rate in our more established markets in Europe and North America. A good proportion of these are as a result of technology changes driven by environmental factors such as elimination of chrome plating or the pursuit of lighter vehicles with better fuel efficiency and lower emissions. The services and processes we offer in these areas such as Corr-I-Dur® and low pressure carburising provide our customers with a very high value proposition and consequently we are able to secure above average returns on investment.

The combination of the various elements of our strategy, in technology driven expansion, emerging markets expansion and specific secular growth market expansion, leads to a higher demand for capital investment. Returns on investment in these areas are all very attractive and we expect in the near term that the Group will invest in capital expenditure at a slightly higher level than the depreciation charge.

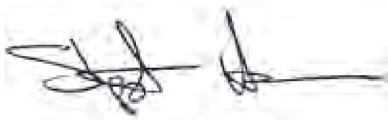
Bodycote is now debt free and has strong cash generation. These characteristics enable us to consider enhancing our potential for future profit growth by increased investment, both internally for organic growth and through selective acquisitions. We seek a balance between gaining immediate returns, longer term growth prospects and limitation of risk. Our acquisition focus is on achieving attractive returns on investment through 'bolt-ons' to our existing business.

Summary & outlook

2011 has been another year of improving operational and financial performance for the Group. The performance improvement and growth in the last few years has been continuous and the Group is starting to march to a drumbeat, notwithstanding the hesitation that occurred in the global economic recovery in the second half of 2011.

Bodycote's strategy is aimed at growing the business above and beyond the background growth rate of the global economy while delivering consistently superior value. The pace of execution of this strategy is gaining momentum and we enter 2012 in good shape.

The macroeconomic environment may continue to be challenging, but with nearly half of the Group's activity in areas which have long term growth drivers that are less likely to be impacted by economic headwinds we believe there is a good prospect that the business will continue to move forward in the coming year.



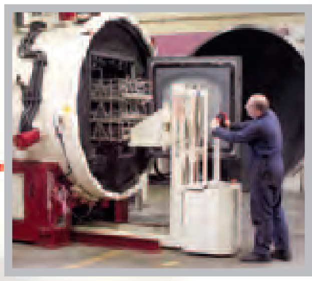
S.C. Harris
Chief Executive
23 February 2012

Injecting better performance – a component journey

AUTOMOTIVE DIESEL INJECTORS
Injector part failure due to wear is a costly hazard, leading to potential damage to other areas of the engine. The diesel injectors shown in this example are used in trucks, and each truck can have between 6-12 injectors. As part of the manufacturing process, the part must go through various thermal processing stages to enable it to perform to the required standard in service.

The injector begins life either as an alloy steel forging or steel bar.

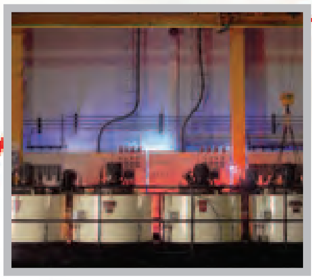
The injector is rough machined to within tight tolerance of its final size, adding fuel ports and passageways.

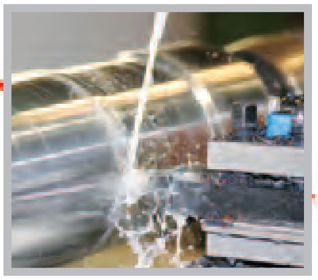


To obtain the correct core structure prior to nitriding, the part is hardened and tempered, to provide the necessary toughness and impact resistant properties.

The part is thermal deburred to remove any burrs in the passageways and to activate the surface by neutralising the chromium, which helps accelerate the diffusion of nitrogen into the surface during the nitriding cycle, ensuring a uniform case depth.

Controlled gas nitriding gives the part very high surface hardness with minimum distortion, providing excellent wear and corrosion resistance.





Due to the nitriding process, minimal finishing operations are needed. The part undergoes finish grinding and lapping to its final size.

End application – truck engine

BODYCOTE COMPONENT JOURNEYS
This is just one example of how Bodycote brings together the huge wealth of knowledge and expertise from across the Group to provide the vital engineering services our customers need...

For more component journeys visit **www.bodycote.com**

Denotes the parts of the component journey undertaken by Bodycote

Business performance

	2011 £m	2010 £m
Revenue	**570.7**	499.8
Operating profit	**80.4**	51.2
Add back:		
Impairment of goodwill and acquired intangible fixed assets	**4.2**	–
Amortisation of acquired intangible fixed assets	**0.9**	0.9
Headline operating profit	**85.5**	52.1

	2011 £m	2010 £m
Headline operating profit	**85.5**	52.1
Add back non-cash items:		
Depreciation and amortisation	**50.2**	47.4
Impairment of fixed assets	**0.5**	–
Share-based payments	**5.4**	4.2
Loss on disposal of property, plant and equipment	**0.7**	0.7
Headline EBITDA[1]	**142.3**	104.4
Net capital expenditure	**(44.5)**	(35.8)
Net working capital movement	**(1.8)**	8.7
Headline operating cash flow	**96.0**	77.3
Cash cost of restructuring	**(5.7)**	(9.2)
Operating cash flow	**90.3**	68.1
Interest	**(4.5)**	(5.5)
Taxation	**(15.3)**	(5.4)
Free cash flow	**70.5**	57.2

Group revenue from continuing operations was £570.7m, an increase of £70.9m (14.2%) on 2010 (£499.8m). The increase in revenues at constant exchange rates amounted to £68.4m (13.7%).

Headline operating profit for the Group's continuing operations was £85.5m, an increase of £33.4m compared to 2010. Foreign exchange rate movements decreased profits by £0.3m. Headline operating margin from continuing operations increased from 10.4% to 15.0%.

Strong profit growth, disciplined capital spending and working capital control have resulted in excellent operating cash flow of £90.3m (2010: £68.1m). This has enabled debt to be paid down fully over the last two years.

Capital expenditure has continued to be managed carefully. Capital spend (net of asset sales) in 2011 was £44.5m, being 0.9 times depreciation compared to 0.8 times in 2010. There has been a continued focus on cash collection and debtor days remain at 59 at 31 December 2011 (31 December 2010: 59). The increase in sales of £70.9m compared to 2010 has resulted in an increase in debtors of £7.9m, but an increase in payables reduced the net increase in working capital to £1.8m.

Definitions:
1 Earnings before interest, tax, depreciation, amortisation, share-based payments, impairment of fixed assets, loss on disposal of property, plant and equipment and exceptional items.

Safety critical service – a component journey

AIRCRAFT ENGINE SHAFT

The main drive shaft in a civil aircraft engine is a safety critical component. In service part failure could mean disaster. Thermal processing is essential to ensure this part has the necessary material properties to operate effectively, keeping the aircraft in the air.

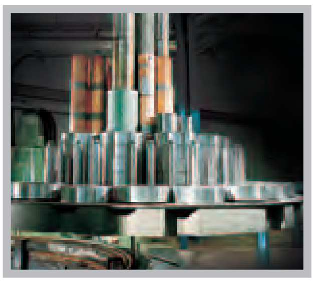
The component begins life as steel bar from which a forging is made.

The forged shaft is hardened and tempered to give the correct tensile strength.

Rough machining is carried out, usually to within 1/16th inch of the final part size.

The shaft is stabilised at approximately 50°C below the final tempering temperature to remove any machining stresses

The part undergoes final machining and grinding.



Areas that do not require surface hardening are masked using bronze, tin or copper plating and the shaft is then gas nitrided at a temperature not exceeding the stabilising temperature. This diffuses nitrogen into the surface to provide high hardness and excellent wear resistance.

Post nitriding, the plating and the white layer (nitrogen-rich layer which does not diffuse into the surface) are removed.

End application – aircraft, or land-based gas turbine, engine

BODYCOTE COMPONENT JOURNEYS

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For more component journeys visit www.bodycote.com

Denotes the parts of the component journey undertaken by Bodycote

Business review –
Aerospace, Defence & Energy divisions

Increasing durability

Turbine blades and vanes

Turbine blades and vanes, whether from an aircraft or land-based gas turbine engine, must withstand extreme temperatures in operation. These materials frequently operate at temperatures approaching their melting point - heat treatment, HIP and the use of surface technology allow these blades to operate reliably at these high temperatures for extended periods of time. Bodycote operates an international network of quality accredited facilities, in support of prime manufacturers and their supply chains.

Results

Revenues for the Aerospace, Defence & Energy (ADE) divisions were £233.5m in 2011 compared to £202.1m in 2010, an increase of 15.5% (17.0% in constant currencies). This growth reflects a continuation of the strong growth in revenue to oil & gas customers and increasing activity in the aerospace sector, both for new build and maintenance requirements. Industrial gas turbine (IGT) demand remained weak in Europe but improved in North America. Sales from the Group's proprietary HIP product fabrication (HIP PF) technology grew by over 60%.

Headline operating profit[1] for ADE was £51.1m (2010: £33.9m). The headline operating profit margin improved from 16.8% to 21.9% reflecting the divisions' lower cost base and higher capacity utilisation.

During 2011, heat treatment capacity has been added in southern USA as the Group's revenues from conventional drilling for oil and hydraulic fracturing (fracking) for gas have increased. The Group's aerospace capability has been enhanced in California and the greenfield site in Empalme, Mexico was completed. In the coming year, it is expected that capital expenditure will be slightly above depreciation as we support increasing customer requirements in a number of countries stemming from strong anticipated demand in the aerospace and energy markets. Net capital expenditure in 2011 was £15.2m (2010: £9.9m) which represents 0.8 times depreciation (2010: 0.6 times depreciation).

Capital employed in ADE in 2011 was £219.2m (2010: £230.1m). The reduction reflects continuing management focus on improving return on capital. Return on capital employed in 2011 was 23.3% (2010: 14.7%).

Achievements in 2011

The heat treatment business gained additional approvals from Boeing for titanium processing and concluded several important new or extended long-term agreements. A number of major suppliers in the oil & gas sector have chosen to use our proprietary HIP PF technology for the first time. A new long term agreement for HIP Services was signed with PCC Structurals, a subsidiary of Precision Castparts Corp and the Group committed to additional large HIP capacity to support this contract and the ongoing growth in HIP Product Fabrication.

Organisation and people

Overall headcount at 31 December 2011 was 1,983 (2010: 1,926), an increase of 3.0% compared to revenue growth in ADE of 15.5%.

Looking ahead

With exceptionally strong order books at the aircraft OEMs, no sign of weakness in oil prices and with the strength of our offering in heat treatment, surface technology and HIP, the ADE business is expected to build on the success seen in 2011 in the coming year. The business will be maintaining its clear focus on customer service and flexibility as it strives to stay ahead of the growing customer requirements for Bodycote's services.

1 Headline operating profit is reconciled to operating profit in note 2 to the financial statements.

ADE revenue by geography

Western Europe	111.9
North America	120.1
Emerging Markets	1.5
Total	**233.5**

ADE revenue by market sector

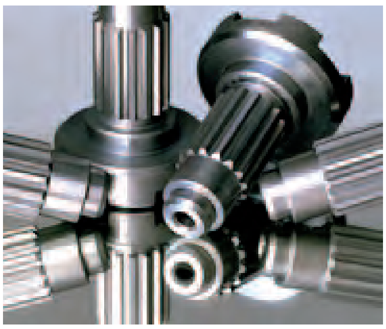
Aerospace & Defence	106.0
Energy	60.0
Automotive & General industrial	67.5
Total	**233.5**

Business review –
Automotive & General Industrial divisions

Strength with reliability

Transmission components

Transmission components form part of the drivetrain of all automotive vehicles, from excavators to trucks to cars. These hard working components are given a longer lifetime through thermal processing processes such as carburising, nitriding and also electron beam welding. Bodycote has developed partnerships with major automotive OEMs and their supply chains by offering comprehensive and high quality thermal processing support on a global, and local, basis.



Results

Automotive & General Industrial (AGI) revenues were £337.2m in 2011, compared to £297.7m in 2010, an increase of 13.3% (11.5% in constant currencies). This growth reflects a widespread improvement in demand along with market share gains, particularly with general industrial customers. The rate of sales growth was good across all of the automotive and general industrial sectors in the first half of 2011 building on the improvements seen in 2010. In the second half, the year on year growth slowed due to the substantial strengthening in the second half of 2010 but progress remained sound. Sales of the Group's proprietary Speciality Stainless Steel Processes (S^3P) grew by over 20%.

Headline operating profit[1] in AGI was £44.7m compared to £25.6m in 2010. Headline margins improved markedly, from 8.6% to 13.3% reflecting the divisions' lower cost base and higher capacity utilisation.

Net capital expenditure in 2011 was £27.0m (2010: £24.3m), which represents 0.9 times depreciation (2010: 0.8 times depreciation). Assuming no material change in demand in 2012 we expect that capital expenditure will be just above depreciation in 2012 as we take advantage of numerous incremental sales opportunities across the network. Return on capital employed in 2011 was 15.6% (2010: 8.8%). The increase reflects continuing focus on improving capital returns by increasingly targeting higher added-value activities. On average, capital employed in 2011 was £286.2m (2010: £289.4m).

Achievements in 2011

The focus in 2011 has been to build on the foundation established by the major restructuring programme of 2008 and 2009. The exit from loss making facilities and cessation of much low added value processing has seen a significant improvement in the profitability and return on capital in the AGI business. The Group has increased its capacity for S^3P by 25% in 2011. New outsourcing contracts have been won in all geographies. The minority partner in the increasingly successful Romanian business was bought out.

Organisation and people

In July 2008, prior to the global economic downturn, the AGI business employed 5,201 people. Notwithstanding revenues in AGI increasing by 13.3%, headcount has declined, from 3,456 at the end of 2010, to 3,423 at 31 December 2011, clearly demonstrating success in keeping costs under control and driving productivity.

Looking ahead

Expansion of the footprint in the emerging markets and a focus on technology change driven growth (particularly with processes such as Corr-I-Dur® and low pressure carburising), will continue to be the priorities for the AGI business. With restructuring completed in Brazil, we have a revitalised platform that should enable growth to start to mirror the levels of achievement that are being obtained in the rest of the emerging markets.

1 Headline operating profit is reconciled to operating profit in note 2 to the financial statements.

AGI revenue by geography

Western Europe	239.6
North America	47.4
Emerging Markets	50.2
Total	**337.2**

AGI revenue by market sector

Automotive	136.5
Civil Engineering, Agriculture, Rail and Marine	98.4
Other General Industrial	90.3
Energy	12.0
Total	**337.2**

Finance Director's report

David Landless
Finance Director

Financial overview

	2011 £m	2010 £m
Revenue	**570.7**	499.8
Headline operating profit	**85.5**	52.1
Amortisation of acquired intangible fixed assets	**(0.9)**	(0.9)
Impairment charge	**(4.2)**	–
Operating profit	**80.4**	51.2
Net finance charge	**(4.6)**	(6.0)
Profit before taxation	**75.8**	45.2
Taxation	**(19.8)**	(11.7)
Profit for the year – continuing operations	**56.0**	33.5
Loss for the year – discontinued operations	**–**	(5.8)
Profit for the year	**56.0**	27.7

Group revenues for 2011 increased by 14.2% from £499.8m to £570.7m. In constant currencies the annual increase was 13.7% (£68.4m).

Headline operating profit for the year increased from £52.1m to £85.5m, and headline operating margin was 15.0% (2010: 10.4%). Operating profit was £80.4m (2010: £51.2m) after charging £0.9m (2010: £0.9m) in respect of the amortisation of acquired intangible assets and £4.2m (2010: £nil) in respect of the impairment of goodwill and other intangible assets.

Headline operating cash flow[1] for the Group was £96.0m (2010: £77.3m). This was 112.3% of headline operating profit (2010: 148.4%). Capital expenditure was again below depreciation at 0.9 times (2010: 0.8 times) as the Group continued to focus on increasing the utilisation of existing equipment. Working capital increased in line with activity levels, with increases in inventory and receivables largely offset by a corresponding increase in the level of payables.

After deducting interest and tax, the Group recorded positive free cash flow of £70.5m (2010: £57.2m).

Exceptional costs

Total exceptional costs charged to the income statement amounted to £5.1m (2010: £0.9m). The amortisation of acquired intangible assets arises from acquisitions in prior years and the level of the charge remains constant at £0.9m (2010: £0.9m).

The charge for impairment of goodwill and other intangible assets of £4.2m (2010: £nil) relates to the Group's South American operations and reflects low current profitability in that region, as a consequence of the benefits of reorganisation taking longer to be realised than expected and the reduced size of the business following restructuring. No goodwill remains on the Group's balance sheet in respect of these businesses. The Board has concluded that no other impairment charge is required in 2011.

Except for the finalisation of work in France and Italy, which will be completed in 2012, restructuring actions are now complete. Net cash expenditure in 2011 as a result of the programme was £5.7m (2010: £9.2m). As the restructuring programme is now essentially complete, further savings will be modest.

Restructuring provisions outstanding at 31 December 2011 total £15.5m. Of the remaining costs, £8.8m is expected to be spent in 2012 and £6.7m in 2013 and later. All expenditure after the end of 2012 will relate to ongoing environmental remediation, primarily in the USA.

1 Headline operating cash flow is reconciled on page 15.

Profit before tax from continuing operations

Headline profit before tax for continuing operations was £80.9m (2010: £46.1m). Profit before tax for continuing operations was £75.8m (2010: £45.2m), and these amounts are reconciled as follows:

	2011 £m	2010 £m
Headline operating profit	**85.5**	52.1
Net finance charge	**(4.6)**	(6.0)
Headline profit before tax	**80.9**	46.1
Amortisation of acquired intangible fixed assets	**(0.9)**	(0.9)
Impairment charge	**(4.2)**	–
Profit before tax – continuing operations	**75.8**	45.2

Finance charge

The net finance charge from the continuing operations of the Group was £4.6m compared to £6.0m in 2010 (see details below). Higher net interest rates were more than offset by lower average net debt during the year. Facility fees and financing costs were lower following refinancing during the year by £0.3m and pension finance charges were lower by £0.2m. Bank and other charges were also lower by £0.2m.

	2011 £m	2010 £m
Net interest payable	**1.2**	1.9
Financing costs	**2.0**	2.3
Bank and other charges	**0.7**	0.9
Pension finance charge	**0.7**	0.9
Net finance charge	**4.6**	6.0

Taxation

The tax charge was £19.8m for the year (2010: £11.7m). The effective tax rate of 26.1% (2010: 25.9%) resulted from the blending of differing tax rates in each of the countries in which the Group operates.

The headline tax rate for 2011 was 24.6% (2010: 25.4%), being stated before amortisation of goodwill and acquired intangibles (which are generally not allowable for tax purposes).

Subject to any future tax legislation changes, the headline tax rate is expected to remain below the current UK statutory tax rate of 26% in the medium term.

Discontinued operations

Bodycote has not discontinued any business streams during 2011.

Earnings per share

Basic headline earnings per share from continuing operations (as defined in note 10) increased to 32.7p from 18.3p. Basic earnings per share for the year are shown in the table below:

	2011 Pence	2010 Pence
Basic earnings per share from:		
Continuing operations	**30.0**	18.0
Discontinued operations	**–**	(3.1)
Continuing and discontinued operations	**30.0**	14.9

Dividend

The Board has recommended a final dividend of 7.3p (2010: 5.75p) bringing the total dividend to 10.9p per share (2010: 8.7p). If approved by shareholders, the final dividend of 7.3p per share for 2011 will be paid on 4 May 2012 to all shareholders on the register at close of business on 10 April 2012.

Capital structure

The Group's balance sheet at 31 December 2011 is summarised below:

	Assets £m	Liabilities £m	Net Assets £m
Property, plant and equipment	443.9	–	443.9
Goodwill and intangible assets	111.5	–	111.5
Current assets and liabilities	130.2	(149.0)	(18.8)
Other non-current assets and liabilities	2.7	(16.1)	(13.4)
Retirement benefit obligations	–	(13.5)	(13.5)
Deferred tax	52.3	(79.5)	(27.2)
Total before net cash	740.6	(258.1)	482.5
Net cash	18.1	(18.0)	0.1
Net assets as at 31 December 2011	**758.7**	**(276.1)**	**482.6**
Net assets as at 31 December 2010	771.2	(320.4)	450.8

Net assets increased by £31.8m (7.1%) to £482.6m (2010: £450.8m). The major movements compared to 31 December 2010 were a significant reduction in net debt of £51.4m, a decrease in property, plant and equipment of £14.1m, a reduction of goodwill and intangible assets of £6.6m, an increase in retirement benefit obligations of £1.9m, together with a decrease in net current liabilities of £5.0m and an increase in net deferred tax liabilities of £2.4m.

The decrease in property, plant and equipment was due to net capital expenditure of £44.5m being exceeded by depreciation of £48.2m, with foreign exchange variances increasing the net reduction to £14.1m.

Net deferred tax liabilities increased by £2.4m as a result of the use of tax losses reducing deferred tax assets, and an increase in deferred tax liabilities resulting from capital investments. Restructuring provisions reduced by £4.7m, as Group restructuring activities proceeded as planned.

Retirement benefit obligations increased by £1.9m during the year, primarily as a result of a change in discount rates reflecting lower corporate bond rates.

Net cash / (debt)

Group net cash at 31 December 2011 was £0.1m (2010: net debt £51.3m). During the year, loans of £58.5m under committed facilities were repaid. The Group continues to be able to borrow at competitive rates and therefore currently deems this to be the most effective means of funding.

Finance Director's report continued

Cash flow

The net decrease in cash and cash equivalents was £7.7m (2010: increase of £0.5m), made up of net cash from operating activities of £119.8m (2010: £95.6m), less investing activities of £45.9m (2010: £36.6m) and less cash used in financing activities of £81.6m (2010: £58.5m).

The increase in net cash flow from operating activities from £95.6m to £119.8m is driven primarily by the increase in headline EBITDA[1] from £104.4m to £142.3m. Working capital increased in line with activity levels with increases in inventory and receivables largely offset by a corresponding increase in the level of payables. The net effect was an increase in the level of working capital of £1.8m (2010: decrease of £8.7m).

Net cash outflows from investing activities increased from £36.6m to £45.9m, as the levels of net capital expenditure in 2011 at £44.5m (2010: £35.8m), although higher than in the prior year, remained below historical levels, reflecting continued tight management control.

Net cash outflows used in financing activities increased from £58.5m to £81.6m. 2010 saw the repayment of £34.0m of loans, while 2011 saw a further repayment of loans of £59.3m, together with payment of dividends totalling £17.4m (2010: £20.9m).

There has been a continued focus on cash collection with debtor days at 31 December 2011 remaining constant at 59 days. Net interest payments for the year were £4.5m (2010: £5.5m) and tax payments were £15.3m (2010: £5.4m) as a result of the significant increase in profits.

Capital expenditure

Net capital expenditure (capital expenditure less proceeds from asset disposals) for the year was £44.5m (2010: £35.8m). The multiple of net capital expenditure to depreciation was 0.9 times (2010: 0.8 times), which reflects the Group's continued careful management of its capital expenditure programme. As at 31 December 2011 the Group had capital expenditure creditors of £13.1m (2010: £6.9m). Major capital projects that were in progress during 2011 include additional investment in our HIP and S³P businesses, establishment of our new aerospace facility in Mexico, purchase and installation of new equipment in Poland, and expansion of our geographic footprint in China.

Borrowing facilities

During 2011, the £110m and US$20m revolving credit facilities were refinanced with a committed facility for £125m with a maturity date of 31 August 2016. The new facility has lower costs and improved terms compared to those it replaced. Total funding now available to Bodycote under its committed facilities is £236.4m (2010: £230.9m), expiring between July 2013 and August 2016.

At 31 December 2011, the Group had the following committed facilities:

Facility	Expiry Date	Facility £m	Loan and Letter of Credit Utilisation £m	**Facility Headroom £m**
€125m Revolving Credit	31 July 2013	104.9	6.0	**98.9**
£125m Revolving Credit	31 August 2016	125.0	–	**125.0**
		229.9	6.0	**223.9**
$10m Letter of Credit	31 August 2016	6.5	5.1	**1.4**
		236.4	11.1	**225.3**

Capital management

The Group manages its capital to ensure that entities in the Group will be able to continue as going concerns, while maximising the return to shareholders. The capital structure of the Group consists of debt, which includes borrowings, cash and cash equivalents and equity attributable to equity holders of the parent, comprising capital, reserves and retained earnings.

The capital structure is reviewed regularly by the Board of Directors. The Group's policy is to maintain gearing, determined as the proportion of net debt to total capital, within defined parameters, allowing movement in the capital structure appropriate to the business cycle and corporate activity. The gearing ratio at 31 December 2011 has fallen to zero (2010: 11%) as a result of the year end net cash position and the increased profit in the period.

Defined benefit pension arrangements

The Group has defined benefit pension obligations in the UK, Germany, Switzerland, Liechtenstein, USA and Brazil and cash lump sum obligations in France, Italy and Turkey, the entire liabilities for which are reflected in the Group balance sheet. The net deficits in these arrangements are as follows:

	2011 £m	2010 £m
Funded		
UK	**1.8**	0.6
Other Western Europe	**0.7**	0.7
North America	**0.9**	0.5
	3.4	1.8
Unfunded		
Western Europe	**9.9**	9.5
Emerging Markets	**0.2**	0.3
	10.1	9.8
Total deficit	**13.5**	11.6

The UK plan is closed to new entrants but the 110 active members continue to accrue benefits. The arrangements in France, Italy and Turkey are open to new members. All other arrangements are closed to new entrants.

1 Headline EBITDA is reconciled on page 15.

Post balance sheet events

There are no post balance sheet events following the 2011 year end.

Change in accounting policies

The changes in accounting policies are detailed in the Accounting Policies on page 55 of this report. The adoption of new accounting policies has not had any material impact on the amounts reported in these financial statements.

Going concern

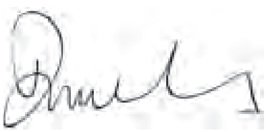
In determining the basis of preparation for the Annual Report, the Directors have considered the Group's business activities, together with the factors likely to affect its future development, performance and position, as set out in this Group Review. This includes an overview of the Group's financial position, its cash flows, liquidity position and borrowing facilities.

The Group meets its working capital requirements through a combination of committed and uncommitted facilities and overdrafts. The overdrafts and uncommitted facilities are repayable on demand but the committed facilities are due for renewal as set out below. There is sufficient headroom in the committed facility covenants to assume that these facilities can be operated as contracted for the foreseeable future. The committed facilities as at 31 December 2011 were as follows:

- €125m Revolving Credit Facility maturing 31 July 2013
- £125m Revolving Credit Facility maturing 31 August 2016
- $10m Letter of Credit Facility maturing 31 August 2016

The Group's forecasts and projections, taking account of reasonable potential changes in trading performance, show that the Group should be able to operate within the level of its current committed facilities.

The Directors have reviewed forecasts and projections for the Group's markets and services, assessing the committed facility and financial covenant headroom, central liquidity and the Group's ability to access further funding. The Directors also reviewed downside sensitivity analysis over the forecast period, thereby taking into account the uncertainties arising from the current economic environment. Following this review, the Directors have formed a judgement, at the time of approving the financial statements, that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason the Directors continue to adopt the going concern basis in preparing the financial statements.



D.F. Landless
Finance Director
23 February 2012

Principal risks and uncertainties

Effective management of risks is essential to the delivery of the Group's objectives. Under the leadership of the Vice-President (Risk and Business Processes), the Group is continuing to develop its risk management framework. The approach taken has been to identify and evaluate the business critical risks for each sub-division, and to determine measures in place to manage and mitigate each risk. In 2012 development of the risk management framework will focus on assurance that mitigation activities are effective. This work will be undertaken by Ernst & Young LLP as part of their new outsourced Internal Audit contract for the Group. Ernst & Young LLP have leading internal audit advisory and risk capability and they will help the Group develop its assurance framework.

The principal risks described below represent the most significant areas which the Board believes have a higher probability of impacting the Group's financial performance and position, together with the actions initiated to mitigate the consequences.

Market and Customer Risks

Markets

Bodycote's presence in 27 countries and in a wide variety of end markets acts as a natural hedge to balance out localised economic volatility. Nevertheless, the Group is continuously working to improve its responsiveness to changes in demand by keeping the cost base flexible without impacting customer service levels. The Board is mindful of the potential for volatility in demand for the Group's services while the Eurozone debt problems continue. Significant efforts have been made to strengthen Bodycote's sales capability which includes maintaining close contact with customers to provide management with market intelligence. Furthermore the business uses analytical tools to track changes in demand and detailed plans document the measures to respond rapidly to a fall in sales.

Loss of key customers

The Group benefits from many long-term and partnership agreements with key customers. Damage to, or loss of, any of these relationships may be detrimental to Group results, although the Board believes this is highly unlikely as Bodycote has excellent long-term relationships with its major customers and the Group's network of strategically located facilities ensures that it is the supplier of choice to these major manufacturers. Furthermore there is no significant customer dependency, with the Group's top ten customers accounting for less than 13% of sales and the balance made up by many thousands of customers.

Corporate and Community Risks

Human Resources

Bodycote is reliant on its ability to recruit, develop and retain staff to meet future growth plans. Competition for resources is high and there is a risk that Bodycote may not be able to attract or to retain skilled individuals. As the market leader, Bodycote is seen as a source of talent by competitors, while the Group competes with employers from a wide range of sectors to attract staff into the business. The Group continued to invest in the implementation of its Human Resources Strategy, which covers succession planning, staff development, performance management, recruitment and the remuneration strategy. This was supported by the recruitment of a Group Learning & Development Manager and through the roll-out of HR software, such as SuccessFactors, on an enterprise level.

Safety & Health

Bodycote is committed to providing the highest level of protection in its work environment and to protecting the safety of its employees. The Group's work environment presents a number of risks which require management. Shortcomings in health and safety arrangements can have a significant effect on individual employees, cause disruption to business and lead to financial penalties and loss of reputation. Safety and Health (S&H) policies are set by the Chief Executive Officer, supported by the newly appointed Group Head of Safety, Health and Environment and all facilities are required to operate in accordance with these policies. Responsibility for implementation of S&H policies lies with divisional management and each division has a professionally competent S&H manager in place. All facilities are subject to safety audits at least once a year, following standard audit programmes, and findings are reported to divisional and corporate management.

Environment

Bodycote is committed to providing the highest level of protection to the environment. Environmental policy is set by the Chief Executive Officer, supported by the newly appointed Group Head of Safety, Health and Environment. Historical use of solvents and other hazardous chemicals could have led to ground contamination. The environmental laws of the various jurisdictions impose actual and potential obligations on Bodycote to remediate contaminated sites, both those currently in use and, in some cases, those which have been sold. Bodycote incurs costs annually in meeting its obligations and maintains a provision of £15.8m to meet these liabilities. If this existing provision is inadequate to meet costs arising from environmental obligations, then this could impact the Group's results. Some of the Group's heat treatment plants continue to use solvents and other hazardous chemicals in small quantities but the risk of future contamination is managed by stringent procedures, typically under the requirements of the ISO 14001 environmental standard.

Operational Risks

Service quality

The Bodycote brand is reliant on the repeatable delivery of parts to agreed specification to an agreed time. Deterioration in quality or service levels can have serious long term consequences financially and to Bodycote's reputation. Work that is released into use which is not in compliance with specification could arise as a result of system or human failure. Bodycote has stringent quality systems in place managed by qualified staff. Where necessary plants have relevant accreditations, such as ISO 9001, Nadcap and TS 16949. All facilities are subject to internal audits, external audits by accreditors or customer inspections at least once a year.

Regulatory Risks

Regulatory and legislative compliance

Bodycote operates in 27 countries which all have unique legislative and regulatory requirements, including tax regulations. In some countries regulations can vary from state to state. Non-compliance could lead to penalties, disruption to business, and diversion of management time and loss of reputation. To mitigate this risk Bodycote engages specialists with expertise in the local legislative and regulatory landscape to perform compliance activity or to advise local management.

Financial Risks

The Group's treasury function provides a centralised service to the Group for funding, foreign exchange, interest rate management and counterparty risk. Treasury activities have the objective of minimising risk and treasury operations are conducted within a framework of policies and guidelines authorised and reviewed periodically by the Board. Further details on the Group's financial risks and risk management policies are provided in note 20 to the financial statements.

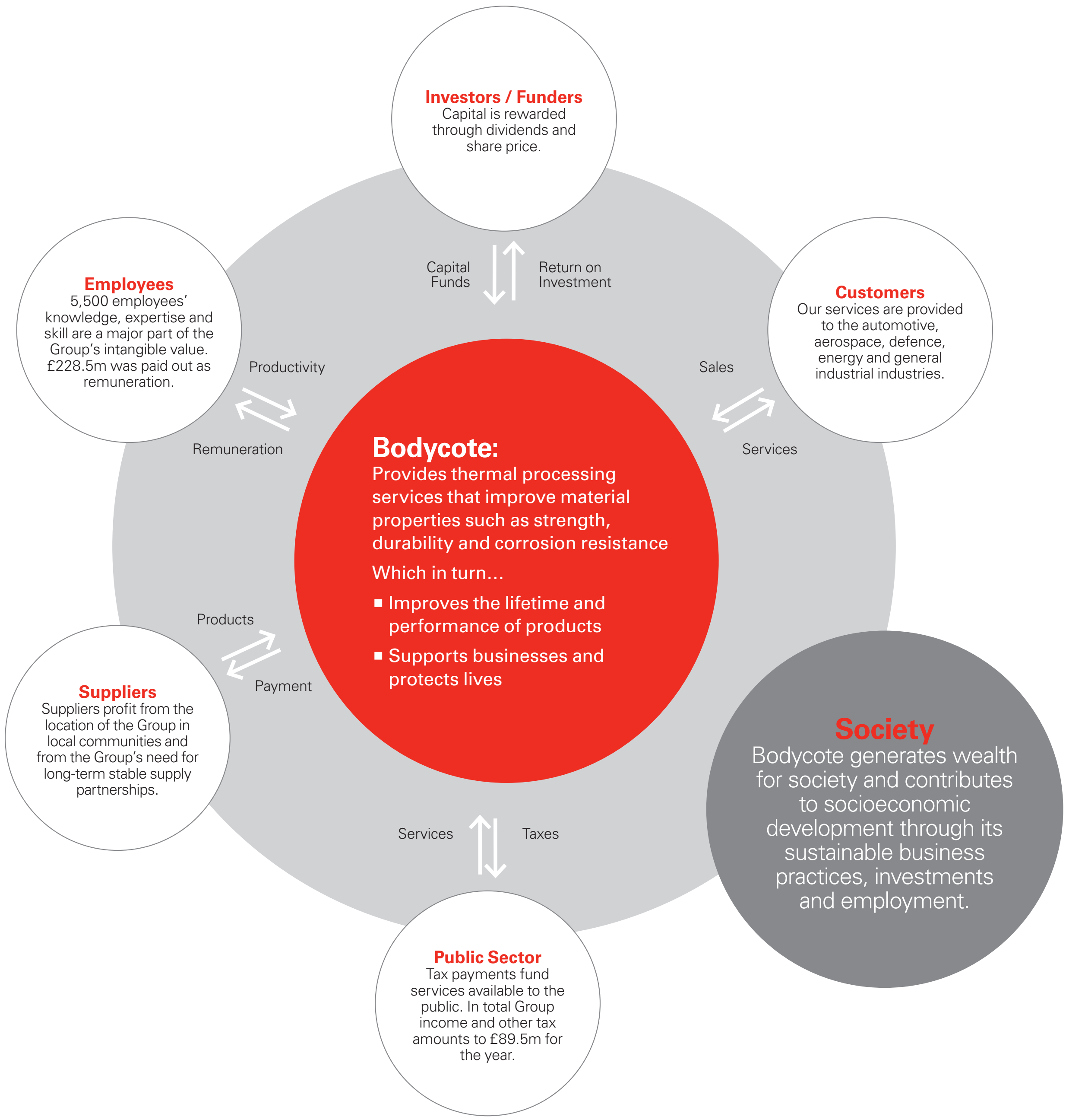
D.F. Landless
Finance Director
23 February 2012

Risk	Description	Impact	Mitigation
Market and Customer Risks			
Markets	A substantial proportion of Bodycote's sales are closely linked to the economic cycle, 39% of Group sales are in Eurozone countries. Sales in the markets served by the AGI businesses (67% of the total Group) tend to develop in line with or ahead of the economic cycle, whereas aerospace and defence sales (20%) tend to track behind the economic cycle. Sales to the energy sectors (13%) are closely linked to energy prices, which in turn can be affected by general economic activity. Short order visibility means that accurately forecasting demand remains difficult.	As a low proportion of the Group's costs are variable (approx 20%), a fall in sales will have a significant impact on profitability.	■ Engage in continuous dialogue with customers and monitor macro-economic forecasts which should alert the Group to likely changes in demand. ■ Maintain flexibility of cost base e.g. by ensuring that a proportion of the workforce is employed on temporary contracts. ■ Respond quickly to changes in customer demand on a local or a Group-wide level.
Loss of key customers	Damage to the relationship with key customers that will result in loss of sales.	A loss of a key customer will result in a reduction in profit and may affect the viability of one or more of the Group's facilities.	■ Continue the emphasis on long-term agreements. ■ Maintain excellent relationships with major customers. Use key account management to monitor customer satisfaction with Group's service levels.
Corporate and Community Risks			
Human Resources	Bodycote's growth plans rely on its ability to retain, develop and attract staff.	A shortage of staff with the appropriate skills will impede the Group's ability to execute its business plans.	■ Continue development of an HR strategy to address the long-term development and retention of staff. ■ Develop succession plans. ■ Ensure performance management processes are properly implemented and used effectively.
Safety and Health	Shortcomings in safety and health framework.	Failure to develop, implement or comply with the highest levels of safety and health processes can lead to injury, financial and reputational loss.	■ Appointed Group Head of Safety, Health and Environment. ■ Comprehensive health and safety policies in place. ■ Maintain Group-wide health and safety policies enforced by divisional health and safety teams. ■ Safety compliance audits at least once a year at all plants.
Environment	Ground and water contamination through the use of potentially hazardous substances and emissions of carbon dioxide.	Financial impact of cleaning up contamination from past and present activities involving hazardous substances. Reputational impact, particularly for facilities which operate in urban or residential areas.	■ Appointed Group Head of Safety, Health and Environment. ■ Remediation of contaminated sites as required by local legislation. ■ Reduce use of hazardous substances, such as chlorinated solvents. ■ Adopt ISO 14001 certification.
Operational Risks			
Service quality	Work being released for end use that has not been processed to specification.	Processed part will not perform as required, leading to financial cost of remediation, breakdown in customer relationship, reputational loss, and potential for damages / litigation.	■ Maintain industry relevant accreditations. ■ Divisional quality teams to maintain quality process at plant level. ■ Perform quality audits at all plants at least once a year.
Regulatory Risks			
Regulatory and legislative compliance	Non-compliance with regulatory or legislative requirements.	Non-compliance could lead to financial penalties, disruption to business, diversion of management time, personal and corporate liability and loss of reputation.	■ Engage local specialists to support Bodycote at local, divisional and Group level. ■ Develop business process to incorporate local regulatory requirements.

Corporate responsibility and sustainability

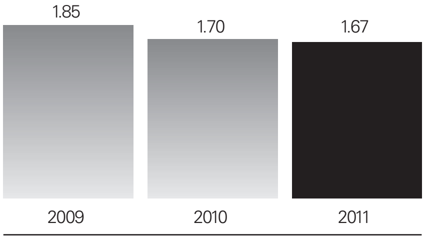
As a group, Bodycote is committed to acting responsibly as a good corporate citizen, to reducing the environmental impact of the Group's activities and to providing our employees with a safe working environment.

Bodycote's stakeholder model shows how its interactions on various levels contribute towards socioeconomic growth and development. These exchanges, based on mutually beneficial relationships, provide the basis for the company's growth and sustainability, which in return provides benefits to employees, investors, suppliers, customers, the public sector and wider society.

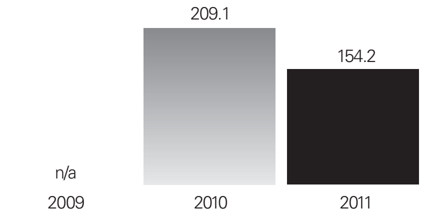


Corporate responsibility and sustainability continued

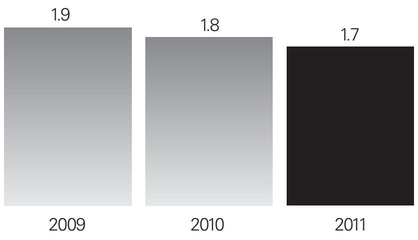
Water consumption
(thousand m^3/£m sales)



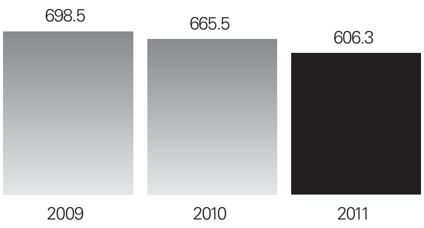
Chlorinated solvents
(kg/£m sales)



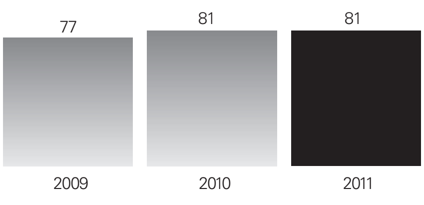
Accident frequency[1]



Carbon footprint
(tonne CO_2e/£m sales)



ISO 14001 accredited facilities
%



Our approach
Bodycote's objective is to create superior shareholder returns through the provision of selected thermal processing services that are highly valued by our customers and to achieve this in a safe working environment, while continually seeking to minimise the impact on the environment.

Bodycote is dedicated to improving management of corporate responsibility issues and is implementing policies and initiatives to achieve this goal. The future success and growth of the Group is intrinsically linked to our ability to ensure the Group's operations are sustainable and that we can nurture and develop our talent.

Our people
The strength of the Group primarily rests in its people and one of the key challenges for management is to ensure availability of appropriately qualified people to support its continued growth. Bodycote is fortunate to have a competent and committed international team that is well respected in technical and business circles. Most acquisitions have been based on historical relationships with Bodycote personnel, which reflects the integrity of the Group's people.

Bodycote invests in the training and development of its people both at local and group level. At local level the Company is committed to providing the appropriate skills and technical training which will allow its employees to operate effectively and safely in their roles and deliver excellent customer service. At group level a number of initiatives are currently being rolled out to drive excellence in management.

An initiative to build further understanding and skill in the area of performance management is underway and being cascaded globally through the management population. Through communication of clear messages coupled with skill development, the organisation aims to raise the capability of its management population in driving performance. This initiative is backed by a new performance management IS system which supports the process.

Bodycote's employment policies are non-discriminatory, complying with all current legislation to engender equal opportunity irrespective of race, gender, religion, disability, sexual orientation or nationality. Harassment is not tolerated.

Customers and suppliers
Bodycote has no significant suppliers who are wholly dependent upon the Group's business. Suppliers are paid in line with contractual and legal obligations.

We endeavour to respond quickly to changing customer demand, to identify emerging needs and to improve service availability and quality. We stay close to our current and potential customers building long-term relationships.

Community
During 2011 Bodycote launched a campaign to raise funds for the Japanese Red Cross, following the devastating earthquake and tsunami which hit the country. We encouraged our staff to make a donation, which the Group matched. The funds were donated directly to the Japanese Red Cross to assist those working to rebuild homes and communities.

1 The accident rate for 2011 includes data for some regions that were previously not reported. Accident frequency is defined as the number of lost time accidents per 200,000 hours worked.

Responsible business ethics

All Bodycote personnel are expected to apply a high ethical standard, consistent with an international UK-listed company. Directors and employees are expected to ensure that their personal interests do not at any time conflict with those of Bodycote. Shareholder employees are advised of and comply with share dealing codes.

Bodycote has systems in place designed to ensure compliance with all applicable laws and regulations and conformity with all relevant codes of business practice. Further, Bodycote does not make political donations.

With regard to competition, Bodycote aims to win business in a differentiated high-value manner. The Group does not employ unfair trading methods and it competes vigorously but fairly within the requirements of the applicable laws. Employees are prohibited from either giving or receiving any inducements.

Our Open Door Policy has been translated into all languages used throughout the Group. The policy allows employees to report their concern orally or in writing and in confidence to an independent third party provider to ensure anonymity. Reports are transcribed and sent to the Vice President Risk and Business Processes, who then passes the matter to the appropriate individual in the business to address.

A Bribery Training site has been put in place, translated into the major languages used throughout the Group, and relevant employees (approximately 15% of our workforce) have completed the interactive course. We have also reviewed our Competition Law training and are in the process of putting a similar training site in place.

Operational SHE performance

Bodycote is committed to building and maintaining a high reliability organisation; one that delivers consistently high performance across all aspects of safety, health and environmental (SHE) management. Its objective is to be known for the excellence of its SHE performance in all of its business activities and at all of its sites.

Safety and health

The nature of the Group's operations is such that employees are regularly exposed to hazards in the workplace. Bodycote aims to manage these hazards and thereby minimise risks to employees through the deployment of a robust safety management system, which includes appropriate policies and procedures.

KPI – accident frequency (lost-time injury rate)

Although Bodycote has reduced its lost-time accident rate by 30% over the past five years, it recognises the need to improve. A revitalised global improvement strategy has been initiated, which will focus on all aspects of the safety management system, whilst developing cultural maturity. An important element of this is the role of leadership, including the active engagement of managers at all levels in managing safety, whilst recognising that all employees have responsibilities for their own safety and the safety of others.

Environment

A proactive approach to improving energy efficiency means that Bodycote has implemented a variety of systems to reduce water and gas consumption and re-use energy. The continuing focus on lessening its impact on the environment has resulted in Bodycote advancing towards ISO 14001 accreditation at all of its facilities, with most of the Group having already achieved this standard.

Further efficiencies are always being sought, and to this end a global project is underway to implement an active energy management system within Bodycote globally. Through metering individual processes and equipment, it will be possible to compare similar processes at different sites and to identify opportunities to reduce energy use.

At every stage where Bodycote is involved in the manufacturing cycle, our operational aim is to lessen the overall impact on the environment, not just in our own operations, but also those of our customers. Bodycote operates modern, efficient equipment, which is operated around the clock so as to optimise thermal processing cycles. Without Bodycote, many companies would be using older technology in-house and running their equipment at reduced capacity, both of which are a drain on energy resources. Working with Bodycote enables our customers to commit more easily to carbon reduction initiatives.

Bodycote also reduces the carbon footprint of its customers' activities by increasing the lifespan of their products, by improving metallurgical properties and enhancing corrosion resistance. For example, surface treatment technology is widely used in the reclamation of damaged and worn components, offering a cost-effective and energy-efficient alternative to the need to manufacture new replacement parts, and treated parts often last up to twenty times longer than the original.

So, whilst thermal processing is an energy intensive business, it is a vital part of the manufacturing chain and its use saves the energy it consumes many times over.

KPI – ISO 14001 accredited facilities

Reducing the environmental impact of the Group's activities is taken very seriously. Compliance with the requirements of ISO 14001 helps to minimise the risk of adverse environmental effects at Bodycote's locations. At the end of 2011, 81% of our plants had achieved ISO 14001 accreditation – 139 plants out of a total of 171.

Carbon footprint and water consumption

Total CO_2e emissions per £m sales decreased by 9% in 2011 and water usage per £m sales decreased by 2%. The Group's total CO_2 emission data is based on Scope 1 and Scope 2 emissions, as defined by the UK Government's Department for Environment, Food and Rural Affairs, and data relating to this has been calculated to include country-specific electricity conversion factors.

Chlorinated solvent use

The use of chlorinated solvents in Bodycote's thermal processing activities has been reduced in recent years as aqueous degreasing facilities have been introduced. In 2011 the overall solvent use decreased by 16% compared with the previous year, including the complete cessation of methylene chloride use.

Corporate responsibility and sustainability continued

A greener, cleaner environment

Reducing any detrimental impact on the environment has become a growing focus of industry worldwide and Bodycote can assist with the drive towards carbon reduction and environmentally friendly approaches in a number of ways.

For example, certain heat treatment and thermally sprayed surface treatments are leading the way in the replacement of older, less environmentally friendly processes such as chrome plating.

Future restrictions that will be placed on chrome plating due to health and environmental issues have led many businesses, including the major aerospace companies, to embark on initiatives to replace it. These companies have identified thermal spray coatings as the preferred replacement for chrome plating.

Bodycote has been involved in a number of initiatives to replace chrome plate and results have shown that, in addition to the environmental benefits, thermally sprayed tungsten carbide outperforms hard chrome plate for both wear and corrosion protection.

Modern thermal processing techniques have allowed designers and manufacturers to use much lighter materials, such as aluminium and titanium, and have significantly prolonged component lifetimes. Through the effective use of thermal processing, parts can now be lighter and overall component weight reduced, leading to improved efficiency and reduced fuel consumption of products in service.

Board of Directors and advisers

Board of Directors

Executive Directors

S.C. Harris – Chief Executive
Appointed a Director on 1 November 2008 and Chief Executive from 12 January 2009. Executive Director at Spectris plc from 2003 to 2008 and at Powell Duffryn plc from 1995 to 2003. Prior to this he held several senior positions in APV Inc. in the United States from 1984 to 1995. Non-Executive Director of Mondi plc since 2011 and was previously a Non-Executive Director of Brixton plc from 2006 to 2009. Member of the Nomination Committee. A Chartered Engineer.

D.F. Landless – Finance Director
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.

Non-Executive Directors

A.M. Thomson – Chairman
Appointed a Director in 2007. Chairman of Hays PLC (2010) and Hamsard 3054 Ltd (Polypipe), and Non-Executive Director of Alstom SA. Immediate Past President of the Institute of Chartered Accountants of Scotland. Served as Finance Director of Smiths Group plc from 1995 to 2006 and of Rugby Group plc from 1992 to 1995. Member of the Remuneration Committee and Chairman of the Nomination Committee. A Chartered Accountant.

J. Vogelsang – Senior Independent Non-Executive Director – Netherlands
Appointed a Director in 2003. Non-Executive Director of Metex SA (2007). 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.

J.A. Biles
Appointed a Director in 2007. Non-Executive Director of Sutton & East Surrey Water plc (2006), and previously of Charter International plc (2005 to 2012), Hermes Fund Managers Limited (2005 to 2011), ArmorGroup International plc (2004 to 2008), and of Northern Ireland Electricity plc (previously Viridian Group plc) (2005 to 2011). Finance Director of FKI plc from 1998 to 2004 and Group Finance Director of Chubb Security PLC (1991 to 1997). Chairman of the Audit Committee and member of the Remuneration and Nomination Committees. A Chartered Accountant.

K. Rajagopal
Appointed a Director on 24 September 2008. Chairman of UMC3 (2010) and of HHV Pumps Ltd (2009). Non-Executive Director of W.S. Atkins plc (2008), Spirax-Sarco Engineering plc (2009) and E2V Technologies PLC (2010). Past member of UK Council for Science and Technology and the Audit Commission. Executive Director of BOC Group plc (2000 to 2006) and Chief Executive of BOC Edwards (1998 to 2006) and Non-Executive Director of Foseco plc (2005 to 2008). Member of the Audit, Remuneration and Nomination Committees. A Mechanical Engineer.

Secretary and registered office

U.S. Ball – FCIS
Springwood Court, Springwood Close, Tytherington Business Park, Macclesfield, Cheshire SK10 2XF.
Tel: +44(0)1625 505300 Fax: +44(0)1625 505313.
Registered Number 519057 England and Wales.

Advisers

Auditor
Deloitte LLP

Principal Bankers
HSBC Bank plc, Barclays Bank PLC, The Royal Bank of Scotland plc, Svenska Handelsbanken AB, Lloyds TSB Bank plc, UniCredit Bank AG, ING Bank NV and Wells Fargo Bank, NA.

Solicitors
Eversheds LLP and Herbert Smith LLP.

Financial Advisers
Lazard & Co. Limited

Brokers
Credit Suisse Securities (Europe) Limited and Investec Investment Banking.

Registrars
Capita Registrars Limited, Huddersfield.

The Directors are pleased to submit their report and the audited financial statements for the year ended 31 December 2011.

The Chairman's statement, the Chief Executive's review, the Finance Director's report, and all the information contained on pages 4 to 48 together comprise the Directors' report for the year ended 31 December 2011.

Principal activities

The Company is a holding company with subsidiaries carrying on business in the provision of thermal processing services. The activities and locations of the principal subsidiary undertakings are set out on pages 97 and 98.

Group review

The Group review, which encompasses:

- Strategy and objectives;
- Measuring our progress;
- Chairman's statement;
- Chief Executive's review;
- Business performance;
- Markets;
- Business overview;
- Business review;
- Finance Director's report; and
- Corporate responsibility and sustainability

is provided on pages 4 to 32 of this Annual Report. This is a review of the development of the businesses of the Group, the financial performance during the year ended 31 December 2011, key performance indicators, a description of the principal risks and uncertainties facing the Group and information about the use of financial instruments. The Group review has been prepared solely to assist the shareholders in assessing the Group's strategies and the potential of those strategies. It should not be relied on by any other party for any other purpose. Forward-looking statements have been made by the Directors in good faith using information available up to the date of this report and such statements should be regarded with caution because of the inherent uncertainties in economic trends and business risks. Since the end of the financial year no important events affecting the business of the Group have occurred.

Dividends

The Board is recommending a final dividend of 7.3p per ordinary share making a total for the year of 10.9p per share (2010: 8.7p). The final dividend, if approved, will be paid on 4 May 2012 to shareholders on the register at the close of business on 10 April 2012.

Share capital

The Company's issued ordinary share capital as at 31 December 2011 was £33.0m and during the year was increased by the issue of 1,381,750 ordinary shares between 7 February and 21 December 2011 for a total consideration of £238,666, in connection with the

Directors
The current Directors and their biographical details are listed on page 33 and all served throughout the year. Under the Articles of Association of the Company each Director must retire from office and stand for re-election by shareholders as a minimum at every third annual general meeting in order to continue to serve as a Director. However in view of the UK Corporate Governance Code and to further increase accountability, all Directors retired at the Annual General Meeting in 2011 and stood for re-election by the shareholders. Going forward all Directors will retire at the Annual General Meeting and will stand for re-election by the shareholder, if they wish to continue to serve as Directors of the Company. Accordingly, those Directors retiring and offering themselves for re-election at the 2012 Annual General Meeting are Messrs A.M. Thomson, S.C. Harris, D.F. Landless, J. Vogelsang, J.A. Biles and Dr K. Rajagopal. The service agreements for Messrs Harris and Landless are terminable by 12 months' notice. The remaining Directors do not have a service agreement with the Company and their appointments are terminable by six months' notice.

Directors' interests in contracts and shares
Details of the Executive Directors' service contracts and details of the Directors' interests in the Company's shares and share incentive plans are shown in the Board report on remuneration on pages 43 to 48. No Director has had any dealings in any shares or options in the Company since 31 December 2011. Qualifying third party indemnity provision (as defined by section 234 of the Companies Act 2006) has remained in force for the Directors for the year ended 31 December 2011 and, as at the date of this report, remains in force for the benefit of the current Directors in relation to certain losses and liabilities which they may incur (or have incurred) to third parties in the course of their duties. Apart from these exceptions, 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.

Potential conflicts of interest
During 2008 the duties owed by directors to a Company were codified and extended by the Companies Act 2006 so that directors not only had to declare actual conflicts of interests in transactions as they arose but also had a duty to avoid such conflicts whether real or potential. Potential conflicts of interest could arise where a single director owes a fiduciary duty to more than one organisation (a 'Situational Conflict') which typically will be the case where a director holds directorships in more than one Company. In order to ensure that each Director was complying with the new duties, each Director provided the Company with a formal declaration to disclose what Situational Conflicts affected him. The Board reviewed the declarations and approved the existence of each declared Situational Conflict until September 2012 and permitted each affected Director to attend and vote at Bodycote Directors' meetings, on the basis that each such Director continued to keep Bodycote's information confidential, and provided overall that such authorisation remained appropriate and in the interests of shareholders. Where such authorisation becomes inappropriate or not in the interests of Bodycote shareholders, the Chairman or the Nomination Committee can revoke an authorisation. No such revocations have been made.

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 strategy, 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. The Group publishes in 11 languages, via the Group intranet, an electronic magazine for all staff detailing the Group's activities, performance and some of its personalities. The Group's Open Door Policy has been relaunched as the Group's Open Door Line under which employee concerns can be voiced over the phone on an anonymous basis in the local language. Approximately 1,600 Bodycote employees are connected to the Bodycote intranet, which improves knowledge of Group activities, and assists greatly with technology exchange and co-ordination. 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 £9,000 (2010: £6,000). There were no political contributions in 2010 or 2011.

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 Group were 46 days (2010: 46 days).

Directors' report continued

Shareholders

An analysis of the Company's shareholders and the shares in issue at 16 February 2012 and details of the interests of major shareholders in voting shares notified to the Company pursuant to chapter 5 of the Disclosure and Transparency Rules are given on page 99.

Auditor

In accordance with the provisions of section 489 of the Companies Act 2006, a resolution for the reappointment of Deloitte LLP as Auditor is to be proposed at the forthcoming Annual General Meeting. Each person who is a Director at the date of approval of this Annual Report confirms that:

- so far as each Director is aware, there is no relevant audit information of which the Company's Auditor is unaware; and
- each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's Auditor is aware of that information.

This statement is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Annual General Meeting

The 2012 Annual General Meeting will be held on 25 April 2012 in accordance with the notice being sent to shareholders with this report.

By order of the Board:

U.S. Ball
Secretary
23 February 2012

Springwood Court
Springwood Close
Tytherington Business Park
Macclesfield
Cheshire
SK10 2XF

Corporate governance statement

Chairman's message
As Chairman I have taken a leading role in shaping the governance agenda at Bodycote and wanted to take this opportunity to address shareholders on what I believe are the important governance developments at Bodycote over the last year.

The policy of the Board is to manage the affairs of the Company in accordance with the principles of corporate governance contained in the UK Corporate Governance Code by promoting wide discussions on topics to which Board members contribute and demonstrate mutual engagement.

We strive to maintain best practice and continually seek to improve our practices for the benefit of our shareholders.

Alan Thomson
Chairman

Governance reporting
Board diversity
Following the publication of the Davies Report on the representation of women on plc boards, our Nominations Committee discussed its recommendation.

Bodycote is a global business with operations in 27 countries and therefore diversity generally is an integral part of how we do business. The Nominations Committee considers diversity when making appointments to the Board, taking into account relevant skills, experience, knowledge, personality, ethnicity and gender. Our prime responsibility, however, is the strength of the Board and our overriding aim in any new appointments must always be to select the best candidate. As, over time, we recruit new members we would expect to address the issue of gender and ethnicity but do not propose to set targets for the percentage of women on our Board in future years.

Female representation on our Executive Committee is currently 20%. We will increase female representation on the Board if appropriate candidates are available when Board vacancies arise. Females represent about 20% of our employees.

Succession planning
Succession planning ensures that appropriate senior leadership resources are in place to achieve Bodycote's strategic objectives. The plans are regularly reviewed by the Nomination Committee.

The Board further develops its knowledge and gains greater visibility of executive talent and management succession by visiting the Group's sites and meeting with key talent and senior executives.

A clear road map for non-executive refreshment has been developed in 2011 and external consultants were appointed.

Board evaluation
During the year, the Board conducted an evaluation of its own performance and that of its committees and individual Directors. The process involved the completion by each Director of a confidential questionnaire in a form consistent with previous years, and including amongst other areas: remit and objectives, Board composition, training and resources, governance, stakeholder engagement, Board procedures and overall effectiveness.

The respective Chairmen analysed the completed questionnaires and summarised the findings in a report for the respective Committee and Board. The Chairman subsequently conducted one-to-one discussions with each of the Board members after which he reported back to the whole Board on the evaluation process. The responses to the questionnaires demonstrated a high degree of consistency and the evaluation process affirmed the Board's confidence in the Group's system of corporate governance. Board members work well together with open discussions being a feature of all debates. Arising from the exercise, the Board has concluded that the focus should be placed on divisional growth strategies, technology development, Safety & Health and sustainability as well as continued training.

Messrs S.C. Harris and D.F. Landless were appraised internally in January and February 2012. The Remuneration and Audit Committees reviewed their own performance in December 2011 and the Nomination Committee reviewed its performance in November 2011.

Led by the Senior Independent Non-Executive Director, the Directors have carried out an evaluation of the Chairman's performance in November 2011.

Compliance reporting
In respect of the financial year 2011 Bodycote's obligation under the Disclosure and Transparency Rules is to prepare a corporate governance statement with reference to The UK Corporate Governance Code issued by the FRC in June 2010 (the 'New Code').

In respect of the year ended 31 December 2011 Bodycote has complied with the provisions of the 2010 Code, with the exception of provision E1.1. The Board has taken the view that generally it is the responsibility of the Chief Executive and the Finance Director to manage relationships with institutional investors. The Chairman also meets 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 Board expect the Senior Independent or other Non-Executive Directors to become involved, notwithstanding that the 2010 Code specifies attendance of the Senior Independent Non-Executive Director at meetings with major shareholders. Regular feedback by the Company's advisers on investor meetings and results presentations is circulated to all Directors.

Apart from this distinct area, Bodycote was in compliance with the provisions of the 2010 Code throughout 2011.

Operation of the code
Taken together with the Audit Committee Report, the Nomination Committee Report and the Board report on remuneration presented on pages 37 to 48, this statement explains how Bodycote has applied the principles of good corporate governance set out in the 2010 Code.

Corporate governance statement continued

Leadership
The Board is responsible to shareholders for good corporate governance, setting the Company's strategic objectives, values and standards and ensuring the necessary resources are in place to achieve the objectives.

The Board met on nine occasions during 2011, including a specific meeting to review and update the Company's long-term strategy.

The Board of Directors comprises six members, of whom four are Non-Executive Directors and two are Executive Directors led by the Company's part-time Non-Executive Chairman, Mr A.M. Thomson, who also chairs the Nomination Committee. The Chief Executive is Mr S.C. Harris and the Senior Independent Non-Executive Director is Mr J. Vogelsang, who also chairs the Remuneration Committee. The Audit Committee is chaired by Mr J.A. Biles. Brief biographical details of all Directors are given on page 33. The Board makes visits to UK and overseas facilities. Certain defined powers and issues are reserved for the Board to decide, inter alia:

- Strategy;
- Approval of financial statements and circulars;
- Capital projects, acquisitions and disposals;
- Annual budgets;
- Directors' appointments, service agreements, remuneration and succession planning;
- Policies for financial statements, treasury, safety, health and environment, donations;
- Committees' terms of reference;
- Board and committee chairmen and membership;
- Investments;
- Equity and bank financing;
- Internal control and risk management;
- Corporate governance;
- Key external and internal appointments; and
- Employee share incentives and pension arrangements.

In advance of Board meetings Directors are supplied with up-to-date information about the trading performance of each operating division and sub-division, 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 division, in terms of severity and frequency rates for accidents at work.

Where required, a Director may seek independent professional advice, the cost of which is reimbursed by 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. However, this has been superseded by the Directors' decision to stand for yearly re-election. Non-Executive Directors, including the Chairman, are appointed for fixed terms not exceeding three years from the date of first election by shareholders, after which the appointment may be extended by mutual agreement. A statement of the Directors' responsibilities is set out on page 49. The Board also operates four committees. These are the Nomination Committee, the Remuneration Committee and the Audit Committee.

So that the necessary actions can be taken promptly, a Finance Committee, comprising the Chairman (or failing him any other Non-Executive Director), the Chief Executive and the Finance Director operates between the dates of scheduled Board meetings and is authorised to make decisions, within limits defined by the Board, in respect of certain finance, treasury, tax or investment matters.

Independence of Non-Executive Directors
The Board considers that Messrs J.A. Biles, J. Vogelsang and Dr K. Rajagopal are all independent for the purposes of the Code.

Commitment
Attendance of Directors at regular scheduled meetings of the Board and its Committees is shown in the table below:

	Full Board		Audit Committee		Remuneration Committee		Nomination Committee	
Director	Eligible	Attended	Eligible	Attended	Eligible	Attended	Eligible	Attended
A.M. Thomson	9	9	–	–	6	6	2	2
S.C. Harris	9	9	–	–	–	–	2	2
J. Vogelsang	9	9	4	4	6	6	2	2
J.A. Biles	9	9	4	4	6	6	2	2
K. Rajagopal	9	9	4	4	6	6	2	2
D.F. Landless	9	9	–	–	–	–	–	–

All Directors attended the maximum number of scheduled Audit, Remuneration and Nomination Committee meetings that they were scheduled to attend. All Directors attended the maximum number of scheduled Board meetings. In addition by invitation Messrs Thomson, Harris and Landless attended the whole or part of all the meetings of the Audit, Nomination and Remuneration Committees.

Proposals for re-election

The Board decided, in line with the New Code, that all Directors will retire annually and, other than in the case of any Director who has decided to stand down from the Board, will offer themselves for re-election at the Annual General Meeting. Accordingly Messrs A.M. Thomson, S.C. Harris, D.F. Landless, J. Vogelsang, J.A. Biles and Dr K. Rajagopal will stand for re-election and the Board recommends to shareholders that they re-elect all the Directors.

The performance of each Director was evaluated as indicated above and the Board confirms in respect of each that their performance continues to be effective and that each continues to demonstrate commitment to his respective role.

Internal control and risk management

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 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 and with revised guidance on internal control published October 2005. The Board's monitoring covers all controls, including financial, operational and compliance controls and risk management systems. 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.

The Group prepares a comprehensive annual budget which is closely monitored and updated quarterly. The Group's authority matrix clearly sets out authority limits for those with delegated responsibility and specifies what can only be decided with central approval.

The Internal Audit department monitors the Group's internal financial control system and its reviews are conducted on the basis of plans approved by the Audit Committee, to which Internal Audit reports are submitted on a regular basis.

Each Division provides assurance on specified financial and non-financial controls and these are reported twice-yearly to the Audit Committee.

During 2011, in compliance with provision C.2.1, management performed a specific assessment for the purpose of this annual report. Management's assessment, which has been reviewed by the Audit Committee and the Board, included a review of all Group and operational risks (by means of workshops and interviews) and the risks identified (both before and after mitigating actions) were assessed using conventional impact and likelihood scoring, and further assessment, monitoring and review work was scheduled for 2012. The Group's risk management framework is progressively being embedded throughout the Group. The principal risks and uncertainties affecting the Group are shown in the Finance Director's report on page 26. No significant previously unidentified risks were uncovered as part of this process, and the necessary actions have been or are being taken to remedy any significant failings or weaknesses identified as part of the reviews.

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. In November 2011 the Group held a Capital Markets day, informing analysts and major shareholders of the Group's strategy and progress. The business of the Annual General Meeting comprises a review of the Group's operations for the benefit of shareholders attending. In addition, internet users are 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 access recent announcements and copies of results presentations and can enrol to hear live presentations. On a regular basis, Bodycote's financial advisers, corporate brokers and financial public relations consultants provide the Directors with opinion surveys from analysts and investing institutions following visits and meetings with the Chief Executive and Finance Director. 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, such as the introduction of long-term incentive and share matching schemes in 2006 and changes thereto in 2009 and 2010, the Company has sought and will continue to seek the views of leading investors.

By order of the Board:

U.S. Ball
Secretary
23 February 2012

Springwood Court
Springwood Close
Tytherington Business Park
Macclesfield
Cheshire SK10 2XF

Report of the Nomination Committee

Role of the Nomination Committee

The Nomination Committee is a sub-committee of the Board whose purpose is to advise the Board on the appointment and, if necessary, dismissal of Executive and Non-Executive Directors. The full terms of reference of the Nomination Committee are provided on the Company's website.

Composition of the Nomination Committee

The Nomination Committee comprises all the independent Non-Executive Directors together with the Chairman and Chief Executive. The quorum necessary for the transaction of business is two, each of whom must be an independent Non-Executive Director.

The Chairman acts as the Chairman of the Committee, although the Chairman may not chair the Committee when it is dealing with the matter of succession to the Chairmanship of the Company. Only members of the Committee have the right to attend the Committee meetings. However, other individuals and external advisers may be invited to attend for all or part of any meeting as and when appropriate.

The Company Secretary is secretary to the Committee.

The Committee has the authority to seek any information that is required from any officer or employee of the Company or its subsidiaries. In connection with its duties, the Committee is authorised by the Board to take such independent advice (including legal or other professional advice, at the Company's expense) as it considers necessary, including requests for information from, or commissioning investigations, by external advisers.

Main activities of the Nomination Committee

Mr A.M. Thomson chairs the Nomination Committee which also comprises Messrs J.A. Biles, J. Vogelsang, S.C. Harris and Dr K. Rajagopal.

In 2011 the Committee discussed succession planning, board diversity and assessment of the Chief Executive and other senior executives. In particular, the need to broaden the Board membership with respect to gender, ethnicity and age was discussed and we have engaged an international search firm to identify suitable candidates with relevant experience. The Committee considered and authorised the potential conflicts of interest which might arise where a Director has fiduciary responsibilities in respect of other organisations. The committee understands that no inappropriate conflicts of interest exist. The Committee also assigned the Chairman to review and agree with the Chief Executive the Group's objectives for the forthcoming year.

In November 2011 the Nomination Committee, with both Executive Directors in attendance, carried out a formal evaluation of the Board's performance, and reviewed the Board's size and composition, the frequency of and process for Board and committee meetings, and best practice for the handling of a number of Board issues including the review of strategy, letters of appointment and Directors' training.

On behalf of the Committee:

A.M. Thomson
Chairman of the Nomination Committee
23 February 2012

Report of the Audit Committee

The Audit Committee is a sub-committee of the Board whose main role is to encourage and safeguard the highest standards of integrity, financial reporting, risk management and internal controls.

The Committee's responsibilities are set out in written terms of reference which include all matters indicated by the Disclosure and Transparency Rules and the Code, which are available for inspection on the Company's website, and include reviewing the form and content of interim and year end accounts and results announcements, risk management and internal financial controls, monitoring internal audit, considering the appointment of the external auditor and agreeing the nature and scope of their work and monitoring and reviewing their independence, objectivity and effectiveness.

Composition of the Audit Committee

The Audit Committee comprises Messrs J.A. Biles, J. Vogelsang and Dr K. Rajagopal who are all independent Non-Executive Directors. Their biographical details are set out on page 33 and their remuneration is shown on page 47. The Chairman of the Audit Committee since 16 August 2007 has been Mr J.A. Biles, who was appointed a Director on that date, following a recommendation from the Nomination Committee. The Audit Committee Chairman is considered to have recent and relevant financial experience. Mr Biles is a chartered accountant, who served as a plc finance director (FKI plc from 1998 to 2004 and Chubb Security plc from 1991 to 1997) and until its takeover in January 2012 was also the Chairman of the Audit Committee of Charter International plc (2005). The Company Secretary is secretary to the Audit Committee. The Chairman, Chief Executive, Finance Director, Senior Internal Auditor, Group Financial Controller, Vice-President (Risk and Business Processes), Group Treasurer, Head of Tax, other senior finance personnel and external auditors attend Audit Committee meetings as appropriate by invitation.

Main activities of the Audit Committee

The Audit Committee met four times during 2011, and in February 2012 to consider this financial report and all Committee members attended the maximum number of meetings they were scheduled to attend. The Committee also meets separately with the Vice-President (Risk and Business Processes) and with the external auditor, without management being present, after the end of most formal meetings.

In addition, the Committee Chairman has preparatory meetings with the external auditor and, where necessary, with Group senior management, prior to committee meetings. At their meetings, the Audit Committee considers an agenda of items including the minutes of the last meeting and a list of action points from previous meetings, to ensure that these are progressed. In addition, a number of specific items were reviewed:

- At their February and July meetings, the Audit Committee reviewed respectively the preliminary and interim announcements of results and the draft reports and accounts for the financial year and the half year. On these occasions the Committee reviewed reports from the external auditor, identifying any accounting or judgemental items requiring its attention (including approval of the processes, assumptions and outcomes to assess fair values and impairments) and commenting on risk management and control matters. Specific areas of judgement discussed and challenged by the committee, included:
  - Impairment of goodwill, intangible and tangible fixed assets, including an assessment of the discount rates used, and the appropriateness of specific risk factors applied to cash generating units and the adequacy of sensitivities applied
  - Environmental costs, including the adequacy of the Group's provisions
  - Remaining restructuring actions, and the appropriateness of outstanding provisions
  - Claims provisions and litigation, including the adequacy and valuation of provisions
  - Accounting for employee share schemes
  - Adequacy of revenue recognition policies
  - Accounting for taxation
  - Validity of the Going Concern assumption used in psion [illegible]

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Board report on remuneration

The Remuneration Committee

This report sets out the policy and disclosures on Directors' remuneration as required by the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 issued under the Companies Act 2006 (the 'Act'). In accordance with the Act, a resolution to approve this report will be proposed at the forthcoming Annual General Meeting of the Company.

The Remuneration Committee (the 'Committee') determines the remuneration of Executive Directors and senior executives, and the terms of the service contracts and all other terms and conditions of employment of the Executive Directors.

Committee membership

The members of the Remuneration Committee during 2011 were:

J. Vogelsang (Chairman)

J.A. Biles

A.M. Thomson

Dr K. Rajagopal

The Committee's full terms of reference are available on the Group's website. None of the Committee members has any personal financial interest (other than as a shareholder), conflict of interest, cross-directorships or day-to-day involvement in the running of the business.

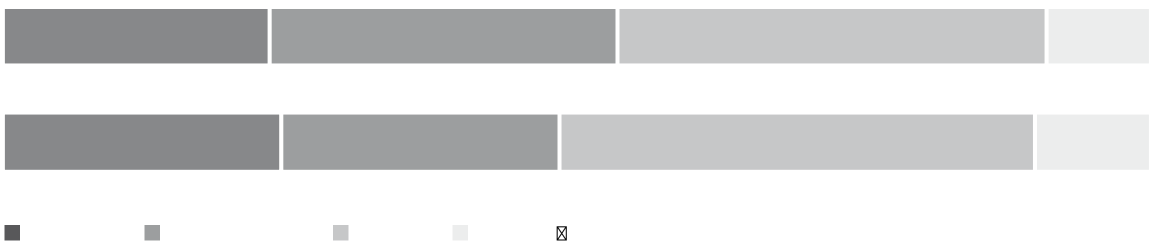
Committee activities

During the year the Committee met six times to consider amongst other matters:

Theme	Agenda items
Best practice	■ The Company's remuneration policy in light of discussions during the Bodycote AGM and the revised ABI guidelines on Executive Remuneration published in October 2011 ■ A review of the current UK corporate governance environment and the implications for the Company
Executive Directors' and senior executives' remuneration	■ Basic salaries payable to each of the Executive Directors ■ The annual bonus and payments for the financial year ended 31 December 2010 ■ The annual bonus structure and performance targets for the financial year ended 31 December 2011 ■ The conditional awards made under the Bodycote Incentive Plan and Bodycote Co-Investment Plan ■ Pension arrangements for senior executives
Reporting	■ Consideration and approval of the remuneration report for 2011

Remuneration policy and structure

The Committee is responsible for remuneration policies that are consistent with the Group's overall business strategy and thereby attract and retain high calibre executives at the same time as delivering value for shareholders. Remuneration includes both fixed and variable elements of pay, variable pay being clearly linked to superior performance. The charts below demonstrate the balance between fixed and variable performance based pay for each Executive Director based on the maximum entitlements.



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The Committee also has discretion to reduce the awards by up to 10% if the safety performance is less than targeted.

For 2012 the Committee has determined that the bonus opportunity for Executive Directors and senior executives will again be contingent on meeting targets relating to safety, operating profit, cash management and personal objectives. No bonus will be paid for the cash management element unless the level of operating profit achieved is at least 95% of target.

Bodycote Incentive Plan (BIP)
The Company operates the BIP under which Executive Directors and senior executives received a conditional award of Bodycote shares up to a maximum of 175% of base salary. Vestings of awards are based upon two performance measures, over a three year period.

50% of the award is subject to a return on capital employed ("ROCE") performance condition and 50% of the award is subject to an earnings per share ("EPS") performance condition.

	ROCE		EPS	
Award year	**Threshold performance**	**Maximum performance**	**Threshold performance**	**Maximum performance**
2009	10%	14.6%	16.0p	28.0p
2010	11.1%	16%	19.8p	31.0p
2011	14.6%	20%	28.3p	39.8p
2012	18.7%	23%	36.2p	62.15p

In the event that threshold performance for both EPS and ROCE is not achieved none of the conditional awards will vest. Regardless of ROCE performance, should EPS at the end of the performance period be below 16p for any BIP awards made between 2009 and 2011 and below 31.1p for awards made in 2012, then no award shall vest.

The Committee intends to use the ROCE and EPS measures in combination for BIP Awards made in 2012. Details of the awards made under the BIP are provided on page 47. Following completion of the performance period on 31 December 2011, the Remuneration Committee has determined that 175% of the BIP awards made in 2009 shall vest (2008: nil). In reaching this conclusion, the Remuneration Committee took into account specific audit procedures carried out by the external auditors.

During the financial year the Remuneration Committee also approved the introduction of the Bodycote Investment Incentive Plan which provided a long-term savings vehicle for senior executives which aids retention whilst recognising the needs for flexibility in long-term wealth planning. Company contributions are discretionary and vary year on year. Contributions for the Executive Directors are shown on page 47.

Bodycote Co-investment Plan ('CIP')
The CIP provides a link between the Company's short and long-term incentive arrangements and permits executives to invest in shares up to a value equivalent to 40% of net basic salary. The CIP provides for the grant of awards of matching shares to participants on an annual basis in a maximum ratio of 1:1 to the gross investment made in deferred shares. Deferred shares must be held for three years and matching shares are subject to an absolute Total Shareholder Return ('TSR') target. The threshold target for CIP matching awards is TSR growth of not less than 4% per annum compound in excess of growth in the Consumer Prices Index (CPI) for a threshold matching ratio of 1:2. 10% per annum compound growth in excess of growth in the CPI will be required for a vesting matching ratio of 1:1.

Details of the awards under the CIP together with awards made under the legacy arrangement known as the Bodycote Share Match Plan ('BSMP') and the joining award made to Mr Harris in October 2008 are noted on page 48. Following completion of the performance period on 31 December 2011, the Remuneration Committee has determined that 100% of the matching awards made in 2009 under the BSMP and 100% of the joining award shall vest.

Advisers
During the year the Committee has taken independent advice from Ernst & Young LLP on remuneration together with legal advice from Eversheds. Fees relating to the Ernst & Young LLP services were £60,000, which included, amongst other things, benchmarking of executive salaries, advice on the impact of changes to the UK pensions regime, implementation of an approved French sub-plan, advice relating to the accounting costs of the Company's share plans and the transfer of the Company's employee benefit trust to a new trustee. Fees for Eversheds legal advice were £5,000 which related to the review of non-executive directors' letters of appointment and claw back.

Total Shareholder Return
The graph on page 47 illustrates the Company's TSR performance since 2006 relative to the FTSE All Share Industrial Index of which the Company is a component part. This sector is considered the most appropriate comparator Group over the five-year period to December 2011. In line with market practice the calculation for TSR assumes reinvestment of dividends and is based on data provided by Datastream.

Board report on remuneration continued

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 the employer at any time, and by payment of one year's remuneration in lieu of notice by the employer. With the exception of David Landless, the Executive Directors do not have a change of control clause. David Landless' service contract was agreed in accordance with what was considered best practice at the time of its execution in 2001 and provides for one year's remuneration on a change of control if his employment is terminated. To the extent that executive contracts are renewed, or new appointments made, the Committee will continue to adopt a policy of best practice when entering into service contracts. In any case legally appropriate factors would be taken into account to mitigate any compensation payment, covering basic salary, annual 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 Harris' service agreement is dated 6 October 2008 and Mr Landless' contract is dated 26 September 2001.

Shareholding policy

In 2005, the Committee introduced a shareholding retention policy under which Executive Directors and other senior executives are expected, within five years of that date or commencement of employment if later, to build up a shareholding in the Company. In respect of Executive Directors the expectation is to hold at least 100% of basic salary. As at 31 December 2011 the Committee is satisfied that the Executive Directors have fulfilled this requirement.

Fees retained for external non-executive directorships

Executive Directors may hold positions in other companies as non-executive directors. Stephen Harris was the only Executive Director with such a position held at Mondi plc from 1 March 2011 and in accordance with Group policy he retained fees for the year of £59,035.

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 which have been agreed in accordance with best practice which set out the terms of his appointment, including membership of Board committees, the fees to be paid and the time commitment expected from the Director. The letter also covers such matters as the confidentiality of information and Bodycote's share dealing code. During the year letters of appointment for the Chairman and each Non-Executive Director were renewed, each for a period of no longer than three years. Each is terminable under the Company's Articles of Association, the Act, by the Director's resignation or otherwise on six months' notice if termination occurs before expiry of the term. To determine the fees it pays to Non-Executive Directors, the Board takes into account the need to attract individuals of appropriate calibre and expertise, the fees paid to Non-Executive Directors by other companies of a similar size and scale of operations and the time commitment attached to each appointment. The Board keeps fees under review. The Chairman and Non-Executive Directors are not entitled to any pension or other employment benefits or to participate in any incentive scheme.

Approved by the Board:

J. Vogelsang
Chairman of the Remuneration Committee
23 February 2012

Emoluments during the year – audited

	Basic salary and fees £000	Benefits £000	Annual bonus £000	Total 2011 £000	Total 2010 £000
Executive Directors					
S.C. Harris*	436	26	538	**1,000**	818
D.F. Landless**	279	28	259	**566**	557
	715	54	797	**1,566**	1,375
Non-Executive Directors					
A.M. Thomson	140	–	–	**140**	130
J. Vogelsang	51	–	–	**51**	46
J.A. Biles	51	–	–	**51**	47
K. Rajagopal	43	–	–	**43**	40
	1,000	54	797	**1,851**	1,638

* Stephen Harris waived his right to his 2011 and 2010 annual bonus prior to determination. The amount of £1m (2010: £818,000) shown as an emolument included a figure of £538,000 (2010: £391,000) contributed to a long term savings vehicle for employees.

** David Landless waived his right to 2% of his 2011 annual bonus prior to determination. The amount of £566,000 shown as an emolument included a figure of £5,180 contributed to a long term savings vehicle for employees.

Directors' interests – audited

The beneficial interest of the Directors and their families in the ordinary shares of the Company are detailed below.

Ordinary shareholdings	31 December 2011 Number of ordinary shares	31 December 2010 Number of ordinary shares
Executive Directors		
S.C. Harris	**160,730**	138,690
D.F. Landless	**136,284**	134,948
Non-Executive Directors		
A.M. Thomson	**41,841**	41,841
J. Vogelsang	**–**	–
J.A. Biles	**23,157**	23,157
K. Rajagopal	**22,368**	17,368

None of the Directors have a beneficial interest in the shares of any other Group Company, or non-beneficial interest in the Company or any other Group Company.

Directors' interests under the Bodycote Incentive Plan – audited

	Interests as at 1 January 2011	Awarded in year	Lapsed in year	Interests as at 31 December 2011	Market price at award date	Vesting date
S.C. Harris	514,138	–	–	**514,138**	£1.56	February 2012
	391,345	–	–	**391,345**	£1.79	February 2013
	–	234,767	–	**234,767**	£2.98	February 2014
D.F. Landless	132,275	–	132,275	**–**	£1.89	May 2011
	344,215	–	–	**344,215**	£1.56	February 2012
	262,004	–	–	**262,004**	£1.79	February 2013
	–	157,176	–	**157,176**	£2.98	February 2014

Board report on remuneration continued

Directors' interests under the Bodycote Co-Investment Plan (formerly Bodycote Share Match Plan) – audited

	Interests as at 1 January 2011	Awarded / (lapsed) in year*	As at 31 December 2011	Market price at award date	Vesting date
S.C. Harris	142,747	–	**142,747**	£1.40	March 2012
	23,437	–	**23,437**	£1.87	March 2012
	82,942	–	**82,942**	£1.93	May 2013
	–	10,608	**10,608**	£3.75	May 2014
D.F. Landless	8,252	(8,252)	**–**	£1.79	March 2011
	4,480	–	**4,480**	£1.87	March 2012
	8,010	–	**8,010**	£1.89	May 2013
	–	2,783	**2,783**	£3.75	May 2014

* Shares acquired via investment of the net of tax annual bonus under the Co-investment Plan are eligible for a matching award by reference to the gross amount invested.

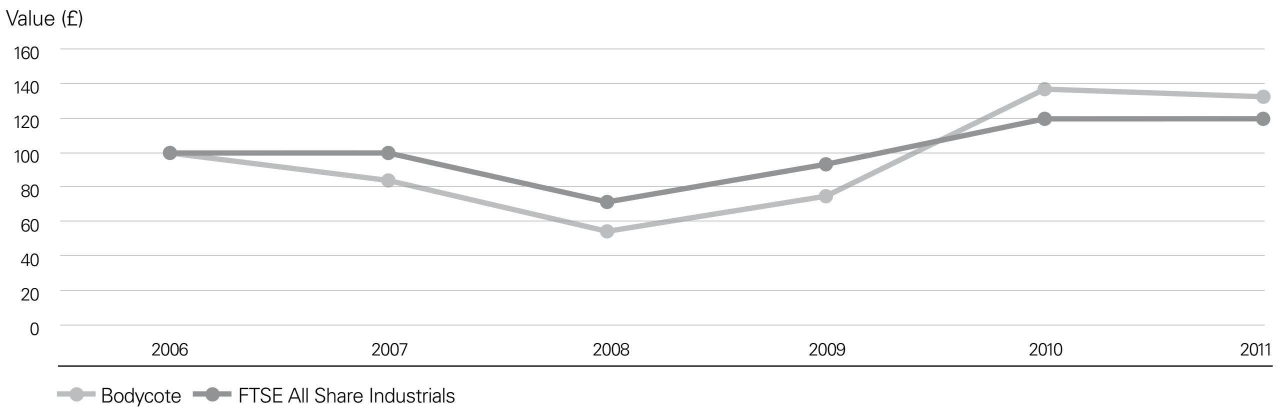
Directors' Pensions – audited

Director	Accrued annual pension at 01/01/11 £000	Transfer value at 01/01/11 £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	Member's contributions £000	Accrued annual pension at 31/12/11 £000	Transfer value at 31/12/11 £000
D.F. Landless	41	686	3.3	1.1	4.4	47	220	17	**45**	**942**

Over the year to 31 December 2011, the Trustee of the Bodycote UK Pension Scheme has reviewed the basis on which transfer values are calculated to allow for the change of statutory indexation from RPI to CPI. The transfer value at 31 December 2011 incorporates these changes. The transfer value at 1 January 2011 does not include any allowance for CPI indexation. For information, had the Trustee reviewed the transfer value basis prior to 1 January 2011, the transfer value quoted at 1 January 2011 would have been £627,000. The inflation used above is a measure consistent with the CPI assumption used in the transfer value basis for the Scheme.

Total Shareholder Return

This graph looks at the value, up to 31/12/11, of £100 invested in Bodycote plc on 31/12/06 compared with that of £100 invested in the FTSE All Share Industries. The points plotted are the values at financial year ends.



Directors' responsibilities statement

Responsibility of Directors for the preparation of the Annual Report and financial statements

The Directors are responsible for preparing the Annual Report, the Board report on remuneration and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Article 4 of the IAS Regulation and have elected to prepare the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the accounts unless they are satisfied that they 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 the parent Company financial statements, the Directors are required to:

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

In preparing the Group financial statements, International Accounting Standard 1 requires that Directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the Company's ability to continue as a going concern.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Responsibility statement of the Directors in respect of the Annual Report and financial statements

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the relevant financial reporting framework, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Chairman's statement, the Chief Executive's report, the Finance Director's report, all the information contained on pages 4 to 48 together comprise the Directors' report for the year ended 31 December 2011. It includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

This responsibility statement was approved by the Board of Directors on 23 February 2012 and is signed on its behalf by:

S.C. Harris
Chief Executive
23 February 2012

D.F. Landless
Finance Director
23 February 2012

Independent auditor's report

To the Members of Bodycote plc

We have audited the group financial statements of Bodycote plc for the year ended 31 December 2011, which comprise the Consolidated income statement, the Consolidated statement of comprehensive income, the Consolidated balance sheet, the Consolidated cash flow statement, the Consolidated statement of changes in equity, the Statement of group accounting policies and the related notes 1 to 30. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor's 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 auditor

As explained more fully in the Directors' responsibilities statement, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the group financial statements:

- give a true and fair view of the state of the group's affairs as at 31 December 2011 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion:

- the part of the Board Report on Remuneration to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' report for the financial year for which the group financial statements are prepared is consistent with the group financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statement contained within the Group Review in relation to going concern;
- the part of the Corporate Governance Statement relating to the company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the board on directors remuneration.

Other matter

We have reported separately on the parent company financial statements of Bodycote plc for the year ended 31 December 2011.

Nicola Mitchell

Nicola Mitchell (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Manchester, UK
23 February 2012

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Consolidated balance sheet

At 31 December 2011

	Note	2011 £m	2010 £m
Non-current assets			
Goodwill	11	**102.6**	107.7
Other intangible assets	12	**8.9**	10.4
Property, plant and equipment	13	**443.9**	458.0
Other investments	14	**0.8**	0.5
Deferred tax assets	21	**52.3**	48.3
Trade and other receivables	17	**1.9**	2.6
		610.4	627.5
Current assets			
Inventories	15	**16.7**	14.4
Finance lease receivables	16	**–**	0.4
Current tax assets		**2.4**	–
Trade and other receivables	17	**105.8**	99.2
Cash and bank balances	17	**18.1**	23.5
Assets held for sale	18	**5.3**	6.2
		148.3	143.7
Total assets		**758.7**	771.2
Current liabilities			
Trade and other payables	23	**126.9**	120.4
Current tax liabilities		**11.4**	9.6
Obligations under finance leases	22	**0.2**	0.4
Borrowings	19	**10.8**	8.9
Derivative financial instruments	20	**0.1**	–
Provisions	24	**10.6**	14.0
		160.0	153.3
Net current liabilities		**(11.7)**	(9.6)
Non-current liabilities			
Borrowings	19	**6.5**	64.8
Retirement benefit obligations	30	**13.5**	11.6
Deferred tax liabilities	21	**79.5**	73.1
Obligations under finance leases	22	**0.5**	0.7
Derivative financial instruments	20	**0.2**	–
Provisions	24	**11.4**	12.8
Other payables	23	**4.5**	4.1
		116.1	167.1
Total liabilities		**276.1**	320.4
Net assets		**482.6**	450.8
Equity			
Share capital	25	**33.0**	32.8
Share premium account		**176.9**	176.3
Own shares		**(6.7)**	(8.0)
Other reserves		**143.1**	138.1
Hedging and translation reserves		**24.7**	36.0
Retained earnings		**110.3**	73.9
Equity attributable to equity holders of the parent		**481.3**	449.1
Non-controlling interests		**1.3**	1.7
Total equity		**482.6**	450.8

The financial statements of Bodycote plc, registered number 519057, were approved by the Board of Directors and authorised for issue on 23 February 2012.

They were signed on its behalf by:

S. C. Harris
D. F. Landless } Directors

Consolidated cash flow statement

For the year ended 31 December 2011

	Note	2011 £m	2010 £m
Net cash from operating activities	26	**119.8**	95.6
Investing activities			
Purchases of property, plant and equipment		**(43.6)**	(35.2)
Proceeds on disposal of property, plant and equipment and intangible assets		**1.5**	1.4
Purchases of intangible fixed assets		**(2.4)**	(2.0)
Acquisition of business / purchase of non-controlling interest / investments		**(1.4)**	(0.8)
Net cash used in investing activities		**(45.9)**	(36.6)
Financing activities			
Interest received		**0.6**	0.3
Interest paid		**(5.1)**	(5.8)
Dividends paid		**(17.4)**	(20.9)
Dividends paid to a non-controlling shareholder		**(0.1)**	(0.1)
Repayments of bank loans		**(59.3)**	(34.0)
Payments of obligations under finance leases		**(0.4)**	(1.3)
New bank loans raised		**0.4**	3.2
New obligations under finance leases		**–**	0.2
Proceeds on issue of ordinary share capital		**0.8**	0.6
Own shares purchased / settlement of share options		**(1.1)**	(0.7)
Net cash used in financing activities		**(81.6)**	(58.5)
Net (decrease) / increase in cash and cash equivalents		**(7.7)**	0.5
Cash and cash equivalents at beginning of year		**17.6**	16.3
Effect of foreign exchange rate changes		**(0.4)**	0.8
Cash and cash equivalents at end of year	26	**9.5**	17.6

Consolidated statement of changes in equity

For the year ended 31 December 2011

	Share capital £m	Share premium account £m	Own shares £m	Other reserves £m	Hedging and translation reserves £m	Retained earnings £m	Equity attributable to equity holders of the parent £m	Non-controlling interests £m	Total equity £m
1 January 2010	32.5	176.0	(7.3)	134.1	26.3	58.7	420.3	2.3	422.6
Net profit for the year	–	–	–	–	–	27.6	27.6	0.1	27.7
Exchange differences on translation of overseas operations	–	–	–	–	10.7	–	10.7	–	10.7
Movement on hedges of net investments	–	–	–	–	(1.0)	–	(1.0)	–	(1.0)
Reduction of revaluation surplus	–	–	–	(0.1)	–	–	(0.1)	–	(0.1)
Actuarial gains on defined benefit pension schemes net of deferred tax	–	–	–	–	–	2.8	2.8	–	2.8
Total comprehensive income for the year	–	–	–	(0.1)	9.7	30.4	40.0	0.1	40.1
Issue of share capital	0.3	0.3	–	–	–	–	0.6	–	0.6
Acquired in the year / settlement of share options	–	–	(0.7)	–	–	–	(0.7)	–	(0.7)
Share-based payments	–	–	–	4.1	–	0.2	4.3	–	4.3
Dividends paid	–	–	–	–	–	(15.4)	(15.4)	(0.1)	(15.5)
Purchase of non-controlling interest	–	–	–	–	–	–	–	(0.6)	(0.6)
31 December 2010	**32.8**	**176.3**	**(8.0)**	**138.1**	**36.0**	**73.9**	**449.1**	**1.7**	**450.8**
Net profit for the year	**–**	**–**	**–**	**–**	**–**	**55.8**	**55.8**	**0.2**	**56.0**
Exchange differences on translation of overseas operations	**–**	**–**	**–**	**(0.2)**	**(11.7)**	**–**	**(11.9)**	**(0.4)**	**(12.3)**
Movement on hedges of net investments	**–**	**–**	**–**	**–**	**0.4**	**–**	**0.4**	**–**	**0.4**
Realisation of revaluation surplus	**–**	**–**	**–**	**(0.2)**	**–**	**0.2**	**–**	**–**	**–**
Actuarial losses on defined benefit pension schemes net of deferred tax	**–**	**–**	**–**	**–**	**–**	**(1.5)**	**(1.5)**	**–**	**(1.5)**
Total comprehensive income for the year	**–**	**–**	**–**	**(0.4)**	**(11.3)**	**54.5**	**42.8**	**(0.2)**	**42.6**
Issue of share capital	**0.2**	**0.6**	**–**	**–**	**–**	**–**	**0.8**	**–**	**0.8**
Acquired in the year / settlement of share options	**–**	**–**	**1.3**	**–**	**–**	**(2.4)**	**(1.1)**	**–**	**(1.1)**
Share-based payments	**–**	**–**	**–**	**5.4**	**–**	**–**	**5.4**	**–**	**5.4**
Deferred tax on share-based payment transactions	**–**	**–**	**–**	**–**	**–**	**1.7**	**1.7**	**–**	**1.7**
Dividends paid	**–**	**–**	**–**	**–**	**–**	**(17.4)**	**(17.4)**	**(0.1)**	**(17.5)**
Purchase of non-controlling interest	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(0.1)**	**(0.1)**
31 December 2011	**33.0**	**176.9**	**(6.7)**	**143.1**	**24.7**	**110.3**	**481.3**	**1.3**	**482.6**

Included in other reserves is the capital redemption reserve arising on redemption of the Group's B shares of £129.4m (2010: £129.4m) and the share-based payments reserve of £11.9m (2010: £6.6m).

The own shares reserve represents the cost of shares in Bodycote plc purchased in the market. At 31 December 2011 5,089,830 (2010: 3,837,581) ordinary shares of 17 3 / 11p each were held by the Bodycote International Employee Benefit Trust to satisfy share-based payments under the Group's incentive schemes (see note 28).

Group accounting policies

Year ended 31 December 2011

Basis of accounting

The financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS). The financial statements have also been prepared in accordance with IFRS adopted by the European Union and therefore the Group financial statements comply with article 4 of EU IAS Regulation as adopted for use in the EU.

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 (IFRIC). 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.

The financial statements have been prepared on the historical cost basis, with the exception of accounting for certain financial instruments. Historical cost is generally based on the fair value of the consideration given in exchange for the assets. The principal accounting policies adopted are set out below.

Adoption of new and revised standards

The following new and revised Standards and Interpretations have been adopted in the current year. Their adoption has not had any significant impact on the amounts reported in these financial statements but, with the exception of the amendment to IFRS 1, may impact the accounting or disclosure for future transactions and arrangements.

IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*

The Interpretation provides guidance on the accounting for 'debt for equity swaps' from the perspective of the borrower.

The following amendments were made as part of Improvements to IFRSs (2010):

Amendment to IFRS 3 *Business Combinations*

IFRS 3 has been amended such that only those non-controlling interests which are current ownership interests and which entitle their holders to a proportionate share of net assets upon liquidation can be measured at fair value or the proportionate share of net identifiable assets. Other non-controlling interests are measured at fair value, unless another measurement basis is required by IFRSs.

Amendment to IFRS 7 *Financial Instruments: Disclosures*

The amendment clarifies the required level of disclosure around credit risk and collateral held and provides relief from disclosure of renegotiated financial assets. The impact of this amendment has been to reduce the level of disclosure on collateral that the entity holds as security on financial assets that are past due or impaired.

Amendment to IFRS 1 *Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters*

The amendment provides a limited exemption for first-time adopters from providing comparative fair-value hierarchy disclosures under IFRS 7.

IAS 24 (2009) *Related Party Disclosures*

The revised Standard has a new, clearer definition of a related party, with inconsistencies under the previous definition having been removed.

Amendment to IAS 32 *Classification of Rights Issues*

Under the amendment, rights issues of instruments issued to acquire a fixed number of an entity's own non-derivative equity instruments for a fixed amount in any currency and which otherwise meet the definition of equity are classified as equity.

Amendments to IFRIC 14 *Prepayments of a Minimum Funding Requirement*

The amendments now enable recognition of an asset in the form of prepaid minimum funding contributions.

Going concern

The Directors have at the time of approving the financial statements a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Finance director's report on page 25.

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.

The results of subsidiaries acquired or disposed 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.

Group accounting policies continued

Year ended 31 December 2011

Non-controlling interests in subsidiaries are identified separately from the Group's equity therein. Those interests of non-controlling shareholders that are present ownership interests entitling their holders to a proportionate share of net assets upon liquidation may initially be measured at fair value or at the non-controlling interests' proportionate share of the fair value of the acquiree's identifiable net assets. The choice of measurement is made on an acquisition-by-acquisition basis. Other non-controlling interests are initially measured at fair value. Subsequent to acquisition, the carrying amount of non-controlling interests is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity. Total comprehensive income is attributed to non-controlling interests even if this results in the non-controlling interests having a deficit balance.

Changes in the Group's interests in subsidiaries that do not result in a loss of control are accounted for as equity transactions. The carrying amount of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the Company.

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), less liabilities of the subsidiary and any non-controlling interests. Amounts previously recognised in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred directly to retained earnings) in the same manner as would be required if the relevant assets or liabilities are disposed of. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 Financial Instruments: Recognition and Measurement or, when applicable, the costs on initial recognition of an investment in an associate or jointly controlled entity.

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 an associate in excess of the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate) are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the associate at the date of acquisition is recognised as goodwill. The goodwill is included within the carrying amount of the investment. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities 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 in a business combination is recognised as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the cost of acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of a subsidiary or associate at the date of acquisition. If after restatement, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

Goodwill is not amortised but is reviewed for impairment at least annually. For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units expected to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment at least annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to acquired intangibles, followed by the other tangible assets of the unit. An impairment loss recognised for goodwill is not reversed in a subsequent period.

On disposal of a subsidiary or associate, 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. Revenue is recognised on the completion of services rendered.

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. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Gains and losses arising on retranslation are included in net profit or loss for the period.

Exchange differences are recognised in profit or loss in the period in which they arise except for:

- Exchange differences on transactions entered into to hedge certain foreign currency risks (see below under financial instruments / hedge accounting); and
- Exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation) which are recognised initially in the consolidated statement of comprehensive income and reclassified from equity to profit or loss on disposal or partial disposal of the net investment.

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. Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

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.

Exceptional items
Exceptional items consist of amortisation of acquired intangibles, impairment charges, and other one off items which the Group considers significant for separate disclosure.

Discontinued operations
In accordance with IFRS 5 'Non-current Assets Held for Sale and Discontinued Operations', the Group has separately disclosed the results of the Testing division as discontinued following the disposal of the business in October 2008, and subsequent provision adjustment during 2010.

Group accounting policies continued

Year ended 31 December 2011

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 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 consolidated statement of comprehensive income.

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 adjusted for unrecognised past service cost, and as reduced by the fair value of the scheme assets. Any asset resulting from this calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the scheme.

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.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set-off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

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, less their residual values, 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.

Assets in the course of construction are carried at cost, plus appropriate borrowing costs, less any recognised impairment loss. Depreciation commences when the assets are ready for their intended use.

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.

Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables'. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment. Interest income is recognised by applying the effective interest rate, except for trade receivables, which 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 in 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.

Bank borrowings

Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of transaction costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accruals basis to the income statement using the 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.

Other financial liabilities

Other financial liabilities are not interest-bearing and are stated at their nominal value.

Derecognition of financial liabilities

The Group derecognises financial liabilities when, and only when, the Group's obligations are discharged, cancelled or they expire.

Equity instruments

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

Impairment of financial assets

Financial assets are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

Objective evidence of impairment could include:

- significant financial difficulty of the customer or counterparty; or
- default or delinquency in payments.

For certain categories of financial asset, such as trade receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with default on receivables.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectable, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

Group accounting policies continued

Year ended 31 December 2011

Derivative financial instruments

The Group uses derivative financial instruments, in particular interest rate swaps, foreign currency swaps and forward exchange contracts, to manage the financial risks arising from the business activities and the financing of those activities. The Group does not use derivative financial instruments for speculative purposes.

The use of financial derivatives is governed by the Group's policies approved by the Board of Directors, which provide written principles on the use of financial derivatives.

Derivative financial instruments are recognised as assets and liabilities measured at their fair value on the balance sheet date. Changes in the fair value of any derivative instruments that do not fulfil the criteria for hedge accounting contained in IAS 39 are recognised immediately in the income statement. A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months.

Hedge accounting

The Group uses foreign currency debt and cross currency swaps to hedge its exposure to changes in the underlying net assets of overseas operations arising from foreign exchange rate movements.

The Group maintains documentation of the relationship between the hedged item and the hedging instrument at the inception of a hedging transaction together with the risk management objective and the strategy underlying the designated hedge. The Group also documents its assessment, both at the inception of the hedging relationship and subsequently on an ongoing basis, of the effectiveness of the hedge in offsetting movements in the fair values or cash flows of the hedged items.

When hedge accounting is used, the relevant hedging relationships are classified as fair value hedges, cash flow hedges or net investment hedges.

Note 20 sets out the details of the fair values of the derivative instruments used for hedging purposes.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedged item attributable to the hedged risk are recognised in the line of the income statement relating to the hedged item.

Cash flow hedge

Cash flow hedging matches the cash flows of hedged items against the corresponding cash flow of the derivative. The effective part of any gain or loss on the derivative is recognised directly in other comprehensive income and the hedged item is accounted for in accordance with the policy for that financial instrument. Any ineffective part of any gain or loss 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. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to net profit or loss for the period.

Net investment hedge

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. To the extent the hedge is effective, changes in the fair value of the hedging instrument arising from the hedged risk are recognised in the consolidated statement of comprehensive income and accumulated in the hedging and translation reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement and is included in other operating expenses.

Gains and losses accumulated in equity are included in the income statement in the event that the foreign operation is disposed of.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, when it is probable that the Group will be required to settle that obligation and when a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

Provisions for restructuring costs are recognised when the Group has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it.

The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring which are those amounts that are both necessarily entailed by the restructuring and not associated with the ongoing activities of the entity.

Share-based payments

The Group has applied the requirements of IFRS 2 'Share-based Payment'.

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. At each balance sheet date, the Group revises its estimate of the number of equity instruments expected to vest as a result of the effect of non-market based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimates with a corresponding adjustment to the equity-settled employee benefits reserve.

Critical judgements in applying the Group's accounting policies

In the process of applying the Group's accounting policies, which are described above, the directors have 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 and fixed assets

Determining whether goodwill and fixed assets are impaired requires an estimation of the value in use of the cash-generating units to which the assets have 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. The carrying amount of goodwill at the balance sheet date was £102.6m, after an impairment loss of £3.7m was recognised in 2011. Further details are provided in note 11.

Retirement benefit schemes

Accounting for retirement benefit schemes under IAS 19 requires an assessment of the future benefits payable in accordance with actuarial assumptions, which are set out in note 30.

Taxation

The Group is subject to taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for tax. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current tax provision, deferred tax provisions and income statement in the period in which such determination is made.

General information

Bodycote 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 33. The nature of the Group's operations and its principal activities are set out on page 34 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 Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

- IFRS 1 (amended) — Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters
- IFRS 7 (amended) — Disclosures – Transfers of Financial Assets
- IFRS 9 — Financial Instruments
- IFRS 10 — Consolidated Financial Statements
- IFRS 11 — Joint Arrangements
- IFRS 12 — Disclosure of Interests in Other Entities
- IFRS 13 — Fair Value Measurement
- IAS 1 (amended) — Presentation of Items of Other Comprehensive Income
- IAS 12 (amended) — Deferred Tax: Recovery of Underlying Assets
- IAS 19 (revised) — Employee Benefits
- IAS 27 (revised) — Separate Financial Statements
- IAS 28 (revised) — Investments in Associates and Joint Ventures

The directors do not expect that the adoption of the standards listed above will have a material impact on the financial statements of the Group in future periods, except as follows:

- IFRS 9 will impact both the measurement and disclosures of Financial Instruments;
- IFRS 12 will impact the disclosure of interests Bodycote plc has in other entities;
- IFRS 13 will impact the measurement of fair value for certain assets and liabilities as well as the associated disclosures; and
- IAS 19 (revised) will impact the measurement of the various components representing movements in the defined benefit pension obligation and associated disclosures, but not the Group's total obligation. It is likely that following the replacement of expected returns on plan assets with a net finance cost in the income statement, the profit for the period will be reduced and accordingly other comprehensive income increased.

Beyond the information above, it is not practicable to provide a reasonable estimate of the effect of these standards until a detailed review has been completed.

Notes to the consolidated financial statements

Year ended 31 December 2011

1. Revenue

	2011 £m	2010 £m
Continuing operations		
Heat treatment and metal joining, hot isostatic pressing and surface technology services	**570.7**	499.8
Other operating income (see note 3)	**4.5**	2.3
Investment revenue (see note 5)	**0.2**	0.3
Total Revenue (as defined in IAS 18, Revenue)	**575.4**	502.4

2. Business and geographical segments

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the Chief Executive to allocate resources to the segments and to assess their performance.

The Group's reportable segments have been determined in accordance with the activity of the Group, focusing on key market sectors. Principally, this splits the Group into two business areas being:

- Aerospace, Defence & Energy (ADE); and
- Automotive & General Industrial (AGI)

This initial split is determined following consideration of factors including the different customer sets, differing service requirements and different characteristics of business activity. A further split is then made for the geographical divisions of the Group being:

- Western Europe
- North America; and
- Emerging Markets.

Group	ADE 2011 £m	AGI 2011 £m	Head Office and eliminations 2011 £m	Consolidated 2011 £m
Revenue				
Total revenue	233.5	337.2	–	570.7
Result				
Headline operating profit prior to share-based payments and unallocated corporate expenses	53.2	47.8	–	101.0
Share-based payments	(2.1)	(3.1)	(2.0)	(7.2)
Unallocated corporate expenses	–	–	(8.3)	(8.3)
Headline operating profit / (loss)	51.1	44.7	(10.3)	85.5
Amortisation of acquired intangible fixed assets	(0.2)	(0.7)	–	(0.9)
Impairment charge	–	(4.2)	–	(4.2)
Segment result	50.9	39.8	(10.3)	80.4
Investment revenue				0.2
Finance costs				(4.8)
Profit before taxation				75.8
Taxation				(19.8)
Profit for the year				56.0

Inter-segment sales are not material in either year.

The Group does not rely on any individual major customers.

The impairment charge relates to the impairment of goodwill and acquired intangible fixed assets pertaining to the Group's South American operations (see notes 11 and 12).

2. Business and geographical segments (continued)

Aerospace, Defence & Energy	**Western Europe 2011 £m**	**North America 2011 £m**	**Emerging markets 2011 £m**	**Total ADE 2011 £m**
Revenue				
Total revenue	**111.9**	**120.1**	**1.5**	**233.5**
Result				
Headline operating profit prior to share-based payments	**23.6**	**29.4**	**0.2**	**53.2**
Share-based payments	**(1.0)**	**(1.1)**	**–**	**(2.1)**
Headline operating profit	**22.6**	**28.3**	**0.2**	**51.1**
Amortisation of acquired intangible fixed assets	**(0.2)**	**–**	**–**	**(0.2)**
Impairment charge	**–**	**–**	**–**	**–**
Segment result	**22.4**	**28.3**	**0.2**	**50.9**

Automotive & General Industrial	**Western Europe 2011 £m**	**North America 2011 £m**	**Emerging markets 2011 £m**	**Total AGI 2011 £m**
Revenue				
Total revenue	**239.6**	**47.4**	**50.2**	**337.2**
Result				
Headline operating profit prior to share-based payments	**36.0**	**8.3**	**3.5**	**47.8**
Share-based payments	**(2.5)**	**(0.5)**	**(0.1)**	**(3.1)**
Headline operating profit	**33.5**	**7.8**	**3.4**	**44.7**
Amortisation of acquired intangible fixed assets	**(0.1)**	**–**	**(0.6)**	**(0.7)**
Impairment charge	**–**	**–**	**(4.2)**	**(4.2)**
Segment result	**33.4**	**7.8**	**(1.4)**	**39.8**

Group	ADE 2010 £m	AGI 2010 £m	Head Office and eliminations 2010 £m	Consolidated 2010 £m
Revenue				
Total revenue	202.1	297.7	–	499.8
Result				
Headline operating profit prior to share-based payments and unallocated corporate expenses	35.1	27.2	–	62.3
Share-based payments	(1.2)	(1.6)	(1.4)	(4.2)
Unallocated corporate expenses	–	–	(6.0)	(6.0)
Headline operating profit / (loss)	33.9	25.6	(7.4)	52.1
Amortisation of acquired intangible fixed assets	(0.4)	(0.5)	–	(0.9)
Segment result	33.5	25.1	(7.4)	51.2
Investment revenue				0.3
Finance costs				(6.3)
Profit before taxation				45.2
Taxation				(11.7)
Profit for the year				33.5

Notes to the consolidated financial statements

Year ended 31 December 2011

2. Business and geographical segments (continued)

Aerospace, Defence & Energy	Western Europe 2010 £m	North America 2010 £m	Emerging markets 2010 £m	Total ADE 2010 £m
Revenue				
Total revenue	92.2	108.9	1.0	202.1
Result				
Headline operating profit / (loss) prior to share-based payments	15.7	19.5	(0.1)	35.1
Share-based payments	(0.5)	(0.7)	–	(1.2)
Headline operating profit / (loss)	15.2	18.8	(0.1)	33.9
Amortisation of acquired intangible fixed assets	(0.2)	(0.2)	–	(0.4)
Segment result	15.0	18.6	(0.1)	33.5

Automotive & General Industrial	Western Europe 2010 £m	North America 2010 £m	Emerging markets 2010 £m	Total AGI 2010 £m
Revenue				
Total revenue	204.6	43.0	50.1	297.7
Result				
Headline operating profit prior to share-based payments	21.3	5.4	0.5	27.2
Share-based payments	(1.2)	(0.3)	(0.1)	(1.6)
Headline operating profit	20.1	5.1	0.4	25.6
Amortisation of acquired intangible fixed assets	(0.1)	–	(0.4)	(0.5)
Segment result	20.0	5.1	–	25.1

Other information

Group	**ADE 2011 £m**	**AGI 2011 £m**	**Head Office and eliminations 2011 £m**	**Consolidated 2011 £m**
Capital additions	**16.1**	**27.7**	**2.2**	**46.0**
Depreciation and amortisation	**18.5**	**30.8**	**1.8**	**51.1**
Impairment losses recognised in income	**–**	**4.2**	**–**	**4.2**
Balance sheet				
Assets:				
Segment assets	**314.0**	**411.7**	**29.8**	**755.5**
Other investments	**–**	**–**	**0.8**	**0.8**
Consolidated total assets	**314.0**	**411.7**	**30.6**	**756.3**
Liabilities:				
Segment liabilities	**(67.3)**	**(128.0)**	**(78.4)**	**(273.7)**
	246.7	**283.7**	**(47.8)**	**482.6**
Allocation of head office net liabilities	**(22.2)**	**(25.6)**	**47.8**	**–**
Adjusted segment net assets	**224.5**	**258.1**	**–**	**482.6**

2. Business and geographical segments (continued)

Aerospace, Defence & Energy	**Western Europe 2011 £m**	**North America 2011 £m**	**Emerging markets 2011 £m**	**Total ADE 2011 £m**
Capital additions	**5.0**	**11.1**	**–**	**16.1**
Depreciation and amortisation	**10.5**	**7.8**	**0.2**	**18.5**
Balance sheet				
Assets:				
Segment assets	**171.8**	**140.1**	**2.1**	**314.0**
Liabilities:				
Segment liabilities	**(33.6)**	**(33.4)**	**(0.3)**	**(67.3)**
Segment net assets	**138.2**	**106.7**	**1.8**	**246.7**

Automotive & General Industrial	**Western Europe 2011 £m**	**North America 2011 £m**	**Emerging markets 2011 £m**	**Total AGI 2011 £m**
Capital additions	**17.7**	**3.9**	**6.1**	**27.7**
Depreciation and amortisation	**22.4**	**3.3**	**5.1**	**30.8**
Impairment losses recognised in income	**–**	**–**	**4.2**	**4.2**
Balance sheet				
Assets:				
Segment assets	**292.9**	**56.0**	**62.8**	**411.7**
Liabilities:				
Segment liabilities	**(96.3)**	**(15.3)**	**(16.4)**	**(128.0)**
Segment net assets	**196.6**	**40.7**	**46.4**	**283.7**

Group	ADE 2010 £m	AGI 2010 £m	Head Office and eliminations 2010 £m	Consolidated 2010 £m
Capital additions	10.1	25.3	1.8	37.2
Depreciation and amortisation	17.8	29.5	1.0	48.3
Balance sheet				
Assets:				
Segment assets	307.0	435.7	28.0	770.7
Other investments	–	0.5	–	0.5
Consolidated total assets	307.0	436.2	28.0	771.2
Liabilities:				
Segment liabilities	(64.7)	(123.9)	(131.8)	(320.4)
	242.3	312.3	(103.8)	450.8
Allocation of head office net liabilities	(45.3)	(58.5)	103.8	–
Adjusted segment net assets	197.0	253.8	–	450.8

Notes to the consolidated financial statements

Year ended 31 December 2011

2. Business and geographical segments (continued)

Aerospace, Defence & Energy	Western Europe 2010 £m	North America 2010 £m	Emerging markets 2010 £m	Total ADE 2010 £m
Capital additions	6.0	4.1	–	10.1
Depreciation and amortisation	9.5	8.1	0.2	17.8
Balance sheet				
Assets:				
Segment assets	168.8	136.1	2.1	307.0
Consolidated total assets	168.8	136.1	2.1	307.0
Liabilities:				
Segment liabilities	(29.1)	(35.3)	(0.3)	(64.7)
Segment net assets	139.7	100.8	1.8	242.3

Automotive & General Industrial	Western Europe 2010 £m	North America 2010 £m	Emerging markets 2010 £m	Total AGI 2010 £m
Capital additions	13.1	2.3	9.9	25.3
Depreciation and amortisation	22.0	3.1	4.4	29.5
Balance sheet				
Assets:				
Segment assets	304.1	54.4	77.2	435.7
Other investments	0.5	–	–	0.5
Consolidated total assets	304.6	54.4	77.2	436.2
Liabilities:				
Segment liabilities	(94.6)	(15.3)	(14.0)	(123.9)
Segment net assets	210.0	39.1	63.2	312.3

Revenue by country

	2011 £m	2010 £m
USA	**156.3**	142.9
France	**91.9**	76.3
Germany	**67.7**	61.1
UK	**59.4**	54.7
Sweden	**47.3**	32.7
Netherlands	**25.7**	22.5
Others	**122.4**	109.6
Total Revenue – continuing operations	**570.7**	499.8

It is considered by the Group that the cost of producing a geographical analysis of non-current assets other than financial instruments, deferred tax assets and post-employment benefit assets would outweigh the benefits. The Group reviews business assets by business segment rather than geographically.

3. Operating profit

	Continuing operations 2011 £m	Continuing operations 2010 £m
Revenue	**570.7**	499.8
Cost of sales	**(361.1)**	(332.9)
Gross profit	**209.6**	166.9
Other operating income	**4.5**	2.3
Distribution costs	**(17.9)**	(17.4)
Administration expenses*	**(109.5)**	(99.7)
Other operating expenses	**(1.2)**	–
Amortisation of acquired intangible fixed assets*	**(0.9)**	(0.9)
Impairment charge*	**(4.2)**	–
Operating profit	**80.4**	51.2

* Administration expenses total £114.6m (2010: £100.6m).

Exceptional items comprise:

	2011 £m	2010 £m
Amortisation of acquired intangible fixed assets	**0.9**	0.9
Impairment of goodwill	**3.7**	–
Impairment of acquired intangible fixed assets	**0.5**	–
	5.1	0.9

Further details of these items are included in the Finance Director's Report on pages 22 to 27.

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

	2011 £m	2010 £m
Continuing operations:		
Net foreign exchange losses	**0.1**	–
Depreciation of property, plant and equipment	**48.2**	46.1
Amortisation of intangible fixed assets	**2.9**	2.2
Impairment of goodwill (see note 11)	**3.7**	–
Impairment of acquired intangible fixed assets (see note 12)	**0.5**	–
Loss on disposal of property, plant and equipment	**0.7**	0.7
Staff costs (see note 4)	**228.5**	207.6
Release of negative goodwill (see note 13)	**(0.6)**	–
Acquisition reorganisation costs (see note 13)	**0.5**	–
Acquisition costs (see note 13)	**0.1**	–
Impairment loss on trade receivables	**–**	1.1
Reversal of fixed asset impairment	**(0.4)**	(1.0)

The analysis of auditor's remuneration on a worldwide basis is as follows:

	2011 £m	2010 £m
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**0.1**	0.1
Fees payable to the Company's auditor and its associates for other services:		
The audit of the Company's subsidiaries	**0.5**	0.6
Total audit fees	**0.6**	0.7
Other taxation advisory services	**0.1**	–
Corporate finance services	**0.1**	–
Total non-audit fees	**0.2**	–
	0.8	0.7

In addition to the amounts shown above, the auditor received fees of £5,000 (2010: £5,000) for the audit of the Group's pension schemes.

Fees paid to Deloitte LLP and its associates for non-audit services to the Company are not required to be disclosed because the consolidated financial statements are required to disclose such fees on a consolidated basis.

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 auditor.

Notes to the consolidated financial statements

Year ended 31 December 2011

4. Staff costs

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

	2011 Number	2010 Number
ADE:		
Western Europe	**1,010**	1,001
North America	**939**	900
Emerging Markets	**12**	10
AGI:		
Western Europe	**2,075**	2,053
North America	**497**	460
Emerging Markets	**897**	1,070
Shared services	**70**	79
Head office	**33**	30
	5,533	5,603

Their aggregate remuneration comprised:

	2011 £m	2010 £m
Wages and salaries	**189.1**	172.8
Social security costs	**33.8**	29.6
Other pension costs	**5.6**	5.2
	228.5	207.6

Disclosure of individual directors' remuneration, share interests, share options, long term incentive schemes, pension contributions and pension entitlements required by the Companies Act 2006 and those specified for audit by the Listing Rules of the Financial Services Authority are shown in the tables in the Board Report on Remuneration on pages 43 to 48 and form part of these financial statements.

5. Investment revenue

	2011 £m	2010 £m
Interest on bank deposits	**0.1**	0.2
Other interest receivable	**0.1**	0.1
Total interest and investment revenue	**0.2**	0.3

All investment revenue relates to bank balances and other receivables.

6. Finance costs

	2011 £m	2010 £m
Interest on bank overdrafts and loans*	**1.1**	1.8
Interest on obligations under finance leases	**0.1**	0.2
Total interest expense	**1.2**	2.0
Interest on pension scheme liabilities	**5.1**	5.2
Return on pension assets	**(4.4)**	(4.3)
Other finance charges*	**2.9**	3.4
Total finance costs	**4.8**	6.3

* Amounts arising on financial liabilities measured at amortised cost.

7. Taxation

	Continuing operations		Discontinued operations		Total	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
Current taxation – charge for the year	**18.0**	8.8	**–**	–	**18.0**	8.8
Current taxation – adjustments in respect of previous years	**(4.7)**	(3.8)	**–**	5.8	**(4.7)**	2.0
Deferred tax (see note 21)	**6.5**	6.7	**–**	–	**6.5**	6.7
	19.8	11.7	**–**	5.8	**19.8**	17.5

UK corporation tax is calculated at 26.5% (2010: 28.0%) of the estimated assessable profit for the year. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

Of the total charge to current tax £Nil (2010: £5.8m) is additional provisions relating to taxation expected to arise from the 2008 disposal of the Testing business.

7. Taxation (continued)

The charge for the year can be reconciled to the profit per the income statement as follows:

	2011 £m	2010 £m
Profit before tax:		
Continuing operations	75.8	45.2
Tax at the UK corporation tax rate of 26.5% (2010: 28.0%)	20.1	12.7
Tax effect of expenses that are not deductible in determining taxable profit	2.1	(3.8)
Deferred tax assets (recognised) / not recognised	(1.7)	3.7
Tax provision in respect of the disposal of the Testing division	–	5.8
Tax effect of other adjustments in respect of previous years	(4.0)	(1.8)
Effect of different tax rates of subsidiaries operating in other jurisdictions	3.3	0.9
Tax expense for the year	19.8	17.5

Tax on items taken directly to equity is a credit of £2.2m (2010: charge of £0.9m).

8. Discontinued operations

The Testing business was sold on 17 October 2008. During 2010 various provisions, primarily relating to taxation arising from the sale were reassessed.

The results of the discontinued operations included in the consolidated income statement were as follows:

	2011 £m	2010 £m
Attributable tax expense	–	(5.8)
Net loss attributable to discontinued operations	–	(5.8)

9. Dividends

	2011 £m	2010 £m
Amounts recognised as distributions to equity holders in the year:		
Final dividend for the year ended 31 December 2010 of 5.75p (2009: 5.35p) per share	10.7	9.9
Interim dividend for the year ended 31 December 2011 of 3.6p (2010: 2.95p) per share	6.7	5.5
	17.4	15.4
Proposed final dividend for the year ended 31 December 2011 of 7.3p (2010: 5.75p) per share	14.0	10.9

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.

The dividend is waived on shares held by the Bodycote International Employee Benefit Trust.

10. Earnings / (loss) per share

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

	2011 £m	2010 £m
Earnings		
Earnings for the purpose of basic earnings per share being net profit attributable to equity holders of the parent	55.8	27.6

	2011 Number	2010 Number
Number of shares		
Weighted average number of ordinary shares for the purpose of basic earnings per share	185,838,882	185,543,260
Effect of dilutive potential ordinary shares:		
Share options	3,780,964	180,586
Weighted average number of ordinary shares for the purpose of diluted earnings per share	189,619,846	185,723,846

From continuing operations

	2011 £m	2010 £m
Earnings		
Net profit attributable to equity holders of the parent	55.8	27.6
Adjustments to exclude loss for the year from discontinued operations	–	5.8
Profit from continuing operations for the purpose of basic earnings per share excluding discontinued operations	55.8	33.4

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10. Earnings / (loss) per share (continued)

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

Earnings per share from continuing and discontinued operations:

	2011 Pence	2010 Pence
Basic	**30.0**	14.9
Diluted	**29.4**	14.9

Loss per share from discontinued operations:

	2011 Pence	2010 Pence
Basic	**–**	(3.1)
Diluted	**–**	(3.1)

Earnings per share from continuing operations:

	2011 Pence	2010 Pence
Basic	**30.0**	18.0
Diluted	**29.4**	18.0

Headline earnings

	2011 £m	2010 £m
Net profit attributable to equity holders of the parent	**55.8**	27.6
Add back:		
Impairment charge	**4.2**	–
Amortisation of acquired intangible fixed assets (net of tax)	**0.8**	0.8
Major facility closure costs (net of tax)	**–**	(0.2)
Loss for the year – discontinued operations	**–**	5.8
Headline earnings from continuing operations	**60.8**	34.0

Earnings per share from headline earnings:

	2011 Pence	2010 Pence
Basic	**32.7**	18.3
Diluted	**32.1**	18.3

11. Goodwill

	2011 £m	2010 £m
Cost		
At 1 January	**178.1**	177.3
Exchange differences	**(2.6)**	1.3
Adjustment for deferred consideration	**–**	(0.5)
At 31 December	**175.5**	178.1
Accumulated impairment		
At 1 January	**70.4**	69.4
Exchange differences	**(1.2)**	1.0
Impairment losses for the year	**3.7**	–
At 31 December	**72.9**	70.4
Carrying amount	**102.6**	107.7

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 has been allocated as follows:

	2011 £m	2010 £m
ADE:		
Western Europe	**26.7**	26.8
North America	**37.1**	37.1
AGI:		
Western Europe	**17.6**	17.9
North America	**15.2**	15.2
Emerging Markets	**6.0**	10.7
	102.6	107.7

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

The recoverable amounts of the cash generating units are determined from value in use calculations. The key assumptions for those calculations are the discount rates, growth rates and expected changes to selling prices and direct costs during the period. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to cash generating units. The rate used to discount the forecast cash flows for cash generating units is 9.5% (2010: 9.5%). This rate is risk adjusted, for specific countries, where the Group perceives a risk premium is appropriate. A risk premium of 20% has been applied to the South American operations, and a risk premium of 10% has been applied to the far eastern operations. The recoverable amount is the sum of the discounted cash flows over a fifteen year period, being management's expectation of the useful life of the existing asset base.

The Group prepares cash flow forecasts based on management estimates for the next five years. The expected sales reflect management's expectation of how sales will develop at this point in the economic cycle. The expected profit margin reflects management's experience of each cash generating unit's profitability at the forecast level of sales and incorporates the impact of the restructuring programme, where appropriate. Cash flows after five years are based on an estimated growth rate of 3.2% (2010: 3.2%), being the historical weighted average growth in GDP in the markets that the Group operates in. This rate does not exceed the average long-term growth rate for the relevant markets.

The Group has conducted a sensitivity analysis on the impairment test of each cash generating unit's carrying value. A cut in the sales growth rate by 18.9% would result in the recoverable amount of goodwill for the Group being reduced to its carrying value.

The charge for impairment of goodwill and acquired intangible fixed assets relates to the Group's South American operations. Trading activity has lagged expectations, which together with an increase in the perceived risk-adjusted discount rate, has led to an impairment of goodwill and acquired intangible fixed assets. With improved market conditions the Board has concluded that no other impairment charge is required in 2011.

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Year ended 31 December 2011

12. Other intangible assets

	Software £m	Other intangible assets acquired through business combinations £m	Total £m
Cost			
At 1 January 2010	11.7	10.5	22.2
Exchange differences	–	0.2	0.2
Additions	2.0	–	2.0
Disposals	(0.5)	–	(0.5)
At 1 January 2011	**13.2**	**10.7**	**23.9**
Exchange differences	**(0.2)**	**(0.9)**	**(1.1)**
Additions	**2.4**	**–**	**2.4**
Acquired on acquisition of business (see note 13)	**–**	**0.3**	**0.3**
Disposals	**(0.8)**	**–**	**(0.8)**
At 31 December 2011	**14.6**	**10.1**	**24.7**
Amortisation			
At 1 January 2010	7.5	3.8	11.3
Exchange differences	–	0.1	0.1
Charge for the year	1.3	0.9	2.2
Disposals	(0.1)	–	(0.1)
At 1 January 2011	**8.7**	**4.8**	**13.5**
Exchange differences	**(0.2)**	**(0.4)**	**(0.6)**
Charge for the year	**2.0**	**0.9**	**2.9**
Impairment loss (see note 11)	**–**	**0.5**	**0.5**
Disposals	**(0.5)**	**–**	**(0.5)**
At 31 December 2011	**10.0**	**5.8**	**15.8**
Carrying amount			
At 31 December 2011	**4.6**	**4.3**	**8.9**
At 31 December 2010	4.5	5.9	10.4

The amortisation periods for intangible assets are:

	Years
Software	3 to 5
Customer relationships	10 to 15
Membership lists	15

Intangible assets are amortised on a straight-line basis and the amortisation is recognised within administration expenses.

13. Property, plant and equipment

	Land and buildings						
	Freehold £m	Long leasehold £m	Short leasehold £m	Plant and machinery £m	Fixtures and fittings £m	Assets under construction £m	Total £m
Cost or valuation							
At 1 January 2010	198.7	1.6	21.7	697.0	36.4	28.3	983.7
Additions	5.0	–	0.3	25.5	1.1	3.3	35.2
Exchange differences	1.4	0.1	0.3	10.0	0.1	1.7	13.6
Reduction of revaluation surplus	(0.1)	–	–	–	–	–	(0.1)
Reclassified as held for sale	0.6	–	–	(0.2)	(0.1)	–	0.3
Recategorisation	3.5	0.1	(2.0)	7.1	0.1	(8.8)	–
Disposals	(2.1)	–	(0.4)	(16.4)	(2.6)	(0.5)	(22.0)
At 1 January 2011	**207.0**	**1.8**	**19.9**	**723.0**	**35.0**	**24.0**	**1,010.7**
Additions	**1.1**	**–**	**0.5**	**19.1**	**2.1**	**20.8**	**43.6**
Acquisition of business	**–**	**–**	**–**	**0.7**	**–**	**0.3**	**1.0**
Exchange differences	**(4.1)**	**(0.2)**	**(0.7)**	**(16.2)**	**(1.1)**	**(0.1)**	**(22.4)**
Transfer from / (to) assets held for sale	**0.6**	**–**	**–**	**–**	**–**	**–**	**0.6**
Recategorisation	**3.6**	**–**	**(1.3)**	**13.9**	**0.1**	**(16.3)**	**–**
Disposals	**(2.7)**	**–**	**(0.1)**	**(29.9)**	**(3.2)**	**–**	**(35.9)**
Disposal of subsidiaries	**–**	**–**	**–**	**(0.2)**	**(0.1)**	**–**	**(0.3)**
At 31 December 2011	**205.5**	**1.6**	**18.3**	**710.4**	**32.8**	**28.7**	**997.3**
Accumulated depreciation and impairment							
At 1 January 2010	66.0	0.3	10.2	416.4	29.0	–	521.9
Charge for the year	5.2	0.3	0.8	38.0	1.8	–	46.1
Impairment losses incurred / (reversed)	(0.2)	–	–	(0.8)	–	–	(1.0)
Exchange differences	–	–	0.3	5.0	0.3	–	5.6
On assets reclassified as held for sale	0.6	–	–	–	(0.1)	–	0.5
Recategorisation	0.4	–	(0.4)	(0.1)	0.1	–	–
Eliminated on disposals	(2.1)	–	(0.4)	(15.5)	(2.4)	–	(20.4)
At 1 January 2011	**69.9**	**0.6**	**10.5**	**443.0**	**28.7**	**–**	**552.7**
Charge for the year	**5.4**	**0.3**	**0.6**	**39.9**	**2.0**	**–**	**48.2**
Impairment losses incurred / (reversed)	**0.5**	**–**	**–**	**(0.9)**	**–**	**–**	**(0.4)**
Exchange differences	**(1.4)**	**(0.1)**	**(0.3)**	**(10.2)**	**(0.8)**	**–**	**(12.8)**
Transfer from / (to) assets held for sale	**(0.1)**	**–**	**–**	**–**	**–**	**–**	**(0.1)**
Recategorisation	**0.1**	**–**	**(0.3)**	**0.3**	**(0.1)**	**–**	**–**
Eliminated on disposals	**(2.6)**	**–**	**(0.1)**	**(28.2)**	**(3.1)**	**–**	**(34.0)**
Eliminated on disposal of subsidiaries	**–**	**–**	**–**	**(0.1)**	**(0.1)**	**–**	**(0.2)**
At 31 December 2011	**71.8**	**0.8**	**10.4**	**443.8**	**26.6**	**–**	**553.4**
Carrying amount							
At 31 December 2011	**133.7**	**0.8**	**7.9**	**266.6**	**6.2**	**28.7**	**443.9**
At 31 December 2010	137.1	1.2	9.4	280.0	6.3	24.0	458.0

The carrying amount of leased assets is £0.7m (2010: £2.1m).

The Group has pledged land and buildings having a carrying amount of approximately £0.6m (2010: £0.4m) to secure banking facilities granted to the Group.

At 31 December 2011 the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £4.6m (2010: £2.5m).

In addition to the above, property, plant and equipment amounting to £5.3m (2010: £6.2m) has been classified as held for sale.

During the year, the Group acquired the French Heat Treatment business of Oerlikon Balzers for a total consideration of £0.5m. Total net assets acquired (including acquired intangible fixed assets) were £1.1m, resulting in negative goodwill of £0.6m being credited to the income statement, along with charges for costs to re-organise the operations of £0.5m, and acquisition costs of £0.1m. On the basis of materiality no further disclosures have been included.

14. Subsidiaries and other investments

A list of the significant investments in subsidiaries, including the name, country of incorporation and proportion of ownership interest is given on pages 97 and 98.

	2011 £m	2010 £m
Sundry investments	**0.8**	0.5

The sundry investments relate to the Bodycote Investment Incentive Plan, as explained in the Board Report on Remuneration.

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15. Inventories

	2011 £m	2010 £m
Raw materials	**12.4**	10.1
Work-in-progress	**4.2**	4.1
Finished goods and goods for resale	**0.1**	0.2
	16.7	14.4

16. Finance lease receivables

	Minimum lease payments 2011 £m	Minimum lease payments 2010 £m	Present value of minimum lease payments 2011 £m	Present value of minimum lease payments 2010 £m
Amounts receivable under finance leases:				
Within one year	–	0.4	–	0.4
Less: unearned finance income	–	–		
Present value of minimum lease payments receivable	–	0.4		
Analysed as:				
Current finance lease receivables (recoverable within 12 months)			–	0.4
The present value of minimum lease payments is denominated in the following currencies:				
Euro			–	0.2
US Dollar			–	0.2
			–	0.4

The finance leasing arrangements that the Group had entered into with Ionbond AG, for 3 PVD machines, matured during the year with the assets transferring to Ionbond AG as per the contracts.

17. Other financial assets

Trade and other receivables

	2011 £m	2010 £m
Amounts falling due within one year:		
Amount receivable for the supply of services	**92.0**	85.3
Other debtors and prepayments*	**13.8**	13.9
	105.8	99.2
Amounts falling due after more than one year:		
Other debtors and prepayments*	**1.9**	2.6

* Other financial assets include prepayments and other debtors, which are not included as financial assets under IFRS 7.

The average credit period given to customers for the supply of services as at 31 December 2011 is 59 days (2010: 59 days). An allowance has been made for estimated irrecoverable amounts from the supply of services of £6.2m (2010: £6.9m). 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, cash and trade and other receivables.

The Group's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables. An allowance for impairment is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of cash flows.

The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with high credit-ratings assigned by international credit-rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers. Further disclosure of the Group's financial instrument risk management activities is set out in note 20.

Included in the Group's trade receivable balance are debtors with a carrying amount of £17.7m (2010: £16.7m) which are past due at the reporting date for which the Group has not provided as there has not been a significant change in credit quality and the amounts are still considered recoverable. The Group does not hold any collateral over these balances.

17. Other financial assets (continued)

Ageing of past due but not impaired receivables:

	2011 £m	2010 £m
Amounts overdue by up to 1 month	**14.6**	13.2
Amounts overdue by 1–2 months	**1.8**	2.2
Amounts overdue by 2–3 months	**0.4**	0.4
Amounts overdue by more than 3 months	**0.9**	0.9
	17.7	16.7

Movement in the allowance for doubtful debts:

	2011 £m	2010 £m
Balance at 1 January	**6.9**	8.1
Impairment losses recognised	**1.6**	2.6
Amounts written off as uncollectable	**(0.4)**	(2.2)
Impairment losses reversed	**(1.6)**	(1.5)
Exchange differences	**(0.3)**	(0.1)
	6.2	6.9

In determining the recoverability of a trade receivable the Group considers any change in the quality of the trade receivable from the date credit was initially granted up to the reporting date. The concentration of credit risk is limited due to the customer base being large and unrelated. Accordingly the Directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

Included in the allowance for doubtful debts are individually impaired trade receivables with a gross balance of £8.9m (2010: £8.6m). The impairment recognised represents the difference between the carrying amount of these trade receivables and the present value of the expected proceeds. The Group does not hold any collateral over these balances.

Ageing of impaired trade receivables:

	2011 £m	2010 £m
Less than 3 months	**2.8**	–
3–12 months	**1.8**	1.8
Over 12 months	**4.3**	6.8
	8.9	8.6

Cash and bank balances

Cash and bank 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 to their fair value. A breakdown of significant cash and bank balances by currency is as follows:

	2011 £m	2010 £m
Sterling	**2.2**	0.2
Euro	**6.2**	12.2
US Dollar	**2.5**	0.8
Canadian Dollar	**2.3**	0.2
Chinese Yuan	**0.8**	0.7
Indian Rupee	**0.7**	0.5
Thai Baht	**0.6**	0.5
Danish Krone	**0.5**	–
Polish Zloty	**0.5**	1.5
Czech Republic Koruna	**0.4**	0.7
Romanian Leu	**0.4**	0.4
Swedish Krona	**0.2**	2.3
Swiss Franc	**0.2**	0.9
Japanese Yen	**0.2**	0.4
Mexican Peso	**0.1**	0.4
Brazilian Real	**–**	1.1
Other	**0.3**	0.7
Total cash and bank balances	**18.1**	23.5

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18. Assets held for sale

As a result of the restructuring programme a number of Group assets are currently held for sale. They comprise the following:

	2011 £m	2010 £m
Property, plant and equipment	**5.3**	6.2

It is expected that the disposal of these assets will be completed during 2012. The assets held for sale are analysed between operating segments as follows:

	2011 £m	2010 £m
ADE:		
Western Europe	**1.3**	1.3
North America	**0.7**	0.6
AGI:		
Western Europe	**1.6**	1.8
North America	**0.3**	0.3
Emerging Markets	**1.4**	2.2
	5.3	6.2

19. Borrowings

	2011 £m	2010 £m
Borrowings at amortised cost:		
Bank overdrafts	**8.6**	5.9
Loans	**8.7**	67.8
	17.3	73.7
The borrowings are repayable as follows:		
On demand or within one year	**10.8**	8.9
In the second year	**6.1**	0.1
In the third to fifth years	**0.2**	64.5
After five years	**0.2**	0.2
	17.3	73.7
Less: Amount due for settlement within 12 months (shown under current liabilities)	**(10.8)**	(8.9)
Amount due for settlement after 12 months	**6.5**	64.8

Analysis of borrowings by currency:

	Sterling £m	**Euro £m**	**US Dollar £m**	**Other currencies £m**	**Total £m**
At 31 December 2011					
Bank overdrafts	**1.7**	**3.0**	**3.5**	**0.4**	**8.6**
Loans	**6.0**	**0.1**	**–**	**2.6**	**8.7**
	7.7	**3.1**	**3.5**	**3.0**	**17.3**
At 31 December 2010					
Bank overdrafts	–	5.0	0.8	0.1	5.9
Loans	48.0	8.8	9.9	1.1	67.8
	48.0	13.8	10.7	1.2	73.7

The weighted average interest rates paid were as follows:

	2011 %	2010 %
Bank overdrafts and loans	**2.1**	1.7

Loans and finance leases of £1.4m (2010: £1.5m) 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. Borrowings (continued)

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

	2011 £m	2010 £m
Bank overdrafts	**8.6**	5.9
Loans	**8.7**	67.8

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

(i) Bank overdrafts are repayable on demand. No overdrafts are secured.

(ii) The Group has two principal borrowing facilities which are secured by upstream guarantees provided by subsidiaries:

(a) Drawings of £Nil (2010: £Nil) under a Revolving Credit Facility of £125m. This unsecured facility commenced on 27 July 2011 and matures on 31 August 2016. The multi currency drawings under this facility carry an interest rate of between 1.15% and 2.00% above LIBOR (the margin at 31 December 2011 was 1.15%).

(b) Drawings of £6.0m (2010: £64.4m) under a Revolving Credit Facility of €125m. This unsecured facility commenced on 31 July 2006 for a period of seven years. The multi currency drawings under this facility carry an interest rate of between 0.80% and 1.10% above LIBOR (the margin at 31 December 2011 was 0.80%).

At 31 December 2011 the Group had available £223.9m (2010: £160.9m) of undrawn committed borrowing facilities.

All borrowings are classified as financial liabilities measured at amortised cost.

20. Derivative financial instruments

Currency derivatives that are designated and effective as hedging instruments carried at fair value

Asset / (liability)	Notional amount 2011 £m	Fair value 2011 £m	Notional amount 2010 £m	Fair value 2010 £m
Current				
Forward foreign exchange contracts	**1.3**	**(0.1)**	0.9	–
Non-current				
Forward foreign exchange contracts	**3.2**	**(0.2)**	–	–
Total				
Forward foreign exchange contracts	**4.5**	**(0.3)**	0.9	–

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 significant in either 2011 or 2010.

In accordance with IFRS 7 'Improving Disclosures about Financial Instruments', the Group's financial instruments are considered to be classified as level 2 instruments. Fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liabilities, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Fair value is determined using quoted forward exchange rates and yield curves derived from quoted interest rates matching maturities of the contracts.

The Group's interest rate risk is primarily in relation to its fixed rate borrowings (fair value risk) and floating rate borrowings (cash flow risk). From time to time the Group will use interest rate derivative contracts to manage its exposure to interest rate movements within Group policy. However at the balance sheet date the Group had no interest rate derivative contracts.

Asset / (liability)	Sterling 2011 £m	Euro 2011 £m	US Dollar 2011 £m	Swedish Krona 2011 £m	Total fair value 2011 £m
Forward foreign exchange contracts	**0.3**	**(4.5)**	**3.9**	**–**	**(0.3)**
On demand or within one year	**0.3**	**(1.3)**	**0.9**	**–**	**(0.1)**
In the second year	**–**	**(3.2)**	**3.0**	**–**	**(0.2)**
	0.3	**(4.5)**	**3.9**	**–**	**(0.3)**

Asset / (liability)	Sterling 2010 £m	Euro 2010 £m	US Dollar 2010 £m	Swedish Krona 2010 £m	Total fair value 2010 £m
Forward foreign exchange contracts	(0.2)	0.3	0.4	(0.5)	–
On demand or within one year	(0.2)	0.3	0.4	(0.5)	–
In the second year	–	–	–	–	–
	(0.2)	0.3	0.4	(0.5)	–

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Year ended 31 December 2011

20. Derivative financial instruments (continued)

Financial risk management

The Group's treasury function provides a centralised service to the Group for funding, foreign exchange, interest rate management and counterparty risk. Treasury activities have the objective of minimising risk and treasury operations are conducted within a framework of policies and guidelines reviewed and authorised by the Board.

The Group uses a number of derivative instruments that are transacted, for risk management purposes only, by specialist treasury personnel. The use of financial instruments, including derivatives, is permitted when approved by the Board, where the effect is to minimise risk for the Group. Speculative trading of derivatives or other financial instruments is not permitted. There has been no significant change during the financial year, or since the end of the year, to the types or scope of financial risks faced by the Group.

Liquidity risk

Liquidity risk is defined as the risk that the Group might not be able to settle or meet its obligations on time or at a reasonable price. Liquidity risk arises as a result of mismatches between cash inflows and outflows from the business. This risk is monitored on a centralised basis through regular cash flow forecasting, a three-year rolling strategic plan, an annual budget agreed by the Board each December and a quarterly re-forecast undertaken during the financial year. To mitigate the risk, the resulting forecast net debt / cash is measured against the liquidity headroom policy which, at the current net debt / cash levels, requires committed facilities (plus term loans in excess of one year) to exceed net debt by 50% (minimum facilities of £100m).

As at 31 December 2011, the Group had revolving credit committed facilities of £229.9m (2010: £230.9m) which exceeded net cash of £0.1m (2010: net debt of £51.3m) by £230.0m (2010: £179.6m or 350%). The Group also uses uncommitted short-term bank facilities to manage short-term liquidity but these facilities are excluded from the liquidity headroom policy. The Group manages longer-term liquidity through committed bank facilities and will, if appropriate, raise funds on capital markets. Following the completion of the 5 year £125m Revolving Credit and $10m Letter of Credit facilities on 27 July 2011, the Group's principal committed bank facilities have the following maturity dates:

- €125m Revolving Credit Facility 31 July 2013 (1.6 years)
- £125m Revolving Credit Facility 31 August 2016 (4.7 years)
- $10m Letter of Credit Facility 31 August 2016 (4.7 years)

In addition, cash management pooling, netting and concentration techniques are used to minimise borrowings. As at 31 December 2011, the Group had gross cash of £18.1m (2010: £23.5m).

Interest rate risk

Interest rate risk arises on borrowings and cash balances (and derivative liabilities and assets) which are at floating interest rates. Changes in interest rates could have the effect of either increasing or decreasing the Group's net profit. Under the Group's interest rate management policy, the interest rates on each of the Group's major currency monetary assets and liabilities are managed to achieve the desired mix of fixed and variable rates for each major net currency exposure. The major interest rate risk is to UK rates but exposures also exist to rates in the USA, Europe and Sweden. Measurement of this interest rate risk and its potential volatility to the Group's reported financial performance is undertaken on a monthly basis and the Board uses this information to determine, from time to time, an appropriate mix of fixed and floating rates.

As at 31 December 2011, 8% of gross debt and 0% of gross cash were at fixed rates (2010: 2% of gross debt, 0% of gross cash). The average tenure of the fixed rate debt was 3.6 years (2010: 5.2 years).

Currency risk

Bodycote has operations in 27 countries and is therefore exposed to foreign exchange translation risk when the profits and net assets of these entities are consolidated into the Group accounts.

Over 89% of the Group's sales are in currencies other than sterling (EUR 38%, USD 27% and SEK 8%). Cumulatively over the year, sterling rates moved such that the sales for the year were £2.6m better than if sales had been translated at the rates prevailing in 2010.

It is Group policy not to hedge exposure for the translation of reported profits.

The Group's balance sheet translation policy is not to actively hedge currency net assets. However, where appropriate, the Group will still match centrally held currency borrowings to the net assets. The Group principally borrows in sterling but also maintains debt in US Dollar, Euro and Swedish Krona, consistent with the location of the Group's assets. The Group recognises foreign exchange movements in equity for the translation of net investment hedging instruments and balances.

Transaction foreign exchange exposures arise when entities within the Group enter into contracts to pay or receive funds in a currency different from the functional currency of the entity concerned. 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. Even though approximately 89% of the Group's sales are generated outside the UK, the nature of the business is such that cross border sales and purchases are limited and, other than interest, such exposures are immaterial for the Group.

Market risk sensitivity analysis

The Group has measured the estimated charge to the income statement and equity of either an instantaneous increase or decrease of 1% (100 basis points) in market interest rates or a 10% strengthening or weakening in sterling against all other currencies from the applicable rates as at 31 December 2011, for all financial instruments with all other variables remaining constant. This analysis is for illustrative purposes only. The sensitivity analysis excludes the impact of market risks on net post employment benefit obligations.

20. Derivative financial instruments (continued)

Interest rate sensitivity

The interest rate sensitivity analysis is based on the following assumptions:

- changes in market interest rates affect the interest income or expense of variable interest financial instruments;
- changes in market interest rates only affect the income statement in relation to financial instruments with fixed interest if these are recognised at their fair value; and
- changes in market interest rates affect the fair value of derivative financial instruments designated as hedging instruments.

Under these assumptions, a one percentage point fall or rise in market interest rates for all currencies in which the Group has variable net cash or net borrowings at 31 December 2011 would reduce or increase profit before tax by approximately £0.1m (2010: £0.5m). There is no significant impact on equity.

Currency sensitivity

Taking the 2011 sales by currency, a 10% weakening / strengthening in the 2011 cumulative average rates for all currencies versus sterling would have given rise to a +£56.8m / -£46.5m movement in sales respectively. The impact on headline operating profit is affected by the mix of losses and profits in the various currencies. However, taking the 2011 operating profit mix, a 10% weakening / strengthening in 2011 cumulative average rates for all currencies would have given rise to a +£9.9m / -£8.1m movement in headline operating profit.

Counterparty risk

Counterparty risk encompasses settlement risk on derivative financial instruments and money market contracts and credit risk on cash, time deposits and money market funds. The Group monitors its credit exposure to its counterparties via their credit ratings (where applicable) and through its policy, thereby limiting its exposure to any one party to ensure there is no significant concentration of credit risk. Group policy is to enter into such transactions only with counterparties with a long-term credit rating of A- / A3 or better. However, acquired businesses occasionally have dealings with banks with lower credit ratings. Business with such banks is moved as soon as practicable.

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 periods:

	Accelerated tax depreciation £m	Tax losses £m	Retirement benefit obligations £m	Other £m	Total £m
At 1 January 2010	54.2	(12.3)	(4.1)	(21.3)	16.5
(Credit) / charge to income	(2.5)	5.3	–	3.9	6.7
Charge to equity	–	–	0.9	–	0.9
Disposal of subsidiaries	–	(0.1)	–	–	(0.1)
Transfers	(10.7)	(1.7)	0.1	13.0	0.7
Exchange differences	–	(0.1)	–	0.2	0.1
Effect of change in tax rate:					
Income statement	0.1	–	–	(0.1)	–
At 1 January 2011	**41.1**	**(8.9)**	**(3.1)**	**(4.3)**	**24.8**
(Credit) / charge to income	**1.4**	**8.0**	**0.4**	**(3.3)**	**6.5**
Credit to equity	**–**	**–**	**(0.5)**	**(1.7)**	**(2.2)**
Transfers	**(2.9)**	**(3.8)**	**(0.1)**	**5.2**	**(1.6)**
Exchange differences	**(0.5)**	**0.3**	**0.1**	**(0.2)**	**(0.3)**
Effect of change in tax rate:					
Income statement	**0.4**	**–**	**–**	**(0.4)**	**–**
At 31 December 2011	**39.5**	**(4.4)**	**(3.2)**	**(4.7)**	**27.2**

The following is the analysis of the deferred tax balances for financial reporting purposes:

	2011 £m	2010 £m
Deferred tax liabilities	**79.5**	73.1
Deferred tax assets	**(52.3)**	(48.3)
	27.2	24.8

Other deferred tax assets relate to provisions recognised in the financial statements that are not yet deductible for tax purposes, in particular in relation to restructuring charges, share-based payments and local profit differences that are expected to reverse over time.

At the balance sheet date, the Group has unused tax losses of £183.1m (2010: £208.0m) available for offset against future profits. A deferred tax asset has been recognised in respect of £96.3m (2010: £101.0m) of such losses, based on management forecasts of future taxable profits against which the assets can be recovered in the relevant jurisdictions. No deferred tax asset has been recognised in respect of the remaining £86.8m (2010: £107.0m) of such losses where there remains uncertainty over the timing of utilisation relating to future profitability. The majority of losses may be carried forward indefinitely.

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22. Obligations under finance leases

	Minimum lease payments		Present value of minimum lease payments	
	2011	2010	**2011**	2010
	£m	£m	**£m**	£m
Amounts payable under finance leases:				
Within one year	**0.3**	0.5	**0.2**	0.4
In the second to fifth years inclusive	**0.5**	0.5	**0.5**	0.4
After five years	**–**	0.3	**–**	0.3
	0.8	1.3	**0.7**	1.1
Less: future finance charges	**(0.1)**	(0.2)		
Present value of lease obligations	**0.7**	1.1		
Analysed as:				
Amount due for settlement after 12 months			**0.5**	0.7
Amount due for settlement within 12 months (shown under current liabilities)			**0.2**	0.4
			0.7	1.1

The present value of minimum lease payments is denominated in the following currencies:

	2011	2010
Sterling	**0.5**	0.6
US Dollar	**0.1**	0.3
Euro	**0.1**	0.2
	0.7	1.1

It is the Group's policy to lease certain of its fixtures and equipment under finance leases. The average lease term is 5.2 years. For the year ended 31 December 2011, the average effective borrowing rate was 7.8% (2010: 7.8%). 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

Trade and other payables

	2011 £m	2010 £m
Amounts falling due within one year:		
Trade creditors	**39.8**	38.6
Other taxes and social security*	**16.6**	16.5
Other creditors	**20.8**	21.8
Accruals and deferred income	**49.7**	43.5
	126.9	120.4
Amounts falling due after more than one year:		
Other creditors	**4.5**	4.1

*Other financial liabilities include other taxes and social security, which are not included as financial liabilities in IFRS 7.

Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases as at 31 December 2011 is 47 days (2010: 46 days).

The Directors consider that the carrying amount of trade payables approximates to their fair value.

23. Other financial liabilities (continued)

The following table details the Group's remaining contractual maturity for its financial liabilities. The table has been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay. The table includes both interest and principal cash flows.

	Less than 1 year 2011 £m	**1–2 years 2011 £m**	**2–5 years 2011 £m**	**5+ years 2011 £m**	**Total 2011 £m**
Non-interest bearing*	**137.5**	**3.4**	**5.2**	**7.3**	**153.4**
Finance lease liability	**0.3**	**0.2**	**0.3**	**–**	**0.8**
Bank loans and overdrafts	**16.9**	**0.2**	**0.2**	**0.2**	**17.5**
Derivative financial instruments	**1.3**	**3.4**	**–**	**–**	**4.7**
	156.0	**7.2**	**5.7**	**7.5**	**176.4**

	Less than 1 year 2010 £m	1–2 years 2010 £m	2–5 years 2010 £m	5+ years 2010 £m	Total 2010 £m
Non-interest bearing*	134.4	3.5	4.7	8.7	151.3
Finance lease liability	0.5	0.3	0.2	0.3	1.3
Bank loans and overdrafts	95.5	0.2	0.2	0.3	96.2
Derivative financial instruments	0.9	–	–	–	0.9
	231.3	4.0	5.1	9.3	249.7

Of the £17.4m (2010: £96.2m) bank loan and overdraft outflows disclosed above, £Nil (2010: £Nil) and £6.0m (2010: £64.4m) of bank loans are drawn under committed facilities maturing on 31 August 2016 and 31 July 2013 respectively. The overdrafts are on-demand and largely part of pooling arrangements, which include offsetting cash balances. Of the £4.7m (2010: £0.9m) derivative financial instrument outflows disclosed above, £4.5m (2010: £0.9m) are matched by derivative cash inflows.

* Non-interest bearing financial liabilities include other taxes and social security, which are not included as financial liabilities in IFRS 7. These are payable in less than one year.

24. Provisions

	Restructuring £m	**Restructuring Environmental £m**	**Environmental £m**	**Total £m**
At 1 January 2011	**10.0**	**10.2**	**6.6**	**26.8**
Increase in provision	**1.2**	**–**	**0.4**	**1.6**
Utilisation of provision	**(4.9)**	**(0.8)**	**(0.4)**	**(6.1)**
Exchange difference	**(0.1)**	**(0.1)**	**(0.1)**	**(0.3)**
At 31 December 2011	**6.2**	**9.3**	**6.5**	**22.0**
Included in current liabilities				**10.6**
Included in non-current liabilities				**11.4**
				22.0

The restructuring provision relates to the remaining costs associated with the closure of various Heat Treatment sites. Further details are contained in the Finance Director's Report.

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 and is separated into Restructuring Environmental and Environmental to separately identify environmental provisions relating to the restructuring programme from those arising in the ordinary course of business.

The increase in restructuring provisions is due to the ongoing implementation of the global restructuring initiatives. In addition income of £0.1m was recognised following the disposal of non core assets associated with the restructuring plans. The reversal of certain asset impairments of £0.6m was also recognised in relation to the ongoing restructuring.

Cash outflows in respect of these liabilities are expected to occur within 5 years.

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25. Share capital

	2011 £m	2010 £m
Issued and fully paid:		
191,263,667 (2010: 189,881,917) ordinary shares of 17 $^{3}/_{11}$p each	**33.0**	32.8

26. Notes to the cash flow statement

	2011 £m	2010 £m
Profit for the year	**56.0**	27.7
Adjustments for:		
Investment revenue	**(0.2)**	(0.3)
Finance costs	**4.8**	6.3
Taxation – continuing and discontinued	**19.8**	17.5
Depreciation of property, plant and equipment	**48.2**	46.1
Amortisation of intangible assets	**2.9**	2.2
Loss on disposal of property, plant and equipment	**0.7**	0.7
Share-based payments	**5.4**	4.2
Impairment / reversal of impairment of fixed assets	**(0.1)**	–
Impairment charge	**4.2**	–
Negative goodwill released to income	**(0.6)**	–
Major facility closure costs	**–**	(1.6)
EBITDA*	**141.1**	102.8
Increase in inventories	**(2.8)**	(2.7)
Increase in receivables	**(7.9)**	(4.7)
Increase in payables	**8.9**	15.5
Decrease in provisions	**(4.5)**	(7.0)
Cash generated by operations	**134.8**	103.9
Cash inflow / (outflow) from settlement of derivative financial instruments	**0.3**	(2.9)
Income taxes paid	**(15.3)**	(5.4)
Net cash from operating activities	**119.8**	95.6

* Earnings before interest, tax, depreciation, amortisation, impairment and share-based payments.

	2011 £m	2010 £m
Cash and cash equivalents comprise:		
Cash and bank balances	**18.1**	23.5
Bank overdrafts (included in borrowings)	**(8.6)**	(5.9)
	9.5	17.6

27. Operating lease arrangements – the Group as lessee

	2011 £m	2010 £m
Minimum lease payments under operating leases recognised as an expense	**14.6**	14.4

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:

	2011 £m	2010 £m
Within one year	**10.7**	11.7
In the second to fifth years inclusive	**21.1**	19.2
After five years	**15.0**	14.6
	46.8	45.5

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

28. Share-based payments

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 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 2011	No. of options outstanding 2010
Apr-01	203.37	2004-2011	–	262,002
Sep-02	125.76	2005-2012	**53,474**	112,295
Sep-03	147.27	2006-2013	**139,031**	311,654
			192,505	685,951

Movements in share options are summarised as follows:

	Number of shares under option 2011	Weighted average exercise price 2011 pence	Number of shares under option 2010	Weighted average exercise price 2010 pence
Outstanding at the beginning of the year	**685,951**	**165.18**	1,266,320	183.95
Exercised during the year	**(381,750)**	**172.15**	(214,204)	167.77
Expired during the year	**(111,696)**	**184.95**	(366,165)	222.16
Outstanding and exercisable at the end of the year	**192,505**	**141.25**	685,951	165.18

The weighted average share price at the date of exercise for share options exercised during the year was 172.15 pence. The options outstanding at 31 December 2011 had a weighted average exercise price of 141.25 pence, and a weighted average remaining contractual life of 1.4 years. The average share price during the year was 310.2 pence.

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

		2011	2010
Weighted average share price	pence	**157.5**	157.5
Weighted average exercise price	pence	**157.5**	157.5
Expected volatility	%	**42.7**	42.7
Expected life	years	**3.0**	3.0
Risk-free rate	%	**4.0**	4.0
Expected dividends	%	**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.

Bodycote Incentive Plan (BIP)

The Company operates the BIP under which Executive Directors and senior executives received a conditional award of Bodycote shares up to a maximum of 175% of base salary. Vestings of awards are based upon two performance measures, over a three year period.

Fifty per cent of the award is subject to a return on capital employed ("ROCE") performance condition and fifty per cent of the award is subject to an earnings per share ("EPS") performance condition.

In the event that threshold performance for both EPS and ROCE is not achieved none of the conditional awards will vest.

Bodycote Co-investment Plan ("CIP")

The CIP permits executives to invest in shares up to a value equivalent to 40% of net basic salary. The CIP provides for the grant of awards of matching shares to participants on an annual basis in a maximum ratio of 1:1 to the gross investment made in deferred shares. Deferred shares must be held for three years and matching shares are subject to an absolute Total Shareholder Return ("TSR") target. The threshold target for CIP matching awards is TSR growth of not less than 4% per annum compound in excess of growth in the Consumer Prices Index (CPI) for a threshold matching ratio of 1:2 . 10% per annum compound growth in excess of growth in the CPI will be required for a vesting matching ratio of 1:1.

The number of outstanding share awards is as follows:

	BIP 2011	CIP 2011	BIP 2010	CIP 2010
Balance at 1 January	**4,491,128**	**193,257**	2,445,972	–
Granted during the year	**1,372,585**	**64,176**	2,307,051	195,466
Expired during the year	**(479,146)**	**(21,451)**	(261,895)	(2,209)
Balance at 31 December	**5,384,567**	**235,982**	4,491,128	193,257

Exercise Price = £Nil

Fair value is calculated as the share price at the date of the award. No exercise price is payable at vesting.

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28. Share-based payments (continued)

The inputs to the Monte Carlo Valuation model, used to determine the charge to the income statement for CIP are as follows:

		2011	2010
Weighted average share price	pence	**375.8**	180.0
Weighted average exercise price	pence	**Nil**	Nil
Expected volatility	%	**50.0**	50.0
Expected Life	years	**3.0**	3.0
Risk-free rate	%	**4.0**	4.0
Expected dividend yields	%	**2.3**	2.3

The Group recognised total expenses of £5.4m (2010: £4.2m) related to equity-settled share-based payment transactions.

29. 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.

The remuneration of the Board of Directors, who are considered key management personnel of the Group, was as follows:

	2011 £m	2010 £m
Short-term employee benefits	**1.9**	1.6
Share-based payments	**–**	–
	1.9	1.6

Further information about the remuneration of the individual directors is provided in the Board Report on Remuneration on pages 43 to 48.

30. Retirement benefit obligations

The Group operated a number of pension schemes and provided leaving service benefits to certain employees 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 below as follows:

Defined benefit schemes

	2011 £m	2010 £m
UK Scheme	**(1.8)**	(0.6)
Non-UK Schemes	**(11.7)**	(11.0)
	(13.5)	(11.6)

Total expense recognised in income statement

	2011 £m	2010 £m
UK Scheme	**0.9**	1.1
Non-UK Schemes	**1.3**	1.2
	2.2	2.3

Further details of the Group's defined benefit arrangements are given in the Finance Director's Report on page 24.

UK Scheme

The Company sponsors the Bodycote UK Pension Scheme which is a funded defined benefit arrangement for certain UK employees. The preliminary actuarial valuation of the scheme was carried out by a qualified independent actuary as at 6 April 2011 and was updated on an approximate basis to 31 December 2011.

The contributions made by the employer over the financial year have been £1.1m, comprising £0.7m in respect of benefit accrual and £0.4m in respect of ongoing expense. This level of contribution is currently under review following the 6 April 2011 triennial valuation of the Scheme.

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

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

	2011 £m	2010 £m
Defined benefit obligation at start of year	**75.8**	73.6
Current service cost	**0.8**	0.8
Interest cost	**4.1**	4.2
Contributions by plan participants	**0.3**	0.3
Actuarial loss / (gain)	**7.2**	(0.8)
Benefits paid, death in service insurance premiums and expenses	**(6.0)**	(2.3)
Defined benefit obligation at end of year	**82.2**	75.8

30. Retirement benefit obligations (continued)

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

	2011 £m	2010 £m
Fair value of assets at start of year	**75.2**	69.9
Expected return on assets	**4.0**	3.9
Actuarial gain	**5.6**	2.3
Contributions by employer	**1.1**	1.0
Contributions by plan participants	**0.3**	0.3
Age related rebate	**0.2**	0.1
Benefits paid, death in service insurance premiums and expenses	**(6.0)**	(2.3)
Fair value of assets at end of year	**80.4**	75.2

Total expense recognised in the income statement

	2011 £m	2010 £m
Current service cost	**0.8**	0.8
Interest on pension scheme liabilities	**4.1**	4.2
Expected return on pension scheme assets	**(4.0)**	(3.9)
Total expenses	**0.9**	1.1

Of the total expenses for the year £0.8m (2010: £0.8m) has been included in cost of sales and overheads and the remaining £0.1m (2010: £0.3m) has been included in finance costs. The cumulative amount of actuarial losses recognised in other comprehensive income since adoption of IAS 19 is £11.5m.

Assets

	2011 £m	2010 £m	2009 £m
Equities (including property)	**27.1**	32.2	26.0
Bonds (including gilts)	**47.9**	38.1	38.7
Cash	**1.0**	0.2	0.1
With profits insured policy	**–**	–	0.6
Hedge funds	**4.4**	4.7	4.5
	80.4	75.2	69.9

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

Expected long-term rates of return
The expected long-term return on cash is equal to bank base rate 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 rates 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:

	2011 % per annum	2010 % per annum	2009 % per annum
Equities	**5.4**	6.9	7.3
Bonds	**3.8**	4.9	5.3
With profits insured policy	**–**	–	5.3
Hedge funds	**5.4**	6.9	7.3
Cash	**0.5**	0.5	0.5
Overall for scheme	**4.4**	5.8	6.1

Actual return on plan assets
The actual return on the plan assets for the year ended 31 December 2011 was 13.5% (2010: 8.8%).

Assumptions

	2011 % per annum	2010 % per annum	2009 % per annum
RPI inflation	**3.25**	3.65	3.70
CPI inflation	**2.75**	3.15	–
Salary increases	**3.00**	3.00	3.00
Rate of discount	**4.75**	5.50	5.70
Allowance for pension in payment increases of RPI or 5% p.a. if less	**3.58***	3.55	3.60
Allowance for pension in payment increases of RPI or 3% p.a. if less	**2.62**	2.75	2.80
Allowance for revaluation of deferred pensions	**2.75**	3.15	3.70

* CPI minimum 3%, maximum 5% for 2011

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Year ended 31 December 2011

30. Retirement benefit obligations (continued)

Mortality – current pensioners: Actuarial tables used	**S1PxA YoB CMI 2010 1.5% long term trend**	PA 92 YoB MC, 1% underpin	PA 92 YoB MC, 1% underpin
Life expectancy for members currently aged 65	**22.7**	22.5	22.5

Mortality – future pensioners: Actuarial tables used	**S1PxA YoB CMI 2010 1.5% long term trend**	PA 92 YoB MC, 1% underpin	PA 92 YoB MC, 1% underpin
Life expectancy at age 65 for members currently aged 40	**25.6**	24.0	24.0

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

	2011 £m	2010 £m	2009 £m
Present value of defined benefit obligation	**82.2**	75.8	73.6
Fair value of plan assets	**(80.4)**	(75.2)	(69.9)
Deficit in the scheme	**1.8**	0.6	3.7

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2011 is that recognised in the balance sheet.

The best estimate of contributions to be paid into the plan for the year ending 31 December 2012 is £1.2m.

Amounts for the current and previous four years

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Fair value of assets	**(80.4)**	(75.2)	(69.9)	(63.0)	(47.6)
Present value of defined benefit obligation	**82.2**	75.8	73.6	63.7	61.0
Deficit in the scheme	**1.8**	0.6	3.7	0.7	13.4
Gain / (loss) from experience adjustment on plan liabilities	**(7.7)**	–	–	(0.4)	0.1
Gain / (loss) from experience adjustment on plan assets	**5.7**	2.3	4.5	(10.7)	(0.8)

Impact of changes to assumptions
The impact of changes to certain assumptions on the current deficit and the 2012 charge to the income statement on the UK scheme is shown in the table below:

	Impact on current deficit £m	**Impact on 2012 charge to income statement £m**
Change in discount rate by 0.25% (decrease in rate increases liability)	**3.6**	–
Change in inflation assumption by 0.25% (increase in rate increases liability)	**1.2**	0.1
Change in mortality assumption from S1PxA CMI 2010 1.5% long term trend rate to S1PxA CMI 2010 1.0% long-term trend rate	**1.7**	0.1
Change in the value of equities by 5% (decrease increases liability)	**1.2**	0.1
Change in the expected return on equities assumption by 0.25%	**–**	0.1

30. Retirement benefit obligations (continued)

Combined non-UK disclosures

The Group operates schemes in the USA, Brazil and continental Europe. In the US there are three defined benefit pension arrangements. These are Metallurgical Inc Pension Plan, Combined Bodycote Pension Plan and the Supplemental Retirement Plan. All are closed to new accrual. The last full actuarial valuation of these schemes was carried out by a qualified independent actuary as at 1 January 2008 (31 December 2008 for the Metallurgical Plan) and updated on an approximate basis to 31 December 2011. Contributions made by the Company over the year were £0.4m. The Group also operates a defined benefit scheme for 1 employee in Brazil.

In Europe the Group operates defined benefit pension, post retirement and long-service arrangements for certain employees in France, Germany, Italy, Turkey (all of which are unfunded), Switzerland and Liechtenstein.

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

	2011 £m	2010 £m
Defined benefit obligation at start of year	**22.0**	19.8
Current service cost	**0.6**	0.6
Interest cost	**1.0**	1.0
Actuarial loss	**0.6**	–
Benefits paid, death in service insurance premiums and expenses	**(1.7)**	(0.9)
Settlement	**–**	–
Employee contributions	**0.2**	0.1
Past service cost	**–**	0.6
Acquisitions	**0.1**	–
Exchange rate (gain) / loss	**(0.8)**	0.8
Defined benefit obligation at end of year	**22.0**	22.0

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

	2011 £m	2010 £m
Fair value of assets at start of year	**10.4**	8.5
Expected return on assets	**0.4**	0.4
Actuarial (loss) / gain	**(0.2)**	0.1
Contributions by employer	**0.4**	0.5
Contributions by employees	**0.2**	0.1
Benefits paid, death in service insurance premiums and expenses	**(1.3)**	(0.3)
Exchange rate (loss) / gain	**(0.2)**	1.1
Fair value of assets at end of year	**9.7**	10.4

Total expense recognised in the income statement

	2011 £m	2010 £m
Current service cost	**0.6**	0.6
Interest on pension scheme liabilities	**1.0**	1.0
Expected return on pension scheme assets	**(0.4)**	(0.4)
Acquisitions	**0.1**	–
Total expenses	**1.3**	1.2

Of the total expenses for the year £0.7m (2010: £0.6m) has been included in costs of sales and overheads and the remaining £0.6m (2010: £0.6m) has been included in the finance costs. The cumulative amount of actuarial losses recognised in the Statement of Comprehensive Income since adoption of IAS 19 is £2.7m.

Notes to the consolidated financial statements

Year ended 31 December 2011

30. Retirement benefit obligations (continued)

Assets

	2011 £m	2010 £m	2009 £m
Equities	**1.1**	1.1	0.9
Bonds	**0.5**	0.6	0.7
Cash	**1.4**	1.3	0.9
Insurance contracts – Brazil	**0.2**	1.2	1.0
Insurance contracts – Switzerland and Liechtenstein	**6.5**	6.2	5.0
	9.7	10.4	8.5

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

Expected long-term rates of return

The expected long-term return on assets varies by country and each reflect the respective expected future market rates or returns on assets underlying insurance contracts where relevant.

Actual return on plan assets

The actual return on the plan assets for the year ending 31 December 2011 was 0%.

Assumptions for 2011

	Salary increases % per annum	**Rate of discount % per annum**	**Inflation % per annum**	**Pension increases % per annum**
USA	n/a	4.75	n/a	n/a
Brazil	6.59	10.30	4.50	n/a
France	3.00	4.60	2.00	n/a
Germany	2.50	4.60	n/a	1.75
Italy	n/a	4.80	2.00	n/a
Turkey	n/a	10.00	5.10	n/a
Liechtenstein	2.50	2.40	n/a	n/a
Switzerland	3.00	2.40	n/a	n/a

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

	2011 £m	2010 £m	2009 £m
Present value of defined benefit obligation	**22.0**	22.0	19.8
Fair value of plan assets	**(9.7)**	(10.4)	(8.5)
Deficit in the scheme	**12.3**	11.6	11.3
Unrecognised prior service cost	**(0.6)**	(0.6)	–
Net liability recognised in the balance sheet	**11.7**	11.0	11.3

As all actuarial gains and losses are recognised, the deficit shown above at 31 December 2011 is that recognised in the balance sheet.

Amounts for the current and previous four years

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Fair value of assets	**(9.7)**	(10.4)	(8.5)	(8.4)	(4.1)
Present value of defined benefit obligation	**22.0**	22.0	19.8	22.6	14.6
Deficit in the scheme	**12.3**	11.6	11.3	14.2	10.5
Gain / (loss) from experience adjustment on plan liabilities	**0.1**	0.5	(0.3)	(3.7)	(0.9)
Gain / (loss) from experience adjustment on plan assets	**(0.2)**	0.1	0.6	2.9	0.1
Loss from effects of changing assumptions	**(0.6)**	(0.5)	(0.7)	(0.5)	(1.2)

The only funded plans are those operated in USA, Brazil, Switzerland and Liechtenstein. The best estimate of contributions to be paid into the plans for the year ending 31 December 2012 is £0.4m.

Five Year Summary

	2011 £m	2010 £m	2009 £m	2008 £m	2007 £m
Revenue					
Existing operations	**570.7**	499.8	435.4	551.8	465.2
Discontinued operations	–	–	–	164.9	175.3
Revenue – continuing and discontinued operations	**570.7**	499.8	435.4	716.7	640.5
Profit for continuing and discontinued operations:					
Headline operating profit	**85.5**	52.1	8.0	91.7	91.3
Share of results of associates' interest and tax	–	–	–	–	–
Amortisation and impairment of goodwill and intangible fixed assets	**(0.9)**	(0.9)	(32.8)	(33.8)	(9.1)
Impairment charge	**(4.2)**	–	–	(12.1)	–
Major facility closure costs	–	–	(25.4)	(77.6)	(5.4)
Change to pension scheme rules	–	–	–	–	4.1
Bid response costs	–	–	–	–	(2.1)
Profit on disposal of operations	–	–	–	199.3	–
Profit / (loss) before interest and tax	**80.4**	51.2	(50.2)	167.5	78.8
Net interest payable	**(4.6)**	(6.0)	(4.3)	(10.0)	(10.3)
Profit / (loss) before taxation	**75.8**	45.2	(54.5)	157.5	68.5
Taxation	**(19.8)**	(17.5)	3.4	(6.8)	(14.7)
Profit / (loss) after taxation	**56.0**	27.7	(51.1)	150.7	53.8
Non-controlling interests	**(0.2)**	(0.1)	1.0	(0.9)	(1.0)
Profit / (loss) attributable to the equity holders of the parent	**55.8**	27.6	(50.1)	149.8	52.8
Headline earnings per share (pence)	**32.7**	18.3	0.4	17.5	16.6
Dividends per share (pence)	**10.9**	8.7	8.3	8.3	8.0
Assets employed					
Intangible fixed assets	**111.5**	118.1	118.8	154.4	227.3
Tangible fixed assets	**443.9**	458.0	461.8	533.3	508.9
Other assets and liabilities	**(72.9)**	(74.0)	(72.5)	(126.1)	(41.4)
	482.5	502.1	508.1	561.6	694.8
Financed by					
Share capital	**33.0**	32.8	32.5	32.4	32.4
Reserves	**448.3**	416.3	387.8	459.6	457.6
Shareholders' funds	**481.3**	449.1	420.3	492.0	490.0
Non-controlling interests	**1.3**	1.7	2.3	4.9	6.6
Net borrowings / (cash)	**(0.1)**	51.3	85.5	64.7	198.2
Capital Employed	**482.5**	502.1	508.1	561.6	694.8
Net assets per share (pence)	**251.6**	236.5	223.4	262.4	151.4
Return on capital employed (%):					
Headline operating profit (continuing and discontinued operations) divided by average capital employed	**16.9**	10.1	1.5	12.6	13.9

Independent auditor's report

To the Members of Bodycote plc

We have audited the parent company financial statements of Bodycote plc for the year ended 31 December 2011, which comprise the Parent Company Balance Sheet, the Company Accounting Policies and the related notes 1 to 11. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor's 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 auditor

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the parent company financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2011;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the parent company financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the Group financial statements of Bodycote plc for the year ended 31 December 2011 and the information in the Board Report on Remuneration that is described as having been audited.

Nicola Mitchell

Nicola Mitchell (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Manchester, UK
23 February 2012

Company balance sheet

At 31 December 2011

	Note	2011 £m	2010 £m
Fixed assets			
Tangible fixed assets	2	**3.5**	3.1
Investments	3	**401.2**	393.2
		404.7	396.3
Current assets			
Debtors:			
– due within one year	4	**7.1**	11.2
– due after one year	4	**35.5**	56.8
Cash at bank and in hand		**1.3**	0.7
		43.9	68.7
Current liabilities			
Creditors: Amounts falling due within one year	5	**(10.1)**	(8.1)
Net current assets		**33.8**	60.6
Total assets less current liabilities		**438.5**	456.9
Creditors: Amounts falling due after more than one year	5	**(0.4)**	(0.6)
Net assets		**438.1**	456.3
Capital and reserves			
Called-up share capital	7	**33.0**	32.8
Share premium account	7	**176.9**	176.3
Other reserves	7	**135.4**	124.6
Profit and loss account	7	**92.8**	122.6
Shareholders' funds		**438.1**	456.3

The financial statements of Bodycote plc, registered number 519057, were approved by the Board of Directors and authorised for issue on 23 February 2012. They were signed on its behalf by:

S. C. Harris
D. F. Landless } Directors

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Company accounting policies

Accounting convention
The financial statements have been prepared under the historical cost convention and in accordance with applicable law and United Kingdom accounting standards. The principal accounting policies are summarised below. They have all 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 408 of the Companies Act 2006 a separate profit and loss account dealing with the results of the Company has not been presented.

Going concern
The Directors have at the time of approving the financial statements, a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the financial statements. Further detail is contained in the Finance Director's Report on page 25.

Investments
Investments are held at cost less provision for impairment.

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. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Gains and losses arising on retranslation are included in net profit or loss for the period.

Pension costs
For defined benefit and defined contribution schemes, the amount charged to the profit and loss account in respect of pension costs is the contributions payable in the year. For further details see note 10.

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 on a straight-line basis 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 net of depreciation and any provision for impairment. 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:

Fixtures and fittings	10% to 20%
Software	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 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.

Related party transactions

The Company has taken advantage of the exemption contained in FRS 8 'Related Party Transactions' not to disclose transactions or balances with wholly-owned entities of the Group.

Share-based payments

The Company has applied the requirements of FRS 20 'Share-based Payment'.

The Company 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. At each balance sheet date, the Company revises its estimate of the number of equity instruments expected to vest as a result of the effect of non-market based vesting conditions. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimates with a corresponding adjustment to the equity-settled employee benefits reserve.

Notes to the company financial statements

Year ended 31 December 2011

1. Loss for the year

Bodycote plc reported a loss for the financial year ended 31 December 2011 of £10.0m (2010: loss £8.3m).

The auditor's remuneration for audit and other services is disclosed in note 3 to the consolidated financial statements.

Disclosure of individual directors' remuneration, share interests, share options, long term incentive schemes, pension contributions and pension entitlements required by the Companies Act 2006 and those specified for audit by the Listing Rules of the Financial Services Authority are shown in the tables in the Board Report on Remuneration on pages 43 to 48 and form part of these financial statements.

2. Tangible fixed assets

	Fixtures and fittings £m	Software £m	Total £m
Cost			
At 1 January 2011	0.9	3.7	4.6
Additions	0.2	1.7	1.9
Disposals	(0.3)	–	(0.3)
At 31 December 2011	**0.8**	**5.4**	**6.2**
Depreciation			
At 1 January 2011	0.4	1.1	1.5
Charge for the year	0.1	1.4	1.5
Disposals	(0.3)	–	(0.3)
At 31 December 2011	**0.2**	**2.5**	**2.7**
Net book value			
At 31 December 2011	**0.6**	**2.9**	**3.5**
At 31 December 2010	0.5	2.6	3.1

3. Investments

	Shares £m	Sundry investments £m	Total £m
Cost			
At 1 January 2011	400.3	–	400.3
Acquisitions	7.8	0.8	8.6
Disposals	(0.6)	–	(0.6)
At 31 December 2011	**407.5**	**0.8**	**408.3**
Provision for impairment			
At 1 January 2011 and at 31 December 2011	**7.1**	**–**	**7.1**
Net book value			
At 31 December 2011	**400.4**	**0.8**	**401.2**
At 31 December 2010	393.2	–	393.2

The sundry investments relate to the Bodycote Investment Incentive Plan, as explained in the Board Report on Remuneration.

Details of principal subsidiary undertakings of the Company are shown on pages 97 and 98.

4. Debtors

	2011 £m	2010 £m
Amounts falling due within one year:		
Amounts owed by subsidiary undertakings	**0.8**	0.5
Corporation tax recoverable	**3.4**	6.3
Deferred taxation (note 6)	**1.8**	2.5
Finance lease receivables	**–**	0.4
Other debtors and prepayments	**1.1**	1.5
	7.1	11.2
Amounts falling due after more than one year:		
Amounts owed by subsidiary undertakings	**34.8**	56.8
Other debtors	**0.7**	–
	35.5	56.8
	42.6	68.0

5. Creditors

	2011 £m	2010 £m
Amounts falling due within one year:		
Trade creditors	**0.7**	0.9
Amounts owed to subsidiary undertakings	**0.1**	2.9
Other taxes and social security	**0.2**	0.1
Other creditors	**3.0**	0.8
Accruals and deferred income	**6.1**	3.4
	10.1	8.1
Amounts falling due after more than one year:		
Amounts owed to subsidiary undertakings	**0.4**	0.6
	0.4	0.6

6. Deferred tax asset

	£m
At 1 January 2011	2.5
Profit and loss charge	(0.7)
At 31 December 2011	**1.8**

	2011 £m	2010 £m
Deferred tax is recognised as follows:		
Tax losses	**0.4**	0.4
Other timing differences	**1.4**	2.1
Deferred tax asset	**1.8**	2.5

Notes to the company financial statements

Year ended 31 December 2011

7. Capital and reserves

Share capital:
Ordinary shares (allotted, called-up and fully paid)

	Number of shares	£m
At 1 January 2011	189,881,917	32.8
Allotted in the year	1,381,750	0.2
At 31 December 2011	**191,263,667**	**33.0**

Details of share options in issue on the Company's share capital and share-based payments are set out in note 28 to the consolidated financial statements.

Reserves:

	Share premium account £m	Other reserves £m	Profit and loss account £m	Total £m
At 1 January 2011	176.3	124.6	122.6	423.5
Dividends paid	–	–	(17.4)	(17.4)
Loss for the year	–	–	(10.0)	(10.0)
Premium arising on issue of equity shares (net of expenses)	0.6	–	–	0.6
Share-based payments	–	9.5	–	9.5
Acquisition of own shares	–	(1.1)	–	(1.1)
Settlement of share options	–	2.4	(2.4)	–
At 31 December 2011	**176.9**	**135.4**	**92.8**	**405.1**

The other reserves are stated after deducting £6.7m (2010: £8.0m) relating to shares held in the Bodycote International Employee Benefit Trust. The Bodycote International Employee Benefit Trust holds Bodycote plc shares and satisfies awards made under various employee incentive schemes when issuance of new shares is not appropriate.

At 31 December 2011 5,089,830 (2010: 3,837,581) ordinary shares of 17 $^{3}/_{11}$p each were held by the Bodycote International Employee Benefit Trust and, following recommendations by the employer, are provisionally allocated to satisfy awards under employee incentive schemes. The trust waives payment of dividend. The market value of these shares was £13.4m (2010: £10.8m).

Included in other reserves is the capital redemption reserve of £129.4m (2010: £129.4m).

8. Contingent liabilities

The Company has guaranteed bank overdrafts, loans and letters of credit of certain subsidiary undertakings amounting to £18.6m (2010: £80.5m).

9. Financial commitments

Annual commitments under non-cancellable operating leases are as follows:

	2011 £m	2010 £m
Within one year	**0.3**	0.3
In the second to fifth years inclusive	**0.8**	0.8
After five years	**0.3**	0.5
	1.4	1.6

Operating lease payments represent rentals payable by the Company for its land and buildings.

10. Pension commitments

The Company participates in a group defined benefit scheme, the details of which are disclosed in note 30 to the consolidated 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 30 to the consolidated financial statements. These also satisfy the requirements of FRS17 'Retirement Benefits'.

The contributions made by the Company over the financial year to both the defined contribution and the defined benefit schemes amounted to £0.4m (2010: £0.4m) and £0.1m (2010: £0.1m) respectively.

11. Related party transactions

During the current and prior year, the Company has not entered into any transactions with related parties who are not wholly-owned members of the Group.

Principal subsidiary undertakings

Thermal Processing – Heat Treatment and Metal Joining

Company name	Plants	Country of Incorporation
*Bodycote Heat Treatments Limited	Cambridge, Chard, Cheltenham, Coventry, Derby, Gillingham, Great Barr, Hazel Grove, Macclesfield, Rotherham, Skelmersdale, Stillington and Woodford	England
Bodycote Hardiff GmbH	Landsberg	Germany
Bodycote Wärmebehandlung GmbH	Ebersbach, Eching, Essen, Esslingen, Karben, Korntal, Langenfeld, Langenselbold, Lüdenscheid, Menden, Nürnberg, Otterfing, Remscheid, Sömmerda, Sprockhövel and Wehingen	Germany
Nitrion GmbH Nitriding Technology and Equipment	Otterfing	Germany
Bodycote Hardingscentrum BV	Diemen, Hengelo, Tilburg and Venlo	Netherlands
Bodycote Hardiff BV	Apeldoorn	Netherlands
Bodycote Värmebehandling AB	Göteborg, Hudiksvall, Karlskoga, Malmö, Mora, Stockholm, Värnamo and Västerås	Sweden
Bodycote SAS	Ambazac, Amiens, Beaugency, Billy-Berclau, Cernay, Chanteloup les Vignes, Chassieu, Condé sur Noireau, Duttlenheim, Gemenos, Gennevilliers, Lagny sur Marne, La Monnerie Le Montel, La Talaudière, Le Subdray, Neuilly en Thelle, Nogent, Pusignan, Serres Castet, St Aubin les Elbeuf, St Nicolas d'Aliermont, St Rémy en Mauges, Villaz and Voreppe	France
Techmeta SA	Metz-Tessy	France
Nitruvid SAS	Argenteuil and Gandrange	France
Bodycote Belgium SA	Brussels	Belgium
Bodycote Lämpökäsittely Oy	Pieksämäki, Tampere, Vaasa and Vantaa	Finland
Bodycote Varmebehandling A/S	Herlev and Ejby	Denmark
Bodycote Italia Srl	Gorgonzola	Italy
Bodycote Trattamenti Termici SPA	Flero, Madone and Rodengo	Italy
Bodycote Wärmebehandlung Wien GmbH	Kapfenberg, Marchtrenk and Vienna	Austria
Bodycote Rheintal Wärmebehandlung AG	Schaan	Liechtenstein
Bodycote Schweiz Wärmebehandlung AG	Urdorf	Switzerland
Bodycote HT S.r.o	Brno, Liberec, Krnov, Plzen and Prague	Czech Republic
Bodycote Polska Sp z.o.o	Czestochowa, Chelmno, Swiebodzin, Warsaw and Zabrze	Poland
Bodycote Tratamente Termice SRL	Brasov and Cugir	Romania
Bodycote Hökezelö KFT	Budapest	Hungary
‡Bodycote Istas Isil Islem Sanayi ve Ticaret AS (60% owned)	Ankara, Bursa, Istanbul and Izmir	Turkey
Bodycote Thermal Processing, Inc.	Fremont, Santa Fe Springs, Huntington Park, Rancho Dominguez, Vernon, Westminster CA, Berlin, Waterbury, South Windsor, Suffield CT, Ipswich, Worcester MA, Canton, Livonia MI, Cincinnati, Cleveland, London OH, Oklahoma City, Tulsa OK, Arlington, Houston, Fort Worth TX, Laconia NH, Melrose Park IL, Indianapolis IN, Eden Prairie MN, Rochester NY, Sturtevant and New Berlin WI	USA
Bodycote Thermal Processing Canada, Inc.	Newmarket and Kitchener ON	Canada
Bodycote Thermal Processing Mexico Limited	Silao and Guaymas, Mexico	England
Bodycote Brasimet Processamento Termico Ltda	Campinas, Joinville, Sao Leopoldo and Jundiai	Brazil
Bodycote Wuxi Technology Co. Limited	Wuxi	China
Bodycote (Ningbo) Heat Treatment Co. Limited	Ningbo	China
Bodycote Metallurgical Services India Pvt Limited	Ranjangaon	India

Principal subsidiary undertakings continued

Thermal Processing – Hot Isostatic Pressing

Company name	Plants	Country of Incorporation
*Bodycote H.I.P. Ltd	Chesterfield and Hereford	England
Bodycote IMT Inc.	Andover MA, London OH and Princeton KT and Camas WA	USA
Bodycote Heiß-Isostatisches Pressen GmbH	Haag	Germany
Bodycote IMT NV	Sint-Niklaas	Belgium
Bodycote Japan K.K.	Nagoya	Japan
Bodycote SAS	Magny-Cours	France
Bodycote Hot Isostatic Pressing AB	Surahammer	Sweden

Thermal Processing – Surface Engineering

Company name	Plants	Country of Incorporation
*Bodycote Metallurgical Coatings Limited	Knowsley, Macclesfield, Stonehouse, Newport, Neath, Skelmersdale, Wolverhampton and Dubai	England
Bodycote K-Tech, Inc.	Hot Springs, AR	USA
Bodycote Ytbehandling AB	Katrineholm, Karlstad, and Västra Frölunda	Sweden
Bodycote Singapore Pte Ltd	Singapore	Singapore
Bodycote Argentina SA	Buenos Aires	The Argentine

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

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Shareholder enquiries

Enquiries on the following administrative matters can be addressed to the Company's registrars at The Registry, 34 Beckenham Road, Beckenham, Kent BR3 4TU. Telephone 0871 664 0300 (calls to 0871 numbers cost 10p per minute plus network extras – lines are open 8.30am until 5.30pm, Monday to Friday) or +44 (0)208 639 3399; 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.

Share dealing service

Information on a low cost share dealing service offered by our registrar is available from Capita on 0871 664 0346 (calls cost 10p per minute plus network extras; lines are open 8am to 4.30pm, Monday to Friday). For the on-line service, Capita's commission rates are 1% of the value of the deal (minimum £20.00, maximum £75) and for the telephone service, Capita's commission rates are 1.50% of the value of the deal (minimum £25.00, maximum £102.50).

Dividend reinvestment plan ('DRIP')

This plan allows you to use your dividends to buy further shares in Bodycote plc. For any shareholders who wish to re-invest dividend payments in the Company, a facility is provided by Capita IRG Trustees Ltd in conjunction with Capita Registrars. Under this facility, cash dividends are used to purchase additional shares. Shares are bought on the dividend payment date at the current market price. Any cash left over which is insufficient to purchase a whole share will be carried forward and held without interest, in a Client Money bank account. Any shareholder requiring further information should contact Capita on 0871 664 0381 (Calls cost 10p per minute plus any network extras from within the UK; lines are open from 9am to 5.30 pm Monday to Friday), if calling from overseas +44 (0)208 639 3402. Fax: 0208 639 1023. Email: shares@capitaregistrars.com or visit www.capitaregistrars.com.

Overseas shareholders

Capita are now able to provide you with a service that will convert your sterling dividends into your local currency at a competitive rate. You can choose to receive payment directly into your bank account, or you can be sent a draft in your local currency. Further details are available from Capita Registrars, Freepost RLYX-GZTU-KRRG, SAS, The Registry, 34 Beckenham Road, Beckenham, Kent BR3 9ZA; telephone UK: 0871 664 0385 (Calls cost 10 pence per minute plus network extras; lines are open to 9.00am to 5.30pm, Mon - Fri) or +44 20 8639 3405 (from outside the UK) or by logging on to www.capitaregistrars.com/international.

Duplicate share register accounts

If you are receiving more than one copy of our report, it may be that your shares are registered in two or more accounts on our register of members. If that was not your intention you might consider merging them into one single entry. Please contact Capita who will be pleased to carry out your instructions.

Shareholder analysis

Analysis of share register as at 16 February 2012:

Holding range	Number of Shareholders	%	Number of shares	%
1 to 1,000	1,062	41.4	461,330	0.2
1,001 to 10,000	1,089	42.4	3,358,457	1.8
10,001 to 100,000	254	9.9	7,819,039	4.1
100,001 to 500,000	102	4.0	22,254,097	11.6
500,001 and over	60	2.3	157,370,744	82.3
	2,567	100.0	191,263,667	100.0

Type of shareholders	% of Shareholders	% of total shares
Directors' interests	0.2	0.2
Major institutional and corporate holdings	26.1	95.2
Other shareholdings	73.7	4.6
	100.0	100.0

As at 23 February 2012 the following voting rights in the Company had been notified in accordance with the Disclosure and Transparency Rules.

Type of shareholders	Number of shares	%
Standard Life Investments Ltd	26,906,667	14.07
Schroders plc	13,187,266	6.89
Aberforth Partners LLP	9,427,581	4.93
Baillie Gifford & Co	9,402,000	4.92
Norges Bank	7,657,126	4.00
Legal & General Group plc	7,546,421	3.95

Financial Calendar

Annual General Meeting	25 April 2012
Final dividend for 2011	4 May 2012
Interim results for 2012	July 2012
Interim dividend for 2012	November 2012
Results for 2012	February 2013

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